

**SUPPLEMENT DATED MARCH 25, 2013 TO THE REMARKETING MEMORANDUM OF  
PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON DATED  
FEBRUARY 20, 2013**

**\$65,250,000**

**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON  
CONSOLIDATED SYSTEM REVENUE BONDS  
REFUNDING SERIES 2008B (NON-AMT)**

Public Utility District No. 1 of Chelan County, Washington (the “District”) is providing this Supplement, dated March 25, 2013 (this “Supplement”), amending and supplementing the Remarketing Memorandum, dated February 20, 2013 (the “Original Remarketing Memorandum” and together with this Supplement, the “Remarketing Memorandum”), of the District relating to the outstanding Public Utility District No. 1 of Chelan County, Washington, Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT) (the “2008B Bonds”). Except as otherwise set forth in this Supplement, all capitalized terms used and not otherwise defined herein have meanings set forth in the Original Remarketing Memorandum.

**2008B Credit Facility**

After the date of the Original Remarketing Memorandum, the District and Union Bank, N.A. (the “Bank”) agreed to revise certain provisions of the 2008B Credit Facility, including provisions relating to the Event of Termination, certain of the Events of Default and the Suspension Event, such revisions to be effective on April 24, 2013 (the “Effective Date”). On March 25, 2013, the District provided notice of such revisions to the Trustee to be forwarded to The Depository Trust Company, as the registered owner of the 2008B Bonds, and also on the Electronic Municipal Market Access system maintained by the Municipal Securities Rulemaking Board. Any owners of the 2008B Bonds who desire to do so for any reason may elect to exercise their demand purchase rights pursuant to the 2008B Supplemental Resolution prior to the Effective Date.

To reflect the revisions to the 2008B Credit Facility, the description of the 2008B Credit Facility in the Original Remarketing Memorandum under the heading “THE BANK AND THE 2008B CREDIT FACILITY—The 2008B Credit Facility—*Events of Default*” and appearing on pages 23 through 25 thereof is revised to read as follows. Additions are shown in double underscore italics, and deletions are shown in ~~strike through~~.

***Events of Default***

**Event of Termination.** The 2008B Credit Facility provides that it will be an “Event of Termination” if the Rating Agencies (as defined in the 2008B Credit Facility) shall (i) reduce their long-term unenhanced ratings assigned to the 2008B Bonds or any other Bonds (as further defined in the 2008B Credit Facility and for purposes of this section of this Remarketing Memorandum, “Parity Bonds”) below Investment Grade (as defined in the 2008B Credit Facility), or (ii) suspend or withdraw their long-term ratings assigned to the 2008B Bonds or any Parity Bonds ~~other than as a result of (A) debt maturity, redemption or defeasance, or (B) in the case of the 2008B Bonds or other Parity Bonds supported by credit enhancement, the reduction, suspension or withdrawal of the long term ratings assigned to the Bank or to the other related credit enhancer~~ for credit related reasons.

**Events of Default Resulting in Immediate Termination.** Each of the following events constitutes an “Event of Default” under the 2008B Credit Facility:

(a) the District shall fail to pay when due any principal or interest on the 2008B Bonds or any Credit Facility Provider Bond (as defined in the 2008B Credit Facility) (other than a failure to pay any 2008B Bonds or Credit Facility Provider Bonds which have been accelerated pursuant to the terms of the 2008B Credit Facility and other than such principal or interest which is part of the Purchase Price (as defined in the 2008B Credit Facility) of any Tendered Bonds); or

(b) the District shall fail to pay when due (whether by scheduled maturity, required prepayment or acceleration) any Parity Bonds (~~subject to certain exceptions contained in the 2008B Credit Facility~~ other than as a result of a failure to pay any Parity Bonds which have been accelerated pursuant to the terms of a letter of credit, credit agreement, liquidity facility or other similar instrument related to any such Parity Bonds) or any interest thereon, and such failure shall continue beyond any applicable period of grace specified in any underlying resolution, indenture, contract or instrument pursuant to which such Parity Bonds have been issued; or

(c) one or more final, nonappealable money judgments against the District payable from the Revenues which, individually or in the aggregate, equal or exceed \$20,000,000 shall remain unpaid, unstayed, undischarged, unbonded or undismissed for a period exceeding the later of (i) that permitted by State law and (ii) sixty (60) days; or

(d) the District shall (i) commence any case, proceeding or other action under any existing or future law of any jurisdiction relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it as bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding up, liquidation, dissolution, composition or other relief with respect to it or its Debts (as defined in the 2008B Credit Facility); or (ii) commence any case, proceeding or other action seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or make a general assignment for the benefit of its creditors; or (iii) have commenced against it any case, proceeding or other action of a nature described in clause (i) above which (A) results in an order for such relief or in the appointment of a receiver, trustee, custodian or other similar official, or (B) remains undismissed, undischarged or unbonded for a period of sixty (60) days; or (iv) take any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts summarized in clauses (i), (ii), (iii) or (iv) of this paragraph (d); or (v) become insolvent within the meaning of Section 101(32) of the United States Bankruptcy Code; or

(e) any provision of the 2008B Credit Facility, the 2008B Bonds or the Resolution relating to (i) the obligation of the District to pay, when due, the principal or interest payable on the 2008B Bonds or any Parity Bonds or (ii) the Lien (as defined in the 2008B Credit Facility) on or pledge of the Revenues securing the 2008B Bonds or any Parity Bonds shall (A) cease to be valid and binding on the District or shall be declared to be null and void, invalid or unenforceable as the result of a final nonappealable judgment by any federal or state court or as a result of any legislative or administrative action by any governmental authority having jurisdiction over the District, or (B) be repudiated or otherwise denied by an authorized officer of the District in writing; or

(f) a debt moratorium or comparable extraordinary restriction on repayment of debt shall have been declared or announced by the District (whether or not in writing) or any governmental authority with appropriate jurisdiction in a finding or ruling with respect to the 2008B Bonds or all Parity Bonds.

**Events of Default not Resulting in Immediate Termination or Suspension.** Each of the following will constitute an “Event of Default” under the 2008B Credit Facility:

(a) **Misrepresentation.** Any material representation made by the District under the 2008B Credit Facility shall prove to be untrue in any material respect on the date as of which it was made; or

(b) **Non Payment of Fees.** The District shall fail to pay any amounts when due under the 2008B Credit Facility or the Fee Agreement (as defined in the 2008B Credit Facility) (other than those described in paragraph (a) under the subheading “—Events of Default Resulting in Immediate Termination” above) which failure is not remedied within ten (10) business days after the Trustee and the District have received written notice thereof from the Bank; or

(c) **Certain Breaches.** The District shall breach any of the terms or provisions of certain covenants in the 2008B Credit Facility, subject to certain qualifications therein; or

(d) **Other Breaches.** The District shall breach any other terms or provisions of the 2008B Credit Facility which breach is not remedied within thirty (30) days after the District has received written notice thereof from the Bank; or

(e) **Invalidity.** Any material provision of the 2008B Credit Facility or any Related Document (other than as described in paragraph (e) under the subheading “—Events of Default Resulting in Immediate Termination” above) shall at any time for any reason cease to be valid and binding on the District or shall be declared to be null and void, or the validity or enforceability thereof shall be contested by the District or by any governmental authority having jurisdiction; or

(f) **Cross Default.** The occurrence of any “event of default” by the District (after giving effect to any applicable cure period) as defined in the Resolution (which is not waived pursuant to the terms thereof) which is not otherwise described under this subheading, “Events of Default not Resulting in Immediate Termination or Suspension,” which would permit the acceleration of any Parity Bonds, other than the failure of the Bank to provide funds for the purchase of Tendered Bonds when required by the terms and conditions of the 2008B Credit Facility; or

(g) **Other Debt.** The District shall default in the payment of or performance under any Debt in a principal amount of \$20,000,000 or more, and such default permits the acceleration of the payment of such principal; or

(h) **Swap Contracts.** The District shall default in the payment of any amount under any Swap Contract (as defined in the 2008B Credit Facility) and such default causes a termination of the Swap Contract and gives rise to an obligation of the District to make a termination payment aggregating in excess of \$20,000,000.

**Suspension Event.** The 2008B Credit Facility provides that it will be a “Suspension Event” under the 2008B Credit Facility if there shall have been commenced against the District any case, proceeding or other action under the United States Bankruptcy Code seeking to adjudicate it as bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding up, liquidation, dissolution, composition or other relief with respect to it under the United States Bankruptcy Code, which remains undismissed, undischarged or unbonded and fewer than sixty (60) days shall have elapsed from the commencement of such case, proceeding or other action.

### **2013 Payment Agreement**

After the date of the Original Remarketing Memorandum, the District exercised its right to voluntarily terminate the forward-starting 2013 Payment Agreement with Goldman Sachs Mitsui Marine

Derivative Products, L.P. (the “GSMMDP”), effective as of March 14, 2013. The District made a termination payment to GSMMDP in the amount of \$9,392,000 from available funds, which amount reflects the then-market value of the 2013 Payment Agreement to GSMMDP. The District elected to terminate the 2013 Payment Agreement because the District no longer intends to issue the refunding Bonds originally expected to be issued in 2013 and associated with the 2013 Payment Agreement, as the Senior Consolidated System Bonds the District had intended to refund with such Bonds have previously been refunded for debt service savings. See page 77 of the Original Remarketing Memorandum under the heading “FINANCIAL INFORMATION—Consolidated System Payment Agreements—2013 Payment Agreement” for additional information regarding the 2013 Payment Agreement.



**\$65,250,000**  
**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON**  
**CONSOLIDATED SYSTEM REVENUE BONDS**  
**REFUNDING SERIES 2008B (NON-AMT)**

**Remarketing Date:** March 6, 2013    **Price:** 100%    **Current CUSIP No.:** 163103RS5    **New CUSIP No.:** 163103UP7    **Due:** July 1, 2032

The Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT) of Public Utility District No. 1 of Chelan County, Washington (the “District”) are being remarketed in the principal amount of \$65,250,000 (the “2008B Bonds”). The proceeds of such remarketing, together with other available funds of the District, will be applied to pay the Purchase Price of the District’s outstanding 2008B Bonds upon the mandatory tender thereof for purchase. The 2008B Bonds will be remarketed as variable rate bonds that bear interest at a Weekly Interest Rate, but may be converted at the option of the District, subject to certain restrictions, to bonds that bear interest at different rates. The Weekly Interest Rate for the 2008B Bonds will be determined by Barclays Capital Inc., as Remarketing Agent for the 2008B Bonds.

So long as Cede & Co., as nominee for The Depository Trust Company (“DTC”), is the registered owner of the 2008B Bonds, individual purchases will be made in book-entry form in authorized denominations, and purchasers of the 2008B Bonds will not receive certificates representing their interests in the 2008B Bonds. Payments of principal and Purchase Price of, and premium, if any, and interest on the 2008B Bonds are to be paid to purchasers by DTC through DTC Participants (defined herein). U.S. Bank National Association (the “Trustee”) serves as Trustee for the 2008B Bonds.

The principal and Purchase Price of and, premium, if any, and interest on the 2008B Bonds are payable solely from and secured by the applicable accounts within the 2008B Bond Fund, the 2008B Reserve Account and Revenues of the Consolidated System pledged to such funds and from amounts on deposit in any sinking fund established for the 2008B Bonds, all as provided in the Master Resolution, as amended and supplemented, including by the 2008B Supplemental Resolution (as defined herein). The 2008B Bonds are issued subject to (1) the prior lien on Revenues of the Senior Consolidated System Bonds and the obligation of the District to deposit Revenues in the bond funds established by the Senior Consolidated System Resolution with respect thereto and (2) the parity lien on Revenues of the Bonds (as defined in the Resolution) heretofore and hereafter issued pursuant to the Resolution (defined herein) and of any Payment Agreement Payments in respect of any Payment Agreements (as defined in the Resolution) heretofore or hereafter entered into with respect to a Series of Bonds on a parity basis. See “SECURITY FOR THE 2008B BONDS.”

The 2008B Bonds are subject to optional and mandatory sinking fund redemption and mandatory tender for purchase as described herein.

**The 2008B Bonds are special limited obligations of the District and are not obligations of the State of Washington or any political subdivision thereof, other than the District. Neither the full faith and credit nor the taxing power of the District, the State of Washington or any political subdivision thereof, are pledged to the payment of principal or Purchase Price of or premium, if any, or interest on the 2008B Bonds.**

The 2008B Bonds are being remarketed in connection with the replacement of the existing Standby Bond Purchase Agreement with respect to the 2008B Bonds, which expires on March 7, 2013. Following the mandatory tender and remarketing of the 2008B Bonds on March 6, 2013, and while the 2008B Bonds bear interest at a Weekly Interest Rate, the payment of the Purchase Price of 2008B Bonds that are tendered or deemed tendered for purchase but not remarketed are payable, subject to certain conditions, from amounts to be made available under a Standby Bond Purchase Agreement, to be dated as of March 1, 2013 (the “2008B Credit Facility”), by and among the District, the Trustee and Union Bank, N.A. (the “Bank”).



The 2008B Credit Facility will be in effect from and after the remarketing of the 2008B Bonds through March 2, 2016, unless earlier terminated or extended as described herein. Under certain circumstances, the 2008B Credit Facility may be suspended or terminated as further described herein. See “THE BANK AND THE 2008B CREDIT FACILITY—The 2008B Credit Facility.”

On June 3, 2009, Orrick, Herrington & Sutcliffe LLP, Bond Counsel, delivered an opinion that, based upon an analysis of then-existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2008B Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”) and Title XIII of the Tax Reform Act of 1986. Bond Counsel further opined that interest on the 2008B Bonds is not a specific preference item for purposes of the federal individual and corporate alternative minimum taxes, nor is it included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expressed no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2008B Bonds. In connection with the execution and delivery of the 2008B Credit Facility, Bond Counsel will be delivering an opinion to the effect that the execution and delivery of the 2008B Credit Facility, in and of itself, will not adversely affect the exclusion of interest on the 2008B Bonds from gross income for federal income tax purposes. The opinion of Bond Counsel delivered in connection with the original issuance of the 2008B Bonds has not been updated as of the date of this Remarketing Memorandum, and Bond Counsel is not rendering any opinion or expressing any view as to the current exclusion of interest on the 2008B Bonds from gross income for federal income tax purposes. See “TAX MATTERS.” A copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F.

*This cover page is not intended to be a summary of the terms of, or the security for, the 2008B Bonds. Investors are advised to read the Remarketing Memorandum in its entirety to obtain information essential to the making of an informed investment decision.*

This Remarketing Memorandum describes the 2008B Bonds only while such 2008B Bonds are in a Weekly Interest Rate Period.

*In connection with the remarketing of the 2008B Bonds, certain legal matters will be passed upon for the District by Orrick, Herrington & Sutcliffe LLP, Seattle, Washington, Bond Counsel and Disclosure Counsel to the District; for the Remarketing Agent, by its counsel, Hawkins Delafield & Wood LLP, New York, New York; and for the Bank, by its counsel, Chapman and Cutler LLP, Chicago, Illinois. It is expected that the remarketed 2008B Bonds will be delivered in book-entry form through the facilities of DTC in New York, New York on or about March 6, 2013.*



# Washington State



**Chelan County**  
Population: 73,200  
Square Miles: 2,994



**Rocky Reach  
Hydro Project**



**Lake Chelan  
Dam**



**Lake Chelan  
Hydro Project**

**Rock Island  
Hydro Project**



**Rock Island  
Dam**

**PUBLIC UTILITY DISTRICT NO. 1 OF  
CHELAN COUNTY, WASHINGTON**

327 North Wenatchee Avenue  
Wenatchee, Washington 98801  
Telephone: (509) 663-8121  
Web Site: www.chelanpud.org\*

**COMMISSION**

Term Expires

Carnan Bergren, President .....	December 31, 2016
Ann Congdon, Vice President .....	December 31, 2016
Dennis Bolz, Secretary .....	December 31, 2014
Randy Smith, Commissioner .....	December 31, 2018
Norman Gutzwiler, Immediate Past President.....	December 31, 2014

**MANAGEMENT**

John Janney .....	General Manager
Kelly Boyd.....	Chief Financial/Risk Officer / CFO-CRO
Gregg Carrington.....	Energy Resources Managing Director
Mike Coleman .....	Fiber & Telecommunications Managing Director
Kirk Hudson .....	Generation & Transmission Managing Director
Jeff Smith.....	District Services Managing Director
John Stoll.....	Customer Utilities Managing Director
Carol A. Wardell .....	General Counsel / CCO
Diane L. Cooper .....	Director – Accounting / Controller
Stacey G. Jagla .....	Internal Auditor
Debra D. Litchfield.....	Director – Treasury / Treasurer

**BOND COUNSEL AND DISTRICT DISCLOSURE COUNSEL**

Orrick, Herrington & Sutcliffe LLP  
Seattle, Washington

**FINANCIAL ADVISOR**

Public Financial Management, Inc.  
Seattle, Washington

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\* Information about the District or other matters on the District’s web site is **not** incorporated herein by this reference. Such information should **not** be relied upon in making any investment decision with respect to the 2008B Bonds. The 2008B Bonds are remarketed only by means of this Remarketing Memorandum.

No dealer, broker, salesperson or any other person has been authorized by the District or the Remarketing Agent to give any information or to make any representations, other than the information and representations contained herein, in connection with the offering of the 2008B Bonds, and if given or made, such information or representations must not be relied upon as having been authorized by any of the foregoing. This Remarketing Memorandum does not constitute an offer to sell or the solicitation of an offer to buy any of the 2008B Bonds, nor shall there be any sale of the 2008B Bonds by any person, in any jurisdiction in which it is unlawful to make such offer, solicitation or sale.

The information set forth herein has been furnished by the District, DTC, the Remarketing Agent, and certain other sources that are believed to be reliable but is not guaranteed as to accuracy or completeness by the Remarketing Agent, and this Remarketing Memorandum is not to be construed as a representation by the Remarketing Agent. The information and expressions of opinion contained herein are subject to change without notice, and neither the delivery of this Remarketing Memorandum nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the District since the date hereof. Any statements made herein involving matters of opinion, estimates or forecasts, whether or not so expressly described herein, are intended solely as such and not as representations of fact or representations that such matters, estimates or forecasts will be realized. This Remarketing Memorandum is not to be construed as a contract with the purchasers of the 2008B Bonds.

CERTAIN STATEMENTS CONTAINED IN THIS REMARKETING MEMORANDUM DO NOT REFLECT HISTORICAL FACTS BUT ARE FORECASTS AND "FORWARD LOOKING STATEMENTS." NO ASSURANCE CAN BE GIVEN THAT THE FUTURE RESULTS DISCUSSED HEREIN WILL BE ACHIEVED, AND ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THE FORECASTS DESCRIBED HEREIN. IN THIS RESPECT, WORDS SUCH AS "ESTIMATE," "FORECAST," "ANTICIPATE," "EXPECT," "INTEND," "PLAN," "BELIEVE," "PROJECT" AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD LOOKING STATEMENTS. ALL PROJECTIONS, FORECASTS, ASSUMPTIONS AND OTHER FORWARD LOOKING STATEMENTS ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THE CAUTIONARY STATEMENTS SET FORTH IN THIS REMARKETING MEMORANDUM.

The Remarketing Agent has provided the following sentence for inclusion in this Remarketing Memorandum. The Remarketing Agent has reviewed the information in this Remarketing Memorandum in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Remarketing Agent does not guarantee the accuracy or completeness of such information.

THE 2008B BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON A SPECIFIC EXEMPTION CONTAINED IN SUCH ACT, NOR HAVE THEY BEEN REGISTERED UNDER THE SECURITIES LAWS OF ANY STATE.



**TABLE OF CONTENTS**

	<b>Page</b>		<b>Page</b>
SUMMARY STATEMENT .....	i	Largest Customers .....	54
INTRODUCTION .....	1	Wholesale Power Management Activity .....	54
APPLICATION OF THE REMARKETING PROCEEDS OF THE 2008B BONDS .....	2	The Fiber and Telecommunications System .....	55
DESCRIPTION OF THE 2008B BONDS .....	2	Pacific Northwest Transmission System .....	59
General .....	2	Energy Northwest .....	60
2008B Bonds During a Weekly Interest Rate Period .....	3	FINANCIAL INFORMATION .....	61
Defeasance .....	9	General .....	61
Trustee and Tender Agent .....	9	Management’s Discussion of Distribution Division Financial Results .....	61
Book-Entry System .....	9	Debt Service Coverage .....	65
SECURITY FOR THE 2008B BONDS .....	10	Power Sales Revenues and District Near-Term Financial Outlook .....	66
Pledge of Revenues .....	10	Strategic Planning .....	67
Limited Obligations .....	11	Outstanding Debt .....	68
Outstanding Bonds .....	11	Interfund and Intersystem Loans .....	70
Senior Consolidated System Bonds .....	11	Annual Debt Service .....	71
Flow of Funds .....	12	Capital Requirements .....	73
Additional Indebtedness .....	13	Consolidated System Liquidity .....	74
Subordinate Obligations .....	13	Investment Policies .....	75
Power Purchase Agreements .....	14	Changes in Accounting Principles .....	75
Intersystem Loans of Bond Proceeds .....	14	Consolidated System Payment Agreements .....	76
Debt Service Reserve Funds .....	15	AGREEMENTS, PROCEEDINGS AND LAWS AFFECTING THE DISTRICT .....	79
Rate Covenant .....	16	Coordination Agreements .....	79
Rate Stabilization Fund .....	17	Endangered Species Act .....	80
Operating Reserve Fund .....	19	DEVELOPMENTS AFFECTING THE ELECTRIC UTILITY INDUSTRY .....	85
Other Covenants .....	19	General .....	85
Sinking Funds for Balloon Bonds .....	19	Recent Market Conditions .....	86
Additional Balloon Indebtedness of the District .....	20	Energy Policy Act of 2005 .....	86
Authorized Investments .....	20	Climate Change and Renewables .....	89
Contingent Payment Obligations .....	21	Financial Services Reform .....	90
Addition of Separate Systems .....	21	Cyber Security .....	91
Certain Provisions of the Master Resolution Relating to Credit Facility Provider Rights .....	21	Electromagnetic Pulse Events .....	91
THE BANK AND THE 2008B CREDIT FACILITY .....	22	Integration of Variable Energy Resources .....	92
The Bank .....	22	State Energy Legislation .....	92
The 2008B Credit Facility .....	22	ECONOMIC AND DEMOGRAPHIC INFORMATION .....	95
THE DISTRICT .....	26	TAX MATTERS .....	98
General .....	26	CONTINUING DISCLOSURE UNDERTAKING .....	99
Management and Administration .....	27	APPROVAL OF LEGAL PROCEEDINGS .....	100
Employees .....	29	LIMITATIONS ON REMEDIES .....	100
Pension Plans .....	29	INITIATIVE AND REFERENDUM .....	100
Other Post-Employment Benefits .....	33	LITIGATION .....	101
Insurance .....	35	INDEPENDENT ACCOUNTANTS .....	101
Dam Safety and Security .....	36	RATINGS .....	101
THE CONSOLIDATED SYSTEM .....	36	REMARKETING .....	101
General .....	36	FINANCIAL ADVISOR .....	102
The District’s “Carbon Footprint” .....	37	MISCELLANEOUS .....	102
Properties and Facilities of the Consolidated System .....	37	APPENDIX A - AUDITED FINANCIAL STATEMENTS OF THE DISTRICT FOR THE YEAR ENDED DECEMBER 31, 2011 .....	A-1
Other Properties and Facilities of the District .....	38	APPENDIX B - PRELIMINARY UNAUDITED FINANCIAL DATA OF THE DISTRICT FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 .....	B-1
Federal Energy Regulatory Commission License Status .....	41	APPENDIX C - SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR CONSOLIDATED SYSTEM RESOLUTION .....	C-1
Consolidated System Energy Resources .....	43	APPENDIX D - SUMMARY OF CERTAIN PROVISIONS OF THE MASTER RESOLUTION AND THE 2008B SUPPLEMENTAL RESOLUTION .....	D-1
Puget Sound Energy Power Sales Contract .....	45	APPENDIX E - COPY OF ORIGINAL BOND COUNSEL OPINION .....	E-1
Alcoa Power Sales Contract .....	46	APPENDIX F - PROPOSED FORM OF OPINION OF BOND COUNSEL .....	F-1
The Prior Power Sales Contracts .....	48	APPENDIX G - BOOK-ENTRY ONLY SYSTEM .....	G-1
Energy Sales; Load/Resource Balancing; Hedging Strategy .....	49	APPENDIX H - DESCRIPTION OF MAJOR POWER PURCHASERS .....	H-1
Electric Rates; Other Rates .....	51	APPENDIX I - SUMMARY OF POWER SALES CONTRACT WITH PUGET SOUND ENERGY, INC. ....	I-1
APPENDIX A - AUDITED FINANCIAL STATEMENTS OF THE DISTRICT FOR THE YEAR ENDED DECEMBER 31, 2011 .....	A-1	APPENDIX J - SUMMARY OF POWER SALES CONTRACT WITH ALCOA, INC. ....	J-1
APPENDIX B - PRELIMINARY UNAUDITED FINANCIAL DATA OF THE DISTRICT FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 .....	B-1	APPENDIX K - FORM OF CONTINUING DISCLOSURE CERTIFICATE .....	K-1
APPENDIX C - SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR CONSOLIDATED SYSTEM RESOLUTION .....	C-1		
APPENDIX D - SUMMARY OF CERTAIN PROVISIONS OF THE MASTER RESOLUTION AND THE 2008B SUPPLEMENTAL RESOLUTION .....	D-1		
APPENDIX E - COPY OF ORIGINAL BOND COUNSEL OPINION .....	E-1		
APPENDIX F - PROPOSED FORM OF OPINION OF BOND COUNSEL .....	F-1		
APPENDIX G - BOOK-ENTRY ONLY SYSTEM .....	G-1		
APPENDIX H - DESCRIPTION OF MAJOR POWER PURCHASERS .....	H-1		
APPENDIX I - SUMMARY OF POWER SALES CONTRACT WITH PUGET SOUND ENERGY, INC. ....	I-1		
APPENDIX J - SUMMARY OF POWER SALES CONTRACT WITH ALCOA, INC. ....	J-1		
APPENDIX K - FORM OF CONTINUING DISCLOSURE CERTIFICATE .....	K-1		

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**\$65,250,000**  
**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON**  
**CONSOLIDATED SYSTEM REVENUE BONDS**  
**REFUNDING SERIES 2008B (NON-AMT)**

**SUMMARY STATEMENT**

This Summary Statement is subject in all respects to the more complete information contained in this Remarketing Memorandum. Investors are advised to read the entire Remarketing Memorandum to obtain information essential to making an informed investment decision. Certain capitalized terms used in this Summary Statement have the meanings specified elsewhere in this Remarketing Memorandum.

**The District**

Public Utility District No. 1 of Chelan County, Washington (the “District”), is a municipal corporation of the State of Washington (the “State”) located in central Washington approximately 138 miles east of Seattle and 165 miles west of Spokane. The District was established in 1936 and began electric utility operations in 1947. In addition to its Distribution Division, which primarily serves Chelan County (the “County”), the District also owns, operates and maintains three major hydroelectric power generating projects: the Rock Island Project, the Rocky Reach Project and the Lake Chelan Project (collectively, the “Hydro-Electric Projects”). The Hydro-Electric Projects typically supply energy in excess of the amount necessary to serve the District’s retail loads. See “THE DISTRICT—General.” In an effort to assist in developing energy resources with low environmental impacts, the District also purchases power from a wind generation project. The District also owns and operates a Water System, a Wastewater System and a Fiber and Telecommunications System, which serve portions of the County.

Under Washington law, the District has the authority to establish separate enterprise funds with respect to its various municipal utility business operations, each of which enterprise funds is accounted for separately. In addition, those utility business operations that generate revenues (known as “systems”) can be separately financed through the issuance of debt by the District payable solely from revenues of that particular system. The District currently has three systems through which it issues debt: the Rock Island System, the Rocky Reach System (collectively, the “Large Hydro Systems”), and the “Consolidated System.” The Consolidated System currently includes (i) the District’s retail electric utility business operations (referred to as the “Distribution Division”), (ii) the Lake Chelan Project, (iii) the Fiber and Telecommunications System, (iv) the Water System, and (v) the Wastewater System. Although these systems have been consolidated into the Consolidated System for financing purposes, all of these systems are accounted for separately and only the four utility business operations have been combined for financial statement reporting purposes. The District also has two enterprise funds, the Internal Service Fund and the Treasury Service Fund, which are used to account for administrative, financing and other costs allocable to more than one system.

See “INTRODUCTION,” “THE DISTRICT—General,” and “THE CONSOLIDATED SYSTEM—General,” “—Properties and Facilities of the Consolidated System” and “—Other Properties and Facilities of the District.”

**The District’s Power Supply**

The District obtains most of its power supply from the Hydro-Electric Projects, which have a combined nameplate rating of 1,988 megawatts (“MW”). The Hydro-Electric Projects typically supply energy in excess of the amount necessary to serve the District’s annual retail loads. See “THE DISTRICT—General.” Because the original investments in the Hydro-Electric Projects were made decades ago, in 2011 the cost of generating energy from the Hydro-Electric Projects was substantially below the market value of such energy. For the year ended December 31, 2011, the Rock Island Project delivered 3,267,000 megawatt hours (“MWh”) of power at an average cost of generation of \$24 per MWh, the Rocky Reach Project delivered 7,125,000 MWh of power at an average cost of generation of \$10 per MWh and the Lake Chelan Project delivered 480,000 MWh of power at an average cost of generation of \$24 per MWh. The Hydro-Electric Projects collectively thus produced 10,872,000 MWh of power at an average cost of generation of \$15 per MWh. For the same period, the “average adjusted wholesale” preference rate for Bonneville Power Administration (“Bonneville”) customers was \$35 per MWh and the Mid-Columbia

Electricity Price Index average was \$24 per MWh. Comparable data for the year ended December 31, 2012 are not yet available.

Under almost all power production and hydrologic conditions, the District's reserved shares of the Hydro-Electric Projects have been sufficient to meet the District's retail load requirements. The District has never failed to meet its retail load requirements, and normally the Distribution Division is a net seller of power. During periods of extremely low water conditions or unusually high peak energy demand, the reserved share of the Hydro-Electric Projects may be insufficient to meet the District's retail load requirements for relatively limited periods. The extent and duration of these shortfalls are estimated in advance by the District's power supply planners. On these occasions the District buys power on the wholesale market to meet the portion of the District's retail load requirements not supplied by the Hydro-Electric Projects.

According to the Average Service Reliability Index (defined as the year-to-date efficiency of the distribution system to deliver electric energy to the District's customers), the District's reliability in 2011 was 99.98%, in 2010 was 99.98% and in 2009 was 99.99%. Reliability information for the year ended December 31, 2012 is not yet available.

See "THE DISTRICT—General."

## **Sales of the District's Power Supply**

### ***General***

The Consolidated System purchases power from the Rock Island and Rocky Reach Projects (as an operating expense of the Consolidated System) for sale to its retail customers through the Distribution Division. The power from the Hydro-Electric Projects, including the Lake Chelan Project, and not allocated for the District's own retail load is sold:

- (a) on a cost-of-service "plus" basis under long-term contracts with an investor-owned utility and a large industrial purchaser;
- (b) on a cost-of-service basis under a long-term contract with another public utility district;
- (c) under fixed-price wholesale market-based slice contracts, each for a fixed percentage of output, with purchasers selected through an annual competitive auction process and with staggered terms of up to five years, consistent with the District's hedging strategy;
- (d) under fixed-price wholesale market-based block contracts, each for a fixed amount of output, with purchasers selected based on market price and credit and liquidity profiles and with varied terms from within the current year plus up to an additional 60 months, consistent with the District's hedging strategy; and
- (e) as short-term surplus power at wholesale market prices to meet the District's "day-ahead" forecast.

These sales are a substantial source of revenues to the District's Consolidated System. See "THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy," "—Puget Sound Energy Power Sales Contract" and "—Alcoa Power Sales Contract" and "FINANCIAL INFORMATION—Management's Discussion of Distribution Division Financial Results" and "—Power Sales Revenues and District Near-Term Financial Outlook."

Prior to November 1, 2011 with respect to the Rocky Reach Project and prior to June 8, 2012 with respect to the Rock Island Project, power from the Rocky Reach and Rock Island Projects, excluding an amount allocated for the District's own retail load, was sold on a cost-of-service basis pursuant to long-term contracts with a number of investor-owned utilities, another public utility district and a large industrial purchaser and into the wholesale market. See "THE CONSOLIDATED SYSTEM—The Prior Power Sales Contracts."

### ***Power Sales Contracts***

In February 2006, the District executed a new long-term power sales contract (the “Puget Contract”) with Puget Sound Energy, Inc. (“Puget Sound Energy”), and in July 2008, the District executed a new long-term power sales contract with Alcoa, Inc. (“Alcoa”) (the “Alcoa Contract” and together with the Puget Contract, the “Power Sales Contracts”). The Puget Contract is scheduled to terminate on October 31, 2031, and the Alcoa Contract is scheduled to terminate on October 31, 2028.

Under the Puget Contract, from November 1, 2011 to June 30, 2012, Puget Sound Energy purchased 25% of the energy and capacity from the Rocky Reach Project and, thereafter, purchases 25% of the combined energy and capacity from both the Rocky Reach and Rock Island Projects. In exchange, Puget Sound Energy pays its percentage share of operation and maintenance, certain debt service-related costs and other costs and charges. In connection with the execution of the Puget Contract, Puget Sound Energy also made a one-time payment of \$89 million to the District for the account of the Consolidated System in April 2006 as a “capacity reservation charge,” which the District may use for any lawful purposes. The District is recognizing the \$89 million payment as revenue of the Consolidated System for accounting purposes in equal annual amounts over the term of the Puget Contract, commencing on November 1, 2011. The District has allocated the entire payment for use by the various systems of the District, including \$18 million allocated to the Fiber and Telecommunications System. See “THE CONSOLIDATED SYSTEM—Puget Sound Energy Power Sales Contract” and APPENDIX I—“Summary of Power Sales Contract with Puget Sound Energy, Inc.”

Under the Alcoa Contract, from November 1, 2011 to June 30, 2012, Alcoa purchased energy equivalent to 27.5% of the output from the Rocky Reach Project and, thereafter, purchases energy equivalent to 26% of the combined output from both the Rocky Reach and Rock Island Projects. In exchange, Alcoa pays its percentage share of operation and maintenance, certain debt service-related costs and other costs and charges. The District retained all capacity rights and environmental attributes and has the right to source energy from other sources. In connection with the execution of the Alcoa Contract, Alcoa also made a one-time payment of \$22.9 million to the District for the account of the Consolidated System in August 2008 as a “capacity reservation charge,” which the District may use for any lawful purposes. The District is recognizing the \$22.9 million payment as revenue of the Consolidated System for accounting purposes in equal annual amounts over the term of the Alcoa Contract, commencing November 1, 2011. This payment is currently held as part of the District’s cash reserves, and no portion of this payment has yet been allocated for use by any specific system of the District. See “THE CONSOLIDATED SYSTEM—Alcoa Power Sales Contract” and APPENDIX J—“Summary of Power Sales Contract with Alcoa, Inc.”

### ***Load/Resource Balancing; Hedging Strategy***

To balance the District’s anticipated power resources and demand for those power resources on an on-going basis, the District, as do most other retail electric utilities, enters into short-term forward physical power sales agreements when resources are expected to exceed demand and enters into short-term forward physical power purchase agreements when demand is expected to exceed the resources estimated to be available.

To mitigate potential wholesale sales and price volatility, to help keep future rates stable and affordable and to maintain financial stability, the District has implemented a comprehensive forward hedging strategy. In addition to the Power Sales Contracts, a key component of the strategy includes executing medium-term power sales contracts for (i) fixed percentages of future output from the Rock Island and Rocky Reach Projects and (ii) fixed amounts of such output, in each case at fixed prices and for staggered terms from within the then-current year plus up to an additional 60 months. This strategy is expected to mitigate the District’s exposure to changes in wholesale power prices and Columbia River flows (the latter of which affects generation at the Hydro-Electric Projects) and to secure a revenue stream for the duration of those contracts. As of September 30, 2012, the District has locked in revenues under these medium-term contracts of \$447.7 million for the period from January 2013 through the end of 2017.

The Consolidated System derives a substantial portion of its annual revenues from wholesale sales of the Distribution Division’s share of surplus power generated by the Hydro-Electric Projects. As a result of the expiration of the Prior Power Sales Contracts and the commencement of deliveries under the Power Sales Contracts,

the amount of surplus power sold by the District in 2011 and 2012, and thus the percentage of annual Distribution Division revenues derived from such wholesale sales, increased from prior years. These wholesale sales provided 45% of annual Distribution Division revenues in fiscal year 2011 and 36% of annual Distribution Division revenues in fiscal year 2010. The information regarding the total revenues generated from such wholesale sales in 2012 is not yet available.

The amount of such power available for sale in any given year, and the prices at which such power can be sold, however, are highly variable, and depend to a large extent on factors outside of the control of the District. In particular, the amount of such power available for sale is dependent upon relative flows down the Columbia River past the Rocky Reach and Rock Island Projects and the timing of such flows, both of which are largely dependent upon weather conditions in and upstream of the Mid-Columbia River and weather conditions in the District's service area, which affects the District's relative load from season to season. The price of such power also is dependent, among other things, on weather conditions inside and outside the Pacific Northwest, the relative demand for power at any given time across the Western United States, general economic conditions, the cost and the availability of alternative sources of power, including in particular energy generated by facilities fueled by natural gas, wind and numerous other factors. The District seeks to moderate the variability in its revenues arising from these factors through a variety of means, including the implementation of its energy hedging strategy, the maintenance of significant liquidity, including the maintenance of the Rate Stabilization Fund, and its ability to impose rate increases or temporary rate surcharges on relatively short notice.

See "FINANCIAL INFORMATION—Consolidated System Liquidity" and "—Power Sales Revenues and District Near-Term Financial Outlook," "THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy," "—Puget Sound Energy Power Sales Contract" and "—Alcoa Power Sales Contract" and "SECURITY FOR THE 2008B BONDS—Rate Stabilization Fund."

The table on the following page presents the Distribution Division's energy resources and purchased power costs for the fiscal years ended December 31, 2007 through 2011 and for the nine months ended September 30, 2012. The information for fiscal years 2007 through 2011 has been extracted from the District's audited financial statements. The information provided for the nine months ended September 30, 2012 is unaudited and may not be indicative of actual year-end results. The information provided for the nine months ended September 30, 2012 reflects the expiration of the Prior Power Sales Contracts and the commencement of deliveries under the Power Sales Contracts, under which a larger portion of the energy generated by the Rock Island and Rocky Reach Projects is available to the District for sale as surplus power in the wholesale market. See APPENDIX B— "PRELIMINARY UNAUDITED FINANCIAL DATA OF THE DISTRICT FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012."

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**Consolidated System  
Distribution Division  
Energy Requirements, Resources and Power Costs  
Years Ended December 31, 2007 through 2011 and for the Nine Months Ended September 30, 2012**

	2007	2008 <sup>(1)</sup>	2009	2010	2011	Nine Months Ended September 30, 2012
<b>Requirements (000 MWh)</b>						
Total Sales <sup>(2)</sup>	4,845	4,416	4,257	4,227	5,762	6,731
Timing Differences & Losses <sup>(3)</sup>	(64)	(10)	(8)	(67)	(100)	(9)
	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>	<u>5,662</u>	<u>6,722</u>
<b>Resources (000 MWh)</b>						
Rocky Reach Project <sup>(4)</sup>	2,431	2,147	2,041	1,883	3,086	4,424
Rock Island Project	1,516	1,393	1,345	1,283	1,619	1,295
Lake Chelan Project	459	405	338	417	480	286
Non-firm Purchases <sup>(5)</sup>	378	460	525	577	477	717
	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>	<u>5,662</u>	<u>6,722</u>
<b>Purchased Power Costs (\$000)</b>						
Rocky Reach Project	\$ 29,782	\$ 31,449	\$ 28,274	\$ 30,668	\$ 37,112	\$ 58,405
Rock Island Project	33,540	37,309	38,398	40,206	38,509	33,620
Lake Chelan Project	5,171	6,152	9,003	10,198	11,430	8,329
Non-firm Purchases <sup>(5)</sup>	21,127	29,485	18,672	22,880	14,429	18,959
	<u>\$ 89,620</u>	<u>\$ 104,395</u>	<u>\$ 94,857</u>	<u>\$ 103,952</u>	<u>\$ 101,480</u>	<u>\$ 119,313</u>
Average Cost (\$/MWh) <sup>(6)</sup>	\$ 19	\$ 24	\$ 22	\$ 25	\$ 18	\$ 18

<sup>(1)</sup> In 2010, year 2008 total sales and timing differences and losses were restated to correct a data entry error.

<sup>(2)</sup> See Table 7, "Customers, Energy Sales and Revenues."

<sup>(3)</sup> Includes timing differences between actual calendar year energy requirements and monthly billing cycles, and system losses.

<sup>(4)</sup> Effective November 1, 2011, the Distribution Division share of Rocky Reach output increased under the Power Sales Contracts.

<sup>(5)</sup> Non-firm purchases include power purchased to meet local requirements and certain contractual obligations, to hedge price movements and to minimize the District's overall risk exposure to changes in power prices.

<sup>(6)</sup> Includes actual costs of power to the Distribution Division plus allocable administrative and other expenses of the Distribution Division. Fluctuations in average cost are due primarily to fluctuations in water conditions on the Columbia River, which may significantly affect market prices, and fluctuations in power repurchases from Alcoa under the prior power sales contract between the District and Alcoa. See "THE CONSOLIDATED SYSTEM—The Prior Power Sales Contracts."

Source: *The District*.

## **Electric Rates**

The District's retail rates and charges for electric power are fixed by the Commission, free from the jurisdiction and control of the Washington Utilities and Transportation Commission ("WUTC") and, the District believes, free from the jurisdiction and control of the Federal Energy Regulatory Commission ("FERC"). The Hydro-Electric Projects are, however, owned and operated by the District under separate long-term licenses from FERC. The District has covenanted in the Master Resolution to fix, establish, maintain and collect rates and charges for electric power and energy, water, wastewater, fiber and telecommunications, and other services, facilities and commodities sold, furnished or supplied by or through the Consolidated System sufficient to pay the operation and maintenance expenses and all debts and obligations of the Consolidated System.

In 2008, the District increased electric rates by 5% to help move the District away from reliance on wholesale power sales revenues over time. Prior to the 2008 rate increase, the District last increased electric rates in January 2000.

In 2009 and 2010, an unusual combination of low wholesale energy prices, below-average snowpack and a declining interest rate environment resulted in a significant decline in revenues to the District from sales of surplus power and interest income earned on investments. In response to these developments, the District, among other things, implemented a temporary 9% rate surcharge, which went into effect May 1, 2009 and extended through December 31, 2011.

The District adopted an electric rate design change on October 17, 2011. The new rate design, which included an overall retail rate increase of 2.5%, went into effect on January 1, 2012 following the expiration of the 9% surcharge.

If conditions adversely affecting the District's revenues (including below-average river flows and depressed wholesale energy prices) return in the future, the District could re-impose a retail rate surcharge or take other rate action to maintain the health of the District's finances.

See "THE CONSOLIDATED SYSTEM—Electric Rates; Other Rates" and "FINANCIAL INFORMATION—Power Sales Revenues and District Near-Term Financial Outlook" and "—Strategic Planning."

## **Authorization for the 2008B Bonds**

The 2008B Bonds were issued pursuant to Resolution No. 07-13067, adopted by the Commission of the District (the "Commission") on March 12, 2007 (the "Master Resolution"), as amended and supplemented, including by Resolution No. 08-13258, adopted by the Commission on February 11, 2008 (the "Fourth Supplemental Resolution"), and the Certificate of the District, dated as of March 7, 2008 (the "2008B Delivery Certificate"), as amended and supplemented by Resolution No. 09-13452, adopted by the Commission on April 27, 2009 (the "Fifth Supplemental Resolution"), and the Certificate of the District, dated June 3, 2009 (the "2008B Reissuance Delivery Certificate"), and as supplemented by Resolution No. 13-13775, adopted by the Commission on January 7, 2013 (the "Tenth Supplemental Resolution"), and the Certificate of the District, to be dated March 6, 2013 (the "2008B Remarketing Delivery Certificate"). The Fourth Supplemental Resolution, as supplemented by the 2008B Delivery Certificate and as amended and supplemented, including as amended and supplemented by the Fifth Supplemental Resolution, as supplemented by the 2008B Reissuance Delivery Certificate, and as supplemented by the Tenth Supplemental Resolution, as supplemented by the 2008B Remarketing Delivery Certificate, is referred to herein collectively as the "2008B Supplemental Resolution." The Master Resolution, as amended and supplemented, including by the 2008B Supplemental Resolution, is referred to herein collectively as the "Resolution."

## **Pledge of Revenues**

The principal and Purchase Price of and premium, if any, and interest on the 2008B Bonds are payable from and secured by (i) amounts on deposit in the applicable accounts in the Bond Fund established under the 2008B Supplemental Resolution for the 2008B Bonds (the "2008B Bond Fund"), the applicable account in the Reserve Fund established under the 2008B Supplemental Resolution for the 2008B Bonds (the "2008B Reserve



Account”) and any sinking fund that may be established for such 2008B Bonds and (ii) Revenues pledged to such funds and the payment of the Bonds; *provided*, that the lien and charge of the Senior Consolidated System Bonds on Revenues and the obligation of the District to deposit Revenues in the bond funds established by the Senior Consolidated System Resolution have priority over the lien and charge of the Bonds, including the 2008B Bonds, on Revenues. See “SECURITY FOR THE 2008B BONDS—Pledge of Revenues.”

The outstanding 2008B Bonds, together with any other bonds, notes or other evidences of indebtedness heretofore or hereafter issued under the Master Resolution on a parity therewith, are collectively referred to herein as the “Bonds.” As of December 31, 2012, the Bonds were outstanding in the aggregate principal amount of \$521,230,000 (excluding the 2009A/B Bonds (defined herein) held in trust, which are not considered outstanding for financial reporting purposes). As of February 6, 2013, after giving effect to the optional redemption of \$23,565,000 principal amount of 2008B Bonds, the Bonds are outstanding in the aggregate principal amount of \$497,665,000 (excluding the 2009A/B Bonds held in trust).

Pursuant to Resolution No. 95-10188, adopted by the Commission on June 19, 1995, as supplemented and amended, including as amended and restated by Resolution No. 99-11303, adopted by the Commission on November 1, 1999 (collectively, the “Senior Consolidated System Resolution”), the District has issued Chelan Hydro Consolidated System Revenue Bonds (the “Senior Consolidated System Bonds”) payable from and secured by a pledge of Revenues senior to the lien thereon of the Bonds, including the 2008B Bonds. As of December 31, 2012, the Senior Consolidated System Bonds were outstanding in the aggregate principal amount of \$40,430,000. The District has covenanted in the Master Resolution not to issue any additional Senior Consolidated System Bonds under the Senior Consolidated System Resolution and not to issue or incur any additional indebtedness with a lien or charge on Revenues superior or prior to that of the Bonds. See “FINANCIAL INFORMATION—Outstanding Debt.”

Pursuant to the Master Resolution, the District may enter into one or more interest rate swap agreements with respect to all or a portion of a Series of Bonds. The Master Resolution provides that, if and to the extent provided in any Supplemental Resolution authorizing the issuance of a Series of Bonds, regularly scheduled payments due under interest rate swap agreements (“Payment Agreements”) may be paid directly out of the account or accounts in the Bond Fund established with respect to such Series of Bonds, and thus on a parity with debt service on the Bonds. See “FINANCIAL INFORMATION—Consolidated System Payment Agreements.”

### **Limited Obligations**

The 2008B Bonds are special limited obligations of the District and are not obligations of the State or any political subdivision thereof other than the District. Neither the full faith and credit nor the taxing power of the District, the State or any political subdivision thereof, are pledged to the payment of the principal or Purchase Price of or premium, if any, or interest on the 2008B Bonds.

### **2008B Reserve Account**

The 2008B Bonds are secured by a reserve account in the Reserve Fund (the “2008B Reserve Account”) established pursuant to the 2008B Supplemental Resolution. Upon the remarketing of the 2008B Bonds on March 6, 2013, there will be an amount equal to \$972,225 in the 2008B Reserve Account (the “2008B Reserve Account Requirement”). See “SECURITY FOR THE 2008B BONDS—Debt Service Reserve Funds—*Consolidated System*.”

### **The Bank and the 2008B Credit Facility**

From and after the remarketing of the 2008B Bonds on March 6, 2013 and while the 2008B Bonds bear interest at a Weekly Interest Rate, the payment of the Purchase Price of 2008B Bonds that are tendered or deemed tendered for purchase but not remarketed will be payable, subject to certain conditions, from amounts to be made available under a Standby Bond Purchase Agreement, to be dated as of March 1, 2013 (the “2008B Credit Facility”), by and among the District, the Trustee and Union Bank, N.A. (the “Bank”). The 2008B Credit Facility permits the Trustee to draw funds (in an amount not to exceed the available amount thereunder) sufficient to pay the Purchase

Price of 2008B Bonds tendered or deemed tendered for purchase and not remarketed. The initial term of the 2008B Credit Facility will end on March 2, 2016, unless earlier terminated or extended as provided therein and described herein. Under certain circumstances, the Bank's obligation under the 2008B Credit Facility to purchase 2008B Bonds may be suspended or terminated, and, in some limited instances, such obligation may be suspended or terminated without notice to the District or the holders of the 2008B Bonds. See "THE BANK AND THE 2008B CREDIT FACILITY—The 2008B Credit Facility—*Events of Default*—Event of Termination," "—Events of Default Resulting in Immediate Termination" and "—Suspension Event" and "—*Remedies*—Immediate Termination" and "—Suspension – Involuntary Proceedings."

### **Additional Indebtedness**

The District has covenanted in the Master Resolution not to issue any additional Senior Consolidated System Bonds under the Senior Consolidated System Resolution and not to issue or incur any additional indebtedness with a lien or charge on Revenues superior or prior to that of the Bonds.

Upon compliance with certain terms and conditions contained in the Master Resolution, the District may issue additional bonds, notes and other evidences of indebtedness with a lien and charge on Revenues on a parity with that of outstanding Bonds, including the 2008B Bonds, for any lawful purpose, including, without limitation, (1) the refunding of outstanding Bonds, Senior Consolidated System Bonds, Prior Rock Island Bonds (each as defined herein), bonds of the Water System and bonds of the Wastewater System and (2) financing or refinancing the cost of additions, betterments or improvements to, or renewals and replacements of, the Consolidated System, and for other lawful purposes of the District. The Master Resolution allows the District substantial flexibility as to the terms and conditions of any additional Bonds hereafter issued with a lien and charge on Revenues on a parity with that of the 2008B Bonds.

The Resolution does not prevent the District from issuing or incurring any additional indebtedness with a lien or charge on Revenues junior and subordinate to the lien or charge of the Bonds

The Resolution contains no restrictions on the issuance of Rock Island Bonds or Rocky Reach Bonds (each as defined herein). The District may issue additional Rock Island Bonds and Rocky Reach Bonds for purposes of refunding outstanding Prior Rock Island Bonds and Rock Island Bonds and Rocky Reach Bonds, refunding outstanding Senior Consolidated System Bonds or Bonds, the proceeds of which were loaned to the Rock Island and Rocky Reach Systems, and financing or refinancing the cost of additions, betterments or improvements to, or renewals and replacements of, the Rock Island System or Rocky Reach System, as applicable, and other lawful purposes of the District. Such bonds, however, would be issued under separate master resolutions of the District, not under the Master Resolution.

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**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON**

**REMARKETING MEMORANDUM**

**RELATING TO**

**\$65,250,000**

**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON  
CONSOLIDATED SYSTEM REVENUE BONDS  
REFUNDING SERIES 2008B (NON-AMT)**

**INTRODUCTION**

The purpose of this Remarketing Memorandum, including the cover, inside front cover, summary statement and appendices hereto, is to provide information concerning Public Utility District No. 1 of Chelan County, Washington (the "District"), its Consolidated System, and its Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT), currently outstanding in the aggregate principal amount of \$65,250,000 (the "2008B Bonds"), in connection with the mandatory tender and remarketing of the 2008B Bonds on March 6, 2013 (the "Mandatory Tender Date"). The 2008B Bonds are being remarketed in connection with the replacement of the existing Standby Bond Purchase Agreement securing the payment of the Purchase Price of the 2008B Bonds that is scheduled to expire on March 7, 2013.

The 2008B Bonds were issued pursuant to Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington, Chapter 167 of the Laws of Washington, 1983, as amended and supplemented, constituting Chapter 39.46 of the Revised Code of Washington, and Chapter 138 of the Laws of Washington, 1965, as amended and supplemented, constituting Chapter 39.53 of the Revised Code of Washington (collectively, the "Enabling Act"), and pursuant to Resolution No. 07-13067, adopted by the Commission on March 12, 2007 (the "Master Resolution"), as amended and supplemented, including as amended and supplemented by Resolution No. 08-13258, adopted by the Commission on February 11, 2008 (the "Fourth Supplemental Resolution"), and the Certificate of the District, date March 7, 2008 (the "2008B Delivery Certificate").

The American Recovery and Reinvestment Act of 2009, enacted on February 19, 2009 ("ARRA"), permitted issuers, such as the District, to refund certain of their outstanding bonds the interest on which is a specific preference item for purposes of the federal individual and corporate alternative minimum taxes, such as the 2008B Bonds, with bonds, the interest on which is *not* a specific preference item for such purposes. In accordance with such provisions of ARRA and pursuant to Resolution No. 09-13452, adopted by the Commission on April 27, 2009 (the "Fifth Supplemental Resolution"), and the Certificate of the District, dated June 3, 2009 (the "2008B Reissuance Certificate"), the District reissued the 2008B Bonds on June 3, 2009 so that the interest thereon is not a specific preference item for purposes of the federal individual and corporate minimum taxes.

From and after the remarketing of the 2008B Bonds on March 6, 2013 and while the 2008B Bonds bear interest at a Weekly Interest Rate, the payment of the Purchase Price of 2008B Bonds that are tendered or deemed tendered for purchase but not remarketed will be payable, subject to certain conditions, from amounts to be made available by Union Bank, N.A. (the "Bank") under a new Standby Bond Purchase Agreement, to be dated as of March 1, 2013 (the "2008B Credit Facility"), by and among the District, U.S. Bank National Association (the "Trustee") and the Bank. The execution and delivery of the 2008B Credit Facility and related actions are authorized pursuant to Resolution No. 13-13775, adopted by the Commission on January 7, 2013 (the "Tenth Supplemental Resolution"), and the Certificate of the District to be dated as of March 6, 2013 (the "2008B Remarketing Delivery Certificate"). The Fourth Supplemental Resolution, as amended and supplemented by the Fifth Supplemental Resolution and as supplemented by the Tenth Supplemental Resolution, is referred to herein collectively as the "2008B Supplemental Resolution." The Master Resolution, as amended and supplemented, including as supplemented by the 2008B Supplemental Resolution, is referred to herein collectively as the "Resolution."

This Remarketing Memorandum contains estimates and projections prepared by the District. Such estimates and projections are based upon a number of assumptions with respect to future events and conditions, including, without limitation, water conditions, federal and state environmental and other laws and regulations, and economic conditions. While the District believes that these assumptions are reasonable, they are dependent on such future events and conditions. To the extent actual events and conditions differ from such assumptions, actual results will vary from the projections, and these variances could be substantial.

The District's audited financial statements and accompanying notes for the fiscal year ended December 31, 2011 are included in this Remarketing Memorandum in APPENDIX A. Some financial data in this Remarketing Memorandum is provided as of December 31, 2011 because the District's audited financial statements for the fiscal year ended December 31, 2012 are not yet available. Certain preliminary unaudited financial and operating data as of September 30, 2012 have been provided for informational purposes; however, such data may not be indicative of actual year-end results. See "FINANCIAL INFORMATION—General" and APPENDIX B—"PRELIMINARY UNAUDITED FINANCIAL DATA OF THE DISTRICT FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012."

This Remarketing Memorandum includes summaries of the terms of the Senior Consolidated System Bonds, the Outstanding Bonds, including the 2008B Bonds, the Master Resolution, the 2008B Supplemental Resolution, the Senior Consolidated System Resolution, the Power Sales Contracts and certain contracts and arrangements for the purchase and sale of power and energy. The summaries of and references to all agreements, documents, statutes, resolutions, reports and other instruments referred to herein do not purport to be complete, comprehensive or definitive, and each such summary and reference is qualified in its entirety by reference to each such agreement, document, statute, report or instrument. Capitalized terms not defined herein shall have the meanings as set forth in Appendices C, D, H, I and J or in the respective documents.

#### **APPLICATION OF THE REMARKETING PROCEEDS OF THE 2008B BONDS**

On the Mandatory Tender Date, the remarketing proceeds of the 2008B Bonds are to be applied to pay the portion of the Purchase Price of the 2008B Bonds on the Mandatory Tender Date allocable to the principal amount of the 2008B Bonds. The District expects to use other available funds to pay the accrued interest on the 2008B Bonds to the Mandatory Tender Date and to pay other costs relating to the mandatory tender and remarketing of the 2008B Bonds.

#### **DESCRIPTION OF THE 2008B BONDS**

##### **General**

The 2008B Bonds were issued and are being remarketed in the form of fully registered bonds without coupons in authorized denominations in a Weekly Interest Rate Period in the aggregate principal amount of \$65,250,000. So long as the 2008B Bonds are registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"), purchases of beneficial interests in the 2008B Bonds will be made in book-entry form, without certificates. See APPENDIX G—"Book-Entry Only System."

If the book-entry only system for the 2008B Bonds is discontinued, (i) the principal and Purchase Price of and premium, if any, on each 2008B Bond will be payable to the owner thereof by check or draft at maturity, upon acceleration or on the date fixed for redemption, as the case may be, upon the presentation and surrender of each such 2008B Bond to the Trustee; (ii) interest on the 2008B Bonds will be payable by the Trustee on each Interest Payment Date by check or draft mailed to each owner as of the Record Date, at the most recent address shown on the Bond Register; *provided*, that payment of interest to each owner who owns of record \$1,000,000 or more in aggregate principal amount of 2008B Bonds may be made to such owner by wire transfer to such wire address within the United States as that owner may request in writing prior to the Record Date; and (iii) the 2008B Bonds will be exchangeable for fully registered certificated 2008B Bonds in any authorized denominations. Payments of defaulted interest shall be made as of a special record date to be fixed by the Trustee, notice of which special record date shall be given to the owners by the Trustee not less than ten days prior thereto. See APPENDIX G—"Book-Entry Only System."

The Trustee may impose a charge sufficient to reimburse the District for any tax, fee or other governmental charge required to be paid with respect to such exchange or any transfer of a 2008B Bond.

Capitalized terms used herein not otherwise defined shall have the meanings given in APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution.”

## **2008B Bonds During a Weekly Interest Rate Period**

### ***General***

The 2008B Bonds will bear interest at a Weekly Interest Rate. While the 2008B Bonds are in a Weekly Interest Rate Period, the interest will be computed (other than on Credit Facility Provider Bonds) on the basis of a 365- or 366- day year and the actual number of days elapsed. Interest on the 2008B Bonds will be payable on each Interest Payment Date for the period commencing on the first day of the immediately preceding month (or the first day of the Weekly Interest Rate Period if such first day is not the first day of the month) to and including the last day of such immediately preceding month, unless such Interest Payment Date shall be the day after the last day of the Weekly Interest Rate Period, in which case interest will be payable on that Interest Payment Date for the period commencing on the first day after the last month for which interest has been paid to but not including that Interest Payment Date. While the 2008B Bonds are in a Weekly Interest Rate Period, the authorized denominations for the 2008B Bonds will be \$100,000 and integral multiples of \$5,000 in excess of \$100,000.

“Interest Payment Date” means, in connection with any Weekly Interest Rate Period, (a) the first Wednesday of each calendar month, or, if such first Wednesday shall not be a Business Day, the next Business Day, and the Business Day after the last day of such Weekly Interest Rate Period, (b) with respect to any 2008B Bond, the day on which that 2008B Bond becomes a Credit Facility Provider Bond, and (c) with respect to any Credit Facility Provider Bond, the first Business Day of each calendar month, and the date on which such Credit Facility Provider Bond is remarketed pursuant to the 2008B Supplemental Resolution. The date on which any 2008B Bond is subject to mandatory sinking fund redemption will be an Interest Payment Date with respect to such 2008B Bond.

### ***Remarketing Agreement and Remarketing Agent***

The District expects to enter into the Remarketing Agreement, to be dated as of March 6, 2013 (the “Remarketing Agreement”), with Barclays Capital Inc., as the remarketing agent (the “Remarketing Agent”) with respect to the 2008B Bonds. The Remarketing Agreement will supersede any such prior agreements between the District and the Remarketing Agent.

### ***Determination and Notice of Weekly Interest Rate***

The Remarketing Agent will determine the Weekly Interest Rate on the Business Day prior to the first day of any Weekly Interest Rate Period and thereafter on Tuesday of each week (or the next Business Day if such Tuesday is not a Business Day) by 4:00 P.M. New York City time. The first Weekly Interest Rate determined for each Weekly Interest Rate Period will apply to the period commencing on the first day of such period and ending on the next Tuesday. Thereafter, each Weekly Interest Rate will apply to the period commencing on Wednesday and ending on the next Tuesday, unless such Weekly Interest Rate Period ends on a day other than a Tuesday, in which event the last Weekly Interest Rate for such Weekly Interest Rate Period will apply to the period commencing on the Wednesday before the last day of such Weekly Interest Rate Period and ending on such last day.

The Weekly Interest Rate on the 2008B Bonds will be the rate determined by the Remarketing Agent on such dates (taking into account the Interest Rate Factors) to be the minimum interest rate which, if borne by such 2008B Bonds for the Weekly Interest Rate Period, would enable the Remarketing Agent to sell such 2008B Bonds on that day at a price equal to the principal amount thereof plus accrued interest, if any; *provided, however*, that in no event will the rate of interest determined on any date to be borne by the 2008B Bonds (other than Credit Facility Provider Bonds) exceed the Maximum Rate as of such date of determination. “Maximum Rate” means the lower of (a) the maximum rate of interest covered by the 2008B Credit Facility and (b) the maximum rate of interest, if any, then provided by law.

The Remarketing Agent is required to give promptly telephonic or, at the request of the District, electronic notice, confirmed in writing, to the District, the Tender Agent and the Trustee, of each Weekly Interest Rate. The 2008B Supplemental Resolution provides that the determination of each Weekly Interest Rate by the Remarketing Agent shall be conclusive and binding upon the Remarketing Agent, the Trustee, each Credit Facility Provider, the District, the Tender Agent and the Owners, except that such determination shall not apply to Credit Facility Provider Bonds, which shall at all times be subject to the Credit Facility Provider Interest Rate for the 2008B Bonds.

If the Remarketing Agent fails to determine a Weekly Interest Rate for any week, the interest rate for such week will be the same as the Weekly Interest Rate for the immediately preceding week.

#### ***Change in Interest Rate Period of the 2008B Bonds***

At the option of the District, all or a portion of the 2008B Bonds (in an amount which is an Authorized Denomination for the new Interest Rate Period) may be converted to a different Interest Rate Period, including a Fixed-Rate Interest Period. The District may terminate a Weekly Interest Rate Period for the 2008B Bonds, or any portion thereof in Authorized Denominations, on any Business Day, upon notice to the Trustee. To effect the termination of any Weekly Interest Rate Period, the District is required to give written notice to the Trustee no later than seven (7) Business Days before the termination date selected by the District specifying (i) the termination date, and (ii) the Authorized Denominations to be subject to new Interest Rate Periods after such termination date. The Trustee is required under the Resolution to promptly give written notice of the District's election to change any Interest Rate Period to the Tender Agent, the Remarketing Agent and each Credit Facility Provider.

*Conditions Precedent to Change in Interest Rate Period.* Any change in the Interest Rate Periods for the 2008B Bonds will be effective only if (i) a Favorable Opinion of Bond Counsel is delivered and not withdrawn prior to the effective date of the change in Interest Rate Period, (ii) the new Credit Facility, if any, is issued to the Trustee or the Tender Agent, as the case may be, on or before that effective date and satisfies the requirements of the 2008B Supplemental Resolution, and (iii) before the effective date of the change in Interest Rate Period, unless the 2008B Bonds subject to such change in Interest Rate Period will continue to be secured by the same Credit Facility, the Trustee receives from the Rating Agencies (A) certification or confirmation of the rating or ratings to be assigned to the new Interest Rate Period and (B) confirmation that the change in Interest Rate Period will not, by itself, cause the ratings on such 2008B Bonds to be lowered or withdrawn.

If the conditions precedent to the change in Interest Rate Period from a Weekly Interest Rate Period are not satisfied, then (i) the 2008B Bonds scheduled to be subject to the new Interest Rate Period, other than Credit Facility Provider Bonds, will be subject to the mandatory tender for purchase on the day such new Interest Rate Period would have become effective and (ii) the 2008B Bonds will remain in and be remarketed in the Weekly Interest Rate Period. See “—Mandatory Purchase – Change in Interest Rate.”

*Selection of 2008B Bonds.* If only a portion of the 2008B Bonds are to be subject to a new Interest Rate Period, the Trustee is to select the 2008B Bonds to be subject to the new Interest Rate Period by random drawing conducted by the Trustee.

*Notice to Owners of Change in Interest Rate Period.* At least five Business Days prior to the effective date of the new Interest Rate Period for 2008B Bonds, the Trustee is required under the Resolution to give written notice to the Tender Agent, the Remarketing Agent and the Credit Facility Providers and to each Owner of 2008B Bonds subject to a new Interest Rate Period, of the change in the Interest Rate Period.

At least two Business Days prior to the effective date of a new Interest Rate Period for any of the 2008B Bonds, the District is required to provide to the Trustee, the Tender Agent and the Remarketing Agent the following information: (i) the new Interest Rate Period to be in effect for such 2008B Bonds, (ii) if a new Interest Rate Period will be a Fixed-Term Interest Rate Period, the new optional redemption provisions, if any, to be applicable to that Fixed-Term Interest Rate Period, (iii) the Interest Payment Dates to be in effect for such 2008B Bonds, (iv) whether a Credit Facility will be in effect for such 2008B Bonds and the terms thereof and the Credit Facility Provider, and (v) information regarding the credit ratings assigned or to be assigned to such 2008B Bonds upon such change to a new Interest Rate Period, as certified to the Trustee by the District.

### ***Demand Purchase of 2008B Bonds***

While 2008B Bonds are in a Weekly Interest Rate Period, any 2008B Bond will be purchased or deemed purchased, as described below in “—Purchase and Remarketing of the 2008B Bonds,” at a Purchase Price equal to the principal amount thereof, plus accrued interest, if any, to the Purchase Date, on the first Business Day occurring on or after the seventh day after delivery by the Owner of such 2008B Bond to the Tender Agent at the Delivery Office of an irrevocable written notice stating the principal amount and identifying numbers of such 2008B Bond to be purchased; *provided, however*, that the principal amount to be purchased and the principal amount of such 2008B Bond, if any, to be retained by such Owner are both required to be an Authorized Denomination. The notice shall also state the date on which such 2008B Bond shall be purchased, which date shall be a Business Day at least seven days following the date of receipt of such notice by the Tender Agent. If such notice is not received by the Tender Agent’s close of business, it shall be deemed received on the following Business Day. Payment of the Purchase Price of such 2008B Bond is required to be made in immediately available funds, by wire transfer of the Tender Agent, on the Purchase Date as soon as practicable following delivery of such 2008B Bond to the Tender Agent. All such 2008B Bonds are to be delivered to the Tender Agent at the Delivery Office, at or prior to 3:00 P.M., New York City time, on the Purchase Date.

***Notwithstanding the provisions of the 2008B Supplemental Resolution summarized in the foregoing paragraph, while a Credit Facility Agreement (including the 2008B Credit Facility) is in effect for the 2008B Bonds and while such 2008B Bonds are in a Weekly Interest Rate Period, the 2008B Supplemental Resolution provides that the Owners of such 2008B Bonds shall have no right to demand purchase of such 2008B Bonds as described above effective as of the date of any revocation, termination or cancellation of such Credit Facility Agreement pursuant to its terms. Under certain circumstances, the Bank may suspend or terminate its obligation under the 2008B Credit Facility to purchase the 2008B Bonds, and, in limited instances, such obligation may be suspended or terminated without notice to the District or the holders of the 2008B Bonds. See “THE BANK AND THE 2008B CREDIT FACILITY—The 2008B Credit Facility—Events of Default—Event of Termination,” “—Events of Default Resulting in Immediate Termination” and “—Suspension Event” and “—Remedies—Immediate Termination” and “—Suspension – Involuntary Proceedings.”***

### ***Mandatory Tender for Purchase***

While in a Weekly Interest Rate Period, the 2008B Bonds will be subject to mandatory tender for purchase as described below. No Owner shall have the right to retain any 2008B Bond required to be purchased in a mandatory tender.

***Change in Interest Rate Period.*** On the first day of a new Interest Rate Period for 2008B Bonds, such 2008B Bonds, or portions thereof in Authorized Denominations, are to be purchased or deemed purchased at a Purchase Price equal to the principal amount thereof.

***Termination or Expiration of Credit Facility; Substitution of Credit Facility.*** If the Tender Agent is required to give notice to Owners of 2008B Bonds pursuant to the 2008B Supplemental Resolution in connection with a Termination Date or a Substitution Date for any Credit Facility securing such 2008B Bonds, including the 2008B Credit Facility, the 2008B Bonds secured by the Credit Facility are required to be purchased or deemed purchased one Business Day before that Termination Date or Substitution Date, as the case may be, at a Purchase Price equal to 100 percent of the principal amount thereof, plus accrued interest, if any.

***Mandatory Purchase of Unauthorized Denominations.*** All 2008B Bonds will be subject to mandatory purchase on the first day of each Daily Interest Rate Period, Weekly Interest Rate Period and CP Interest Rate Period if such 2008B Bonds are not in Authorized Denominations, at a Purchase Price equal to the principal amount thereof, plus accrued interest, if any.

***Mandatory Purchase at Direction of Credit Facility Provider.*** If within ten days after the Tender Agent requests payment under a Credit Facility, to pay interest on 2008B Bonds the Trustee receives telephonic notice, promptly confirmed in writing, from the Credit Facility Provider that the amount available to be paid under that Credit Facility to pay interest will not be reinstated, or if the Trustee receives telephonic notice, promptly confirmed in writing, from the Credit Facility Provider that an event of default has occurred under the Credit Facility or the

Credit Facility Agreement with respect thereto and if that Credit Facility or Credit Facility Agreement provides that in such event the Credit Facility may be drawn upon to pay the Purchase Price of 2008B Bonds secured thereby and the Credit Facility Provider is then, in accordance with the terms of the Credit Facility or Credit Facility Agreement, obligated to make such payment, then all 2008B Bonds payable from payments under that Credit Facility shall be subject to mandatory purchase and shall be purchased or deemed purchased on the Purchase Date chosen by the Trustee and occurring not later than 15 days after receipt by the Tender Agent of any such written notice from the Credit Facility Provider. Such 2008B Bonds are to be purchased at a Purchase Price equal to the principal amount thereof plus accrued interest, if any, to the Purchase Date. Within five days after receipt of such written notice from a Credit Facility Provider, the Trustee shall give written notice to the Tender Agent, the Remarketing Agent, each other Credit Facility Provider and to each Owner of 2008B Bonds to be purchased that such 2008B Bonds shall be subject to mandatory tender for purchase and stating the date fixed for such mandatory purchase and the procedures therefor.

*Notwithstanding anything to the contrary contained in the 2008B Supplemental Resolution, no 2008B Bonds required to be purchased as described in the immediately preceding paragraph are to be remarketed.*

In the event that payment is made under the Credit Facility for the 2008B Bonds, including the 2008B Credit Facility, such payment will not be deemed to be a payment of the District, and such payment amounts will continue to be due and payable by the District under the 2008B Supplemental Resolution.

*Payment of the Purchase Price.* Payment of the Purchase Price on any such 2008B Bond subject to mandatory purchase is to be made by check or draft of the Tender Agent on the Purchase Date as soon as practicable following delivery of such 2008B Bond to the Tender Agent. All such 2008B Bonds are to be delivered to the Tender Agent at the Delivery Office, accompanied by an instrument of transfer thereof, in form satisfactory to the Tender Agent, executed in blank by the Owner thereof with the signature of such Owner guaranteed by a bank, trust company, national banking association or other banking institution, or member firm of the New York Stock Exchange and such other documents as the Tender Agent may reasonably require, at or prior to 12:00 noon, New York City time, on the Purchase Date.

#### ***Purchase and Remarketing of 2008B Bonds***

*Purchase of the 2008B Bonds.* The Tender Agent will be required to purchase, on behalf of the District, the 2008B Bonds required to be purchased in accordance with the demand purchase and mandatory tender for purchase provisions described above from the Owners of such 2008B Bonds on the applicable Purchase Date at the applicable Purchase Price.

Funds for the payment of such Purchase Price of 2008B Bonds are to be derived from the following sources in the order of priority indicated: (i) moneys provided to the Tender Agent for such purpose by the District or the Trustee and on deposit in the 2008B Bond Fund; (ii) proceeds of the remarketing of such 2008B Bonds, to purchasers other than the District, furnished to the Tender Agent by the Remarketing Agent and on deposit in the Remarketing Account established for the 2008B Bonds; and (iii) moneys representing the proceeds of payments under a Credit Facility for 2008B Bonds, including the 2008B Credit Facility, and on deposit in the 2008B Credit Facility Purchase Account established pursuant to the 2008B Supplemental Resolution.

Neither the Tender Agent nor the Remarketing Agent will have any responsibility to determine the amount representing accrued interest which may be payable in connection with the purchase of 2008B Bonds and may rely conclusively on the computation of such accrued interest by the Trustee pursuant to the 2008B Supplemental Resolution. The Tender Agent will not be obligated to expend its own funds in connection with any such purchase, or to pay the Purchase Price of any 2008B Bonds in any type of funds other than that received by the Tender Agent for such purchase. Any payment of the Purchase Price of any 2008B Bond required to be made pursuant to the 2008B Supplemental Resolution is to be made by the Tender Agent to the Owner to whom such payment is due by not later than 3:00 P.M. New York City time, on the Purchase Date, at its address as it appears on the Bond Register or at such other address as may be specified by such Owner at least 24 hours prior to the Purchase Date.

All 2008B Bonds required to be purchased in accordance with the demand purchase and mandatory tender for purchase provisions described above will be deemed to have been tendered on the Purchase Date, for all



purposes of the 2008B Supplemental Resolution, whether or not such 2008B Bonds have been delivered to the Tender Agent at the Delivery Office. Upon receipt by the Tender Agent of funds sufficient to purchase such 2008B Bonds, such 2008B Bonds will be deemed purchased and the former Owner of such 2008B Bond will no longer be entitled to the benefits of the Resolution, except for the purpose of the payment of the Purchase Price thereof.

The District will be required to execute, and the Registrar will be required to authenticate and deliver, a new 2008B Bond in an aggregate principal amount equal to the principal amount of the 2008B Bond not delivered but deemed purchased, bearing a number or numbers or other designation not contemporaneously outstanding, and any such new 2008B Bond is to be made available for delivery. Every 2008B Bond authenticated and delivered as described in the preceding sentence will be entitled to all the benefits of the Resolution equally and proportionately with any and all other 2008B Bonds duly executed and delivered under the 2008B Supplemental Resolution, except that any Credit Facility Provider Bond will not be entitled to the benefits of any Credit Facility, including the 2008B Credit Facility.

*Notice of 2008B Bonds Delivered for Purchase.* As soon as practicable and no later than 4:00 P.M., New York City time, on the day the Tender Agent receives notice from the Owner of a 2008B Bond subject to a Weekly Interest Rate, the Tender Agent shall give telephonic or telegraphic notice, promptly confirmed in writing, to the Remarketing Agent, the Trustee, the Credit Facility Provider which provided the Credit Facility, if any, for such 2008B Bonds and the District of the principal amount of 2008B Bonds with respect to which such notice has been delivered to it demanding the purchase of such 2008B Bonds in accordance with the demand purchase provisions of the 2008B Supplemental Resolution described above.

*Remarketing of 2008B Bonds.* Upon receipt of notice that the Tender Agent will be required to effect the purchase of any 2008B Bond in accordance with demand purchase or mandatory tender for purchase provisions described above, the Remarketing Agent will be required to offer for sale and to use its reasonable best efforts to sell such 2008B Bond, any such sale to be made on the Purchase Date at par plus accrued interest, if any. The Remarketing Agent will be required to continue to offer for sale and use its reasonable best efforts to sell any 2008B Bond purchased by the District or any Credit Facility Provider Bonds until such time as the District or the Credit Facility Provider, as applicable, instructs the Remarketing Agent in writing to discontinue such efforts; *provided, however,* that no 2008B Bond purchased by the District will be remarketed without the Favorable Opinion of Bond Counsel.

The Remarketing Agent is required to give telephonic or telegraphic notice, promptly confirmed in writing, to the Tender Agent, specifying the principal amount of 2008B Bonds (including any Credit Facility Provider Bonds), if any, sold by it pursuant to the demand purchase or mandatory tender provisions described above, by 12:00 Noon, New York City time, on each Purchase Date, which notice is to include the names, addresses and taxpayer identification numbers of the new purchasers.

*Delivery of 2008B Bonds.* 2008B Bonds, including Credit Facility Provider Bonds, which have been remarketed by the Remarketing Agent and are purchased with amounts on deposit in the Remarketing Account are to be made available to the Remarketing Agent by the Tender Agent at the Delivery Office upon payment or evidence of payment therefor.

2008B Bonds for which the source of the Purchase Price was moneys on deposit in the 2008B Bond Purchase Account are, subject to the 2008B Supplemental Resolution, to be delivered to or upon the order of the District.

2008B Bonds purchased with moneys provided under a Credit Facility, including the 2008B Credit Facility, that have not been remarketed by the Remarketing Agent (i) are to be registered by the Tender Agent in the name of the Credit Facility Provider or any custodian, nominee, agent or depository designated by the Credit Facility Provider; (ii) will be held by the Tender Agent, for the account of the Credit Facility Provider or its designee or upon the request of the Credit Facility Provider shall be made available by the Tender Agent (without charge to the Credit Facility Provider) to the Credit Facility Provider or its designee; and (iii) are to be reregistered by the Tender Agent in such name or names, and exchanged for 2008B Bonds in such Authorized Denominations as the Credit Facility Provider may direct, all without charge to the Credit Facility Provider.

Notwithstanding the foregoing, no Credit Facility Provider Bond is to be registered to any person other than the Credit Facility Provider or its designee until the Tender Agent receives telephonic notice, promptly confirmed in writing, stating that such Credit Facility has been reinstated in full with respect to such 2008B Bond or has been terminated in accordance with the terms of that Credit Facility.

*Drawings on Credit Facility.* The Tender Agent is required to request payment under a Credit Facility provided for 2008B Bonds, including the 2008B Credit Facility, in accordance with its terms to the extent necessary to make timely payments of the Purchase Price of the 2008B Bonds required to be made pursuant to, and in accordance with, the demand purchase and mandatory tender for purchase provisions described above. The Tender Agent is required to request payment under such Credit Facility no later than the time provided in such Credit Facility in order to receive payment, in immediately available funds, of an amount sufficient to pay the Purchase Price of the 2008B Bonds on the Purchase Date. If any 2008B Bond is purchased by the Credit Facility Provider which provided the Credit Facility pursuant to a request for payment under that Credit Facility, such Credit Facility Provider will be deemed to own such 2008B Bonds. The 2008B Supplemental Resolution provides that Credit Facility Provider Bonds and 2008B Bonds owned by the District shall not be entitled to the benefits of any Credit Facility delivered until remarketed.

*Delivery of Proceeds of Sale.* The proceeds of the sale by the Remarketing Agent of 2008B Bonds are to be delivered to the Tender Agent for deposit in the Remarketing Account established for the 2008B Bonds immediately upon receipt but in no event not later than 12:00 Noon, New York City time, on each Purchase Date.

***Redemption of 2008B Bonds***

*Mandatory Sinking Fund Redemption.* The 2008B Bonds are subject to mandatory sinking fund redemption prior to maturity on July 1 of the years set forth below, at a redemption price equal to the principal amounts to be redeemed, plus interest accrued to the date of redemption.

Redemption Date (July 1 of the years set forth below)	Principal Amount
2013**	\$1,175,000
2014**	1,250,000
2015**	1,330,000
2016**	1,410,000
2017**	18,400,000
2018	1,590,000
2019	1,695,000
2020	1,800,000
2021	1,915,000
2022	2,040,000
2023	2,170,000
2024	2,300,000
2025	2,455,000
2026	1,850,000
2027	785,000
2028	1,630,000
2029	--
2030	--
2031	--
2032 (final maturity)	45,020,000

\*\* On February 6, 2013, the District redeemed (pursuant to its rights of optional redemption) \$23,565,000 principal amount of the 2008B Bonds. The District has directed the Trustee to apply the principal amount of 2008B Bonds so redeemed against the mandatory sinking fund redemptions for 2013 through 2017.

*Optional Redemption.* The 2008B Bonds are subject to redemption prior to maturity while the 2008B Bonds bear interest for a Weekly Interest Rate Period, at the option of the District, as a whole or in part at any time (but if in part only in Authorized Denominations), at the Redemption Price of 100 percent of the unpaid principal amount of the 2008B Bonds to be redeemed, together with interest, if any, accrued thereon to the date of redemption.

*Selection.* Pursuant to the 2008B Supplemental Resolution, the Trustee shall, at the written direction of the District (or in the absence of such written direction, by random drawing conducted by the Trustee), select the particular 2008B Bonds which shall be subject to optional redemption; provided, however, that Credit Facility Provider Bonds are to be selected for redemption first, in the inverse order in which such 2008B Bonds became Credit Facility Provider Bonds.

*Notice and Effect of Redemption.* Notice of redemption of any 2008B Bonds to be redeemed shall be given by first class mail to the owners of the 2008B Bonds designated for redemption at least 15 but not more than 60 days prior to the redemption date, and to certain specified securities depositories and information services. When notice of redemption has been given as provided in the Resolution, the 2008B Bonds designated for redemption shall become due and payable on the redemption date and interest on such 2008B Bonds so called for redemption shall cease to accrue as of that redemption date.

### **Defeasance**

Under the Master Resolution, upon the deposit with the Trustee, at or before maturity, of money or non-callable Government Securities which, together with the earnings thereon, are sufficient to pay the Principal, Purchase Price or Redemption Price of any particular Bond or Bonds, or portions thereof, becoming due, together with all interest accruing thereon to the due date or redemption date, and pays or makes provision for payment of all fees, costs and expenses of the Trustee due or to become due with respect to such Bonds, all liability of the District with respect to such Bond or Bonds (or portions thereof) will cease and such Bond or Bonds (or portions thereof) will be deemed not to be Outstanding under the Master Resolution. The Owner or Owners of such Bond or Bonds (or portions thereof) will be restricted exclusively to the money or Government Securities so deposited, together with any earnings thereon, for any claim, subject to the provisions of the Master Resolution, and such Bond or Bonds will no longer be secured by or entitled to the benefits of the Master Resolution, except as provided in the Master Resolution. If such Bond is to be redeemed prior to maturity, irrevocable notice of such redemption must have been given as provided in the Master Resolution. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—The Master Resolution—Discharge and Defeasance.”

### **Trustee and Tender Agent**

U.S. Bank National Association (the “Trustee” and the “Tender Agent”) has been appointed Trustee and Tender Agent for the 2008B Bonds. The Trustee may be removed or replaced as Trustee and/or Tender Agent by the District as provided in the Resolution.

### **Book-Entry System**

The 2008B Bonds will be delivered in fully registered form only, and when delivered will be registered in the name of Cede & Co., as nominee of DTC. DTC acts as securities depository for the 2008B Bonds. Ownership interests in the 2008B Bonds may be purchased in book-entry only form, in the denominations set forth above. So long as DTC acts as securities depository for the 2008B Bonds, the District, the Trustee, the Tender Agent and the Remarketing Agent shall have no responsibility or obligation with respect to (1) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any beneficial ownership interest in the 2008B Bonds, (2) the delivery to any Participant or any other person, other than an owner as shown in the Bond Register, of any notice with respect to the 2008B Bonds, or (3) the payment to any Participant or any other person, other than an owner as shown in the Bond Register, of any amount with respect to principal or Purchase Price of, premium, if any, or interest on the 2008B Bonds. The District, the Trustee, the Tender Agent and the Remarketing Agent may treat and consider the person in whose name each 2008B Bond is registered in the Bond Register as the holder and absolute owner of such 2008B Bond for the purpose of payment of principal, Purchase Price and interest on such 2008B Bond, for the

purpose of giving notices with respect to such 2008B Bond, and for all other purposes whatsoever. See APPENDIX G—“Book-Entry Only System.”

## SECURITY FOR THE 2008B BONDS

### Pledge of Revenues

The principal and Purchase Price of and premium, if any, and interest on the 2008B Bonds are payable from and secured by (i) amounts on deposit in the applicable accounts in the bond fund established under the 2008B Supplemental Resolution for the 2008B Bonds (the “2008B Bond Fund”), the applicable account in the Reserve Fund established under the 2008B Supplemental Resolution for the 2008B Bonds (the “2008B Reserve Account”) and any sinking fund that may be established for such 2008B Bonds and (ii) Revenues pledged to such funds and the payment of the Bonds; *provided*, that the lien and charge of the Senior Consolidated System Bonds on Revenues and the obligation of the District to deposit Revenues in the bond funds established by the Senior Consolidated System Resolution have priority over the lien and charge of the Bonds, including the 2008B Bonds, on Revenues. The District pledges, obligates and binds itself in the Resolution to pay into the applicable accounts in the 2008B Bond Fund a fixed amount of Revenues, after payment of Operation and Maintenance Expenses without regard to any fixed proportion of Revenues, sufficient in time and amount to pay the principal of and premium, if any, and interest on the 2008B Bonds from time to time Outstanding, as the same respectively become due and payable, either at maturity, or upon purchase, redemption or acceleration thereof pursuant to the terms of the Resolution.

The Enabling Act provides that the revenue obligations and interest thereon issued by a public utility district thereunder shall be a valid claim of the owner thereof only as against the special fund or funds provided for the payment of such obligations and the proportion or amount of the revenues pledged to such fund or funds, and that such pledge of the revenues or other moneys or obligations shall be valid and binding from the time made, that the revenues or other moneys or obligations so pledged and thereafter received by the public utility district shall immediately be subject to the lien of such pledge without any physical delivery or further act, and that the lien of any such pledge shall be valid and binding as against any parties having claims of any kind in tort, contract or otherwise against the public utility district irrespective of whether such parties have notice thereof.

The Resolution defines “Revenues” generally as all revenues, rates and charges received or accrued by the District for electric power and energy, water, wastewater, fiber and telecommunications and other services, facilities and commodities sold, furnished or supplied by the Consolidated System, together with income, earnings and profits therefrom, all as determined in accordance with generally accepted accounting principles (“GAAP”) as applied to governmental entities. The revenues of the Water System and the Wastewater System do not constitute a part of Revenues to the extent such revenues are pledged to the payment of bonds or other obligations for borrowed money of either of those respective systems. Revenues include all amounts received or accrued by the Consolidated System, including principal and interest payments to the Consolidated System on or with respect to loans made by the Consolidated System to any separate system of the District that is not part of the Consolidated System. Revenues do not include proceeds from the issuance of any obligations for borrowed money, amounts loaned to the Consolidated System, Payment Agreement Receipts, proceeds from taxes, customer deposits while retained as such, contributions in aid of construction, gifts, grants, insurance or condemnation proceeds that are properly allocated to a capital account, unrealized mark-to-market gains with respect to any property investment or financial or other agreement, or money received by the District as the proceeds of the sale of any portion of the properties of the Consolidated System.

Once all of the Bonds Outstanding under the Resolution as of August 11, 2009 (excluding the Public Utility District No. 1 of Chelan County, Washington, Consolidated System Revenue Bonds, Series 2009C and Series 2009D), are no longer Outstanding, the definition of “Revenues” will include the following sentence: “Federal and state grant moneys received by the District that do not constitute Contributions-in Aid-of Construction within the meaning of GAAP shall constitute Revenues if designated as such by the District.”

“Operation and Maintenance Expenses” means the costs paid or accrued for the proper operation, maintenance and repair of the Consolidated System and taxes, assessments or other governmental charges lawfully imposed on the Consolidated System or the Revenues, or payments in lieu thereof, all as determined in accordance with GAAP as applied to governmental entities. The operation and maintenance expenses of the Rock Island

System or the Rocky Reach System shall not constitute a part of Operation and Maintenance Expenses unless and until the Rock Island System or the Rocky Reach System, respectively, is consolidated into the Consolidated System. Operation and Maintenance Expenses shall not include depreciation or amortization expense or unrealized mark-to-market losses with respect to any property, investment, or financial or other agreement. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for the definitions of other capitalized terms used above.

Generally accepted accounting principles promulgated by the Governmental Accounting Standards Board (“GASB”) and the Financial Accounting Standards Board (“FASB”) allow for the deferral of various types of revenues and expenses for the intended purpose of providing a more accurate assessment of the financial position of governmental and other entities, as well as financial reporting that better matches the rate-setting process for rate-regulated entities. Accordingly, certain expenses and credits, which are normally reflected in the change of net position as incurred, may be recognized when included in rates and recovered from or refunded to customers. These deferrals include mark-to-market adjustments with respect to certain derivatives transactions, the deferral of the recognition of revenues from prepayments (such as those made by Puget Sound Energy and Alcoa under the Power Sales Contracts), the deferral of significant contributions in aid of construction and other items. The net effect of these changes is such that “Revenues” and “Operation and Maintenance Expenses,” as defined under the Master Resolution, may differ materially from actual cash receipts and cash expenditures for a given Fiscal Year of the District. Consequently, “Net Revenues” as defined under the Master Resolution, may be materially greater or less than the amounts actually available to the District to pay debt service on the Bonds and other obligations of the District. See “FINANCIAL INFORMATION—Changes in Accounting Principles.”

### **Limited Obligations**

The 2008B Bonds are special, limited obligations of the District and shall not in any manner or to any extent constitute general obligations of the District or of the State, or of any political subdivision of the State. The 2008B Bonds are not a charge upon any general fund or upon any moneys or other property of the District, or of the State, or of any political subdivision of the State, other than Revenues and other funds, assets and security pledged therefor pursuant to the Resolution. Neither the full faith and credit nor the taxing power of the District, of the State or of any political subdivision of the State, are pledged to the payment of the 2008B Bonds. The 2008B Bonds shall not constitute indebtedness of the District, or of the State or any political subdivision of the State, within the meaning of the constitutional and statutory provisions and limitations of the State.

### **Outstanding Bonds**

The outstanding 2008B Bonds, together with any other bonds, notes or other evidences of indebtedness heretofore or hereafter issued under the Master Resolution on a parity therewith, are collectively referred to herein as the “Bonds.” As of December 31, 2012, the Bonds were outstanding in the aggregate principal amount of \$521,230,000, excluding \$21,855,000 principal amount of Consolidated System Revenue Bonds, Refunding Series 2009A and \$8,500,000 principal amount of Consolidated System Revenue Bonds, Refunding Series 2009B (collectively, the “2009A/B Bonds”) currently held in trust for the benefit of the District, which are not considered outstanding for financial reporting purposes. As of February 6, 2013, after giving effect to the option redemption of \$23,565,000 principal amount of the 2008B Bonds on February 6, 2013, the Bonds are outstanding in the aggregate principal amount of \$497,665,000 (excluding the 2009A/B Bonds). See “FINANCIAL INFORMATION—Outstanding Debt.”

### **Senior Consolidated System Bonds**

Pursuant to Resolution No. 95-10188, adopted by the Commission on June 19, 1995, as supplemented and amended, including as amended and restated by Resolution No. 99-11303, adopted by the Commission on November 1, 1999, as amended and supplemented (as so amended and supplemented, the “Senior Consolidated System Resolution”), the District has issued its Chelan Hydro Consolidated System Revenue Bonds (the “Senior Consolidated System Bonds”) payable from and secured by a pledge of Revenues, senior to the lien thereon of the Bonds, including the 2008B Bonds. As of December 31, 2012, the Senior Consolidated System Bonds are outstanding in the aggregate principal amount of \$40,430,000. See “FINANCIAL INFORMATION—Outstanding Debt.”

The lien and charge of the Senior Consolidated System Bonds on Revenues, and the obligation of the District to deposit Revenues in the bond funds established by the Senior Consolidated System Resolution, have priority over the lien and charge on Revenues of the Bonds, including the 2008B Bonds.

The covenants and other provisions of the Senior Consolidated System Resolution are different from those of the Master Resolution. See APPENDIX C—“Summary of Certain Provisions of the Senior Consolidated System Resolution.”

### **Flow of Funds**

The District, by Resolution No. 870, adopted on September 14, 1954, created a special fund known as the Revenue Fund (the “Revenue Fund”), which is held by the District. The District has covenanted and agreed to pay all income, revenues, receipts and profits and other moneys derived by the District through the ownership and operation of the Consolidated System, including Revenues, into the Revenue Fund, subject to the terms, limitations, restrictions, covenants, liens, charges and pledges contained in the resolutions of the District that established the Large Hydro Systems and provided for the issuance of bonds to finance those Systems. Unlike the Senior Consolidated System Resolution, the Master Resolution includes a specific flow of funds provision. The Master Resolution provides for the disbursement of Revenues deposited in the Revenue Fund in the following order of priority:

- (a) First, for the payment of Operation and Maintenance Expenses;
- (b) Second, (i) for the payment of the principal of and interest and redemption premium, if any, on any Senior Consolidated System Bonds; (ii) for deposit into a reserve fund securing any Senior Consolidated System Bonds; (iii) for Payment Agreement Payments pursuant to Payment Agreements entered into by the District with respect to any Senior Consolidated System Bonds; and (iv) for payment to any financial institution or insurance company providing any letter of credit, line of credit, or other credit or liquidity facility, including municipal bond insurance and guarantees, that secures the payment of principal of or interest on any Senior Consolidated System Bonds; in each case in any order of priority within this paragraph (b) established by the Senior Consolidated System Resolution;
- (c) Third, for deposit in the Interest Account of each Bond Fund created pursuant to the Resolution;
- (d) Fourth, for deposit in the Bond Retirement Account of each Bond Fund created pursuant to the Resolution;
- (e) Fifth, for deposit in the Reserve Fund pursuant to the Resolution;
- (f) Sixth, (i) for the payment of the principal of and interest and redemption premium, if any, on any Subordinate Obligations; (ii) for deposit into a reserve fund securing any Subordinate Obligations; (iii) for Payment Agreement Payments pursuant to Payment Agreements entered into by the District with respect to any Subordinate Obligations; and (iv) for payment to any financial institution or insurance company providing any letter of credit, line of credit, or other credit or liquidity facility, including municipal bond insurance and guarantees, that secures the payment of principal of or interest on any Subordinate Obligations; in each case in any order of priority within this paragraph (f) which may be hereafter established by the District by resolution;
- (g) Seventh, for any payment due under a Payment Agreement that does not constitute a Payment Agreement Payment;
- (h) Eighth, for any payment due under a Power Purchase Agreement that does not constitute an Operation and Maintenance Expense; and
- (i) Ninth, for any other lawful purpose of the Consolidated System, in any order of priority which may be hereafter established by the District by resolution.

The District may not withdraw moneys from the Revenue Fund in accordance with clauses (e) through (i) above unless the District first determines that the amounts to be withdrawn are not expected to be required for the purposes of clauses (a) through (d) above.

See “—Contingent Payment Obligations” under this heading and APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for the definitions of capitalized terms used above.

### **Additional Indebtedness**

The Enabling Act prohibits the District from creating or incurring indebtedness payable from Revenues that would require the District to set aside for the payment thereof an amount or proportion of Revenues which, in the judgment of the Commission of the District, is greater than that which will be available over and above the amount or proportion required to pay the costs of operation and maintenance of the Consolidated System and the amount or proportion previously pledged to the payment of the District’s revenue obligations, including the Bonds and the Senior Consolidated System Bonds.

*The District has covenanted in the Master Resolution not to issue any additional Senior Consolidated System Bonds under the Senior Consolidated System Resolution and not to issue or incur any additional indebtedness with a lien or charge on Revenues superior or prior to that of the Bonds, including the 2008B Bonds.* The Master Resolution does not prohibit the District from issuing or incurring any indebtedness payable from, or secured by a lien on, revenues of the Water System and the Wastewater System prior to or on a parity with the lien created by the Master Resolution.

Upon compliance with certain terms and conditions contained in the Master Resolution, the District may issue additional Bonds with a lien and charge on Revenues on a parity with that of the currently Outstanding Bonds (including the 2008B Bonds) for any lawful purpose, including, without limitation (i) the refunding of Outstanding Bonds, Senior Consolidated System Bonds, Prior Rock Island Bonds, bonds of the Water System and bonds of the Wastewater System and (ii) financing or refinancing the cost of additions, betterments or improvements to, or renewals and replacements of, the Consolidated System, and for other lawful purposes of the District. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—The Master Resolution—Additional Indebtedness.” The Master Resolution allows the District substantial flexibility as to the terms and conditions of any additional Bonds hereafter issued with a lien and charge on Revenues on a parity with that of the 2008B Bonds.

The Master Resolution permits the District to issue Bonds and enter into Payment Agreements providing for Payment Agreement Payments to be made on a parity with the Bonds. Subsequent Payment Agreements may also provide for Payment Agreement Payments that are subordinate to the Bonds. See “FINANCIAL INFORMATION—Consolidated System Payment Agreements.”

The Resolution contains no restrictions on the issuance of Rock Island Bonds or Rocky Reach Bonds. The District may issue additional Rock Island Bonds and additional Rocky Reach Bonds for purposes of refunding outstanding Rock Island Bonds and Rocky Reach Bonds, respectively, and funding new capital projects of the Rock Island and Rocky Reach Systems, respectively. Such bonds, however, will be issued under separate master resolutions of the District, not under the Resolution.

### **Subordinate Obligations**

The Master Resolution does not prevent the District from issuing or incurring any additional indebtedness with a lien or charge on Revenues junior and subordinate to the lien or charge of the Bonds. Pursuant to Resolution No. 08-13378, adopted by the Commission on October 14, 2008 (as amended and supplemented from time to time, the “Subordinate Consolidated System Resolution”), the District has issued and has outstanding its Consolidated System Subordinate Revenue Notes, Series 2009A and Series 2009B (the “2009A/B Subordinate Notes”). The outstanding 2009A/B Subordinate Notes, together with any other bonds, notes or other evidences of indebtedness hereafter issued under the Subordinate Consolidated System Resolution on a parity therewith, are collectively

referred to herein as the “Subordinate Consolidated System Obligations.” The Subordinate Consolidated System Obligations are payable from and secured by a pledge of Revenues subordinate to the lien thereon of the Senior Consolidated System Bonds and the Bonds. As of December 31, 2012, the Subordinate Consolidated System Obligations were outstanding in the aggregate principal amount of \$28,970,000. See “FINANCIAL INFORMATION—Outstanding Debt.”

The Subordinate Consolidated System Resolution also provides that the District may enter into one or more interest rate swap agreements with respect to all or a portion of a Series of Subordinate Consolidated System Obligations.

On April 1, 2011, the District and Bank of America, N.A. (“Bank of America”) entered into a Line of Credit and Reimbursement Agreement (the “Credit Agreement”) with an available commitment of \$50 million. The District may either draw on the Credit Agreement directly or request that Bank of America issue a letter of credit for certain specified purposes. The District’s obligations under the Credit Agreement are payable from and secured by a pledge of Revenues subordinate to the lien and pledge thereon of the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations, to make required debt service reserve fund deposits with respect thereto, and to make regularly scheduled Payment Agreement Payments. The Credit Agreement is scheduled to expire on April 1, 2014. As of February 19, 2013, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit, and the District currently does not anticipate making any such draws or requests. See “FINANCIAL INFORMATION—Consolidated System Liquidity” and “District Near-Term Outlook; Strategic Planning.”

### **Power Purchase Agreements**

Pursuant to the Master Resolution, “Power Purchase Agreement” means a resolution, contract or agreement with a term of more than five (5) years pursuant to which the Consolidated System is obligated to purchase capacity or energy, including from a separate system of the District, and is obligated to pay for such capacity or energy regardless of whether or not such capacity or energy is taken by or made available or delivered to the Consolidated System.

The Master Resolution restricts the ability of the District to enter into any such Power Purchase Agreements, payable from Revenues, for the purchase of power from new or existing facilities. Such facilities could be owned by another entity, or could be part of a separate system of the District. Before entering into a Power Purchase Agreement, the District must deliver to the Trustee a Certificate of the District demonstrating compliance with the requirements for issuing additional Bonds set forth in the Master Resolution for the first three full Fiscal Years following the Fiscal Year in which such Power Purchase Agreement will become effective. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—The Master Resolution—Additional Bonds Certification.” Any amounts expended by the Consolidated System for the purchase of power under such a contract likely would constitute an Operation and Maintenance Expense of the Consolidated System.

The District has entered into a Power Purchase Agreement with respect to its share of the output from the Nine Canyon Wind Project. See “THE CONSOLIDATED SYSTEM—Consolidated System Energy Resources.”

### **Intersystem Loans of Bond Proceeds**

The District has adopted certain resolutions providing for lending a portion of the proceeds of the Senior Consolidated System Bonds and the Bonds to the Rocky Reach System and the Rock Island System and the repayment of those interfund loans by such Systems to the Consolidated System (the “Loan Resolutions”). See “FINANCIAL INFORMATION—Intersystem Loans” for a discussion of these interfund loans. Under both the Puget Contract and the Alcoa Contract, Puget Sound Energy and Alcoa, respectively will be obligated to make payments that include their proportionate shares of the repayment of such interfund loans. See “THE CONSOLIDATED SYSTEM—Puget Sound Energy Sales Contract” and “—Alcoa Power Sales Contract.” Pursuant to a long-term Power Sales Contract between the District and Public Utility District No. 1 of Douglas, Washington (“Douglas PUD”), Douglas PUD is also obligated to make similar such payments.



The revenues of the Rocky Reach System and the Rock Island System do not constitute Revenues of the Consolidated System and are not pledged to secure the payment of the Senior Consolidated System Bonds or the Bonds, including the 2008B Bonds. The loan repayments, however, made from those revenues to the Consolidated System do constitute Revenues of the Consolidated System and are available to pay the principal and Purchase Price of and premium, if any, and interest on the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations.

## Debt Service Reserve Funds

### *Senior Consolidated System Bonds*

The District has established debt service reserve funds to be held in trust by the District pursuant to the supplemental resolutions authorizing the outstanding Senior Consolidated System Bonds (each, a “Senior Consolidated System Reserve Fund”), and within each such Senior Consolidated System Reserve Fund, a separate reserve account for each series of Senior Consolidated System Bonds secured by such Senior Consolidated System Reserve Fund (each, a “Senior Consolidated System Reserve Account”). Each Senior Consolidated System Reserve Account is to be maintained at the applicable reserve requirement and may be funded with cash, permitted investments, one or more Reserve Fund Credit Policies, or any combination thereof. Each Senior Consolidated System Reserve Account may be drawn upon solely to pay debt service on the series of Senior Consolidated System Bonds secured by such account.

Table 1 below lists each series of outstanding Senior Consolidated System Bonds secured in whole or in part with a Reserve Fund Credit Policy and information regarding each such Reserve Fund Credit Policy.

**Table 1**  
**Senior Consolidated System Bonds**  
**Reserve Account Credit Policies**

<b>Series of Senior Consolidated System Bonds</b>	<b>Outstanding Principal Amount (as of 12/31/2012)</b>	<b>Reserve Account Credit Policy Expiration Date<sup>(1)</sup></b>	<b>Amount of Reserve Account Credit Policy<sup>(2)</sup></b>	<b>Reserve Account Credit Policy Provider<sup>(3)</sup></b>
2004C	15,000,000	July 1, 2014	903,783.33	NPF
2005A	25,430,000	July 1, 2015	1,303,287.50	NPF

<sup>(1)</sup> Generally, the Reserve Account Credit Policies expire upon the final maturity of the related series of Senior Consolidated System Bonds. The Reserve Account Credit Policies relating to the 2004C and 2005A Senior Consolidated System Bonds, however, expire upon initial mandatory tender dates for the 2004C and 2005A Senior Consolidated System Bonds, as applicable. The final maturities for the 2004C and 2005A Senior Consolidated System Bonds are 2024 and 2039, respectively.

<sup>(2)</sup> The amount of each Reserve Account Credit Policy is equal to the applicable reserve requirement.

<sup>(3)</sup> The Reserve Account Credit Policies for the 2004C and 2005A Senior Consolidated System Bonds were issued by Financial Guaranty Insurance Company. All of these Reserve Account Credit Policies are currently reinsured and administered by National Public Finance Guarantee Corporation (“NPF”).

Source: *The District.*

The Senior Consolidated System Resolution requires that a Reserve Fund Credit Policy deposited in a Senior Consolidated System Reserve Account must be from a financial institution whose senior unsecured debt obligations or claims-paying ability is rated in the highest rating category by the Rating Agencies only as of the time of delivery of such Reserve Fund Credit Policy. The Senior Consolidated System Resolution, however, does not require that those ratings be maintained after the date of deposit.

### *Consolidated System Bonds*

The Master Resolution established the Consolidated System Revenue Bonds Reserve Fund (the “Reserve Fund”), and the Master Resolution authorizes the District to establish one or more reserve accounts in the Reserve Fund (each, a “Reserve Account”), each of which may secure one or more Series of Bonds pursuant to the

Supplemental Resolutions authorizing their issuance. The Reserve Fund and the Reserve Accounts therein are held and administered by the Trustee. Each Reserve Account may be drawn upon for the sole purpose of paying the Bonds and Payment Agreement Payments, if any, relating to the Bonds secured by such Reserve Account. Each Reserve Account is to be maintained at all times at the aggregate Reserve Requirements for all Series of Bonds secured by such Reserve Account. The District may satisfy its obligations to fund the Reserve Accounts with Bond proceeds, other available funds of the District, authorized investments, one or more Reserve Account Credit Facilities, or a combination thereof, in an aggregate amount equal to the aggregate Reserve Requirement for the Bonds secured by such Reserve Account.

**2008B Reserve Account.** The Fourth Supplemental Resolution established the 2008B Reserve Account to secure the 2008B Bonds, as well as any future Series of Bonds designated as a “2008B Reserve Account Series.” Upon the delivery of the remarketed 2008B Bonds, the 2008B Reserve Account will be funded in the amount of \$972,225 (the “2008B Reserve Requirement”). The 2008B Reserve Account will continue to secure the 2008B Bonds following the remarketing of the 2008B Bonds on the Mandatory Tender Date.

The District may satisfy its obligation to fund the 2008B Reserve Account through cash, a letter of credit, insurance policy and/or surety bond meeting the requirements set forth in the Resolution, or a combination thereof, in an aggregate amount equal to the 2008B Reserve Requirement.

Moneys in the 2008B Reserve Account may be used solely for the purpose of paying and securing the payment of the principal and Purchase Price of and interest on the 2008B Bonds and any other 2008B Reserve Account Series of Bonds. Moneys in the 2008B Reserve Account may not be used to pay the principal or Purchase Price of or interest on any other Series of Bonds. The 2008B Reserve Account will be held by the Trustee. In the event of the bankruptcy or insolvency of the District, a bankruptcy court may be able to direct the application of moneys in the 2008B Reserve Account to other purposes. The Resolution does not require that any additional series of Bonds be secured by the 2008B Reserve Account.

**Reserve Account Credit Facilities.** The Master Resolution defines “Reserve Account Credit Facility” as a letter of credit, insurance policy, surety bond, or other credit facility provided to the Trustee by a bank, insurance company or other financial institution whose senior unsecured debt obligations are, or whose claims-paying ability is, rated in the highest rating category by each of at least two Rating Agencies, which provides for payment when due, in accordance with the terms thereof, of the principal or redemption price of and/or interest on one or more Series of Bonds or portion thereof. The Master Resolution does not require the District to replace or otherwise address Reserve Account Credit Facilities upon downgrade of a Facility provider. No Bonds are currently secured by a Reserve Account Credit Facility.

### ***Combined District Systems***

As of December 31, 2012, approximately 5% of the District’s aggregate reserve fund requirements for the Senior Consolidated System, Consolidated System, Subordinate Consolidated System, Rock Island System and Rocky Reach System are secured by reserve account credit policies or facilities, with the remaining 95% being funded with cash and investments.

### **Rate Covenant**

The District has covenanted in the Master Resolution to fix, establish, maintain and collect rates and charges for electric power and energy, water, wastewater, fiber and telecommunications and other services, facilities and commodities sold, furnished or supplied by or through the Consolidated System, which shall be fair and nondiscriminatory and adequate to provide the District with Revenues in each Fiscal Year sufficient:

(a) To pay, to the extent not paid from Available Funds or other moneys of the Consolidated System, (i) the Operation and Maintenance Expenses due and payable during such Fiscal Year; (ii) Annual Debt Service on the Bonds and the Senior Consolidated System Bonds due and payable in such Fiscal Year; (iii) the amounts, if any, required to be deposited into the Reserve Fund and any debt service reserve fund for the Senior Consolidated

System Bonds during such Fiscal Year; and (iv) any and all other amounts the District is obligated to pay or set aside from the Revenues by law or contract in such Fiscal Year;

- (b) Together with Available Funds, to provide a Bond Coverage Ratio of at least 1.25, and
- (c) Excluding Available Funds, to provide a Bond Coverage Ratio of at least 1.0.

The District has also covenanted in the Master Resolution that it will fix, establish, maintain and collect rates and charges for electric power and energy and other services, facilities and commodities sold, furnished or supplied by or through the Rock Island System and the Rocky Reach System, respectively, which shall be adequate, together with other available funds of the Rock Island System and the Rocky Reach System, respectively, to make all required payments due from those systems to the Consolidated System, including any payments due on account of loans or advances of funds from the Consolidated System to the Rock Island System and the Rocky Reach System, respectively.

“Available Funds” means, as of any date of calculation, any unencumbered funds of the Consolidated System, including cash and the book value of investments, held in the Rate Stabilization Fund, the Contingency Reserve Fund, and any other similar capital or operating reserve or contingency fund hereafter designated by the Commission, in each case that the District reasonably expects would be available, for all of the first full Fiscal Year following the date of calculation, to pay principal of and interest on Bonds when due. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for the definitions of other capitalized terms used above.

“Bond Coverage Ratio” for any Fiscal Year means the ratio of (a) Adjusted Net Revenues in such Fiscal Year (plus Available Funds, to the extent provided herein), to (b) Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds in such Fiscal Year.

“Adjusted Net Revenues” in any Fiscal Year means: (a) Net Revenues in such Fiscal Year, plus (b) Withdrawals, if any, from the Rate Stabilization Fund that have been allocated to such Fiscal Year, less (c) Deposits, if any, into the Rate Stabilization Fund that have been allocated to such Fiscal Year.

“Contingency Reserve Fund” means the fund of that name previously established by the District within the Consolidated System by Resolution No. 94-10052, adopted by the Commission on December 19, 1994, the moneys in which are held in reserve and available in extraordinary circumstances to pay Operation and Maintenance Expenses, principal of and interest on Bonds, and other costs of the Consolidated System.

See “—Rate Stabilization Fund” below and APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for the definitions of capitalized terms used above.

### **Rate Stabilization Fund**

The District created the Rate Stabilization Fund to be held and administered by the District pursuant to the Master Resolution for the purpose of stabilizing rates and charges for retail customers of the Distribution Division. Pursuant to the Master Resolution, the District is required to transfer from the Revenue Fund into the Rate Stabilization Fund or from the Rate Stabilization Fund into the Revenue Fund such amounts, if any, as the District determines from time to time. If such transfer is made within 90 days after the end of a Fiscal Year, the District may allocate such transfer to the prior Fiscal Year rather than to the current Fiscal Year for purposes of complying with certification requirements for the issuance of additional Bonds or with the District’s rate covenant. The Master Resolution further provides that deposits into the Rate Stabilization Fund made prior to January 1, 2008, shall not be taken into account for purposes of determining Adjusted Net Revenues for the current or preceding Fiscal Years.

The District may withdraw amounts from the Rate Stabilization Fund for any lawful purpose of the District in the event the Commission determines that it is necessary or desirable to do so for purposes of stabilizing rates and charges for retail customers of the Distribution Division.

For purposes of determining whether the District is in compliance with its rate covenant or with the required test for the issuance of additional bonds, deposits made into the Rate Stabilization Fund (excluding the initial deposits made to the fund prior to January 1, 2008) are to be treated as an offset against Net Revenues and withdrawals from the Rate Stabilization Fund will be added to Net Revenues.

On December 3, 2007, the Commission adopted Resolution No. 07-13198 establishing the District's policies regarding the Rate Stabilization Fund. Pursuant to such resolution, if, in connection with any fiscal year, the District experiences an increase in revenues, decrease in operating expenses, or increase in net revenues of the Consolidated System, or unencumbered balances available in the Consolidated System, the Commission is required to consider whether to deposit revenues from the Revenue Fund or other moneys of the Consolidated System into the Rate Stabilization Fund in an amount or amounts to be determined by the Commission. Such resolution further provides, that if in connection with any fiscal year, the District experiences a decrease in revenues, increase in operating expenses, or decrease in net revenues of the Consolidated System, the Commission is required to consider whether to withdraw moneys from the Rate Stabilization Fund to the Revenue Fund in an amount or amounts to be determined by the Commission.

Pursuant to Resolution No. 07-13198, amounts transferred from the Rate Stabilization Fund to the Revenue Fund are required to be used for the following purposes in the following order of priority:

- (1) To pay operating and maintenance expenses of the District;
- (2) To pay for capital costs of the Consolidated System otherwise expected to be paid from revenues of the Consolidated System (other than as set forth below);
- (3) To pay any other costs of the Consolidated System otherwise expected to be paid from revenues of the Consolidated System (other than as set forth below);
- (4) To pay debt service on bonds, notes or other obligations of the Consolidated System for borrowed money the interest on which is taxable to the owners or holders thereof, or to make required deposits into any reserve funds therefor;
- (5) To make required deposits into any reserve funds for bonds, notes or other obligations of the Consolidated System for borrowed money the interest on which is tax-exempt to the owners or holders thereof; and
- (6) To pay debt service on bonds, notes or other obligations of the Consolidated System for borrowed money the interest on which is tax-exempt to the owners or holders thereof.

Resolution No. 07-13198 further provides that the District shall not transfer amounts from the Rate Stabilization Fund to the Revenue Fund or other funds of the Consolidated System unless the Commission reasonably determines that current rates and charges for the commodities and services provided by the Consolidated System, excluding amounts in the Rate Stabilization Fund and other available funds of the District, are projected to be sufficient to provide revenues to pay all operating expenses, debt service costs, planned capital expenditures and any other amounts to be payable from the revenues of the Consolidated System, and to replenish such withdrawal to the extent necessary or otherwise desirable from the Rate Stabilization Fund as soon as is reasonably practicable.

On December 31, 2007, the District made an initial deposit of \$50 million from available funds of the Consolidated System into the Rate Stabilization Fund, and as of September 30, 2012, the District continues to maintain a balance of \$50 million in the Rate Stabilization Fund. See "FINANCIAL INFORMATION—Consolidated System Liquidity."

Pursuant to Resolution No. 07-13198, it is the District's policy to utilize the Rate Stabilization Fund as one tool along with rate increases, surcharges, power adjustment clauses and other related revenue and expense action to protect the District and its ratepayers from unexpected fluctuations in revenues and operating expenses of the Consolidated System. In accordance with RCW 54.24.080 and pursuant to the Master Resolution, the District is

required to fix, establish, maintain and collect rates and charges adequate to provide sufficient revenues in each year. See “— Rate Covenant” under this heading.

See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for the definitions of capitalized terms used above.

### **Operating Reserve Fund**

Pursuant to Resolution No. 07-13198, the District established a fund designated as the “Public Utility District No. 1 of Chelan County, Washington, Operating Reserve Fund” (the “Operating Reserve Fund”) for the purpose of mitigating unexpected fluctuations in revenues and operating expenses within the Consolidated System.

Such resolution provides that the District is required to transfer Consolidated System revenues in excess of working capital needs from the Revenue Fund into the Operating Reserve Fund, or transfer amounts from the Operating Reserve Fund into the Revenue Fund to cover working capital needs, as the District determines from time to time, in order to maintain an adequate reserve for working capital purposes.

Pursuant to Resolution No. 07-13198, the District’s policy is to manage fluctuations in the unencumbered balance in the Consolidated System Revenue Fund on a periodic basis to maintain an adequate working capital balance. The District is authorized to transfer any funds in the Revenue Fund in excess of such needs to the Operating Reserve Fund. The resolution provides that if moneys in the Revenue Fund fall below an adequate working capital balance, the District is required to make a transfer or transfers from the Operating Reserve Fund to the Revenue Fund sufficient to provide for such working capital needs.

On December 31, 2007, the District made an initial deposit of \$52 million from available funds of the Consolidated System into the Operating Reserve Fund. As of September 30, 2012, there was \$57.7 million on deposit in the Operating Reserve Fund. See “FINANCIAL INFORMATION—Consolidated System Liquidity.”

### **Other Covenants**

The District has covenanted in the Master Resolution to maintain, preserve and keep the properties of the Consolidated System in good repair, working order and condition, to make all necessary and proper repairs, renewals, replacements, additions, extensions and betterments thereto and to operate the properties and business of the Consolidated System in an efficient manner and at a reasonable cost. In addition, the District has covenanted in the Master Resolution to use its best efforts to obtain renewals of permits or licenses for the Consolidated System or obtain new permits or licenses, unless such renewals or new permits or licenses are not, in the judgment of the District, in the best interest of the District. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—The Master Resolution—Certain Covenants.”

### **Sinking Funds for Balloon Bonds**

The District has covenanted in the Master Resolution to establish and maintain a Balloon Sinking Fund, to be held by the District, with respect to each Balloon Bond at least three (3) years prior to the maturity date, mandatory redemption date, or date of mandatory tender for purchase of such Bonds in order to secure the payment of the maturing Principal, including Accreted Value, Purchase Price or Redemption Price of such Bonds. The Master Resolution requires the District to fund each such Balloon Sinking Fund in four equal annual installments of one-fourth of such maturing Principal, Purchase Price or Redemption Price commencing not less than three (3) years prior to such payment date, either (i) by deposits from Revenues or other available funds, or (ii) by obtaining one or more Credit Facilities that provide for the payment of such maturing Principal, Purchase Price or Redemption Price. Amounts in each such Balloon Sinking Fund are pledged to the payment of such Bonds on their maturity date, mandatory redemption date, or date of mandatory tender for purchase, and are subject to the lien and charge of the Master Resolution for the benefit of such Bonds. Any amounts in any such Balloon Sinking Fund not required on the maturity date, mandatory redemption date, or date of mandatory tender for purchase may be used for any other lawful purpose of the District. See “FINANCIAL INFORMATION—Consolidated System Liquidity,” footnote 2 to

Table 16 in “—Annual Debt Service,” and APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for definitions of capitalized terms.

### **Additional Balloon Indebtedness of the District**

The District has issued, and there are outstanding, under the Senior Consolidated System Resolution several series of Senior Consolidated System Bonds, the full principal amounts of which come due at maturity. The Senior Consolidated System Resolution defines “Excluded Principal Amounts” to include (i) the Final Compounded Amount of any Capital Appreciation Bond (each as defined in the Senior Consolidated System Resolution) designated as an “Excluded Principal Amount” in a Supplemental Resolution (as defined in the Senior Consolidated System Resolution), (ii) the principal amount of any Tender Obligations (as defined in the Senior Consolidated System Resolution), and (iii) as of the date of calculation, that portion of the principal amount of any series of Senior Consolidated System Bonds which is not required to be amortized by purchase or redemption prior to maturity, and which is designated as an Excluded Principal Payment Amount in a Supplemental Resolution (as defined in the Senior Consolidated System Resolution). The District has covenanted in the Senior Consolidated System Resolution to establish with respect to each Excluded Principal Payment, at least three years prior to the maturity date or date of mandatory tender for purchase for such Senior Consolidated System Bonds, a sinking fund for the payment of the maturing principal amount, accreted value or purchase price of the such series of Senior Consolidated System Bonds. The Senior Consolidated System Resolution provides that the District is required to fund each such sinking fund either by depositing, from Revenues or other available funds, in four equal annual installments of one-fourth of such maturing principal amount, accreted value or purchase price commencing not less than three years prior to such payment date, or by obtaining a Credit Facility (as defined in the Senior Consolidated System Resolution) that provides for the payment of such maturing principal, Accreted Value or purchase price. See APPENDIX C—“Summary of Certain Provisions of the Senior Consolidated Resolution—Definitions” and “—The Senior Consolidated System Resolution—Sinking Funds; Working Capital and Contingency Funds” and “FINANCIAL INFORMATION—Consolidated System Liquidity” and footnote 2 to Table 16 in “—Annual Debt Service” and footnote 4 to Table 14 in “—Outstanding Debt.”

The currently outstanding Subordinate Consolidated System Obligations constitute “Balloon Bonds” under the Subordinate Consolidated System Resolution. Pursuant to the Subordinate Consolidated System Resolution, “Balloon Bonds” means the aggregate principal of Subordinate Consolidated System Obligations of a series (including capital appreciation bonds) that becomes due and payable, either at scheduled maturity, by mandatory sinking fund payment or by mandatory tender for purchase, in any fiscal year constitutes 25% or more of the initial aggregate principal of such series of Subordinate Consolidated System Obligations. Unlike the District’s obligations under the Senior Consolidated System Resolution to establish a Sinking Fund prior to maturity with respect to Excluded Principal Payments (each as defined in the Senior Consolidated System Resolution) or under the Resolution to establish a Balloon Bond Sinking Fund prior to maturity with respect to a series of Balloon Bonds, the District is not obligated under the Subordinate Consolidated System Resolution to set aside funds prior to maturity of a Series of Balloon Bonds.

The 2009A/B Subordinate Notes will mature in the aggregate principal amount of \$28,970,000 on July 1, 2014. There are no credit or liquidity facilities in place to pay the maturing principal amounts of the Subordinate Consolidated System Obligations. Although the District is not required under the Subordinate Consolidated System Resolution to set aside funds in a “sinking fund” prior to the respective maturity dates of such Subordinate Consolidated System Obligations, the District’s liquidity policy requires that the District set aside funds available to pay the maturing principal amounts of the Subordinate Consolidated System Obligations. The District is setting aside funds to pay at maturity the principal amounts of the currently outstanding Subordinate Consolidated System Obligations in four equal annual installments, commencing three years prior to the respective maturity dates of each series of Subordinate Consolidated System Obligation, consistent with the requirements of the Master Resolution for paying Balloon Bonds.

### **Authorized Investments**

All moneys in any of the funds and accounts held by the Trustee, Treasurer or any Fiscal Agent and established pursuant to the Master Resolution may be invested in any obligation or investment in which the District

may legally invest its funds. For a description of the District’s current investment policies and practices, see “FINANCIAL INFORMATION—Investment Policies.”

### **Contingent Payment Obligations**

The District has entered into, and may in the future enter into, contracts and agreements in the course of its business that include an obligation on the part of the District to make payments or post collateral contingent upon the occurrence or nonoccurrence of certain future events, including events that are beyond the direct control of the District. The amount of any such contingent payments or collateral requirements may be substantial. To the extent that the District did not have sufficient funds on hand to make any such payment, it is likely that the District would seek to borrow such amounts through the issuance of additional Bonds or otherwise.

These contracts and agreements may include interest rate swap and other similar agreements, power purchase agreements, including those with “mark-to-market” collateral requirements, commodities futures contracts with respect to the delivery of electric energy or capacity, investment agreements, including for the future delivery of specified securities, energy price swap and similar agreements, other financial and energy hedging transactions, and other such contracts and agreements. Any such payments, or portions thereof, which are subject to characterization as Operation and Maintenance Expenses, would be payable from Revenues prior to the payment of debt service on the Bonds. Other such payments may be payable on a parity with debt service on the Bonds, including any Payment Agreement Payment to a Qualified Counterparty, as such term is defined in the Master Resolution. See “FINANCIAL INFORMATION—Consolidated System Payment Agreements.”

The purposes for such contracts and agreements may include management of the District’s exposure to future changes in interest rates and energy prices, management of the District’s load/resource balance, and other purposes. Such contingent payments or the required posting of collateral may be conditioned upon the future credit ratings of the District and/or other parties to the agreements, maintenance by the District of specified financial ratios, future changes in electric energy or related prices, and other factors. See “THE CONSOLIDATED SYSTEM—Consolidated System Energy Resources” and “—Wholesale Power Management Activity.”

Given the strength of the District’s financial metrics and credit ratings and the terms of the District’s negotiated credit agreements for power marketing activities, the District does not currently anticipate that it would be exposed to substantial contingent payment or collateral requirements. The District cannot guarantee, however, that power purchase or power sales contracts entered into by the District in the future will not expose the District to substantial contingent payment or collateral requirements. To help mitigate this risk, the District entered into the Credit Agreement, which can be drawn upon to satisfy any collateral requirements the District may have in connection with its electricity hedging activities.

### **Addition of Separate Systems**

Pursuant to the Master Resolution, the District may add to the Consolidated System at any time any other separate utility system of the District and any other facilities or systems of the District that the District is authorized by law to own and operate. The District does not currently anticipate adding any facilities or systems to the Consolidated System.

### **Certain Provisions of the Master Resolution Relating to Credit Facility Provider Rights**

Pursuant to the Master Resolution, except as otherwise provided in the Supplemental Resolution authorizing the issuance of a Series of Bonds, if the Credit Facility Provider with respect to such Series of Bonds is not in default in respect of any of its obligations under the Credit Facility securing such Series of Bonds, then: (a) such Credit Facility Provider shall be deemed to be the Owner of such Series of Bonds at all times for the purposes of (i) giving any approval or consent to the effectiveness of any Supplemental Resolution other than a Supplemental Resolution providing for (A) a change in the terms of redemption, purchase or maturity of the principal of any Outstanding Bond of such Series or any interest thereon or a reduction the Principal amount, Purchase Price or Redemption Price thereof or in the rate of interest thereon, or (B) a reduction in the percentage of Owners required to approve or consent to the effectiveness of any Supplemental Resolution, and (ii) giving any

approval or consent or exercising any remedies in connection with the occurrence of an Event of Default; (b) any amendment to the Master Resolution requiring the consent of Owners of such Series of Bonds shall also require the prior written consent of such Credit Facility Provider; and (c) any amendment to the Master Resolution not requiring the consent of Owners of such Series of Bonds shall require the prior written consent of such Credit Facility Provider if its rights shall be materially and adversely affected by such amendment. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—The Master Resolution—Credit Facility Provider Rights.”

“Credit Facility” means a letter of credit, line of credit, or other credit or liquidity facility provided by a financial institution or insurance company, including municipal bond insurance and guarantees, delivered to the Trustee for a Series of Bonds or portion thereof, which provides for payment, in accordance with the terms thereof, of the Principal, Purchase Price and/or Redemption Price of and/or interest on such Series of Bonds or portion thereof.

“Credit Facility Provider” means the financial institution or insurance company that is providing a Credit Facility. See APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution—Definitions” for definitions of other capitalized terms used above. The 2008B Credit Facility does not constitute a “Credit Facility” for the foregoing purposes, nor does the Bank constitute a “Credit Facility Provider” for such purposes.

## **THE BANK AND THE 2008B CREDIT FACILITY**

### **The Bank**

The Bank is a full-service commercial bank providing an array of financial services to individuals, small businesses, middle-market companies, and major corporations. The Bank operates 402 branches and 607 ATMs in California, Oregon, Washington, Texas, Illinois, and New York, as well as two international offices. The Bank serves corporate clients across the country, and has a retail customer base of approximately 1 million households.

The Bank is the primary subsidiary of UnionBanCal Corporation (“UnionBanCal”), the second-largest commercial bank holding company headquartered in California, based on assets of \$88.2 billion at September 30, 2012. UnionBanCal is a wholly owned subsidiary of The Bank of Tokyo-Mitsubishi UFJ, Ltd., and a member of the Mitsubishi UFJ Financial Group (MUFG, NYSE:MTU), one of the world’s largest financial organizations.

For the quarter ending September 30, 2012, UnionBanCal had loans totaling \$54.7 billion, total assets of \$88.2 billion and total deposits of \$65.1 billion. Net income was \$124 million, down from \$187 million for the prior quarter, and down from \$172 million for the year-ago quarter. Copies of the latest annual report and the most recent quarterly report may be obtained at [www.unionbank.com](http://www.unionbank.com) \* or at the Bank’s Los Angeles office, located at 445 South Figueroa Street, Los Angeles, California 90071.

### **The 2008B Credit Facility**

*The following description is a summary of certain provisions of the 2008B Credit Facility. Such summary does not purport to be a complete description or restatement of the material provisions of the 2008B Credit Facility. Investors should obtain and review a copy of the 2008B Credit Facility to understand all of the terms of the 2008B Credit Facility.*

#### **General**

The 2008B Credit Facility provides that, subject to the terms and conditions set forth in such 2008B Credit Facility, the Bank shall extend credit to the District through the purchase of 2008B Bonds tendered or deemed tendered pursuant to the 2008B Supplemental Resolution (as more fully defined in the 2008B Credit Facility,

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\* Information about the Bank or other matters on the Bank’s web site is **not** incorporated herein by this reference.



“Tendered Bonds”). The 2008B Credit Facility is scheduled to expire on March 2, 2016 (the “Stated Expiration Date”), unless extended or terminated pursuant to its terms.

Under certain circumstances described below, the obligation of the Bank to purchase Tendered Bonds may be immediately suspended or terminated without notice to the owners of the 2008B Bonds. In such event, sufficient funds may not be available to purchase Tendered Bonds. In addition, the 2008B Credit Facility does not provide support or security for the payment of regularly scheduled principal of, premium, if any, or interest on the 2008B Bonds.

#### ***Purchase of Tendered Bonds by the Bank***

The Bank will purchase from time to time Tendered Bonds during the period from and including March 6, 2013 (following the mandatory tender of the 2008B Bonds), to and including the Stated Expiration Date (unless earlier terminated pursuant to the terms of the 2008B Credit Facility). The price to be paid by the Bank for the Tendered Bonds will be equal to the aggregate principal amount of the Tendered Bonds, provided that the aggregate principal amount of such Tendered Bonds so purchased shall not exceed the Available Principal Commitment (as defined in the 2008B Credit Facility), plus the lesser of (i) the Available Interest Commitment (as defined in the 2008B Credit Facility) and (ii) interest accrued thereon to the date of such purchase.

#### ***Events of Default***

**Event of Termination.** The 2008B Credit Facility provides that it will be an “Event of Termination” if the Rating Agencies (as defined in the 2008B Credit Facility) shall (i) reduce their long-term unenhanced ratings assigned to the 2008B Bonds or any other Bonds (as further defined in the 2008B Credit Facility and for purposes of this section of this Remarketing Memorandum, “Parity Bonds”) below Investment Grade (as defined in the 2008B Credit Facility), or (ii) suspend or withdraw their long-term ratings assigned to the 2008B Bonds or any Parity Bonds other than as a result of (A) debt maturity, redemption or defeasance, or (B) in the case of the 2008B Bonds or other Parity Bonds supported by credit enhancement, the reduction, suspension or withdrawal of the long-term ratings assigned to the Bank or to the other related credit enhancer.

**Events of Default Resulting in Immediate Termination.** Each of the following events constitutes an “Event of Default” under the 2008B Credit Facility:

(a) the District shall fail to pay when due any principal or interest on the 2008B Bonds or any Credit Facility Provider Bond (as defined in the 2008B Credit Facility) (other than such principal or interest which is part of the Purchase Price (as defined in the 2008B Credit Facility) of any Tendered Bonds); or

(b) the District shall fail to pay when due (whether by scheduled maturity, required prepayment or acceleration) any Parity Bonds (subject to certain exceptions contained in the 2008B Credit Facility) or any interest thereon, and such failure shall continue beyond any applicable period of grace specified in any underlying resolution, indenture, contract or instrument pursuant to which such Parity Bonds have been issued; or

(c) one or more final, nonappealable money judgments against the District payable from the Revenues which, individually or in the aggregate, equal or exceed \$20,000,000 shall remain unpaid, unstayed, undischarged, unbonded or undismissed for a period exceeding the later of (i) that permitted by State law and (ii) sixty (60) days; or

(d) the District shall (i) commence any case, proceeding or other action under any existing or future law of any jurisdiction relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it as bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding up, liquidation, dissolution, composition or other relief with respect to it or its Debts (as defined in the 2008B Credit Facility); or (ii) commence any case, proceeding or other action seeking appointment of a receiver, trustee, custodian or other similar official for it or for all or any substantial part of its assets, or make a general assignment for the benefit of its creditors; or (iii) have commenced against it any case, proceeding or other action of a nature described in clause (i) above which (A) results in an order for such relief

or in the appointment of a receiver, trustee, custodian or other similar official, or (B) remains undismissed, undischarged or unbonded for a period of sixty (60) days; or (iv) take any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts summarized in clauses (i), (ii), (iii) or (iv) of this paragraph (d); or (v) become insolvent within the meaning of Section 101(32) of the United States Bankruptcy Code; or

(e) any provision of the 2008B Credit Facility, the 2008B Bonds or the Resolution relating to (i) the obligation of the District to pay, when due, the principal or interest payable on the 2008B Bonds or any Parity Bonds or (ii) the Lien (as defined in the 2008B Credit Facility) on or pledge of the Revenues securing the 2008B Bonds or any Parity Bonds shall (A) cease to be valid and binding on the District or shall be declared to be null and void, invalid or unenforceable as the result of a final nonappealable judgment by any federal or state court or as a result of any legislative or administrative action by any governmental authority having jurisdiction over the District, or (B) be repudiated or otherwise denied by the District; or

(f) a debt moratorium or comparable extraordinary restriction on repayment of debt shall have been declared or announced by the District (whether or not in writing) or any governmental authority with appropriate jurisdiction in a finding or ruling with respect to the 2008B Bonds or all Parity Bonds.

**Events of Default not Resulting in Immediate Termination or Suspension.** Each of the following will constitute an “Event of Default” under the 2008B Credit Facility:

(a) **Misrepresentation.** Any material representation made by the District under the 2008B Credit Facility shall prove to be untrue in any material respect on the date as of which it was made; or

(b) **Non Payment of Fees.** The District shall fail to pay any amounts when due under the 2008B Credit Facility or the Fee Agreement (as defined in the 2008B Credit Facility) (other than those described in paragraph (a) under the subheading “—Events of Default Resulting in Immediate Termination” above) which failure is not remedied within ten (10) business days after the Trustee and the District have received written notice thereof from the Bank; or

(c) **Certain Breaches.** The District shall breach any of the terms or provisions of certain covenants in the 2008B Credit Facility, subject to certain qualifications therein; or

(d) **Other Breaches.** The District shall breach any other terms or provisions of the 2008B Credit Facility which breach is not remedied within thirty (30) days after the District has received written notice thereof from the Bank; or

(e) **Invalidity.** Any material provision of the 2008B Credit Facility or any Related Document (other than as described in paragraph (e) under the subheading “—Events of Default Resulting in Immediate Termination” above) shall at any time for any reason cease to be valid and binding on the District or shall be declared to be null and void, or the validity or enforceability thereof shall be contested by the District or by any governmental authority having jurisdiction; or

(f) **Cross Default.** The occurrence of any “event of default” by the District (after giving effect to any applicable cure period) as defined in the Resolution (which is not waived pursuant to the terms thereof) which is not otherwise described under this subheading, “Events of Default not Resulting in Immediate Termination or Suspension,” which would permit the acceleration of any Parity Bonds, other than the failure of the Bank to provide funds for the purchase of Tendered Bonds when required by the terms and conditions of the 2008B Credit Facility; or

(g) **Other Debt.** The District shall default in the payment of or performance under any Debt in a principal amount of \$20,000,000 or more, and such default permits the acceleration of the payment of such principal; or

(h) **Swap Contracts.** The District shall default in the payment of any amount under any Swap Contract (as defined in the 2008B Credit Facility) and such default causes a termination of the Swap Contract and gives rise to an obligation of the District to make a termination payment aggregating in excess of \$20,000,000.

**Suspension Event.** The 2008B Credit Facility provides that it will be a “Suspension Event” under the 2008B Credit Facility if there shall have been commenced against the District any case, proceeding or other action under the United States Bankruptcy Code seeking to adjudicate it as bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding up, liquidation, dissolution, composition or other relief with respect to it, which remains undismissed, undischarged or unbonded and fewer than sixty (60) days shall have elapsed from the commencement of such case, proceeding or other action.

### ***Remedies***

The following are remedies available to the Bank under the 2008B Credit Facility upon the occurrence of certain Events of Termination, Events of Default and Suspension Events thereunder:

**Immediate Termination.** In the case of any Event of Termination or Event of Default described under “—Event of Default—Event of Termination” or “—Event of Default—Events of Default Resulting in Immediate Termination” above, the Available Commitment (as defined in the 2008B Credit Facility) and Purchase Period (as defined in the 2008B Credit Facility) and the obligation of the Bank to purchase 2008B Bonds shall immediately terminate without notice or demand, and thereafter the Bank shall be under no obligation to purchase 2008B Bonds. Promptly upon the Bank obtaining knowledge of any such Event of Termination or Event of Default, the Bank is required to give written notice of the same to the Trustee, the District and the Remarketing Agent; provided, that the Bank shall incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure shall in no manner affect the termination of the Bank’s Available Commitment and of its obligation to purchase 2008B Bonds pursuant to the 2008B Credit Facility.

**Suspension – Involuntary Proceedings.** Upon the occurrence of any Suspension Event described under the subheading “—Event of Default—Suspension Events” above, the obligation of the Bank to purchase Tendered Bonds shall be immediately suspended until the case, proceeding or other action referred to therein is terminated prior to the court entering an order granting the relief sought. In the event such case, proceeding or other actions is so terminated, the obligation of the Bank under the 2008B Credit Facility to purchase Tendered Bonds shall be reinstated and the terms of the 2008B Credit Facility will continue in full force and effect (unless the obligation of the Bank under the 2008B Credit Facility to purchase Tendered Bonds shall have otherwise terminated in accordance with the terms of the 2008B Credit Facility) as if there had been no such suspension.

**Termination with Notice.** In the case of any Event of Default described under the subheading “—Event of Default--Events of Default not Resulting in Immediate Termination or Suspension” above, the Bank may terminate the Available Commitment and Purchase Period and the obligation of the Bank to purchase Tendered Bonds by giving written notice (a “Notice of Termination”) to the Trustee, the District and the Remarketing Agent, specifying the date on which the Available Commitment and Purchase Period shall terminate, which shall be not less than thirty (30) days from the date of receipt of such notice by the Trustee, and on and after the Purchase Termination Date (as defined in the 2008B Credit Facility), the Bank shall be under no further obligation to purchase Tendered Bonds under the 2008B Credit Facility.

**Other Remedies.** In addition to the rights and remedies summarized in the preceding paragraphs under this subheading “—Remedies,” in the case of any Event of Termination or Event of Default specified under the “—Event of Termination,” “—Events of Default Resulting in Immediate Termination” or “—Events of Default not Resulting in Immediate Termination or Suspension” under the subheading “—Events of Default” above, upon the election of the Bank: (i) all accrued amounts payable under the 2008B Credit Facility (other than payments of principal and redemption price of and interest on the Bonds or payments of Excess Bond Interest (as defined in the 2008B Credit Facility)) shall upon notice to the District become immediately due and payable without presentment, demand, protest or further notice of any kind, all of which are expressly waived by the District; and (ii) the Bank shall have all the rights and remedies available to it under the 2008B Credit Facility, the Related Documents (as defined in the 2008B Credit Facility) or otherwise pursuant to law or equity; provided, however, that the Bank shall

not have the right to terminate its obligation to purchase 2008B Bonds or to declare any amount due under the 2008B Credit Facility due and payable except as provided in the 2008B Credit Facility, or to accelerate the maturity date of any 2008B Bonds. The provisions of the 2008B Credit Facility described in this paragraph shall not limit the exercise of any of the Bank's other remedies described under this subheading "—Remedies."

## THE DISTRICT

### General

The District is a municipal corporation of the State of Washington, located in central Washington approximately 138 miles east of Seattle and 165 miles west of Spokane. The District was established in 1936 and began electric utility operations in 1947. In addition to its Distribution Division (mentioned below), which primarily serves Chelan County (the "County"), the District also owns, operates and maintains three major hydroelectric power generating projects: the Lake Chelan Project, the Rocky Reach Project and the Rock Island Project (collectively, the "Hydro-Electric Projects"). The District obtains most of its retail power supply from its three Hydro-Electric Projects, which have a combined nameplate rating of 1,988 MW. For the year ended December 31, 2011, the Hydro-Electric Projects collectively produced 10,872,000 MWh of power at an average cost of generation of \$15 per MWh. Comparable information for 2012 is not yet available. For the same period, the "average adjusted wholesale" preference rate for Bonneville Power Administration ("Bonneville") customers was \$35 per MWh and the Mid-Columbia Electricity Price Index average was \$24 per MWh. The District also owns and operates the Water System, the Wastewater System and the Fiber and Telecommunications System, which serve portions of the County. The District has its administrative offices in Wenatchee, Washington.

Under Washington law, the District has the authority to establish separate enterprise funds with respect to its various municipal utility business operations, each of which enterprise funds is accounted for separately. In addition, those utility business operations that generate revenues (known as "systems") can be separately financed through the issuance of debt by the District payable solely from revenues of that particular system. The District currently has three systems through which it issues debt: the Rock Island System, the Rocky Reach System, and the "Consolidated System." The Consolidated System currently includes (i) the District's retail electric utility business operations (referred to as the "Distribution Division"), (ii) the Lake Chelan Project, (iii) the Fiber and Telecommunications System, (iv) the Water System, and (v) the Wastewater System. Although these systems have been consolidated into the Consolidated System for financing purposes, all of these systems are accounted for separately and only the four utility business operations have been combined for financial statement reporting purposes. The District also has two enterprise funds, the Internal Service Fund and the Treasury Service Fund, which are used to account for administrative, financing and other costs allocable to more than one system.

Under almost all power production and hydrological conditions, the District's shares of the output of the three Hydro-Electric Projects are sufficient to meet the District's retail load requirements. The District has never failed to meet its retail load requirements, and generally the Distribution Division is a net seller of power. During periods of extremely low water conditions or unusually high peak energy demand, the reserved share of the Hydro-Electric Projects can be insufficient to meet retail load requirements for relatively limited periods. The extent and duration of these shortfalls are estimated in advance by the District's power planners. On these occasions the District buys power on the wholesale market to meet the District's retail load requirements. According to the Average Service Reliability Index (defined as the year-to-date efficiency of the distribution system to deliver electric energy to the District's customers), the District's reliability in 2011 was 99.98%, in 2010 was 99.98% and in 2009 was 99.99%. Reliability information for the year ended December 31, 2012 is not yet available.

The Consolidated System's Distribution Division consists of the District's properties and assets used in distributing electric energy throughout the County. The Consolidated System also includes the Lake Chelan Project, but neither the Rocky Reach System nor the Rock Island System is part of the Consolidated System. The revenues of the Rocky Reach System and the Rock Island System are not part of the Revenues of the Consolidated System. In 1992, the District consolidated its Water System and Wastewater System into what is now called the Consolidated System, preserving, however, substantial flexibility as to the future use of the revenues of such Systems. The District also owns a small hydroelectric project in Stehekin to serve electric customers in a remote portion of the District. This generating project is included in the Distribution Division but not as part of the District's Hydro-Electric Projects.

Pursuant to the Enabling Act, the District is empowered, among other things, to (1) purchase electric energy, (2) sell electric energy at wholesale and retail, (3) acquire, construct and operate electric generating plants and transmission and distribution facilities, and (4) issue revenue obligations for the purpose of financing the acquisition and construction of electric properties and for other corporate purposes. The Enabling Act also requires the District to establish, maintain and collect rates and charges for service which will be fair and nondiscriminatory and adequate to provide revenues sufficient to pay its revenue obligations and the maintenance and operating costs of its electric facilities and renewals and replacements thereto. In addition, the Enabling Act authorizes the District to issue general obligation bonds and to levy a limited property tax.

Cities in the District's service area have statutory authority to provide electric service. No cities, however, currently do so, nor is the District aware of any city or utility that is considering providing such electric service in the County. The District also has statutory rights of eminent domain that, subject to certain limitations, enable the District to acquire various assets and property rights, including electric distribution facilities in the County of any investor-owned utility company that may seek to serve the County.

Under Washington law, public utility districts (such as the District) are authorized to provide retail electrical service beyond their boundaries. The District does provide retail electrical service to a limited number of customers beyond its boundaries; however, no other public utility districts provide retail electrical service within the District's boundaries.

### **Management and Administration**

Pursuant to Washington statutes, the District is administered by a Commission of five elected members serving staggered four- and six-year terms. Three of the commissioners are elected from districts (six-year terms) and two are elected at-large (four-year terms). A Commissioner holds office until his or her successor has been elected and has qualified for office. The legal responsibilities and powers of the District, including the establishment of rates and charges for services rendered, are exercised through the Commission. The Commission also acts as a board of directors and establishes policy, approves plans, budgets and expenditures, and reviews the District's operations, including hiring the General Manager.

The present Commissioners of the District are as follows:

**Carnan Bergren, President**, is currently serving his second term as Commissioner, which expires on December 31, 2016. Mr. Bergren is a life-long Wenatchee Valley resident who spent his career in tree fruit production and marketing. Mr. Bergren was involved in rural community growth issues before running for election to the Commission.

**Ann Congdon, Vice President**, is currently serving her second term as Commissioner, which expires on December 31, 2016. Ms. Congdon serves on the member board of Energy Northwest, a joint operating agency that operates the Columbia Generating Station and the Nine Canyon Wind Project. She has served on several boards locally and is a retired educator and a businesswoman.

**Dennis Bolz, Secretary**, is currently serving his second term as Commissioner, which expires on December 31, 2014. Mr. Bolz has served on several committees, boards, and policy groups and worked in public school education for 31 years.

**Randy Smith, Commissioner**, is currently serving his second term as Commissioner, which expires on December 31, 2018. Mr. Smith represents the District as a delegate to the American Public Power Association. Mr. Smith is an orchardist and has served on the boards of several community, business and national organizations.

**Norman Gutzwiler, Immediate Past President**, is currently serving his second term as Commissioner, which expires on December 31, 2014. Mr. Gutzwiler serves as the District's delegate to the Northwest Public Power Association and serves on numerous advisory boards and commissions at the local, state and national level. Mr. Gutzwiler's background is in horticultural consulting and orcharding.

Senior management of the District includes the following individuals:

**John Janney, General Manager**, was appointed to his present position in August 2010. He previously served as Executive Manager – Finance-Risk Group / CFO-CRO. Mr. Janney began his career in the banking industry, including service at the Federal Reserve Bank of Boston and the Federal Reserve System Board of Governors in Washington, D.C. In 1997, he began working in the energy and utilities industry, assuming increasingly responsible positions in finance, risk and commercial sales and trading at integrated utility companies in the upper Midwest and Western United States and at privately held energy firms. Mr. Janney first joined the District in 2007. Mr. Janney is a certified Financial Risk Manager and holds a master's degree in finance from Boston College.

On February 12, 2013, Mr. Janney announced that he would be leaving the District to spend more time with his family and in serving his church. Mr. Janney has agreed to continue as General Manager until August 1, 2013 so that the District will have time to select a new General Manager without disrupting District operations. The District expects to begin the search for a new General Manager in the next several weeks.

**Kelly Boyd, Chief Financial/Risk Officer / CFO-CRO**, was appointed to her present position in September 2010. She previously served as Director – Strategic Financial Planning Division, Accounting Manager, Internal Auditor and Business Advisor. Ms. Boyd has been employed by the District since September 1993. She began her career at the public accounting firm of PriceWaterhouse and is a certified public accountant.

**Gregg Carrington, Energy Resources Managing Director**, was appointed to his current position in June 2011. He previously served as Managing Director of Environmental Resources, Director of External Affairs, Director of Hydro Services (Engineering) and Director of Licensing and Compliance. Mr. Carrington has been employed by the District since 1997. Prior to joining the District, he was the Regional Director for a consulting company, Licensing and Compliance Manager for a private utility, and he began his career as an engineer for a private consulting company. Mr. Carrington is a licensed professional engineer and holds a masters degree in engineering from Clarkson University.

**Mike Coleman, Fiber & Telecommunications Managing Director**, was appointed in August 2012. Mr. Coleman began his career in the telecommunications industry with Southwestern Bell Telephone/SBC where he held increasingly responsible positions in network operations, sales and engineering at the executive level. Mr. Coleman holds a bachelors degree in engineering and an MBA.

**Kirk Hudson, Generation & Transmission Managing Director**, was appointed to his current position in June 2011. He previously served as Managing Director of Operations, Managing Director of Utility Services, Director of Transmission and Distribution, Supervisor of Project Controls, and Engineering Supervisor. Mr. Hudson has been employed by the District since July 1997. He began his career in the Engineering and Environmental consulting industry in 1990 and is a licensed Civil Engineer in the State of Washington.

**Jeff Smith, District Services Managing Director**, was appointed to his present position in August 2012. He previously served as Director of External Affairs, Director of Community & Intergovernmental Relations, Enterprise Business Solutions Project Manager, Customer Accounting Supervisor and Public Information Officer. Mr. Smith has been employed by the District since February 1988. He began his career at KIRO Broadcasting in Seattle.

**John Stoll, Customer Utilities Managing Director**, was appointed to his current position in June 2011. Mr. Stoll previously served as Director of Customer Service and Distribution, Materials Superintendent, Budget Supervisor and System Accountant. Mr. Stoll has been employed by District since May 1998. He began his career in the accounting profession in 1994 and has passed the Washington State certified public accounting exam.

**Carol A. Wardell, General Counsel / CCO**, was appointed to her position in March 1998. Ms. Wardell has practiced law for over 30 years. Prior to joining the District, Ms. Wardell served as a State of Washington Superior Court Judge (general jurisdiction court). Before assuming the bench, Ms. Wardell represented the District. In 2007, she was appointed Chief Compliance Officer responsible for the District's compliance programs.

## Employees

As of September 30, 2012, the total number of District employees was 710, including some seasonal employees. Of these employees, 286 hold management, administrative and professional positions and 424 are part of a bargaining unit represented by Local 77 of the International Brotherhood of Electrical Workers. On March 19, 2012, the Commission approved a three-year collective bargaining agreement with Local 77, which was ratified by the bargaining unit employees on February 28, 2012. The agreement between the District and Local 77 includes pay increases for bargaining unit employees of 1.00% effective April 1, 2012, 1.50% effective April 1, 2013, and 1.50% effective April 1, 2014, plus additional increases for apprenticeship positions of 0.25% effective April 1, 2012, 1.25% effective April 1, 2013, and 1.50% effective April 1, 2014. The District has never experienced any work stoppages or slowdowns. The District considers its over-all employee relations to be good.

## Pension Plans

**General.** Substantially all of the District's full-time and qualifying part-time employees participate in the Washington State Public Employees Retirement System ("PERS"), administered by the State. The Legislature, rather than participating local government employers, determines pension benefits for participants in PERS.

*The following information regarding PERS was derived from the 2011 Valuation Report (mentioned below) and from the Comprehensive Annual Financial Report for the Washington Department of Retirement System Funds of the State of Washington for the fiscal year ended June 30, 2012 (the "2012 Retirement Fund Audit"). The District believes such information to be reliable, but the District does not guarantee the accuracy or completeness of such information.*

**PERS.** PERS is a multiple-employer, cost-sharing public employee retirement system operated by the State. PERS is comprised of three separate plans for membership and benefit purposes ("PERS 1," "PERS 2" and "PERS 3"). See Note 8 in the District's audited financial statements in APPENDIX A for a description of PERS benefits and eligibility requirements for these plans.

PERS 1 is closed to employees hired after September 30, 1977. Eligible employees hired after that date are members of either PERS 2 or PERS 3. The District is one of almost 1,200 governmental employers that participate in PERS. As of June 30, 2011, 79,363 retirees and beneficiaries were receiving benefits under PERS, 29,925 terminated plan members were entitled to, but not yet receiving, benefits and 152,417 were active plan members. Benefits for active members in PERS 1 or PERS 2 vest after five years of service and in PERS 3 after 10 years unless they qualify for early vesting after five years.

PERS 1 and PERS 2 are defined benefit plans, and PERS 3 is a hybrid plan that includes defined benefits and a defined contribution component. PERS 1 and PERS 2 and the defined benefit portion of PERS 3 are defined benefit plans in which member benefits are specified in advance and are payable from assets of the respective plans. Unlike in a defined contribution plan, where the employer's liability is limited to making its specified contribution and the employee takes the risk that the contributions and investment income thereon will generate sufficient retirement income, in a defined benefit plan the employer takes the risk that contributions and investment income will be sufficient in the future to pay the promised benefits. PERS 1 and PERS 2 are funded by a combination of investment earnings and employer and employee contributions, and the defined benefit component of PERS 3 is funded by employer contributions and investment earnings. Employee contributions and investment earnings finance the defined contribution component of the PERS 3 plan, and the defined contribution retirement benefits depend solely upon the results of investment earnings. The Washington State Investment Board (the "WSIB") estimates that approximately 75 to 80 percent of PERS assets are derived from investment income.

Employers are not liable directly for and do not guarantee the obligations of PERS, but as described below employer contribution rates for defined benefit plans may increase if assets are, or are projected to be, insufficient to pay promised benefits.

The WSIB directs the investment of retirement system assets and invests all retirement funds in a single pool, referred to as the Commingled Trust Fund (the "CTF"). Although in general assets from one plan may not be

used to fund benefits from another plan, the defined benefit portions of PERS 2 and PERS 3 are accounted for in the same fund and all assets of the combined PERS 2/3 defined benefit plan may be used to pay defined benefits of PERS 2 or PERS 3 members.

### ***Actuarial Valuation, Funding Policy and Assumptions***

Actuarial Valuation. Actuarial valuations are prepared on a plan-wide basis and not for individual employers. The Office of the State Actuary (the “OSA”) is required to provide an actuarial valuation of each retirement system, including PERS, every two years. In practice, however, the OSA provides valuations annually, although only the valuations for odd-numbered years (which are released during the following even-numbered year) are used to calculate contribution rates. In those even-numbered years, the OSA provides its preliminary results and recommended contribution rates to the Select Committee on Pension Policy, a committee of the Legislature (the “SCPP”), and to the Pension Funding Council (“PFC”). See “--Contribution Rates” below.

In September 2012, the OSA released an actuarial valuation for June 30, 2011 (the “2011 Valuation Report”). The primary purposes of the 2011 Valuation Report are to determine contribution rates that would be sufficient to fund the State’s retirement plans, including PERS, under the funding policy established by the Legislature and to provide information on the funding progress and developments in the plans over the State fiscal year ended June 30, 2011. Washington statutes require that valuation reports that are used in determining contribution rates be audited by independent actuaries selected by the PFC. The independent audit of the 2011 Valuation Report was performed by Cheiron.

Funding Policy. The State’s funding policy and methods for determining the contribution rates are set forth in RCW Chapters 41.40 and 41.45 RCW (collectively, the “Pension Act”). In 2009, the Pension Act was amended to provide for the amortizing in full the unfunded accrued actuarial liability of PERS 1 over a rolling-10-year period, using methods and assumptions that balance the needs for increased benefit security, decreased contribution rate volatility and affordability of contribution rates. The Pension Act also requires that to the extent feasible all benefits for PERS 2 and PERS members be funded over the working lives of those members. In preparing valuations and making recommendations regarding contribution rates, the OSA uses valuation methods, economic and demographic assumptions, including rates of retirement, rates at which members become disabled, turnover rates and mortality rates, and other assumptions, including assumptions about plan benefits.

Assumptions. Demographic assumptions are based on experience studies, which are generally released every seven years. The demographic assumptions were last updated based upon the 2001-2006 Experience Study Report released in 2007. Economic assumptions are adopted by the PFC and/or prescribed by the Legislature. In August 2011, OSA recommended that the PFC adopt new long-term assumptions about system membership growth and new economic assumptions and that the PFC phase in the changes over the following five biennia, including reducing the assumed rate of inflation from 3.5% to 3.0%; reducing the assumed annual investment return from 8.0% to 7.5%; reducing the 10-year membership growth from 1.25% to 0.95%; and reducing the general salary growth assumption from 4.0% to 3.75%. In late 2011, the PFC adopted lower economic assumptions. In 2012, the Legislature enacted a schedule to decrease the investment rate of return assumption for all plans, assuming a rate of return of 7.9% for the 2013-2015 biennium, 7.8% for the 2015-2017 biennium and 7.7% for the 2017-2019 biennium. For the 2011 Valuation Report, the OSA assumed a rate of inflation of 3.0%, an assumed annual investment return of 7.9%, a 10-year membership growth rate of 0.95%, and a general salary growth assumption of 3.75%.

***Actuarial Funding Rate.*** For purposes of determining the plans’ funded status on an actuarial basis (but not to determine contribution requirements), the OSA determines the ratio of the actuarial value of assets (the “AVA”) to the cost of plan benefits calculated using the Projected Unit Credit (“PUC”) cost method and using a long-term interest rate assumption. Under the PUC cost method, the annual cost of benefits is comprised of (i) the “normal cost” of benefits and (ii) the amount required to amortize the unfunded accrued actuarial liability (the “UAAL”) over a specified period. The “normal cost” is the estimated present value (using the assumed investment rate of 8% as the discount rate) of projected benefits current plan members will earn in the year following the valuation date, and the “normal cost rate” is the level percentage of salary contribution required each year per employee to accumulate, over the projected working lifetime of each employee, the reserves needed to meet the cost of the projected benefits, assuming the UAAL is paid off and that the plan’s actual experience conforms to the



actuarial assumptions used by the OSA in calculating the plan’s actuarial liabilities. The UAAL is the difference between a plan’s actuarial accrued liability (“AAL”) and the actuarial value of the plan’s assets or the present value of benefits earned at the valuation date not covered by current actuarial assets. The AAL represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

To determine a plan’s AVA, the OSA determines the current Market Value of Assets (the “MVA”), taking into account the prior year’s contributions, disbursements and investment returns. To limit fluctuations in contribution rates and plan funded status that would otherwise arise from short-term changes in the MVA, the OSA “smoothes” the inherent volatility in the MVA by deferring a portion of annual investment gains or losses (which occur when the annual return on investments varies from the long-term assumed rate of 7.9%) over a period of not to exceed eight years. To help ensure that the AVA maintains a reasonable relationship to the MVA, any valuation of the AVA may need exceed 130% of, nor drop below 70% of, the MVA.

As of June 30, 2011, the funded status for PERS 1 and PERS 2/PERS 3 on an actuarial basis, based on the PUC method was 71% and 112%, respectively, and as of June 30, 2010, the funded status for PERS 1 was 74% and for PERS 2/3 was 113%.

**Table 2**  
**PERS PUC Liability and Funded Ratio on an Actuarial Basis**

	<u>2010</u>		<u>2011</u>	
	<u>PERS 1</u>	<u>PERS 2/3</u>	<u>PERS 1</u>	<u>PERS 2/3</u>
PUC Liability <sup>(1)(2)</sup>	\$12,531	\$17,272	\$12,567	\$18,815
Valuation Assets <sup>(1)(3)</sup>	<u>9,293</u>	<u>19,474</u>	<u>8,883</u>	<u>20,997</u>
Unfunded Liability <sup>(1)</sup>	\$ 3,238	(\$2,202)	\$ 3,684	(\$2,182)
Funded Ratio	74%	113%	71%	112%

<sup>(1)</sup> Dollars in millions.

<sup>(2)</sup> Liabilities have been valued using the PUC cost method at an interest rate of 7.9%. Note 2(d) to the 2011 Retirement Fund Audit indicates that as of June 30, 2011, PERS 2/3 is funded at 97%, based on using the entry age normal method for determining the UAAL. The actuarial method for PERS 2 and PERS 3 does not separately amortize the UAAL.

<sup>(3)</sup> Assets have been valued using the actuarial asset method.

*Source: Office of the State Actuary; 2011 Valuation Report.*

**Contribution Rates.** The employee contribution rate for PERS 1 is established by statute at 6% of covered payroll for local government unit employees. As of December 31, 2012, the employee contribution rate for PERS 2, which is determined by the PFC, is 4.64% of covered payroll, and effective as of July 1, 2013, will increase to 4.92% of covered payroll. Employee contribution rates for the defined contribution component of PERS 3 are determined by the Director of the Department of Retirement Systems and include six options, ranging from a minimum of 5.0% to a maximum of 15.0% of covered salary. Employees are not required to contribute to the defined benefit component of PERS 3. Some PERS employers “pick up” (pay) their employees’ contributions to PERS, but the District does not.

Employer contribution rates for the upcoming biennium (the State’s two-year period ending on June 30 of an odd-numbered year) are adopted during even-numbered years according to a statutory rate-setting process. Based upon the statutory funding policy, the same contribution rate is charged to employers regardless of the plan in which employees hold membership. The process begins with the OSA performing an actuarial evaluation of each plan and determining recommended contribution rates. As discussed above in “Actuarial Valuation, Funding Policy and Assumptions,” in even-numbered years, the OSA provides its preliminary results and recommended contribution rates to the SPCP and to the PFC. The PFC, based on the recommendations of the OSA and the SPCP, adopts contribution rates. The rates adopted by the PFC are subject to revision by the Legislature, and the Legislature may, and in 11 of the past 12 years has, adopted contribution rates that are lower than those suggested by the OSA and adopted by the PFC. All employers are required to contribute at the levels established by the Legislature.

The OSA does not use the PUC method to develop recommended contribution rates, and because PERS 1 is closed, the OSA uses different methods to determine recommended contribution rates for PERS 1 than for PERS 2

and PERS 3. For PERS 1, the OSA uses a variation of the “entry age normal” cost of method to determine the AAL. Under this method, the annual cost of benefits is comprised of (i) the “normal cost,” determined on an individual basis, from a member’s age at plan entry, and designed to be a level percentage of salary throughout the member’s career, and (ii) the amount necessary to amortize the UAAL. The UAAL is equal to the unfunded actuarial present value of projected benefits less the actuarial present value of future normal costs for all active members and is reset at each valuation date. The OSA bases the present value of future normal costs on the aggregate normal cost rate for PERS 2 and PERS 3, as described below, and the resulting UAAL is amortized over a rolling ten-year period, as a level percentage of projected system payroll. The projected payroll includes payroll from PERS 2 and PERS 3, as well as from some of the State’s other retirement plans, and from new plan entrants. As a result, employers pay the same contribution rate, regardless of the PERS plan in which its employees are members.

For PERS 2 and PERS 3, the OSA uses an “aggregate cost method” to determine the normal cost and the AAL. Under this method, the unfunded actuarial present value of fully projected benefits is amortized over the projected earnings of the active group. The employee contribution for PERS 2 members is 50% of the normal cost. The entire contribution is normal cost, and no UAAL exists. All gains and losses are amortized over future salaries of current active members. The employer contribution for PERS 2 and PERS 3 is the balance of the cost of benefits, plus amounts intended to amortize the PERS 1 UAAL over a ten-year rolling period.

The Legislature also determines benefits, and current law requires that any benefit increases that become effective after June 30, 2009 for PERS 1 members be funded over a fixed 10-year period and that for any benefit enhancements enacted following the adoption of the basic rates a temporary and supplemental contribution rate increase be charged and that supplemental contribution rates be included in the basic rates at the beginning of the next contribution rate-setting cycle. In 2010, the Legislature amended the Pension Act to suspend the minimum contribution rates adopted in 2009 and to adopt, for all PERS plans, rate ceilings effective through 2015 for the portion of the employer contributions rates designed to amortize the UAAL for PERS 1 and established a minimum UAAL rate of 5.25% beginning July 1, 2015. In 2011, Legislature amended the Pension Act again to, among other things, reduce the minimum UAAL rate beginning July 1, 2015 to 3.5% and to eliminate the automatic, annual, service-based adjustment each July 1 to benefits received by eligible PERS 1 retirees, referred to as the “Uniform COLA,” effective as of June 30, 2011, except for those PERS 1 retirees who currently receive a benefit that falls below a specified minimum level.

Two separate lawsuits were filed challenging the repeal of the Uniform COLA adjustment in which the plaintiffs asked for declaratory and injunctive relief seeking, inter alia, restoration of the Uniform COLA adjustment. The court granted class action status for the plaintiffs. In November 2012, the court issued a memorandum of opinion holding, among other things, that the repeal of the Uniform COLA adjustment constituted an unconditional impairment of contract. The court’s final order has been entered.

In 2007, the Legislature repealed the statutory gain sharing provisions that allowed PERS 1 and PERS 3 members to share in “extraordinary investment returns” under certain conditions, effective as of January 2, 2008. The Legislature also adopted new provisions to replace the gain sharing benefit, including new provisions for early retirement. Four separate lawsuits were filed by members and retirees, which were consolidated into one action. One of these lawsuits was voluntarily dismissed in June 2009, leaving only three cases in the consolidated case. In September 2010, the King County Superior Court ruled in favor of the plaintiffs, finding that the repeal of gain sharing was invalid. In January 2011, the court ruled that the State could reserve its right to appeal this first phase of the lawsuit until after the second phase of the lawsuit, addressing the benefits provided to replace gain sharing, is completed. In December 2011, the court heard summary judgment arguments regarding whether the benefits enacted to replace gain sharing could be repealed once gain sharing was restored, and the trial court issued an order holding that the replacement benefits could be repealed as a matter of law. Both parties appealed the decision to the Supreme Court.

As of December 31, 2012, the employer contribution rate for all PERS plans is 7.21% of covered payroll, which includes the employer administrative expense fee (currently 0.16%) and amortization of the PERS 1 UAAL, effective as of July 1, 2013, the rate will increase to 9.19%, including the employer administrative expense fee.

The District does not have any control over the determination of the employer contribution rates or the process for setting such rates. Employee and employer contribution rates are expected to increase over the next

several years, and those increases may be significant, especially if gain sharing and the Uniform COLA are reinstated.

***District Contributions.*** For the year ended December 31, 2011 (the last year for which such information is available), the District's total payroll was approximately \$57.2 million, and the District's total payroll for employees covered by PERS was approximately \$56.5 million. Both the District and its employees made the required contributions to PERS in 2011, with the District contributing \$3,361,862, consisting of \$77,606 to PERS 1, \$2,734,289 to PERS 2 and \$549,967 to PERS 3, and the District's employees contributing \$2,527,395.

***Financial Reporting.*** The actuarial methods used for calculating PERS 1 funded status and recommended contribution rates are different than the methods used for financial reporting by PERS under GASB Statement 25 and by employers under GASB Statement 27, primarily because the actuarial funding method for PERS 1 includes payroll outside the PERS 1 plan. For financial reporting purposes, the Entry Age Cost method is used for PERS 1, and the PERS 1 UAAL is amortized as a level dollar amount over the applicable amortization period (currently, a rolling 10-year period). For PERS 2 and PERS 3, the Aggregate Actuarial Cost Method is used to calculate the contribution rates. Under this method, the unfunded actuarial present value of fully projected benefits is amortized over the projected earnings of the active group. The entire contribution is normal cost, and no PERS 2/3 UAAL exists. All gains and losses are amortized over future salaries of current active members, and minimum contribution rates are based upon 80% of the entry age normal cost rate.

Actual contribution rates for PERS 1 and for PERS 2/3 for funding purposes are also different than annual required contribution rates ("ARCs") for financial reporting purposes. Under GASB Statement 25, which governs reporting by the retirement system, the PERS 1 ARC for the fiscal year ended June 30, 2012 was \$508.0 million of which 51% was contributed, and the ARC for PERS 2/3 was \$407.7 million, of which 94% was contributed.

In June 2012, GASB approved GASB Statement 67 and GASB Statement 68. GASB Statement 67 revises and replaces financial reporting and disclosure requirements of GASB Statements 25 and 50, as they relate to certain pension plans. GASB Statement 68 revises and replaces financial reporting and disclosure requirements of GASB Statements 27 and 50 as they relate to governments that provide certain types of pension plans. GASB Statement 67 will take effect for pension plans in fiscal years beginning after June 15, 2013, and Statement 68 will take effect for employers in fiscal years beginning after June 15, 2014.

GASB Statement 67 requires additional note disclosure and required supplementary information in financial reports for certain defined benefit and defined contribution pension plans.

GASB Statement 68 requires, among other things, that (i) governments providing defined benefit pensions report in their statement of net position a net pension liability (the difference between the total pension liability and the assets set aside in a trust and restricted to pay such benefits); (ii) certain components of pension expense (such as changes in economic and demographic assumptions and differences between assumptions and actual experience) be recognized over a closed period; (iii) the effects on the net pension liability of differences between expected and actual investment returns be recognized in pension expense over a closed 5-year period; (iv) employers calculate pension liability on a more standardized basis, including incorporating into projected costs certain ad hoc postemployment benefit changes (those not written into the benefit plans) if considered to be substantively automatic, using a single actuarial cost method (entry age), and adjusting discount rates under certain circumstances; and (v) that employers provide more extensive note disclosure and supplementary information in their financial statements.

GASB Statement 68 also requires that cost-sharing employers, among other things, record a liability and expense equal to their proportionate share of the collective net pension liability and expense for a cost-sharing plan and provide more extensive note disclosure and supplementary information in their financial statements.

### **Other Post-Employment Benefits**

In June 2004, GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" ("GASB 45"). GASB 45 establishes accounting and financial

reporting standards for how state and local governments should account for and report their costs and obligations related to post-employment health care insurance and other non-pension benefits (“OPEB”). The District pays part of the premiums costs for health insurance made available to retired District employees, and such subsidies are treated as OPEBs under GASB 45. Under GASB 45, unless OPEB plan assets are held in an irrevocable trust with a third-party fiduciary, the plan assets and the corresponding liabilities must be included in a government’s financial statements. In 2007, the District retained an actuary to estimate the amount of the District’s OPEB liability for providing healthcare insurance plan for retirees and determined that unless the District funded an irrevocable trust, it would be required under GASB 45 to recognize unfunded liability of approximately \$1.976 million as of December 31, 2006. The District recognized that liability in 2006, and in 2007 modified its health insurance program and funded an irrevocable trust (the “OPEB Trust”) with U.S. Bank National Association.

The healthcare insurance plan administered by the District for its retired employees is a single-employer defined benefit healthcare insurance plan (the “Plan”) provided through a group health insurance plan with Premera Blue Cross (Premera Blue Cross Plan 3). The Plan provides medical, prescription drug and vision insurance to eligible retirees, spouses and surviving spouses until the age of 65 and to eligible children and surviving children until the age of 26. To be eligible for the Plan, the retiree must retire directly from active service with the District and be eligible to receive retirement benefits under PERS. As of December 31, 2011, there were 646 active participants and 49 retired and surviving participants drawing benefits under the Plan.

Premiums for Plan members are funded with a combination of contributions from the District and contributions from the retirees receiving benefits. For the years ended December 31, 2011 and 2010, the District contributed 28% of the cost of premiums for eligible retired Plan members and their spouses, or \$129,000 and \$126,000, respectively, and Plan members receiving benefits contributed 72% of premium costs, or an aggregate \$330,000 and \$323,000, respectively. The District’s contributions are paid through the OPEB Trust. For accounting purposes, the Plan is a “substantive plan,” based upon the District’s and the employees’ and retirees’ understanding of its terms. Based upon the current terms of the Plan and the results of the biannual actuarial valuations described below, the District expects that its future contributions will be calculated at the level established by the actuary in 2007, adjusted for inflation, with Plan members contributing the remaining premium amounts. Contribution rates may be adjusted and the Plan may be revised at the District’s discretion. The District may also elect to terminate the Plan once there are no more participants.

In July 2011, Mercer (“Mercer”) released its Postretirement Health Benefits Program Actuarial Valuation Report as of January 1, 2011 – Chelan County PUD for the years ended December 31, 2010 and 2011 (the “2011 OPEB Valuation”). Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. As noted in more detail in Note 9 in Appendix A, in valuing the Plan, Mercer made various assumptions, based in part upon the terms of the Plan and in part upon the demographic assumptions, including mortality, disability, termination and retirement rates, used by the Washington State actuary to value PERS pension plans. In the 2011 OPEB Valuation, the actuary also assumed an inflation rate of 2.3% and that the District’s contributions would increase at that rate; and an investment return (and discount rate) of 7% (based upon the investment policy established for the OPEB Trust, including investment allocations of 50% in U.S. stocks, 20% U.S. in fixed income securities, 15% in foreign stocks, 5% in foreign fixed income securities and 10% cash equivalents).

GASB 45 requires the District to disclose in its financial statements a schedule of funding progress for the Plan, the District’s annual required contribution (the “ARC”) and its net OPEB obligation, which are summarized below. The ARC is the “normal cost” plus amortization of the initial unfunded actuarial accrued liability (the “UAAL”). In computing contributions and liabilities, Mercer used the projected unit credit method of funding, which produces an initial liability for benefits credited for service prior to the date the method is introduced. To the extent that the liability is not covered by assets of the plan, the plan has a UAAL to be funded over a period of time in accordance with an amortization schedule. As of January 1, 2011, the OPEB Trust has no UAAL and is required to fund only the normal cost. The normal cost is the sum of the present value (using the assumed investment rate, 7.0%, as the discount rate) of the benefit deemed to accrue for each participant in the Plan year.

The information summarized in Tables 3 and 4 below for fiscal years 2007 and 2008 is based upon the valuation report as of January 1, 2007, and for fiscal years 2009 and 2010 is based upon the valuation report as of January 1, 2009 and for fiscal year 2011 is based upon the 2011 OPEB Valuation. See Note 9 and the Required

Supplementary Information in APPENDIX A—“AUDITED FINANCIAL STATEMENTS OF THE DISTRICT FOR THE YEAR ENDED DECEMBER 31, 2011.”

**Table 3**  
**OPEB Funding Progress**

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
January 1, 2007	\$0	\$2,177,526	\$2,177,526	0%	\$46,311,000	5.00%
January 1, 2008	\$2,177,526	\$2,227,526	\$50,000	98%	\$48,046,983	0.10%
January 1, 2009	\$1,791,487	\$1,573,100	(\$218,387)	114%	\$49,003,415	(0.45)%
January 1, 2010	\$1,791,487	\$1,573,100	(\$218,387)	114%	\$48,038,582	(0.45)%
January 1, 2011	\$2,186,952	\$1,417,889	(\$769,063)	154%	\$48,550,921	(1.58)%

Source: 2011 OPEB Valuation and the District.

**Table 4**  
**Annual Required Contribution and Net OPEB Obligation**

	<u>2008</u>	<u>2009</u>	<u>2010</u> <sup>(1)(2)</sup>	<u>2011</u> <sup>(2)</sup>
Annual Required Contribution (ARC) <sup>(3)</sup>	\$50,000	\$ 0	\$ 0	\$ 0
Interest on Net OPEB Obligation	0	3,500	0	0
ARC Adjustment	<u>0</u>	<u>(53,500)</u>	<u>0</u>	<u>0</u>
Annual OPEB Cost	\$50,000	(\$50,000)	\$ 0	\$ 0
Contributions Made	0	0	0	0
Increase in Net OPEB Obligations	\$50,000	(\$50,000)	\$ 0	\$ 0
Net OPEB Obligation – Beginning of Year	\$ 0	\$50,000	\$ 0	\$ 0
Net OPEB Obligation – End of Year	\$50,000	\$ 0	\$ 0	\$ 0

<sup>(1)</sup> Mercer notes in the valuation report for 2009 that GASB 45 permits the District to use the 2009 Valuation for 2010 so long as there are not “significant changes in benefit provisions, the covered population or other factors that impact long-term assumptions.”

<sup>(2)</sup> Mercer notes in the 2011 OPEB Valuation that GASB 45 permits the District to use the 2011 Valuation for 2012 so long as there are not “significant changes in benefit provisions, the covered population or other factors that impact long-term assumptions.”

<sup>(3)</sup> Mercer notes in the valuation report for 2009 that GASB 45 specifies that the ARC should not be negative as a result of overfunding (implying a payment due from the irrevocable trust to the employer). As a result, the ARC for 2010 and 2011 were \$0 under the current plan and assumptions, and the 2010 and 2011 Annual OPEB Costs were also \$0, as no contributions were made to the OPEB Trust.

Sources: 2011 OPEB Valuation, Valuation Report for 2009, and the District.

## Insurance

The District seeks to maintain insurance with responsible insurers to the extent available at reasonable cost. Insurance limits and retentions are established utilizing standard risk management practices and under the advice of an experienced insurance brokerage firm.

The District currently maintains insurance with retentions plus coverage as follows: general liability, auto and public officials’ liability from \$2 million to \$75 million; property from \$1 million to \$350 million; boiler and machinery from \$500,000 to \$200 million; crime from \$100,000 to \$25 million; and blackout-brownout liability from \$2,500 to \$10 million. The District also carries non-owned aircraft liability, business travel accident, excess workers’ compensation insurance, and some underlying coverage for the Water and Wastewater Systems.

The District utilizes self-insurance programs to pay covered claims up to the deductibles or the self-insured retentions of the policies described above. These programs pay claims which fall within the definitions of coverage in the policies layered above the self-insurance programs. The District also self-insures for its workers' compensation and its employee medical insurance program. Claims not covered by insurance and the self-insurance programs are paid by the appropriate System. The District's self-insurance program funds are maintained in the District's Internal Service Fund. The Internal Service Fund is used to account for administrative and other costs which must be allocated among more than one System. As of September 30, 2012, the self-insurance restricted cash reserve and claim funds had a combined balance of \$5.2 million.

## **Dam Safety and Security**

The area in Eastern Washington in which the District is located has experienced large earthquakes in the past, although the most recent was more than 140 years ago. That earthquake was centered near Lake Chelan and occurred at a time when the area was very sparsely populated. It was apparently felt throughout the Pacific Northwest.

The District's Hydro-Electric Projects were designed to conform to all then-existing Federal Energy Regulatory Commission ("FERC") dam and seismic safety regulations. In addition, the Hydro-Electric Projects are "run of the river" dams, meaning they have very limited reservoir capacity, and are also "low-head," meaning that the reservoir behind the dam is not that much higher than the river immediately below the dam. Thus the potential damage that may arise from dam failure is much less than with "high-head" dams with large reservoirs. Nonetheless, it is possible that a major seismic event could cause significant damage to one or all of the Hydro-Electric Projects, including flooding of the powerhouse or even dam failure. The resulting damage, including in particular to areas immediately downstream of the Hydro-Electric Projects, could be significant.

FERC is currently considering the adoption of new dam safety standards, including Seismic Design Standards, for all hydroelectric facilities around the country that are within its jurisdiction, including the Hydro-Electric Projects. New standards may require modifications or improvements to the Hydro-Electric Projects. The nature and extent of any such modifications or improvements and the costs thereof are unknown at this time, but could be significant. The District, in collaboration with Public Utility District No. 1 of Grant County, Washington ("Grant PUD"), Public Utility District No. 1 of Douglas County, Washington ("Douglas PUD"), and other stakeholders, recently completed a study designed to update the regional seismic hazard potential within the area that could affect the Hydro-Electric Projects. The study was completed in 2012 on a schedule and in a manner approved by FERC and was subsequently accepted by FERC.

The results of the study indicate that both the potential seismic activity and impacts that could affect the Hydro-Electric Projects are more significant than was understood when the Hydro-Electric Projects were originally constructed. The District is working with FERC and Grant PUD to address how the updated seismic potential is to be applied to the Hydro-Electric Projects, including engineering analysis of how the structures will be expected to perform during earthquake events and potential modifications to the Hydro-Electric Projects to ensure they continue to meet or exceed current regulatory standards.

The District relies on comprehensive security systems and measures to ensure critical assets are protected. Many of these security measures are required by federal law due to the nature of the District's facilities, specifically the Hydro-Electric Projects. The District has carefully implemented a number of integrated security measures, including but not limited to: strategically placed security cameras, electronic access control, restricted access, intrusion alarms, locked doors/gates/windows, fencing, signage, policies, procedures and employee training programs.

## **THE CONSOLIDATED SYSTEM**

### **General**

The Consolidated System currently includes (i) the Distribution Division, (ii) the Lake Chelan Project, (iii) the Fiber and Telecommunications System, (iv) the Water System and (v) the Wastewater System. The Rocky

Reach System and the Rock Island System (collectively, the “Large Hydro Systems”) are not part of the Consolidated System.

The Large Hydro Systems produce power and energy in part for use in the Distribution Division and in part for sale to others. The revenues of the Rock Island System and the Rocky Reach System are required to be used to pay the costs of operating, maintaining and providing for certain capital improvements for those Systems and are pledged to payment of the bonds issued by those Systems, and therefore are not available to pay or secure the Senior Consolidated System Bonds, the Bonds, including the 2008B Bonds, or the Subordinate Consolidated System Obligations.

For the year ended December 31, 2011, the Distribution Division served an average of 48,173 retail customers and had energy sales of 5,762,000 MWh and operating revenues of \$149,179,000. Comparable information for the year ended December 31, 2012 is not yet available. Historically, the Distribution Division has obtained most of its power supply from the District’s Hydro-Electric Projects and relatively small amounts from other sources. The Hydro-Electric Projects provide power to the Distribution Division at a comparatively low cost, enabling the District to provide electric service to its customers at rates substantially below those charged by most other utilities in the Pacific Northwest. Power available to the Distribution Division in excess of the amounts required to serve its customer load may be sold on the wholesale market. For a discussion of the District’s wholesale energy sales, see “THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy” and “—Wholesale Power Management Activity.” For a description of the Hydro-Electric Projects, see “THE CONSOLIDATED SYSTEM—Properties and Facilities of the Consolidated System—Hydro-Electric Projects” and “—Other Properties and Facilities of the District.”

The District has retained substantial flexibility with respect to the use of the revenues of the Water System and Wastewater System, including the ability to pledge such revenues to other obligations on a basis senior to that of the Bonds, including the 2008B Bonds. For the year ended December 31, 2011, the Water System served 5,497 customers and the Wastewater System served 487 customers. Comparable information for the year ended December 31, 2012 is not yet available. As of December 31, 2012, the Water System had outstanding long-term debt in the principal amount of \$11,154,698 and Consolidated System intersystem loans payable in the amount of \$5,955,505. As of December 31, 2012, the Wastewater System had no outstanding long-term debt but had Consolidated System intersystem loans payable in the amount of \$437,044. These amounts are based on unaudited financial information and are subject to year-end adjustment. The District’s current policy is to pay operating expenses and debts of the Water System and Wastewater System from the respective revenues of such Systems. A significant portion of the direct debt of the Water and Wastewater Systems is assessment-backed local utility district debt secured by liens on the property benefited by such Systems or low interest loans received from various State and federal programs.

### **The District’s “Carbon Footprint”**

As the District’s energy resources consist almost entirely of hydro-electric power and to a much lesser extent wind power, the District’s utility operations are responsible for very little carbon dioxide emitted through the combustion of fossil fuels, other than carbon associated with wholesale market purchases of fossil fuel generated power. In 2011, the most recent year for which information is available, the District’s calculated fuel mix included approximately 4% carbon dioxide emitting power resources. The District does sell a portion of the environmental attributes associated with some of its hydro-electric power and wind power; however, this is accounted for in the District’s required fuel mix disclosure. The District currently does not foresee any significant additional costs to its utility operations as a result of future legislative or other measures seeking to remedy carbon dioxide loads imposed upon the environment. See, however, “DEVELOPMENTS AFFECTING THE ELECTRIC UTILITY INDUSTRY—State Energy Legislation.”

### **Properties and Facilities of the Consolidated System**

#### ***Distribution Division***

The Distribution Division serves at retail the entire territory within the County. As of December 31, 2011, the Distribution Division included 35 substations with a total capacity of 748,346 kVA, 881 miles of overhead and 843 miles of underground distribution lines and other buildings, equipment, stores and related facilities. As of

December 31, 2011, the gross utility plant of the Distribution Division, including construction work in progress, was \$307,423,000, with net utility plant of \$175,853,000. Comparable information for the year ended December 31, 2012 is not yet available. The Distribution Division also includes the Cashmere system. See “THE DISTRICT—General.”

### ***Hydro-Electric Projects***

**General.** As of December 31, 2011, the combined gross utility plant of the Hydro-Electric Projects, including construction work in progress, was \$1,287,229,000, with net utility plant of \$779,888,000. Comparable information for the year ended December 31, 2012 is not yet available. The Rock Island System and the Rocky Reach System are not part of the Consolidated System. See “—Other Properties and Facilities of the District—The Rock Island System” and “—The Rocky Reach System” below.

**The Lake Chelan Project.** The Lake Chelan Project consists of (i) the Lake Chelan Hydro-Electric Generating Plant, which was placed in commercial operation in the 1920s and which is located at the east end of Lake Chelan in Chelan County, Washington, approximately 38 miles north of the City of Wenatchee, Washington, together with (ii) associated substation and transmission facilities to connect the generating plant with other facilities of the District and Avista Corporation (“Avista”). A dam approximately 40 feet high and 490 feet long allows the regulation of Lake Chelan between elevations of 1,079 feet and 1,100 feet, thereby providing usable storage of approximately 676,000 acre-feet of water. A tunnel approximately two miles in length leads to the powerhouse, which contains two generating units. Modernization of the two units was completed in 2010, resulting in an increase in total nameplate capacity for the Lake Chelan Project from 48 MW to 59 MW. The efficiency of the units was also improved by approximately 6%. Net energy delivered from the generating plant averaged approximately 412,000 MWh annually during the three years from 2009 through 2011. For the year ended December 31, 2011, the generating plant delivered 480,000 MWh, at an average cost of \$24 per MWh. As of December 31, 2011, the gross utility plant of the Lake Chelan Project, including construction work in progress, was \$120,048,000, with net utility plant of \$97,296,000. Comparable information for the year ended December 31, 2012 is not yet available.

### ***Fiber and Telecommunications System***

The Fiber and Telecommunications System has been consolidated into the Consolidated System. See “THE CONSOLIDATED SYSTEM—The Fiber and Telecommunications System” for information regarding the Fiber and Telecommunications System.

### ***Water and Wastewater Systems***

The Water and Wastewater Systems were consolidated into what is now the Consolidated System in 1992; however, the District has preserved substantial flexibility regarding the use of the revenues of such Systems. See “THE CONSOLIDATED SYSTEM—General.”

### **Other Properties and Facilities of the District**

**The Rocky Reach System.** Pursuant to Resolution No. 1412, adopted by the District on November 20, 1956, as amended and supplemented (the “Prior Rocky Reach Resolution”), the District established the Rocky Reach System, and pursuant to Resolution No. 08-13390, adopted by the Commission on October 20, 2008 (the “Rocky Reach Master Resolution”), the District continued the Rocky Reach System. The Rocky Reach System consists of (i) the Rocky Reach Hydro-Electric Generating Plant (the “Rocky Reach Project”), which was placed in commercial operation in 1961, and is located on the Columbia River about seven miles upstream from Wenatchee, Washington, together with (ii) associated substation and transmission facilities to connect the output of the generating plant to the other facilities of the District and to the transmission grid of the Pacific Northwest. A dam with an effective head of approximately 89 feet provides water to 11 turbine generators with a combined nameplate capacity of 1,300 MW. Net energy delivered from the generating plant averaged 5,719,000 MWh annually during the three years from 2009 through 2011. For the year ended December 31, 2011, the generating plant delivered 7,125,000 MWh, at an average cost of \$10 per MWh. As of December 31, 2011, the gross utility plant of the Rocky



Reach System, including construction work in progress, was \$601,612,000, with net utility plant of \$355,565,000. Comparable information for the year ended December 31, 2012 is not yet available.

Pursuant to the Rocky Reach Master Resolution, the District has issued its Rocky Reach Hydro-Electric System Revenue Bonds (the “Rocky Reach Bonds”) payable from and secured by a pledge of the revenues of the Rocky Reach System. As of December 31, 2012, the Rocky Reach Bonds were outstanding in the aggregate principal amount of \$17,675,000. In addition, as of December 31, 2012, intersystem loans payable from the revenues of the Rocky Reach System were \$223,150,935. These amounts are based on unaudited financial information and are subject to year-end adjustment. See “FINANCIAL INFORMATION—Outstanding Debt” and “—Interfund and Intersystem Loans.”

The District previously issued bonds payable by the Rocky Reach System for the purpose of financing relicensing costs of the Rocky Reach System. Such bonds were purchased by the Distribution Division and as of December 31, 2012 were outstanding in the principal amount of \$10,667,308. This amount is based on unaudited financial information and is subject to year-end adjustment.

In 2007, the District completed a modernization program at the Rocky Reach Project at a cost approximately \$180 million. Excessive cracking and wear of the turbine blades required replacement of the original seven turbines. The remaining four newer units were upgraded to “Kaplan”-type turbines with adjustable blades. The District also replaced main transformers, generator breakers, excitation, and governors. The seven original generators were replaced and the stators of the four newer units were replaced with the rotors being refurbished during the modernization program. The results of the modernization program have increased the efficiency of the plant by 4.5% to 5.5%. The turbine design also incorporated then-current technology intended to improve survival of juvenile salmon migrating downstream to the Pacific Ocean.

During routine inspections in 2009, the District became aware of cracks in the rotor spiders of seven units at the Rocky Reach Project. A temporary repair has been applied to all such units until permanent repairs can be made. The units are being repaired under the generator modernization contract warranty. The permanent repairs to the first unit began in September 2010 and were completed in March 2011. The District developed plans to repair two units per year, with the last unit repair expected to be completed in April 2014. Because of experience gained with the repair of the first unit, subsequent outages for each unit repair are expected to last only three months instead of the six months required to complete the permanent repairs to the first unit. The outage schedule for the repairs is expected to result in a reduction of generation availability at the Rocky Reach Project by approximately 4.5% during each year until all repairs are completed. To minimize the economic impacts of these outages, the rotor repairs are scheduled to occur during the fall and winter when power prices and Columbia River flows are expected to be low. While the exact value of lost generation is dependent on future river conditions and market power prices, the average projected estimate is \$1.4 million for each spring outage and \$500,000 for each fall outage. The future combined outages are anticipated to result in potential lost opportunity costs of approximately \$2.4 million. As of December 31, 2012, repairs have been completed on four of seven units.

In October 2011, the main transformer at one of the units was thoroughly inspected due to concerns regarding insipient gassing observed in oil samples. The manufacturer of the transformer performed an on-site inspection, identified several deficiencies, made repairs and returned the transformer to service. Since then, the District has continued to observe an upward trend of gas levels in the oil of the transformer. The District intends to remove the transformer from service in August 2013 and to install and operate a spare transformer for that unit until the original transformer problem can be identified and repaired. The District estimates that an outage of approximately three weeks is required to remove the unit’s main transformer and to install the spare transformer. The warranty for these transformers is currently being reviewed by both the District and the manufacturer. Three other main transformers are showing signs of gassing, but to a much lower magnitude, and do not require corrective action at this time.

**The Rock Island System.** Pursuant to Resolution No. 1137, adopted by the District on December 20, 1955, as amended and supplemented, and Resolution No. 97-10671, adopted by the District on February 27, 1997 (collectively, the “Prior Rock Island Resolution”), the District established and continued the Rock Island System, and pursuant to Resolution No. 08-13391, adopted by the Commission on October 20, 2008 (the “Rock Island Master Resolution”), the District continued the Rock Island System. The Rock Island System consists of (i) the

Rock Island Hydro-Electric Generating Plant (the “Rock Island Project”) located on the Columbia River approximately 12 miles downstream from Wenatchee, Washington, together with (ii) associated substation and transmission facilities to connect the generating plant to the other facilities of the District and Puget Sound Energy and to the transmission grid of the Pacific Northwest. A dam with an effective head of approximately 39 feet provides water to 19 generating units with a combined nameplate capacity of approximately 629 MW. The generating units are housed in two powerhouses. Of the eleven units in the first powerhouse, five, including the station service unit, were placed in commercial operation in 1933 and six in 1952 and 1953. The eight units in the second powerhouse were placed in commercial operation in 1978 and 1979. The first four units in the first powerhouse were originally constructed by Puget Sound Energy, which later sold the dam and generating units to the District. The remaining units in the first powerhouse were constructed by the District. Net energy delivered from the generating plant averaged 2,778,000 MWh annually during the three years from 2009 through 2011. For the year ended December 31, 2011, the generating plant delivered 3,267,000 MWh, at an average cost of \$24 per MWh. As of December 31, 2011, the gross utility plant of the Rock Island System, including construction work in progress, was \$565,569,000, with net utility plant of \$326,937,000. Comparable information for the year ended December 31, 2012 is not yet available.

Pursuant to the Prior Rock Island Resolution, the District has issued its Columbia River-Rock Island Hydro-Electric System Revenue Refunding Bonds, Series 1997A and 1997B (the “Prior Rock Island Bonds”) payable from and secured by a pledge of revenues of the Rock Island System. As of December 31, 2012, the Prior Rock Island Bonds were outstanding in the aggregate principal amount of \$252,659,003. Pursuant to the Rock Island Master Resolution, the District has issued its Rock Island Hydro-Electric System Revenue Bonds (the “Rock Island Bonds”) payable from and secured by a pledge of the revenues of the Rock Island System junior to that of the Prior Rock Island Bonds. As of December 31, 2012, the Rock Island Bonds were outstanding in the aggregate principal amount of \$12,975,000. In addition, as of December 31, 2012, intersystem loans payable from revenues of the Rock Island System were \$149,272,702.15. These amounts are based on unaudited financial information and are subject to year-end adjustment. See “FINANCIAL INFORMATION—Outstanding Debt” and “—Interfund and Intersystem Loans.”

In 2003, the District began a multi-year process to modernize Rock Island Powerhouse No. 1. To date, the District has completed several projects, including installation of new cranes, four new generator step-up transformers and new generator breakers. Work was completed in May 2008 on the first of two units in Powerhouse No. 1 that will receive new turbines, generators, governors and controls. Work on the second unit was completed in April 2012. The new units have improved efficiencies of about 10% and the turbines are safer for fish passage. In addition, three of the four oldest units have received new stators, and rotors and turbine components were repaired on site as necessary. Efficiency improvement of the new stators has been measured at about 1.0%. The turbines are expected to last another 20 years with minor repairs and routine maintenance. The District has spent approximately \$107 million on the modernization program at Powerhouse No. 1 through 2012.

During periodic machine condition monitoring, plant staff observed deterioration over time of the “air gap” between the rotor and the stator, a critical clearance measurement, in the fourth of the oldest generating units that has yet to have the stator, rotor and turbine rehabilitated. The clearance is now below acceptable reliable operating limits, which could limit unit reliability in the short-term. To correct the deterioration, the District intends to install a new stator, to replace key rotor components and to reshape and realign the unit to within industry standards for normal operation. Work on the unit is scheduled and budgeted to be performed in 2017.

Data for an additional unit also shows a deteriorating air gap clearance, however, the unit is continuing to operate normally. The unit is monitored with machine condition monitoring (“MCM”) equipment installed to track shaft vibration and generator conditions, including the air gap. If the air gap reaches a predetermined threshold value, the operator will receive notification from the MCM and the unit will be turned off. Restarting the unit will require either correction of the stator shape to improve the air gap or replacement of the stator, both of which could represent significant outage time. As the air gap for this unit is still above reliable operating limits, the District has not yet engineered, budgeted or scheduled any repairs to the unit to address the air gap deterioration.

Powerhouse No. 2 began operation in the late 1970s and received new generator step-up transformers between 1994 and 1997. In 2008, the District completed installing new generator breakers and other operational improvements, including replacement of the generation unit intake trashracks and installation of a trashrack cleaning

system to reduce intake head losses. These projects are maintaining reliability and resulted in increased energy production of approximately 2.5%.

## **Federal Energy Regulatory Commission License Status**

### ***General***

The District operates the Hydro-Electric Projects under long-term licenses issued by FERC pursuant to the Federal Power Act of 1920, as amended. No competing licensing applications have ever been submitted.

<b><u>Hydro-Electric Project</u></b>	<b><u>Issuance Date</u></b>	<b><u>Expiration Date</u></b>
Lake Chelan Project	November 6, 2006	October 31, 2056
Rocky Reach Project	February 19, 2009	January 31, 2052
Rock Island Project	January 18, 1989	December 31, 2028

### ***Lake Chelan Project***

On November 6, 2006, FERC issued a 50-year license for the Lake Chelan Project. The license reflects the terms of a comprehensive settlement agreement developed by the District with various stakeholders and submitted to FERC in October 2003, with several changes. The license requires detailed management plans for operations, fish, wildlife and recreation resources, which were approved by FERC in November 2007 and in April 2008. In accordance with the settlement agreement, the FERC-approved fish management plans and the required water quality certification, the District constructed three significant capital projects: a low-level outlet structure at the dam, a pump station adjacent to the Lake Chelan Project tailrace and four acres of fish spawning habitat in the lower Chelan River and Lake Chelan Project tailrace. These projects were completed in October 2009.

The settlement agreement and license include measures that are to be carried out by various agencies using funds provided by the District. The costs of these measures are recorded as a liability in the District’s financial statements. The District has set aside funds specifically to pay for these obligations in current and future periods. As of September 30, 2012, the District has internally reserved \$7.6 million for these measures.

### ***Rocky Reach Project***

On February 19, 2009, FERC issued a 43-year license for the Rocky Reach Project. The license, for the most part, is based on a comprehensive settlement agreement developed between the District and stakeholders, including local communities, state and federal agencies, Native American Tribes and environmental groups, and submitted to FERC in March 2006.

The Washington State Department of Ecology (“WDOE”) issued its final water quality certification for the Rocky Reach Project (the “Rocky Reach 401 Certification”) in March 2006. In August 2006, FERC issued a final environmental impact statement for the Rocky Reach Project. In July 2007, National Oceanic and Atmospheric Administration (“NOAA”) issued its Biological Opinion for the Rocky Reach Project evaluating how the new license may affect listed species in the area – specifically, salmon and steelhead – and endorsed continuation of the District’s Habitat Conservation Plan (“HCP”). In December 2008, the U.S. Fish and Wildlife Service (the “USFWS”) filed its Biological Opinion for the Rocky Reach Project, concluding that the Rocky Reach Project is not likely to jeopardize the continued existence of bull trout or destroy or adversely modify designated critical habitat. The USFWS Biological Opinion provided conditions through an “incidental take statement” and requires certain measures be implemented to minimize the “incidental take” of bull trout.

The Rocky Reach Project license includes various operational requirements and environmental protections, including continuation for the HCP for salmon and steelhead, stocking and monitoring of juvenile white sturgeon, research and passage measures for bull trout and passage for pacific lamprey. The license also requires that the

District develop detailed management plans for operations, recreation and wildlife resources. FERC has approved the District's plans, and the District is now implementing those plans.

The Rocky Reach 401 Certification imposes both narrative and numeric criteria. Narrative criteria include consideration of fish spawning, rearing, migration, and harvest, recreation, wildlife, and aesthetics. Water quality numeric criteria include total dissolved gas ("TDG"), temperature, turbidity, toxics, and oil spills.

*Narrative Criteria.* Compliance with the Rocky Reach 401 Certification narrative criteria can be complex and challenging. The District's fish management plans approved by FERC and included in the Rocky Reach 401 Certification seek to protect anadromous salmonids, including those listed as threatened and endangered in the mainstem Columbia River, and other species of concern, including white sturgeon, pacific lamprey and bull trout. Upon license issuance in February 2009, the District began a ten-year effort to implement, monitor and adjust protection, mitigation, and enhancement measures for these species. The ultimate success of these efforts remains uncertain.

*Numeric Criteria.* The District has two areas of concern regarding compliance with numeric criteria at the Rocky Reach Project. The first relates to water temperature. The Rocky Reach Project generally meets the numeric criteria for water temperature under the Rocky Reach 401 Certification, but not in all respects. The license requires the District to monitor water temperature during the first five years of the license. If after five years data collection and modeling show that the Rocky Reach Project is in compliance with water temperature numeric criteria, the WDOE may reduce or eliminate further monitoring requirements. If the Rocky Reach Project is not in compliance with numeric criteria, then the District may be required to identify reasonable and feasible measures to come into compliance. The District also has the option of requesting a change in the Rocky Reach 401 Certification numeric criteria.

A long-term effort is underway by the Environmental Protection Agency (the "EPA") to evaluate temperature increases collectively in the mainstem Mid-Columbia River. This is a difficult and complex process that is being addressed in a draft Columbia and Snake River Mainstem Temperature "Total Maximum Daily Load" ("TMDL"). A TMDL is a calculation of the maximum amount of a "pollutant" (in this case, increased temperature) that a waterbody can receive and still meet water quality standards, and includes an allocation of that amount to the pollutant's various sources. When the temperature TMDL is developed for the Columbia River and Snake River Mainstem, the incremental temperature increase allowed to the Rocky Reach Project may change. The schedule for implementation of the TMDL is yet to be determined and therefore any new requirements that may be imposed on the District are unknown at this time.

The District's second area of concern regarding compliance with the numeric criteria at the Rocky Reach Project is TDG. During certain periods of fish migration, the District passes a portion of the river flow through its spill gates to facilitate downstream passage of juvenile fish rather than through the turbines. While fish spill is recognized as a passage method and often required by federal agencies with jurisdiction, spilling water can increase dissolved gas levels in the water. Too much gas in the water can have negative impacts on fish, which is why the WDOE regulates permissible gas levels. Regulatory agencies attempt to strike a balance between the need for spill to facilitate fish migration and the need for water quality protection. The District routinely files TDG abatement plans with WDOE in order to provide fish spill consistent with requirements in the water quality standards. Based on studies conducted during the relicensing process, the District believes it is able, with slight alterations to operations, to meet the TDG requirements at the Rocky Reach Project. The Rocky Reach 401 Certification requires compliance with TDG standards at year 5 of the license (2014). If the District is in compliance, the WDOE may require the District to continue the project operations that have resulted in such compliance. If the District is not in compliance, the WDOE may require evaluation of new operational and dam structural measures that could be implemented to reduce TDG production at the Rocky Reach Project.

### ***Rock Island Project***

In 1989, FERC issued a 40-year license for the Rock Island Project. In June 2004, FERC approved incorporation of the terms of the HCP into the Rock Island license. See also "AGREEMENTS, PROCEEDINGS AND LAWS AFFECTING THE DISTRICT—Endangered Species Act."

### ***Relicensing Procedure and FERC Options***

The District has covenanted in the Master Resolution to use its best efforts to secure new licenses when the current FERC licenses for the Hydro-Electric Projects expire. Upon expiration of the District's licenses, and assuming that project decommissioning is not at issue in the relicensing proceeding, FERC has three options under existing law: to issue a new license to the District; to issue a new license to a different licensee; or to issue a non-power license to the District or a different licensee (if FERC found that the project should no longer be used for power purposes). The Federal Power Act ("FPA") requires FERC, upon expiration of a license, to issue annual licenses until such time as a new license or non-power license is issued.

Under current law, assuming that project decommissioning is not at issue in the relicensing proceeding, if there is competition for the issuance of a new license, the new license must be issued to the applicant having the final proposal best adapted to serve the public interest, except that insignificant differences between competing applications are not to result in the transfer of a project to a different licensee.

### **Consolidated System Energy Resources**

The District's principal sources of power supply are its Hydro-Electric Projects. See "*—Properties and Facilities of the Consolidated System—Hydro-Electric Projects—The Lake Chelan Project*" and "*—Other Properties and Facilities of the District--The Rocky Reach System*" and "*--The Rock Island System*" under this heading. For the year ended December 31, 2011, the Hydro-Electric Projects provided most of the Distribution Division's retail energy requirements. In addition, during most periods the Hydro-Electric Projects provided surplus generation which was sold in the wholesale power market. During certain hourly peak loads and some periods of exceptionally cold or dry weather, the Distribution Division must purchase additional energy from other sources, including the spot market, to meet its retail load requirements.

Table 6 on the following page presents the Distribution Division's energy resources and purchased power costs for the years 2007 through 2011 and for the nine months ended September 30, 2012. The information for fiscal years 2007 through 2011 has been extracted from the District's audited financial statements. The information provided for the nine months ended September 30, 2012 is unaudited and may not be indicative of actual year-end results. See "FINANCIAL INFORMATION—General."

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**Table 6**  
**Consolidated System**  
**Distribution Division**  
**Energy Requirements, Resources and Power Costs**  
**For the Years Ended December 31, 2007 through 2011 and for the Nine Months Ended September 30, 2012**

	2007	2008 <sup>(1)</sup>	2009	2010	2011	Nine Months Ended September 30, 2012
<b><u>Requirements (000 MWh)</u></b>						
Total Sales <sup>(2)</sup>	4,845	4,416	4,257	4,227	5,762	6,731
Timing Differences & Losses <sup>(3)</sup>	(64)	(10)	(8)	(67)	(100)	(9)
	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>	<u>5,662</u>	<u>6,722</u>
<b><u>Resources (000 MWh)</u></b>						
Rocky Reach Project <sup>(4)</sup>	2,431	2,147	2,041	1,883	3,086	4,424
Rock Island Project	1,516	1,393	1,345	1,283	1,619	1,295
Lake Chelan Project	459	405	338	417	480	286
Non-firm Purchases <sup>(5)</sup>	378	460	525	577	477	717
	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>	<u>5,662</u>	<u>6,722</u>
<b><u>Purchased Power Costs (\$000)</u></b>						
Rocky Reach Project	\$ 29,782	\$ 31,449	\$ 28,274	\$ 30,668	\$ 37,112	\$ 58,405
Rock Island Project	33,540	37,309	38,398	40,206	38,509	33,620
Lake Chelan Project	5,171	6,152	9,003	10,198	11,430	8,329
Non-firm Purchases <sup>(5)</sup>	21,127	29,485	18,672	22,880	14,429	18,959
	<u>\$ 89,620</u>	<u>\$ 104,395</u>	<u>\$ 94,857</u>	<u>\$ 103,952</u>	<u>\$ 101,480</u>	<u>\$ 119,313</u>
Average Cost (\$/MWh) <sup>(6)</sup>	\$ 19	\$ 24	\$ 22	\$ 25	\$ 18	\$ 18

<sup>(1)</sup> In 2010, year 2008 total sales and timing differences and losses were restated to correct a data entry error.

<sup>(2)</sup> See Table 7, "Customers, Energy Sales and Revenues."

<sup>(3)</sup> Includes timing differences between actual calendar year energy requirements and monthly billing cycles, and system losses.

<sup>(4)</sup> Effective November 1, 2011, the Distribution Division share of Rocky Reach output increased under the Power Sales Contracts. See "FINANCIAL INFORMATION—General" and "—Power Sales Revenues and District Near-Term Financial Outlook."

<sup>(5)</sup> Non-firm purchases include power purchased to meet local requirements and certain contractual obligations, to hedge price movements and to minimize the District's overall risk exposure to changes in power prices.

<sup>(6)</sup> Includes actual costs of power to the Distribution Division plus allocable administrative and other expenses of the Distribution Division. Fluctuations in average cost are due primarily to fluctuations in water conditions on the Columbia River, which may significantly affect market prices, and fluctuations in power repurchases from Alcoa under the prior power sales contract between the District and Alcoa. See "THE CONSOLIDATED SYSTEM—The Prior Power Sales Contracts."

Source: *The District*.

### ***The Hydro-Electric Projects***

The Distribution Division obtains approximately three-fourths of its power from the Rocky Reach Project and the Rock Island Project. See "—The Puget Sound Energy Power Sales Contract" and "—The Alcoa Power Sales Contract" under this heading. The entire output of the Lake Chelan Project is taken by the Distribution Division. The Lake Chelan Project output constituted approximately 8% of the Distribution Division's total energy requirements for the year ended December 31, 2011. Comparable information for the year ended December 31, 2012 is not yet available.

### ***Nine Canyon***

The District also is a purchaser of power from the Nine Canyon Wind Project, located in Benton County, Washington. The project is owned and operated by Energy Northwest. There are ten purchasers of power output from the Nine Canyon Wind Project. All are public utility districts in the State of Washington. Upon project startup in 2001, the District joined Nine Canyon as a purchaser, interested in a long-term power supply portfolio that was diversified, adequate for projected load obligations and cost-effective and that included an appropriate level of alternative and renewable power supply resources. In addition, the Washington State legislature had recently required utilities to provide customers with the ability to purchase qualified alternative energy resources, which included facilities fueled by wind.

Phase 1 of the Nine Canyon Wind Project, from which the District purchased a 12.5% share of the output, consists of 37 1.3 MW wind turbines. Phase 1 was certified for commercial operation in September 2002. The capacity of Phase 1 is 48 MW. Under the Phase 1 contract of purchase, the District agreed to pay its 12.5% share of the project's annual budgeted expenses, including debt service on project bonds whether or not the project is operating or capable of operating. As of June 30, 2012, \$51,645,000 principal amount of Phase 1 Bonds are outstanding.

Energy Northwest expanded the project with Phase 2, which added 12 turbines, with a combined capacity of 15.6 MW. The District purchased 12.5% of this additional capacity. Under the amended contract, the District agreed to pay its 12.5% share of the debt service on the Phase 2 project bonds whether or not the project is operating or capable of operating. As of June 30, 2012, \$14,745,000 principal amount of Phase 2 Bonds are outstanding. The District also agreed to pay 12.5% of the combined Phase 1 and Phase 2 annual budgeted operation and maintenance expenses. The District has also agreed to pay up to an additional 3.125% of such expenses in the event one or more other participants fail to make their payments. The first units of Phase 2 were certified for commercial operation in September 2003, with all units certified for commercial operation by December 2003. From 2008 through 2011, the average capacity factor of Phases 1 and 2 combined energy delivered to the District was 25.0%.

Phase 3 of the project (the final phase) is a 14 turbine, 32 MW expansion that was placed into commercial operation in May 2008. The District declined to participate in Phase 3. In October 2006, the District signed a second amended power purchase agreement, reducing the District's share in the combined project from 12.5% to approximately 8.3% upon the commencement of commercial operation of Phase 3. This reduced the District's share in the combined generation output and combined maintenance and operation costs to 8.3%. Although the District's combined project share percentage is now lower, the District's megawatt capacity remains the same at approximately 7.96 megawatts because the expanded project has a larger megawatt capacity. Phase 3 is consistently showing a higher capacity factor than Phase 1 and Phase 2 as was anticipated, averaging 29.3% from 2008 through 2011. The District's debt obligations related to Phases 1 and 2 remain the same at 12.5% share of each as previously described. The District has no obligation to pay bond debt of Phase 3.

### **Puget Sound Energy Power Sales Contract**

In February 2006, the District executed a new long-term power sales contract (the "Puget Contract") with Puget Sound Energy. Deliveries under the Puget Contract commenced on November 1, 2011 and July 1, 2012 for the Rocky Reach and Rock Island Projects, respectively. The Puget Contract is scheduled to terminate on October 31, 2031. Under the Puget Contract, Puget Sound Energy purchases 25% of the combined energy and capacity from both the Rocky Reach and Rock Island Projects. In exchange, Puget Sound Energy is obligated to pay, among other things, its percentage share of (i) the operation and maintenance expenses of the Rocky Reach and Rock Island Projects; (ii) certain debt service-related Financing Costs (as defined in the Puget Contract) with respect to the Rocky Reach and Rock Island Projects; (iii) a Coverage Amount; (iv) an annual Capital Recovery Charge (as defined in the Puget Contract); and (v) an annual Debt Reduction Charge (as defined in the Puget Contract). In addition, Puget Sound Energy made a one-time payment of \$89 million to the District in April 2006 as a "capacity reservation charge," which the District may use for any lawful purposes. The District's Consolidated System is recognizing the \$89 million payment as revenue in equal annual amounts over the term of the Puget Contract, commencing on November 1, 2011. FERC approved the Puget Contract in March 2006.

The Coverage Amount is an amount approximately equal to 15% of the maximum annual debt service related costs with respect to the Rocky Reach and Rock Island Projects, as that amount may increase in connection with the issuance of additional debt. The Debt Reduction Charge will be an amount each year approximately equal to a percentage determined by the District of up to 3.0%, multiplied by the outstanding principal amount of the debt obligations related to the Rocky Reach and Rock Island Projects. The Capital Recovery Charge is an amount approximately equal to a percentage determined by the District of up to 50%, multiplied by \$25 million in 2004 dollars (as adjusted for inflation) and as adjusted by the District based upon updated capital improvement projects. The annual debt service-related Financing Costs are determined based upon a number of factors, including when such debt was incurred (before or after the execution of the Puget Contract), the structure of such debt (serial or term obligations) and whether such debt is for refunding purposes, as more fully described in APPENDIX I—“Summary of Power Sales Contract with Puget Sound Energy, Inc.”

In December 2010, the Commission set the annual Debt Reduction Charge and the Capital Recovery Charge at the maximum rates authorized under the Puget Contract, effective January 1, 2012. In November and December of 2011, the Debt Reduction Charge and Capital Recovery Charge were collected at the default rates under the Puget Contract. The rates may be adjusted by the Commission by giving one year's prior notice. The District estimates the annual value of these charges to Puget Sound Energy to be approximately \$6.4 million in 2012 and \$8.8 million in 2013, which amounts the District expects to use to pay capital expenditures of the Rocky Reach and Rock Island Projects and/or to retire outstanding indebtedness.

The payment obligations of Puget Sound Energy are expected to exceed its 25% share of the actual costs incurred by the District in each fiscal year for operation and maintenance expenses and debt service costs related to the Rocky Reach and Rock Island Projects. The District is free to structure its actual debt service with respect to the Rocky Reach and Rock Island Projects so that debt service related payments by Puget Sound Energy for its portion of the output of the Projects may be greater than, equal to or less than the District's actual debt service.

The payment obligations of Puget Sound Energy under the Puget Contract are absolute and unconditional, regardless of whether it can receive, accept, take delivery of or use all or any portion of such output, and regardless of whether either of the Rocky Reach or Rock Island Projects is operable or operating, or the operation thereof is interrupted, suspended, interfered with, reduced or curtailed, in whole or in part, at any time for any reason. In addition, the payment obligations of Puget Sound Energy under the Puget Contract are subject to a mandatory step-up of its *pro rata* share of the defaulting participant's share in the event of a default by any other long-term power purchaser of the output of the Rocky Reach or Rock Island Projects. In no event will Puget Sound Energy's total share exceed 40% without its written permission due to this provision.

See APPENDIX I—“Summary of Power Sales Contract with Puget Sound Energy, Inc.”

For a description of Puget Sound Energy, see APPENDIX H—“DESCRIPTION OF MAJOR POWER PURCHASERS.”

### **Alcoa Power Sales Contract**

In July 2008, the District executed a new long-term power sales contract with Alcoa, Inc. (“Alcoa”) (the “Alcoa Contract” and together with the Puget Contract, the “Power Sales Contracts”). Deliveries under the Alcoa Contract commenced on November 1, 2011 and July 1, 2012 for the Rocky Reach and Rock Island Projects, respectively. The Alcoa Contract is scheduled to terminate on October 31, 2028. Under the Alcoa Contract, Alcoa purchased energy equivalent to 27.5% of the output of the Rocky Reach Project from November 1, 2011 to June 30, 2012, and thereafter Alcoa will purchase energy equivalent to 26% of the combined Output of both the Rock Island and Rocky Reach Projects. “Output” is defined in the Alcoa Contract as an amount of energy determined in relation to the energy production of the Rock Island Project and the Rocky Reach Project. Energy may be supplied by the District from any source. The District retains for its own benefit and use all capacity, pondage, environmental attributes and other products related to the output of the two Projects except for certain ancillary services necessary to supply the output that will be used at Alcoa's Wenatchee Works aluminum smelting plant. In exchange, Alcoa is obligated to pay, among other things, its percentage share of (i) the operation and maintenance expenses of the Rocky Reach and Rock Island Projects; (ii) certain debt service-related Financing Costs (as defined in the Alcoa Contract) with respect to the Rocky Reach and Rock Island Projects; and (iii) a Coverage Amount (as defined in the



Alcoa Contract). Alcoa is also obligated to pay an annual Capital Recovery Charge (as defined in the Alcoa Contract); and (v) an annual Debt Reduction Charge (as defined in the Alcoa Contract). Alcoa will also pay a credit rating premium based upon the differential between Alcoa's long-term senior unsecured credit ratings and the District's credit ratings. In addition, Alcoa made a one-time payment of \$22.9 million in August 2008 as a capacity reservation charge, which the District may use for any lawful purposes. The District's Consolidated System is recognizing the \$22.9 million payment as revenue in equal annual amounts over the term of the Alcoa Contract, commencing on November 1, 2011. FERC approved the Alcoa Contract in September 2008.

The payment provisions of the Alcoa Contract are similar to those of the Puget Contract, including the Coverage Amount, the Debt Reduction Charge, the Capital Recovery Charge and the Financing Costs provisions summarized above. In December 2010, the Commission set the annual Debt Reduction Charge and the Capital Recovery Charge at the maximum rates authorized under the Alcoa Contract, effective January 1, 2012. In November and December of 2011, the Debt Reduction Charge and Capital Recovery Charge were collected at the default rates under the Alcoa Contract. The rates may be adjusted by the Commission by giving one year's prior notice. The District estimates the annual value of these charges to Alcoa to be approximately \$6.8 million in 2012 and \$9.2 million in 2013, which amounts the District expects to use to pay capital expenditures of the Rocky Reach and Rock Island Projects and/or to retire outstanding indebtedness.

The payment obligations of Alcoa under the Alcoa Contract are expected to exceed Alcoa's percentage share of the actual costs incurred by the District in each fiscal year for operation and maintenance expenses and debt service costs related to the Rocky Reach and Rock Island Projects. The District is free to structure its actual debt service with respect to the Rocky Reach and Rock Island Projects so that debt service related payments by Alcoa for its portion of the output of the Rocky Reach and Rock Island Projects may be greater than, equal to or less than the District's actual debt service.

The payment obligations of Alcoa under the Alcoa Contract are absolute and unconditional, regardless of whether it can receive, accept, take delivery of or use all or any portion of such output, and regardless of whether either of the Rocky Reach or Rock Island Project is operable or operating, or the operation thereof is interrupted, suspended, interfered with, reduced or curtailed, in whole or in part, at any time for any reason. In addition, the payment obligations of Alcoa under the Alcoa Contract are subject to a mandatory step-up of its *pro rata* share of the defaulting participant's share in the event of a default by any other long-term power purchaser of the output of the Rocky Reach or Rock Island Projects.

The Alcoa Contract also provides that:

(i) The Output provided pursuant to the Alcoa Contract is to be used to run the Wenatchee Works project, Alcoa cannot use the energy at any other plant or location and can only resell the energy under certain circumstances described in the Alcoa Contract.

(ii) A deferred capacity reservation charge of up to \$83.7 million is to be paid by Alcoa if the Wenatchee Works project is shut down under certain circumstances. If Alcoa shuts down the Wenatchee Works project for 90 days, Alcoa would be obligated to pay to the District an initial shut down amount (the annual initial shutdown amount of \$8.6 million, prorated for the period shut down). If the initial shutdown continues for 18 months or if there is a second shutdown of 90 days' duration, whichever occurs first, Alcoa would owe the District the entire balance of the deferred capacity reservation charge. The deferred capacity reservation charge declines as time passes during the contract term. Such payments may not be required, however, if the shut down is the result of an Uncontrollable Circumstance (as defined in the Alcoa Contract).

(iii) The District will have the option to terminate the Alcoa Contract if Alcoa operates less than a minimum load of 175 aMW for 18 months, announces permanent shutdown, formally announces it has elected to abandon the Wenatchee Works plant or has sold the plant to a third party without the District's express written consent; however, if the District decides not to terminate the Alcoa Contract, Alcoa will remain liable for all remaining payments under the Alcoa Contract.

(iv) Alcoa may not assign the Alcoa Contract to any other entity without the express written consent of the District. Further, if there is a Change of Control (a person or group acquiring more than 50% of the

combined voting power or outstanding Equity Interests in Alcoa), the District must expressly consent to that event, and if the District does not consent to a Change in Control, the District has the right to terminate the Alcoa Contract. The District's consent to either situation is within the District's sole discretion.

(v) The District may request performance assurance or collateral upon the occurrence of a downgrade event for Alcoa or if the District has reasonable grounds to believe that Alcoa's creditworthiness or performance under the Alcoa Contract has become unsatisfactory. The District may request such performance assurance to cover the sum of approximately three months of periodic payments and an amount equal to the deferred capacity reservation charge described in (ii) above (all as defined in the Alcoa Contract).

See APPENDIX J—"Summary of Power Sales Contract with Alcoa, Inc."

In January 2010, the Commission approved Alcoa's plan to invest an additional \$20 million in power system upgrades that will make it possible to operate a third pot line reliably at Alcoa's Wenatchee Works. The District and Alcoa entered into an Interconnection Agreement, pursuant to which Alcoa will finance upgrades to the District's McKenzie substation, improve the connection at Alcoa for the District's 230-kv Columbia 2 transmission line to the Rocky Reach Project and purchase for the District a part of the Valhalla Substation near Alcoa and currently owned by Bonneville. The District will own and operate the facilities, and Alcoa will be responsible for all costs. Alcoa began operating the third pot line as of March 2011.

For a description of Alcoa, see APPENDIX H—"DESCRIPTION OF MAJOR POWER PURCHASERS."

### **The Prior Power Sales Contracts**

Prior to November 1, 2011, the energy available to the District from its ownership and operation of the Rocky Reach Project was governed by power sales contracts with (i) four investor-owned utility companies (the "Prior IOU Power Sales Contracts"), (ii) Alcoa Power (the "Prior Alcoa Power Contract"), and (iii) Douglas PUD (the "Douglas PUD Power Sales Contract" and together with the Prior IOU Power Sales Contracts and the Prior Alcoa Power Contract, the "Prior Rocky Reach Power Sales Contracts").

Under the Prior IOU Power Sales Contracts, a major portion (59.1%) of the power output of the Rocky Reach Project was sold to four investor-owned utility companies on a take-or-pay and cost-of-service basis, with the balance (40.9%) taken by the District, and each party paid its percentage share of the total annual cost of the Rocky Reach Project. Under the Prior Alcoa Power Contract, energy sales to Alcoa Power, consisting of approximately 23% of the equivalent output of the Rocky Reach Project, were based on a *pro rata* portion of the costs of generation, with Alcoa Power liable for such obligations on a take-or-pay basis. Alcoa Power could purchase additional energy of up to 42 megawatts at a price equal to the District's average industrial rate. All sales to Alcoa Power under the Prior Alcoa Power Contract were classified by the District as "Resale."

Pursuant to the Douglas PUD Power Sales Contract, the District agreed to sell to Douglas PUD, from the District's share of Rocky Reach Project energy, an amount of energy equal to 2.77% of the output of the Rocky Reach Project, upon payment by Douglas PUD of an amount equal to the District's cost of such energy. This contract provides that Douglas PUD has the right to take an additional 2.77% under the same terms and pay the same costs as other "slice purchasers" beginning November 1, 2011. The original term of the Douglas PUD contract ended on October 31, 2011, but the contract can be extended in ten-year increments at the option of Douglas PUD five times, for a final potential term (including extensions) of October 31, 2061. Douglas PUD has provided notice for the first 10-year extension until October 31, 2021 for 5.54% of output of the Rocky Reach Project.

Prior to June 7, 2012, the energy available to the District from its ownership and operation of the Rock Island Project was governed by a power sales contract between the District and Puget Sound Energy, pursuant to which the output of the Rock Island Project was sold on a take-or-pay and cost-of-service basis to Puget Sound Energy, subject to the right of the District to take certain portions of the output for its own use (the "Prior Rock Island Power Sales Contract" and together with the Prior Rocky Reach Power Sales Contracts, the "Prior Power Sales Contracts"). For 2011 and through June 7, 2012, 50% of the power output of the Rock Island Project was sold to Puget Sound Energy and the remaining 50% was taken by the District.

## **Energy Sales; Load/Resource Balancing; Hedging Strategy**

Because approximately 93% of the District's residential customers and a portion of the District's commercial and industrial customers use electricity as a source of energy for space heating, the District's energy sales are significantly affected by the weather. To mitigate potential wholesale sales and price volatility, to help keep future rates stable and affordable and to maintain financial stability, the District has implemented a comprehensive forward hedging strategy. In addition to the Power Sales Contracts, a key component of the strategy includes executing medium-term power sales contracts for (i) fixed percentages of future output from the Rock Island and Rocky Reach Projects and (ii) fixed amounts of such output, in each case at fixed prices and for staggered terms from within the then-current year plus up to an additional 60 months. This strategy is expected to mitigate the District's exposure to changes in wholesale power prices and Columbia River flows (the latter of which affects generation at the Hydro-Electric Projects) and to secure a revenue stream for the duration of those contracts. As of September 30, 2012, the District has locked in revenues under these medium-term contracts of \$447.7 million for the period from January 2013 through the end of 2017.

The Consolidated System derives a substantial portion of its annual revenues from wholesale sales of the Distribution Division's share of surplus power generated by the Hydro-Electric Projects. These wholesale sales provided 45% of annual Distribution Division revenues in fiscal year 2011 and 36% of annual Distribution Division revenues in fiscal year 2010. The amount of surplus power sold by the District in 2011 and 2012 increased from prior years, and thus the percentage of annual Distribution Division revenues derived from such sales, as a result of the expiration of the Prior Power Sales Contracts and the commencement of deliveries under the Power Sales Contracts.

The amount of such power available for sale in any given year, and the prices at which such power can be sold, however, are highly variable, and depend to a large extent on factors outside of the control of the District. In particular, the amount of such power available for sale is dependent upon relative flows down the Columbia River past the Rocky Reach and Rock Island Projects and the timing of such flows, both of which are largely dependent upon weather conditions in and upstream of the Mid-Columbia River and weather conditions in the District's service area, which affects the District's relative load from season to season. The price of such power also is dependent, among other things, on weather conditions inside and outside the Pacific Northwest, the relative demand for power at any given time across the Western United States, general economic conditions, the cost and the availability of alternative sources of power, including in particular energy generated by facilities fueled by natural gas, wind and numerous other factors. The District seeks to moderate the variability in its revenues arising from these factors through a variety of means, including the implementation of its energy hedging strategy, the maintenance of significant liquidity, including the maintenance of the Rate Stabilization Fund, and its ability to impose rate increases or temporary rate surcharges on relatively short notice.

In 2012, the District entered into a new five-year agreement with Powerex, a real-time scheduling service provider, to balance the District's resources with its daily load requirements and other contractual obligations on a real-time basis. In addition to the real-time scheduling services it provides to the District, Powerex also has rights to access the District's balancing authority and scheduling services at the Mid-Columbia energy hub and to access the District's residual system capability. The District has secured additional revenues from the Powerex agreement. FERC approved the agreement with Powerex in November 2012.

Table 7 on the following page presents the District's customers and energy sales of its Distribution Division for the years 2007 through 2011 and for the nine months ended September 30, 2012. The information for fiscal years 2007 through 2011 has been extracted from the District's audited financial statements. The information provided for the nine months ended September 30, 2012 is unaudited. See "FINANCIAL INFORMATION—General."

**Table 7**  
**Distribution Division – Customers, Energy Sales and Revenues**  
**Years Ended December 31, 2007 through 2011 and Nine Months Ending September 30, 2012**

	2007	2008	2009	2010	2011	Nine Months Ended September 30, 2012
<b><u>Customers</u></b>						
Retail:						
Residential	34,129	35,357	35,516	35,687	35,806	36,040
General Service	5,666	5,968	6,027	6,074	6,092	6,144
Industrial	30	32	31	31	30	31
Interdepartmental	501	523	544	549	537	541
Other <sup>(1)</sup>	4,985	5,745	5,749	5,710	5,708	5,688
Total Retail Customers	<u>45,311</u>	<u>47,625</u>	<u>47,867</u>	<u>48,051</u>	<u>48,173</u>	<u>48,444</u>
Resale:	60	68	70	73	78	79
Total Customers	<u>45,371</u>	<u>47,693</u>	<u>47,937</u>	<u>48,124</u>	<u>48,251</u>	<u>48,523</u>
<b><u>Energy Sales (000 MWh)</u></b>						
Retail:						
Residential	723	744	803	738	776	562
General Service	434	447	469	447	470	351
Industrial	297	297	315	296	284	193
Interdepartmental	18	19	20	19	19	16
Other <sup>(1)</sup>	45	47	48	40	41	40
Total Retail Sales	<u>1,517</u>	<u>1,554</u>	<u>1,655</u>	<u>1,540</u>	<u>1,590</u>	<u>1,162</u>
Resale:						
Alcoa Power	1,464	1,380	1,313	1,341	1,622	1,551
Douglas PUD	176	159	146	140	231	326
City of Cashmere <sup>(2)</sup>	61	49	-	-	-	-
Other – Firm	-	-	-	19	586	1,565
Other – Non-firm	1,627	1,274	1,143	1,187	1,733	2,127
Total Sales for Resale	<u>3,328</u>	<u>2,862</u>	<u>2,602</u>	<u>2,687</u>	<u>4,172</u>	<u>5,569</u>
Total Energy Sales	<u>4,845</u>	<u>4,416</u>	<u>4,257</u>	<u>4,227</u>	<u>5,762</u>	<u>6,731</u>
<b><u>Revenue (\$000)</u></b>						
Retail:						
Residential	\$ 21,515	\$ 23,197	\$ 26,203	\$ 25,132	\$ 26,560	\$ 18,138
General Service	13,970	15,154	16,842	16,687	17,468	11,959
Industrial	5,542	5,757	6,378	6,246	6,089	3,923
Interdepartmental	506	559	607	583	583	483
Other <sup>(1)</sup>	1,536	1,650	1,775	1,719	1,688	1,509
Total Retail Revenue	<u>\$ 43,069</u>	<u>\$ 46,317</u>	<u>\$ 51,805</u>	<u>\$ 50,367</u>	<u>\$ 52,388</u>	<u>\$ 36,012</u>
Resale:						
Alcoa Power	\$ 21,427	\$ 25,025	\$ 22,448	\$ 24,740	\$ 24,340	\$ 24,532
Douglas PUD	2,073	2,004	1,930	2,074	2,395	2,952
City of Cashmere <sup>(2)</sup>	830	721	-	-	-	-
Other – Firm	-	-	-	771	19,402	49,808
Other – Non-firm	79,377	66,250	36,484	43,358	47,863	64,108
Total Resale Revenue	<u>\$ 103,707</u>	<u>\$ 94,000</u>	<u>\$ 60,862</u>	<u>\$ 70,943</u>	<u>\$ 94,000</u>	<u>\$ 141,400</u>
Other Revenues	1,256	2,619	1,615	1,511	2,791	7,822
Total Revenue	<u>\$ 148,032</u>	<u>\$ 142,936</u>	<u>\$ 114,282</u>	<u>\$ 122,821</u>	<u>\$ 149,179</u>	<u>\$ 185,234</u>

<sup>(1)</sup> Includes irrigation, frost protection and street/yard lighting.

<sup>(2)</sup> On October 30, 2008, the District acquired the City of Cashmere's distribution system, which is now owned and operated as a part of the District's Distribution Division.

Source: The District.

## **Electric Rates; Other Rates**

The District is empowered and required pursuant to State statutes to establish, maintain and collect rates or charges for electric service which are fair and nondiscriminatory and adequate to provide revenues sufficient for the payment of the principal of and interest on its revenue obligations and for all payments which the District is obligated to set aside in any special fund or funds for such purpose and for the proper operation and maintenance of the Consolidated System and all necessary repairs, replacements and renewals thereof.

The District has maintained rates for retail electric service which have been sufficient to provide for operation and maintenance costs and expenses, debt service, repairs, replacements and renewals and to provide for a major portion of the capital additions to the Consolidated System. Rates and charges of the District are fixed by its Commission. The Commission holds public hearings annually to consider the District's proposed budget. In addition, the Commission holds open meetings to consider the District's construction plan and load forecast and effects on the District's revenue requirements. Based on these planning documents, the District's staff estimates the District's revenue requirements and prepares various rate proposals designed to produce this revenue. The Commission holds public meetings to introduce and explain the proposals to the public and to receive public input. The input is then considered in a public meeting and the Commission makes a final decision as to rates.

The District, pursuant to State statutes, has the full and exclusive authority to regulate and control rates and charges for retail electric service free from the jurisdiction and control of the Washington Utilities and Transportation Commission ("WUTC"). The District is, however, subject to certain rate-making provisions of the federal Public Utility Regulatory Policies Act of 1978, as amended ("PURPA"), governing rate-making policies. The District believes that it is operating in compliance with PURPA.

The District believes that it is exempt under the FPA from any regulation by FERC of its retail electric rates, and neither FERC nor its predecessor agency has ever attempted to assert such regulatory authority over the District.

In 2008, the District increased electric rates by 5% to help move the District away from reliance on wholesale power sales over time. Prior to the 2008 rate increase, the District last increased electric rates in January 2000.

In 2009 and 2010, an unusual combination of low wholesale energy prices, below-average snowpack and a declining interest rate environment resulted in a significant decline in revenues to the District from sales of surplus power and interest income earned on investments. In response to these developments, the District, among other things, implemented a temporary 9% rate surcharge, which went into effect on May 1, 2009 and extended through December 31, 2011.

The District implemented a temporary 2.0% rate increase, effective December 1, 2010 through April 15, 2011, to defray certain anticipated project costs. The District adopted an electric rate design change on October 17, 2011. The new rate design, which included an overall retail rate increase of 2.5%, went into effect on January 1, 2012 following the expiration of the 9% surcharge.

If conditions adversely affecting the District's revenues (including below-average river flows and depressed wholesale energy prices) return in the future, the District could re-impose a retail rate surcharge or take other rate action to maintain the health of the District's finances.

In addition to the electric rate increases and surcharges described above, the District has also implemented rate increases for some of its other systems. The District increased rates for its Water System and Wastewater System by 9% on January 1, 2008, 6.9% for the Water System and 6.5% for the Wastewater System on April 1, 2009, 5.0% for both systems on April 1, 2011 and 6.0% for both systems on April 1, 2012. The District also increased wholesale rates charged to serviced providers for its Fiber and Telecommunications System by 2.0% on January 1, 2008, by an approximate blended rate of 5% on January 1, 2011 and by 9% on August 1, 2012.

Table 8 below presents the District's average monthly electric bills and those of several other major public and private Pacific Northwest utilities. The rates shown are those in effect as of December 1, 2012.

**Table 8**  
**Comparative Monthly Electric Bills<sup>(1)</sup>**  
**As of December 1, 2012**

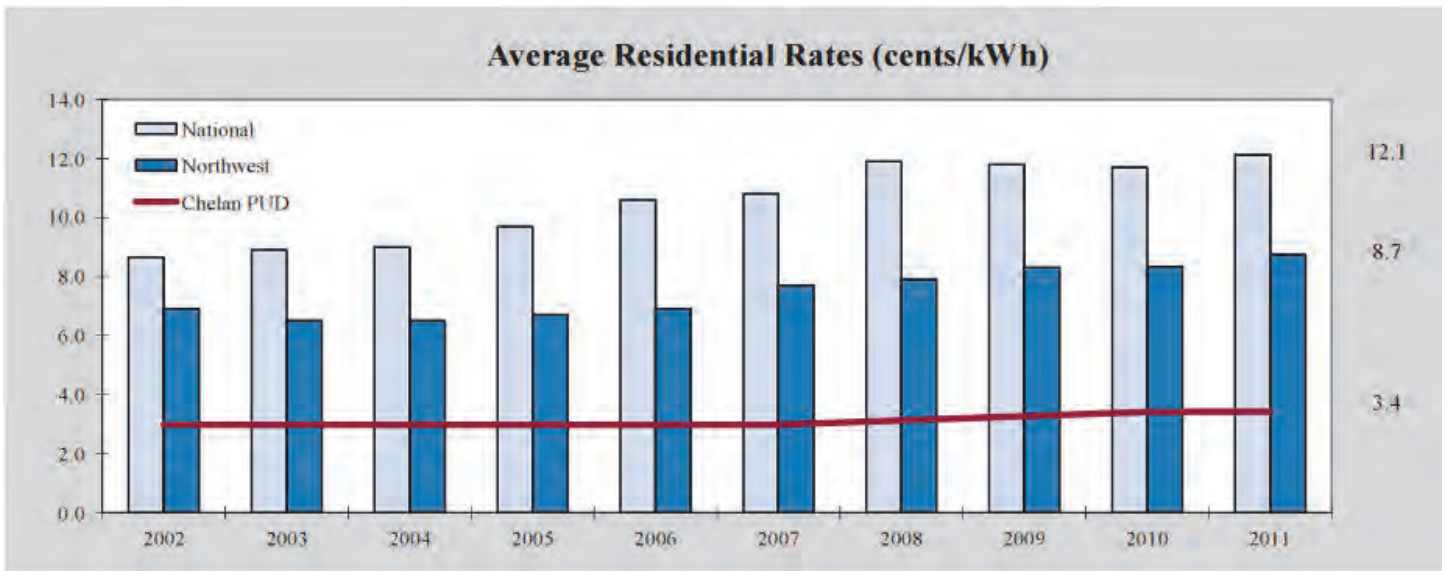
	<b>Residential</b>		<b>Commercial<sup>(2)</sup></b>		<b>Industrial<sup>(2)</sup></b>	
	<b>(1000 kWh)</b>	<b>(2,000 kWh)</b>	<b>(30 kW, 9,000 kWh)</b>		<b>(400 kW, 150,000 kWh)</b>	
	<b>Summer</b>	<b>Winter</b>	<b>Summer</b>	<b>Winter</b>	<b>Summer</b>	<b>Winter</b>
<b>The District</b>	\$35	\$62	\$268	\$268	\$4,510	\$4,510
<b>Selected Municipalities:</b>						
Tacoma Power	77	148	666	666	7,668	7,668
City of Seattle	102	200	621	621	9,324	9,324
<b>Selected Public Utilities:</b>						
Grant County PUD No. 2	52	93	392	392	6,288	6,288
Snohomish County PUD No. 1	85	177	670	748	10,168	11,566
<b>Investor Owned Utilities:</b>						
Avista	80	170	885	885	12,689	12,689
Puget Sound Energy	103	209	819	847	12,035	13,227

<sup>(1)</sup> Computed from the rate schedules provided by the utilities listed. There are some variations in rate schedules and rate classification of the various utilities.

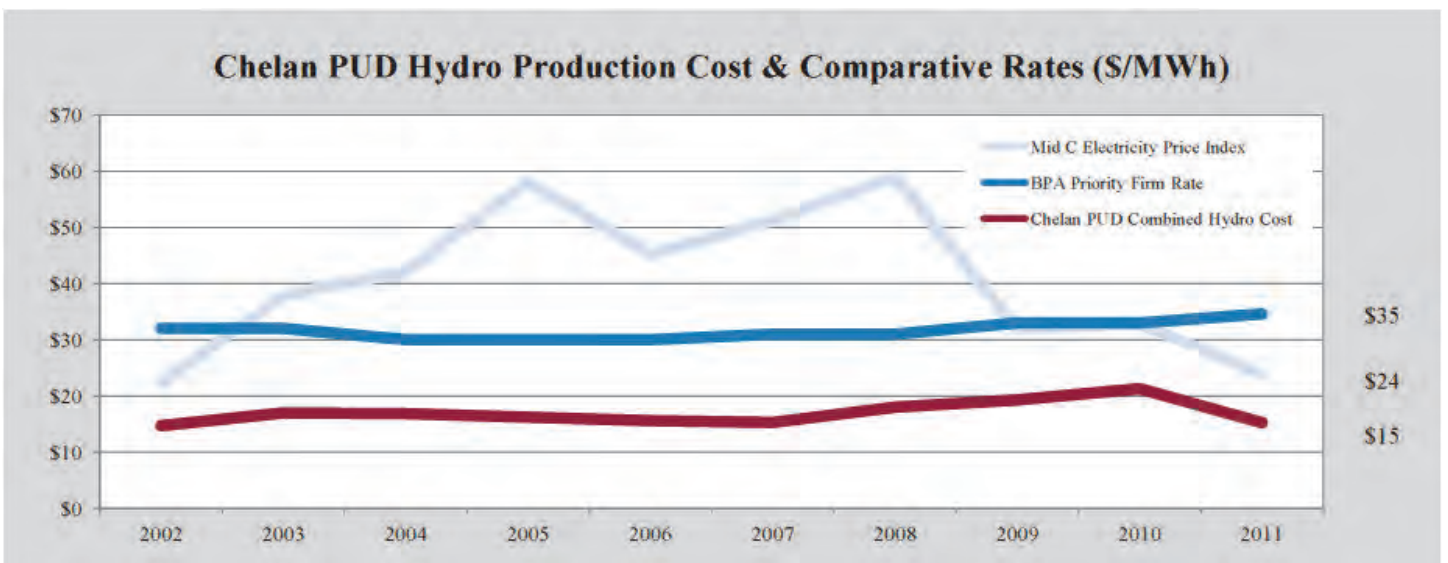
<sup>(2)</sup> Assumes power delivered is three-phase where available. Delivery voltage varies.

The Distribution Division rates are among the lowest in the country. Chart 1 on the following page compares the District with Pacific Northwest and national averages. District residential rates averaged 3.4 cents per kWh in 2011 compared to 8.7 cents per kWh for the Pacific Northwest average and 12.1 cents per kWh for the national average. This is due, in part, to the low-cost hydro generation provided by the District's three Hydro-Electric Projects. Chart 2 on the following page compares the District's combined hydro production cost with the Bonneville priority firm rate available to public utilities and the annual market average based on the Mid-Columbia Electricity Price Index. For 2011, the District's combined Hydro-Electric Projects' production cost was \$15 per MWh (1.46 cents per kWh) compared to Bonneville's firm priority rate of \$35 per MWh (3.46 cents per kWh) and the Mid-Columbia market average of \$24 per MWh (2.38 cents per kWh). Comparable data for 2012 is not yet available.

**CHART 1**



**CHART 2**



## Largest Customers

The largest wholesale customers of the Rock Island and Rocky Reach Systems are the power purchasers of those Systems (collectively, the “Power Purchasers”). See “—The Puget Sound Power Sales Contract,” “—The Alcoa Power Sales Contract” and “—The Prior Power Sales Contracts” under this heading. For the year ended December 31, 2011, the Power Purchasers, which excludes Alcoa and Douglas PUD, collectively purchased approximately 54.7% of the output of the Rock Island and Rocky Reach Systems. Revenues of the Rock Island System and Rocky Reach System do not constitute Revenues pledged to the payment of the Senior Consolidated System Bonds, the Bonds or the Subordinate Consolidated System Obligations.

Table 9 below presents the five largest local customers, including both local wholesale purchasers and major retail customers, of the Distribution Division in terms of MWh sales for the year ended December 31, 2011. Alcoa Power, the Distribution Division’s largest local wholesale purchaser, accounted for 16.3% of the revenues of the Distribution Division. Comparable date for the year ended December 31, 2012 is not yet available.

**Table 9**  
**Consolidated System**  
**Distribution Division**  
**Five Largest Local Wholesale Purchasers and Major Retail Customers<sup>(1)</sup>**  
**2011**

Customer	Business	Energy Sales (000 MWh)	Revenue from Energy Sales (\$000)	Percent of Distribution’s Total Revenue
Alcoa Power <sup>(2)</sup>	Aluminum Mfg.	1,622	\$ 24,340	16.3%
Douglas County PUD	Electric Utility	231	2,395	1.6%
Stemilt Growers Inc.	Agriculture	64	1,308	0.9%
Keyes Fibre Inc.	Paper Products	39	710	0.5%
Trout Inc.	Agriculture	32	642	0.4%
		1,988	\$ 29,395	19.7%

<sup>(1)</sup> Excludes non-firm sales for resale.

<sup>(2)</sup> Under the prior power sales agreement between the District and Alcoa, which expired October 31, 2011, Alcoa assigned its 23% share of the output of the Rocky Reach Project to the Distribution Division, and in return, the Distribution Division provided power equivalent to 23% of the Rocky Reach Project output to Alcoa at cost and procured any additional power needed or sold any surplus power to Alcoa at contractual rates, which approximated market rates. See “THE CONSOLIDATED SYSTEM—The Prior Power Sales Contracts.” The Alcoa Contract became effective November 1, 2011 with respect to the Rocky Reach Project and July 1, 2012 with respect to the Rock Island Project. See “THE CONSOLIDATED SYSTEM—The Alcoa Power Sales Contract.”

## Wholesale Power Management Activity

The District has the opportunity to purchase and sell power from and to a number of power marketing firms, banks, independent power producers and other electric utilities and to enter into future delivery contracts for the forward purchase and sale of electricity. While this creates new opportunities, it also creates risks. The District recognizes these risks and has committed significant resources to mitigate them. In 1998, the District developed a Power Risk Management Policy, which establishes guidelines for monitoring and controlling exposure to market, counterparty/credit, tax and other risks associated with wholesale power transactions. The policy is reviewed and revised at least annually to ensure that the policy remains adequate in the changing energy market. The District maintains a Power Risk Management Committee, comprised of the Senior Managers. Other staff members, as defined by resolution, may serve on the committee during any vacancies of those positions. The District’s General Manager reviews proposed actions and is the final authority on all decisions made by the committee. The committee is responsible for approving the Power Risk Management Policy, approving strategies, monitoring performance, communicating with the Commission, establishing trading and position limits, approving new product offerings, ensuring that strategies are consistent with the District’s business objectives and reviewing financial results. Included in the Power Risk Management Policy noted above is a credit policy, which requires that trades be made only with pre-approved counterparties. The objective of the credit policy is to preserve the capital and liquidity of the District. This is done in part by establishing procedures for granting open lines of credit and for monitoring and



managing customer and counterparty credit exposures related to power marketing activities. The intent of these credit policies and procedures is to maintain customer and counterparty default risk at acceptable levels. See Table 7 – “Distribution Division Customers, Energy Sales and Revenues.”

## **The Fiber and Telecommunications System**

### ***General***

The District built, maintains and operates the Fiber and Telecommunications System that runs throughout the County to provide various communication services necessary for the District to conduct its business. The Fiber and Telecommunications System is strategically placed to provide for the interconnection of many of the District’s facilities, including office buildings, distribution substations, transmission switchyards, and the Hydro-Electric Projects. Through the Fiber and Telecommunications System, the District also provides telecommunications infrastructure access to private retail service providers, all of which have “open access” to the network at rates reviewed and established annually by the Commission. These service providers, in turn, deliver services which may include telephone, television and high-speed Internet access to retail end users. Private retail service providers set their own end user pricing and are directly responsible for billing each end user. The District bills the service providers for the wholesale services provided by the District through the Fiber and Telecommunications System. A significant portion of end users receive services from one large private retail service provider.

As of the December 31, 2012, the District has made fiber-optic services available pursuant to its applicable policies to approximately 29,700 premises through lit distribution hubs. The District intends to continue connecting premises to existing fiber optic distribution hubs upon end user request, as the budget for each year allows. The estimated number of end users of the Fiber and Telecommunications System increased to 12,240 in 2012. Of these end users, approximately 89% use the network to subscribe for data services, approximately 52% subscribe to telephone services and approximately 45% subscribe to video services, with certain users accessing the network for multiple services, all through the retail service providers.

The District completed a Fiber and Telecommunications System strategic planning effort in 2012 under the four key objectives identified within the District’s 2010 Strategic Plan. See “FINANCIAL INFORMATION—Strategic Planning.” The purpose of Fiber and Telecommunications System strategic planning was to perform an assessment of the business unit in terms of the deployed technology, business model, service offerings, financial stability, product rate structures and capital and operational costs. Based on the results of these strategic planning efforts, the General Manager recommended to the Commission several policies intended to help make the Fiber and Telecommunications System self-sustaining over the long term. Based on these recommendations, the Commission took the following actions in 2012: (i) authorized a one-time equity transfer from the Distribution Division to retire approximately \$99 million of intersystem debt; (ii) adopted a five-year business plan and financial policies, including establishing minimum positive cash flow requirements, “savings accounts” to accumulate funds for larger capital expenditures, and minimum cash reserves for emergencies, unanticipated expenses or declining revenues; (iii) established a policy limiting financing for any expansion of the Fiber and Telecommunications System to new areas of the County beyond the present lit fiber distribution footprint to revenues generated by the Fiber and Telecommunications System; (iv) adopted a 9% increase in most Fiber and Telecommunications wholesale rates, effective as August 1, 2012; and (v) hired a new Fiber and Telecommunications System Manager.

Although these policies are intended to make the Fiber and Telecommunications System self-sustaining over the long term, the Fiber and Telecommunications System is subject to, and heavily influenced by, competition, changes in technology and customer preferences. Efforts to improve all areas within the Fiber and Telecommunications business unit are underway. The District continues to review other 2012 strategic planning recommendations, and Fiber and Telecommunications System rates studies are expected to be completed in 2013.

### ***Regulatory Environment and Government Regulation***

Telecommunication services are subject to significant regulatory oversight at the federal, state and local level, which may affect future results.

The Washington State Legislature passed Senate Bill 6675 effective June 8, 2000 (codified as RCW 54.16.330), which authorized public utility districts to provide wholesale telecommunications services. RCW 54.16.340 subjects the District’s telecommunications services to the limited jurisdiction of WUTC with respect to

whether the rates, terms, and conditions for wholesale telecommunications services are unduly or unreasonably discriminatory or preferential. Any such proceeding may only be initiated by petition of a third-party, and not by WUTC.

At the federal level, the Federal Communications Commission (the “FCC”) regulates a number of telecommunications activities, which directly or indirectly impacts the District and the service providers using the Fiber and Telecommunications System. The District has reviewed FCC requirements with outside counsel and believes that all registrations and filings required by Federal regulations in 2012 have been made.

#### ***Agreements with Retail Service Providers***

The District offers wholesale telecommunications facilities (dark fiber) and services to retail service providers authorized to provide telecommunications services to the general public. Service providers requesting dark fiber enter into a Telecommunications Facilities License Agreement with the District. Service providers requesting other telecommunications services offered by the District are required to enter into a Non-Exclusive Telecommunications Access and Transport Services License Agreement with the District. Other business opportunities being explored by the District through separate service provider agreements relate to extension and construction of District fiber optics for purposes of serving cell tower sites.

#### ***Competition***

Charter Communications (“Charter”) is the incumbent cable company in most of the County and offers broadband internet, cable television service, and “Voice over Internet Protocol” or VoIP telephone service via coaxial cable. Charter maintains a direct retail relationship with its customers and does not allow other providers to access its network. Frontier is the incumbent telephone provider in the County and provides traditional telephone service throughout the county, digital subscriber lines (“DSL”) in some areas of the County and satellite television service through DirecTV. Satellite television services are also available from Dish Network and DirecTV. The District’s Fiber and Telecommunications System currently provides the service providers in many areas with faster download speeds than those available from Charter or Frontier. Current broadband internet and television offerings from the service providers are priced competitively with Charter and Frontier.

#### ***Historical Results***

Table 10 on the following page sets forth a summary of financial results of operation of the Fiber and Telecommunications System for fiscal years 2007 through 2011 and for the nine months ended September 30, 2012.

**Table 10**  
**Consolidated System**  
**Fiber and Telecommunications System**  
**Summary of Operating Results**  
**(\$000)**

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>Nine Months Ended September 30, 2012</b>
<b><u>Operating revenues</u></b>						
Wholesale fiber services	\$ 2,563	\$ 3,088	\$ 3,706	\$ 4,109	\$ 4,541	\$ 3,641
Fiber leasing	378	422	464	487	505	374
Intra-district revenues	1,509	1,695	1,869	1,984	1,937	1,583
Total operating revenues	<u>4,450</u>	<u>5,205</u>	<u>6,039</u>	<u>6,580</u>	<u>6,983</u>	<u>5,598</u>
<b><u>Operating expenses</u><sup>(1)</sup></b>						
Administrative and general	1,647	1,601	1,678	1,522	1,637	1,143
Repairs and maintenance	865	806	743	1,043	1,115	1,078
Other operating	1,466	1,582	1,205	1,400	2,613	1,243
Depreciation expense	3,385	4,072	4,764	5,170	5,545	4,306
Total operating expenses	<u>7,363</u>	<u>8,061</u>	<u>8,390</u>	<u>9,135</u>	<u>10,910</u>	<u>7,770</u>
Operating loss	(2,913)	(2,856)	(2,351)	(2,555)	(3,927)	(2,172)
Other expense	(3,617)	(4,091)	(4,733)	(4,856)	(4,882)	(7)
Net loss before capital contributions	<u>(6,530)</u>	<u>(6,947)</u>	<u>(7,084)</u>	<u>(7,411)</u>	<u>(8,809)</u>	<u>(2,179)</u>
Capital contributions	6	309	10	5	21	207
Interfund equity transfers <sup>(2)</sup>	18,000	-	-	94	337	98,978
Changes in Net Position	<u>\$ 11,476</u>	<u>\$ (6,638)</u>	<u>\$ (7,074)</u>	<u>\$ (7,312)</u>	<u>\$ (8,451)</u>	<u>\$ 97,006</u>

<sup>(1)</sup> Includes NOANet assessments.

<sup>(2)</sup> In 2007, represents the portion of the one-time payment of \$89 million from Puget Sound Energy as a capacity reservation charge that was allocated to the Fiber and Telecommunications System. In 2010 and 2011, represents a temporary 2.0% Distribution Division rate increase effective December 1, 2010 through April 15, 2011 intended to defray certain project costs. In 2012, represents a one-time equity transfer from the Distribution Division to retire all internal loans previously made to the Fiber and Telecommunications System.

### ***Technology and Related Risk***

The District has elected to “light” the fiber network with what is referred to as a Passive (unpowered) Optical Network (“PON”), using “Fiber to the Premises” or FTTP equipment. The District’s PON network configuration can serve up to 32 Customer Premises Devices delivering service to homes or businesses from a single strand of fiber. The network can service up to 2,304 premises from a single chassis. This structure greatly reduces the cost of the outside plant deployment by reducing the number of fiber optic strands required and the number of active (powered) nodes, the maintenance required to maintain them, and the associated costs.

Telecommunications is a rapidly evolving industry subject to a high degree of technical obsolescence. While fiber optics is the clear current technological leader in terms of data transfer rates and reliability, broadband data transfer capabilities are increasing with subsequent applications making the prior capacity insufficient. Unlike certain other technologies, the data transfer capacity of the fiber itself is nearly infinite, currently limited only by the capability of commercially available equipment lighting the fiber. District staff anticipates that the electronic equipment lighting the fiber network will need to be periodically upgraded to meet the increasing bandwidth needs of the District and the community, but that the fiber itself will be capable of meeting the broadband needs for the foreseeable future.

The Alcatel-Lucent FTTP platform deployed includes two systems that are technologically disparate: Broadband Passive Optical Network (“BPON”) and Gigabit Passive Optical Network (“GPON”). Both are PON-based systems, provide the same type of services and share the same fiber plant but are not interchangeable or

interoperable between the two systems. The BPON system is near end-of-life with limited vendor technical and product support and is scheduled for a systematic replacement to the next generation GPON product. The replacement is targeted to be completed by the end of 2016.

### ***System Integrity***

In the District's opinion, its reserve funds and insurance coverage are adequate to cover loss or damage associated with the Fiber and Telecommunications System. In addition, the network is designed to have some level of resiliency and redundancy where possible, with ongoing efforts to improve reliability. For example, all of the core equipment is either 48VDC powered with battery backup capability or powered through an uninterruptible power supply and is located within environmentally controlled facilities. In addition, the District's core fiber equipment, failure of which could result in a temporary loss of network function, is maintained in a secure building protected by an advanced fire suppression system and an uninterruptible power system to minimize these risks. This core equipment defines the District's transport systems and includes the following platforms: Synchronous Optical Network, Asynchronous Transfer Mode and 10 Gigabit Ethernet over Multiprotocol Label Switching. Similarly, where possible path diversity is maintained between core network devices either over redundant fiber paths, various transport systems or through multiple network interfaces to improve reliability. Lastly, the District maintains a daily backup copy of all critical network provisioning.

### ***NOANet***

Northwest Open Access Network ("NOANet"), a Washington non-profit mutual corporation, is a wholesale provider of high-speed backbone transport capacity in Washington for internet, Ethernet and TDM services. NOANet has licensed fiber optic cable capacity from Bonneville and other sources to create a network for its municipal electric utility members and rural communities in Washington State. That network became commercially operational in 2001. NOANet makes its facilities and services available at cost to Incumbent Local Exchange Carriers, Competitive Local Exchange Carriers, Inter-eXchange Carriers, Regional Service Providers, Internet Service Providers and Application Service Providers. NOANet is a registered telecommunications company under the regulatory oversight of the Washington Utilities and Transportation Commission.

NOANet was formed pursuant to the Interlocal Cooperation Act (RCW Ch. 39.34) for the purpose of developing a regional telecommunications network for its members. A "member" of a mutual corporation is the effective equivalent of a shareholder. Pursuant to NOANet's Articles of Incorporation, all members must be public agencies located in Bonneville's service area. Members have voting rights equal to their respective percentage interests. NOANet's original members included public utility districts ("PUDs") and one regional electric utility joint action agency, Energy Northwest. The District was a member of NOANet from its inception in 2000 until September 3, 2012. The District provided notice of withdrawal in accordance with the NOANet Articles of Incorporation and Bylaws, effective as of August 31, 2012. At the time of its withdrawal, the District's membership percentage was 11.71%. Douglas County PUD also withdrew from NOANet, effective in July 2012.

Pursuant to an agreement with NOANet (as affirmed by the District in connection with the issuance by NOANet of refunding bonds in June 2011, the "Third Repayment Agreement"), the District is obligated to make payments to NOANet in amounts sufficient, to the extent not otherwise paid from NOANet's revenues, to pay debt service on NOANet's bonds outstanding as of July 12, 2001 and on any bonds issued by NOANet to refund its 2001 bonds. The District has guaranteed the payment of 10.12% of debt service on such long-term bonds, or \$1,096,502 of the approximately \$10,835,000 aggregate principal amount of such bonds outstanding as of December 31, 2012. The District and the other former members of NOANet and the remaining members of NOANet are each also obligated to pay up to an additional 25% of their respective percentage interests to cover any deficiency caused by any other member's or former member's failure to pay pursuant to the Third Repayment Agreement. The payment obligation of each member or former member, including the District, under the Third Repayment Agreement is subordinate to the payment of (1) the operating and maintenance expenses of the member's or former member's utility system, (2) the principal and interest on any existing or future bonds or other obligations of the member's or former member's utility system, and (3) required reserves for such obligations and the bond and note covenants of the member or former member. The District also guaranteed under two separate agreements (the "Fourth Repayment Agreement" and the "Fifth Repayment Agreement" and together with the Third Repayment Agreement, the "Repayment Agreements") two non-revolving lines of credit issued by Bank of America to NOANet in 2008 and 2009, respectively, with credit limits totaling \$1.5 million each. NOANet's outstanding balances for the 2008 and 2009 lines of credit as of December 31, 2012 are \$300,000 and \$500,000, respectively, of which the District has

guaranteed 11.71%, or \$35,130 and \$58,550, respectively. As of December 31, 2012, the District's aggregate obligations under the Repayment Agreements total \$1,190,182.

In 2010, NOANet was awarded and accepted two federal grants in the aggregate amount of approximately \$139 million (the "Grants") under the American Recovery and Reinvestment Act from the National Telecommunications and Information Administration's "Broadband Telecommunications Opportunity Program." NOANet has entered into certain agreements in connection with the Grants with the federal government and others (the "Grant Agreements"). NOANet is the lead entity for a consortium of mostly public agencies, together with a few private entities. The various participants (the "Project Participants") are required pursuant to various agreements (the "Participation Agreements") to provide additional cash and in-kind contributions to the projects being funded, which have a total proposed budget of almost \$185 million. NOANet's share of the required cash match is \$2.7 million. The stated purpose of the Grants is to expand wholesale telecommunications facilities and services to 34 of Washington's 39 counties, most of which are rural areas either underserved or not served by private telecommunications network providers. The Grants are expected to allow completion of NOANet's network system. The District itself was not a Project Participant or a participant in either Grant, and is not a party to any of the Grant Agreements or Participant Agreements. As of the date of its withdrawal from NOANet, the District is no longer responsible for any assessments that may result from the Grant Agreements or the Participant Agreements. Thus, the District believes that it has no obligation to NOANet or otherwise with respect to the Grants, the Grant Agreements, the Participation Agreements or the projects to be funded with such Grants.

### **Pacific Northwest Transmission System**

The Rocky Reach and Rock Island Systems are connected into the Bonneville transmission grid at several points. Bonneville markets power from 29 federal hydro-electric and thermal projects, with an installed peak generating capacity of over 23,500 MW and a firm generating capability of over 8,500 average MW and has the largest transmission system in the Pacific Northwest.

Two 115-kV lines owned by the District extend north to the Lake Chelan area where they connect to the 115-kV facilities of Avista. A 115-kV line owned by the District extends to the west where it connects to the 115-kV facilities of Puget Sound Energy. A 230-kV line owned by the District extends from the Rocky Reach Project switchyard to Alcoa's Wenatchee Works Smelter to provide direct service to Alcoa Power. This line also extends to an interconnection with Grant PUD at the Bonneville Columbia switching station. A 230-kV line owned by Puget Sound Energy has a direct connection to the Rocky Reach Project switchyard and extends west where it is connected into Puget Sound Energy's system in its service area. The District also is interconnected at the Rocky Reach Project switchyard with Douglas PUD by a 230-kV line owned by Douglas PUD. The District's interconnections with Bonneville transmission are:

- (1) one 345-kV Bonneville line connected to the Rocky Reach System switchyard;
- (2) one 230-kV Bonneville line connected to the Rocky Reach System switchyard;
- (3) one 230-kV District-owned line connected to multiple Bonneville transmission lines at the Bonneville Columbia switching station;
- (4) two 115-kV District lines connected to the Bonneville transmission system at the Bonneville Valhalla substation; and
- (5) two 115-kV District transformers connected to the Bonneville transmission system at the Bonneville Valhalla substation to provide direct service to Alcoa.

Bonneville's transmission facilities interconnect with the British Columbia Hydro and Power Authority ("BC Hydro") in the Canadian province of British Columbia and with utilities in the Pacific Southwest of the United States. Bonneville's transmission system includes 360 substations, approximately 15,000 circuit miles of high voltage transmission lines and other related facilities. This transmission system provides about 75% of the Pacific Northwest's high-voltage bulk transmission capacity and serves as the main power grid for the Pacific Northwest. In addition to federal power, the major portion of the power produced from several nonfederal projects, including those of the District, is transmitted over Bonneville's transmission facilities to various investor-owned and publicly-

owned utilities in the Pacific Northwest. Bonneville routinely provides both long- and short-term transmission access to Pacific Northwest utilities for the purpose of wheeling power within the Pacific Northwest.

The Pacific Northwest-Pacific Southwest Intertie (the “Intertie”), which consists of a combination of AC and DC power lines, provides the primary bulk transmission link between the Pacific Northwest and the Pacific Southwest of the United States. Bonneville owns approximately 80% of the portions of the Intertie located north of California and Nevada. The Intertie consists of three high-voltage AC transmission lines with a combined capacity of about 4,800 MW and one high-voltage DC transmission line with a capacity of about 3,100 MW. Bonneville has developed a long-term Intertie access policy and conditions under which it allows nonfederal use of its portion of the Intertie.

## **Energy Northwest**

Energy Northwest is a municipal corporation and joint operating agency in the State of Washington. The membership of Energy Northwest consists of Washington public utility districts and cities. The District withdrew as a member of Energy Northwest in 1995 and subsequently rejoined as a member in 2003. The District is a purchaser of power from the Nine Canyon Wind Project, which is owned and operated by Energy Northwest. See “THE CONSOLIDATED SYSTEM—Consolidated System Energy Resources—Nine Canyon.”

Energy Northwest also owns and operates a nuclear electric generating project, Project No. 2 (“Project No. 2” or the “Columbia Generation Station”), with a net design electrical rating of 1,153 MW, which was placed in commercial operation in 1984. Energy Northwest also owns all or a portion of four other nuclear electric generating projects: Project No. 1 (“Project No. 1”) and Project No. 3 (“Project No. 3”), which were terminated by Energy Northwest in 1994; and Projects Nos. 4 and 5 (“Projects Nos. 4 and 5”), which also were terminated in 1982. Project Nos. 1, 2 and 3 are collectively referred to as the “Net Billed Projects.” Each of the foregoing projects (collectively, the “Energy Northwest Projects”) is financed and accounted for as a separate utility system, except for Projects Nos. 4 and 5, which were financed and accounted for as a single utility system separate and apart from all other Energy Northwest Projects. As of June 30, 2012, Energy Northwest had outstanding approximately \$5.49 billion aggregate principal amount of bonds issued for the Net Billed Projects. Energy Northwest (then known as the Washington Public Power Supply System) defaulted in 1983 on the approximately \$2.25 billion principal amount of bonds it issued in connection with Projects Nos. 4 and 5.

Bonneville acquired the capability of the Net Billed Projects pursuant to net billing agreements (the “Net Billing Agreements”) and, in the case of Project No. 1, exchange agreements with five investor-owned utilities. Bonneville was not a party to any of the agreements entered into in connection with the construction or financing of Projects Nos. 4 and 5. Under the Net Billing Agreements, the District purchased from Energy Northwest and, in turn, assigned to Bonneville the District’s 0.501% and 0.433% share of the capability of Project No. 1 and Energy Northwest’s ownership share of Project No. 3, respectively. The District is not a participant in Project No. 2.

Under the Net Billing Agreements, Bonneville is responsible for the District’s percentage share of the total annual cost of Projects Nos. 1 and 3, including debt service on revenue bonds issued to finance the cost of construction of such Net Billed Projects, whether or not such Net Billing Projects are completed, operable or operating and notwithstanding the suspension, reduction or curtailment of Net Billing Project output. As of June 30, 2012, revenue bonds outstanding for Projects Nos. 1 and 3 totaled approximately \$1.56 billion and \$1.49 billion, respectively. Notwithstanding the assignment of the District’s share of the capability of each Net Billed Project to Bonneville, the District remains unconditionally obligated to pay to Energy Northwest its share of the total annual cost of each Net Billed Project to the extent payments or credits relating to such annual cost are not received by Energy Northwest from Bonneville.

Under the Net Billing Agreements, payment by Bonneville to Energy Northwest of the District’s percentage share of the total annual cost of each Net Billed Project is made by a crediting arrangement whereby Bonneville credits, against amounts which the District owes Bonneville for the purchase of electric power and energy, operation and maintenance of facilities, use of transmission facilities and emerging and standby power, the District’s share of the total annual cost of each Net Billed Project. To the extent the District’s share of such annual cost exceeds amounts owed by the District to Bonneville, Bonneville is obligated, after certain assignment procedures, to pay the amount of such excess directly to the District or to Energy Northwest from funds legally available therefor. The District is obligated under its Net Billing Agreements to pay Energy Northwest (as a purchased power cost of the Distribution Division) the amounts credited or paid to the District by Bonneville.

## FINANCIAL INFORMATION

### General

Revenues from the District's sales of the surplus portion of its share of the energy produced by the District's three Hydro-Electric Projects on the wholesale market have generated substantial revenues for the Consolidated System, providing 45% of annual Distribution Division revenues in 2011 and 36% of annual Distribution Division revenues in 2010. These surplus revenues have allowed the District to keep rates to Distribution Division customers among the lowest in the nation. Comparable data for 2012 are not yet available.

Historically, given the traditional reliance of the Pacific Northwest on hydro-electric energy, there has been an inverse relationship between the level of water flows on the Columbia River and wholesale power prices. That is, when flows were comparatively high and hydro-generated energy comparatively plentiful, prices declined. When flows and therefore hydro-generated energy supply were comparatively low, wholesale prices increased. The net result has been that the District's revenues from sales of surplus energy on the wholesale market have remained relatively constant.

However, there has been a significant increase in the volatility of the volume of water and its monthly share that is available to use for generation as well as the price at the Mid-Columbia trading hub. Increasingly, market prices have shown a correlation with natural gas prices, which may or may not follow water volume. Variable energy generation, such as wind, is also affecting the market prices for electricity at the Mid-Columbia trading hub. For example, *negative* prices, in fact, result when wind is over-producing and other types of generation are required to satisfy "must run" requirements. Given the changes in the electric utility industry and power markets generally, and that hydro-electric energy is becoming a smaller portion of the over-all power supply in the Pacific Northwest, there is no assurance that the historical relationship between hydro-electric power supply and power prices will continue.

The District also has implemented an energy hedging strategy to help stabilize wholesale revenue in volatile markets and during low river flows. The District, as part of its ongoing strategic financial planning, expects to offset any material reduction in revenues from surplus power sales in any given year by maintaining its current strong cash reserve position, by retaining future periodic increases in revenues from surplus energy sales as an additional component of its cash reserves and, if necessary, by rate adjustments or surcharges. See "THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy" and "—Electric Rates; Other Rates."

Some financial data in this Remarketing Memorandum is provided as of December 31, 2011 because the District's audited financial statements for the fiscal year ended December 31, 2012 are not yet available. The District's audited financial statements and accompanying notes for the fiscal year ended December 31, 2011 are included in this Remarketing Memorandum in APPENDIX A. Certain preliminary unaudited financial and operating data as of September 30, 2012 have been provided for informational purposes; however, such data may not be indicative of actual year-end results. The District's financial statements have been prepared in conformity with generally accepted accounting principles applicable to governmental entities applied on a consistent basis. In addition, the information provided for the nine months ended September 30, 2012 reflects significant increases in wholesale power sales revenues in 2012 following the expiration of the Prior Power Sales Contracts and the commencement of deliveries under the Power Sales Contracts, under which a larger portion of the energy generated by the Rock Island and Rocky Reach Projects is available to the District for sale as surplus power in the wholesale market. See "FINANCIAL INFORMATION—Power Sales Revenues and District Near-Term Financial Outlook," "THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy," "—Puget Sound Energy Power Sales Contract" and "—Alcoa Power Sales Contract" and APPENDIX B—"PRELIMINARY UNAUDITED FINANCIAL DATA OF THE DISTRICT FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012."

### Management's Discussion of Distribution Division Financial Results

#### *General*

**Power Sales Contracts.** In February 2006 and July 2008, the District executed the Puget Contract and the Alcoa Contract, respectively. Deliveries under the Power Sales Contracts commenced on

November 1, 2011 for the Rocky Reach Project and July 1, 2012 for the Rock Island Project, after the expiration of the Prior Power Sales Contracts on October 31, 2011 and June 7, 2012, respectively. For a description of the Puget Contract, see “THE CONSOLIDATED SYSTEM—Puget Sound Energy Sales Contract” and APPENDIX I—“Summary of Power Sales Contract with Puget Sound Energy, Inc.” For a description of the Alcoa Contract, see “THE CONSOLIDATED SYSTEM—Alcoa Power Sales Contract” and APPENDIX J—“Summary of Power Sales Contract with Alcoa, Inc.”

**Master Resolution.** On March 12, 2007, the Commission adopted the Master Resolution. The Master Resolution was drafted in contemplation of the Power Sales Contracts with respect to the output from the Rock Island and Rocky Reach Projects. The Master Resolution has been revised from the form of the Senior Consolidated System Resolution with the primary intent of improving the covenants and provisions for the benefit of owners of the Bonds. The changes include the addition of flow-of-funds provisions, modification of the rate covenant and additional bonds test, the addition of a Rate Stabilization Fund, restrictions on the ability of the District to enter into take-or-pay power purchase agreements on a basis which is superior to the lien of the Bonds, and the addition of a third-party bond trustee. For a more detailed description of the Master Resolution, see “SECURITY FOR THE 2008B BONDS—and APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution.”

**Strategic Planning.** In September 2010, after several months of research and planning sessions, including customer surveys, focus group meetings and public meetings, the Commission approved the 2010 Strategic Plan, which incorporated new financial targets intended to put the District’s finances on a more reliable, sustainable path through 2014 and to serve as a foundation for longer-term financial health and growth, even under unusual water flow or power price conditions. The financial targets are intended to permit the District to obtain a sufficient rate of return on District assets, maintain acceptable debt service coverage ratios on the District’s outstanding indebtedness, gradually reduce the District’s debt ratio, and maintain adequate financial liquidity while paying down outstanding debt, building “rainy day” reserves and avoiding large, sudden rate adjustments. See “FINANCIAL INFORMATION—Strategic Planning” and “—Consolidated System Liquidity.”

### ***Distribution Division Results***

**General.** For the year ended December 31, 2011, the Distribution Division incurred a net gain of \$12.0 million compared to a net loss of \$13.9 million for the same period in 2010. The 2010 loss was primarily due to increased purchased power costs resulting from decreased generation at the District’s Hydro-Electric Projects as a result of lower-than-average river flows.

**Operating Revenues.** For the year ended December 31, 2011, Distribution Division operating revenues increased 21.5% compared to the same period in 2010. The increase is due primarily to greater wholesale non-firm power sales. The increase in non-firm sales is partially due to an increase in MW sold, but more importantly, due to a significant increase in price per MW. In 2010, operating revenues increased 7.5% from 2009, also due to significant increase in prices per MWh. Operating revenues in 2009 decreased 20.0% from operating revenues in 2008. During 2008 operating revenues decreased by 3.4% from 2007.

**Operating Expenses.** For the year ended December 31, 2011, Distribution Division operating expenses decreased 0.1% compared to the same period in 2010. Operating expenses in 2010 increased 7.9% compared to the same period in 2009. Operating expenses were higher due primarily to increased purchased power costs resulting from reduced generation at the District’s Hydro-Electric Projects due to lower-than-average river flows in 2010. In 2009, operating expenses decreased 8.4% from 2008. The decrease in 2009 was primarily the result of decreased purchased power costs. Operating expenses in 2008 increased 13% from 2007. The 2008 increase is primarily the result of an increase in purchased power costs.

**Balance Available for Distribution Division Debt Service.** The funds available from the Distribution Division’s operations increased \$28.6 million during 2011, due to higher generation causing decreased purchased power costs. The funds available from the Distribution Division’s operations decreased \$4.3 million during 2010, due to lower generation causing increased purchased power costs. The funds available from the Distribution Division’s operations decreased \$17.5 million in 2009 from 2008 due to decreased revenues caused by lower generation. Funds available in 2008 decreased by \$24.4 million from 2007 as the result of lower operating results.



**Preliminary Results for the Nine Months Ended September 30, 2012.** As of September 30, 2012, the Distribution Division has incurred a year-to-date net gain of \$28.7 million compared to a year-end net gain of \$12.0 million for 2011. For the nine months ended September 30, 2012, Distribution Division operating revenues were \$185.2 million (\$36.0 million greater than 2011 year-end operating revenues) and Distribution Division operating expenses were \$155.5 million (\$14.4 million greater than 2011 year-end operating revenues). The increase in operating revenues is primarily the result of the availability to the District of additional surplus energy for sale under the Power Sales Contracts and the locking in of higher prices on surplus energy through fixed price contracts as described above. Although the District's share of operating expenses is also higher under the Power Sales Contracts, net operating income for the nine months ended September 30, 2012 was \$29.7 million as compared to \$8.1 million for the year ended December 31, 2011. Over the nine months ended September 30, 2012, the funds available from Distribution Division operations for debt service had increased by \$11.7 million.

Table 11 below presents the actual statement of revenues and expenses of the Distribution Division for the years ended December 31, 2007 through 2011 and for the nine months ended September 30, 2012. The Distribution Division is part of the Consolidated System, but is accounted for separately. Table 12 on the following page presents the actual power production cost and power delivered from the Hydro-Electric Projects for the years ended December 31, 2007 through 2011 and for the nine months ended September 30, 2012. The information for fiscal years 2007 through 2011 has been extracted from the District's audited financial statements. The information provided for the nine months ended September 30, 2012 is unaudited and may not be indicative of actual year-end results. See "FINANCIAL INFORMATION--General."

**Table 11**  
**Consolidated System**  
**Distribution Division**  
**Statement of Revenues and Expenses**  
**(\$000)**

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>Nine Months Ended September 30, 2012</b>
Operating Revenues						
Retail	\$ 43,069	\$ 46,317	\$ 51,805	\$ 50,367	\$ 52,388	\$ 36,012
Resale <sup>(1)</sup>	103,708	94,000	60,862	70,943	94,000	141,400
Other <sup>(2)</sup>	1,255	2,619	1,615	1,511	2,791	7,822
Total	<u>148,032</u>	<u>142,936</u>	<u>114,282</u>	<u>122,821</u>	<u>149,179</u>	<u>185,234</u>
Operating Expenses <sup>(1)</sup>	<u>126,582</u>	<u>143,040</u>	<u>130,977</u>	<u>141,310</u>	<u>141,117</u>	<u>155,514</u>
Net Operating Revenue (loss)	21,450	(104)	(16,695)	(18,489)	8,062	29,720
Other Income (Expense)	<u>10,746</u>	<u>11,000</u>	<u>8,139</u>	<u>4,584</u>	<u>4,016</u>	<u>(1,049)</u>
Net Revenue (loss) <sup>(3)</sup>	<u>\$ 32,196</u>	<u>\$ 10,896</u>	<u>\$ (8,556)</u>	<u>\$ (13,905)</u>	<u>\$ 12,078</u>	<u>\$ 28,671</u>

<sup>(1)</sup> Includes contractual purchases and non-firm purchases for resale.

<sup>(2)</sup> Beginning November 1, 2011, the Distribution Division includes transmission revenues under new transmission agreements.

<sup>(3)</sup> Prior to changes in accounting principles, capital contributions and interfund equity transfers.

**Table 12**  
**Hydro-Electric Projects**  
**Power Cost and Net Power Delivered**  
**(\$000 other than for Cost in \$/MWh)**

	2007	2008	2009	2010	2011	Nine Months Ended September 30, 2012
<b>Rocky Reach System</b>						
Operating Expenses <sup>(1)</sup>	\$ 41,938	\$ 44,201	\$ 40,023	\$ 40,777	\$ 40,558	\$ 26,537
Debt Service: <sup>(2)</sup>						
Hydro Issues	1,564	1,553	1,948	2,633	2,628	-
Consolidated System Loans	33,814	34,680	29,942	33,021	33,381	-
Depreciation and Amortization <sup>(2)</sup>	-	-	-	-	-	12,706
Interest Expense <sup>(2)</sup>	-	-	-	-	-	12,100
Other Revenues <sup>(3)(4)</sup>	(4,498)	(4,795)	(1,410)	(1,448)	(2,172)	(595)
Total Power Cost <sup>(4)(5)</sup>	<u>\$ 72,818</u>	<u>\$ 75,639</u>	<u>\$ 70,053</u>	<u>\$ 74,983</u>	<u>\$ 74,395</u>	<u>\$ 50,748</u>
Net Power Delivered (000 MWh)	6,247	5,564	5,169	4,862	7,125	5,660
Cost in \$/MWh <sup>(4)</sup>	\$ 12	\$ 14	\$ 14	\$ 15	\$ 10	\$ 9
Plant Factor <sup>(6)</sup>	55%	49%	45%	43%	63%	66%
Availability Factor <sup>(7)</sup>	98%	98%	99%	91%	94%	95%
Average River Flow (000 CFS) <sup>(8)</sup>	111	103	91	89	141	143
<b>Rock Island System</b>						
Operating Expenses <sup>(1)</sup>	\$ 35,430	\$ 38,715	\$ 39,050	\$ 40,321	\$ 36,675	\$ 28,761
Debt Service: <sup>(2)</sup>						
Hydro Issues	22,577	22,594	22,971	23,560	23,055	-
Consolidated System Loans	12,435	16,335	17,446	19,134	19,492	-
Depreciation and Amortization <sup>(2)</sup>	-	-	-	-	-	7,790
Interest Expense <sup>(2)</sup>	-	-	-	-	-	20,316
Other Revenue <sup>(3)</sup>	(3,198)	(3,026)	(2,736)	(2,602)	(2,204)	(136)
Total Power Cost <sup>(5)</sup>	<u>\$ 67,244</u>	<u>\$ 74,618</u>	<u>\$ 76,731</u>	<u>\$ 80,413</u>	<u>\$ 77,018</u>	<u>\$ 56,731</u>
Net Power Delivered (000 MWh) <sup>(9)</sup>	2,796	2,721	2,572	2,496	3,267	2,616
Cost in \$/MWh	\$ 24	\$ 27	\$ 30	\$ 32	\$ 24	\$ 24
Plant Factor <sup>(6)</sup>	51%	50%	47%	45%	59%	63%
Availability Factor <sup>(7)</sup>	93%	94%	94%	90%	92%	91%
<b>Lake Chelan Project</b>						
Operating Expenses <sup>(1)</sup>	\$ 3,498	\$ 3,426	\$ 3,220	\$ 3,523	\$ 4,729	\$ 3,060
Debt Service: <sup>(2)</sup>						
Hydro Issues	-	-	-	-	-	-
Consolidated System Loans	2,336	3,816	6,552	7,402	7,138	-
Depreciation and Amortization <sup>(2)</sup>	-	-	-	-	-	1,385
Interest Expense <sup>(2)</sup>	-	-	-	-	-	3,039
Other (Revenue)/Expense <sup>(3)</sup>	(663)	(1,090)	(769)	(727)	(436)	193
Total Power Cost <sup>(5)</sup>	<u>\$ 5,171</u>	<u>\$ 6,152</u>	<u>\$ 9,003</u>	<u>\$ 10,198</u>	<u>\$ 11,431</u>	<u>\$ 7,677</u>
Net Power Delivered (000 MWh)	459	405	338	417	480	286
Cost in \$/MWh	\$ 11	\$ 15	\$ 27	\$ 24	\$ 24	\$ 27
Plant Factor <sup>(6)</sup>	109%	96%	80%	81%	93%	74%
Availability Factor <sup>(7)</sup>	99%	100%	68%	99%	98%	99%
<b>Combined Hydro Cost in \$/MWh</b>	<b>\$ 15</b>	<b>\$ 18</b>	<b>\$ 19</b>	<b>\$ 21</b>	<b>\$ 15</b>	<b>\$ 13</b>

<sup>(1)</sup> Does not include depreciation expense.

<sup>(2)</sup> Years 2007 through 2011 are based on accrual debt schedules. Prior to the expirations of the Prior Power Sales Contracts, most capital projects of the Large Hydro Systems were financed with proceeds of Rock Island Bonds or Rocky Reach Bonds (as applicable) and loans from the Consolidated System. Debt service on such bonds and loans was approximately equal to interest expense and depreciation. Following the commencement of deliveries under the Power Sales Contracts, the District expects to finance the majority of capital expenditures with cash.

<sup>(3)</sup> Includes other income and expenses that impact power cost.

<sup>(4)</sup> Year 2011 has been restated to reflect accounting changes following the effectiveness of the Power Sales Contracts as of November 1, 2011.

<sup>(5)</sup> Non-GAAP, may not be comparable with other similarly titled District metrics.

<sup>(6)</sup> Net power delivered as a percentage of rated capacity for the year.

<sup>(7)</sup> Years 2009 and 2010 have been restated to correct a data entry error.

<sup>(8)</sup> Annual average Columbia River flow measured at Rocky Reach Project in thousands of cubic feet per second (000 CFS).

<sup>(9)</sup> After minor sales to operators' cottages and adjustments for encroachment and Canadian Treaty deliveries.

## Debt Service Coverage

Table 13 below reflects the District's Consolidated System Operating Results and debt service coverage requirement under the Master Resolution for the fiscal years 2007 through 2011.

**Table 13**  
**Consolidated System**  
**Operating Results and Debt Service Coverage**  
**(\$000)**

	2007 <sup>(1)</sup>	2008	2009	2010	2011
<b>Operating Revenues<sup>(2)</sup></b>					
Retail <sup>(3)</sup>	\$ 47,145	\$ 50,671	\$ 56,572	\$ 54,989	\$ 57,195
Resale <sup>(4)</sup>	113,314	105,347	75,891	87,702	114,079
Other	18,130	20,172	17,555	18,088	18,792
Total	<u>178,589</u>	<u>176,190</u>	<u>150,018</u>	<u>160,779</u>	<u>190,066</u>
<b>Less: Operating Expenses</b>					
Purchased power and water	(89,941)	(104,720)	(95,200)	(104,265)	(101,787)
Other operation & maintenance	(45,331)	(48,154)	(45,018)	(44,730)	(50,785)
Taxes	(4,260)	(4,497)	(5,021)	(4,653)	(5,100)
Depreciation & amortization	(17,714)	(17,685)	(18,449)	(20,804)	(20,923)
<b>Operating Income (Loss)</b>	<u>21,343</u>	<u>1,134</u>	<u>(13,670)</u>	<u>(13,673)</u>	<u>11,471</u>
<b>Adjustments<sup>(5)</sup></b>					
Add back depreciation & amortization	17,714	17,685	18,449	20,804	20,923
Add investment income	17,915	14,659	8,191	5,405	7,040
Add principal and interest payments from Rocky Reach & Rock Island	44,734	48,870	47,247	51,003	51,888
Less investment earnings credited to Rocky Reach & Rock Island <sup>(6)</sup>	<u>(4,120)</u>	<u>(3,438)</u>	<u>(1,102)</u>	<u>(1,171)</u>	<u>(892)</u>
Total Adjustments	76,243	77,776	72,785	76,041	78,959
<b>Net Revenues<sup>(7)</sup></b>	97,586	78,910	59,115	62,368	90,430
Plus withdrawals (deposits) to Rate Stabilization Fund	-	-	-	-	-
<b>Adjusted Net Revenues</b>	<u>\$ 97,586</u>	<u>\$ 78,910</u>	<u>\$ 59,115</u>	<u>\$ 62,368</u>	<u>\$ 90,430</u>
<b>Available Funds<sup>(8)</sup></b>	<u>\$128,467</u>	<u>\$172,832</u>	<u>\$159,605</u>	<u>\$151,781</u>	<u>\$147,990</u>
<b>Annual Debt Service</b>					
Senior Consolidated System Bonds	\$ 45,836	\$ 39,451	\$ 31,084	\$ 28,817	\$ 34,229
Bonds	915	7,893	10,903	13,237	14,470
Total Debt Service	<u>\$ 46,751</u>	<u>\$ 47,344</u>	<u>\$ 41,951</u>	<u>\$ 42,054</u>	<u>\$ 48,699</u>
<b>Debt Service Coverage</b>					
With available funds (min. 1.25x)	4.84	5.32	5.21	5.09	4.90
Without available funds (min. 1.00x)	2.09	1.67	1.41	1.48	1.86

(1) Year 2007 is restated to reflect clarification to the definitions under the Master Resolution.

(2) Includes revenues of the District's Distribution Division, Financing Facilities, Treasury Services and Internal Service Funds, and Lake Chelan, Fiber and Telecommunications System, Water and Wastewater Systems, all of which are part of the Consolidated System.

(3) Includes retail sales from the District's Distribution Division, Water and Wastewater Systems.

(4) Includes resale sales from the District's Distribution Division, Financing Facilities and Treasury Services Funds, and Lake the Chelan and Fiber and Telecommunications Systems.

(5) As determined pursuant to the definition of Revenues in the Master Resolution.

(6) Year 2007 has been restated to include investment earnings credited back to the Rocky Reach and Rock Island Systems.

(7) As defined in the Master Resolution; not comparable with other similarly titled District metrics.

(8) As defined in the Master Resolution. Includes all unencumbered funds of the District that the District reasonably expects to be available to pay debt service on the Senior Consolidated System Bonds and the Bonds.

## Power Sales Revenues and District Near-Term Financial Outlook

The Consolidated System purchases power from the Rock Island and Rocky Reach Projects (as an operating expense of the Consolidated System) for sale to its retail customers through the Distribution Division. The power from the Hydro-Electric Projects, including the Lake Chelan Project, and not allocated for the District's own retail load is sold:

- (a) on a cost-of-service "plus" basis under long-term contracts with an investor-owned utility and a large industrial purchaser;
- (b) on a cost-of-service basis under a long-term contract with another public utility district;
- (c) under fixed-price wholesale market-based slice contracts, each for a fixed percentage of output, with purchasers selected through an annual competitive auction process and with staggered terms of up to five years, consistent with the District's hedging strategy;
- (d) under fixed-price wholesale market-based block contracts, each for a fixed amount of output, with purchasers selected based on market price and credit and liquidity profiles and with varied terms from within the current year plus up to an additional 60 months, consistent with the District's hedging strategy; and
- (e) as short-term surplus power at wholesale market prices to meet the District's "day-ahead" forecast.

Prior to November 1, 2011 with respect to the Rocky Reach Project and prior to June 8, 2012 with respect to the Rock Island Project, power from the Rocky Reach and Rock Island Projects, excluding an amount allocated for the District's own retail load, was sold on a cost-of-service basis pursuant to long-term contracts with a number of investor-owned utilities, another public utility district and a large industrial purchaser and into the wholesale market. The power from the Rock Island and Rocky Reach Projects delivered under the Puget Contract and the Alcoa Contract is sold on a cost-of-service "plus" basis to Puget Sound Energy and Alcoa. The balance of the power from the Rock Island and Rocky Reach Projects and not allocated for the District's own retail load may be sold as surplus power in the wholesale market as described in (c) through (e) above. Following the expiration of the Prior Power Sales Contracts and the commencement of deliveries under the Power Sales Contracts, the District anticipates recognizing significantly improved wholesale power sales revenues beginning in 2012 as a result of contract terms that are more favorable to the District and the availability to the District of a larger portion of the energy generated by the Rock Island and Rocky Reach Projects for sale as surplus power in the wholesale market (which has increased from approximately 130 aMW under the Prior Power Sales Contracts to approximately 330 aMW under the Power Sales Contracts). See "THE CONSOLIDATED SYSTEM—Puget Sound Energy Sales Contract" and "—Alcoa Power Sales Contract" and APPENDIX I—"Summary of Power Sales Contract with Puget Sound Energy, Inc." and APPENDIX J—"Summary of Power Sales Contract with Alcoa, Inc." The District is recognizing significant increases in wholesale power sales revenues in 2012, and as of September 30, 2012, the District estimated net revenues from sales of surplus power in 2013 of between \$98.4 million and \$125.6 million, resulting in a range in change of net position from an increase of \$62.3 million to an increase of \$89.3 million in 2013. These estimates have not changed substantially since September 30, 2012, and the District also estimates similar results in the three fiscal years thereafter. Actual results will depend upon a variety of factors, many of which are beyond the control of the District, including energy prices in the wholesale markets, general economic conditions, precipitation and snowpack in the Columbia River watershed, regional weather conditions and the price of natural gas for other generating facilities in the region. See also "THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy."

In 2011 and 2010, the sales of surplus power generate substantial revenues for the District's Consolidated System, providing 45% and 36% of annual Distribution Division revenues, respectively. The District's combined financial results for the nine months ended September 30, 2012 have improved compared to the same period in 2011. The increase is due primarily (i) to the transition from cost-of-service to cost-of-service "plus" based long-term contracts as described above, (ii) to the locking in higher prices on surplus energy through fixed price contracts as described above and (iii) to the availability to the District of additional surplus energy for sale under the Power Sales Contracts. Although the District's share of operating expenses is also higher under the Power Sales Contracts, combined District net operating income for the nine months ended September 30, 2012 was \$91.1 million as compared to \$41.7 million for the nine months ended September 30, 2011. See APPENDIX B – "PRELIMINARY

### **Strategic Planning**

In September 2010, after several months of research and planning sessions, including customer surveys, focus group meetings and public meetings, the Commission approved a revised strategic plan (the “2010 Strategic Plan”), which incorporated new financial targets adopted in June 2010, intended to put the District’s finances on a more reliable, sustainable path through 2014 and to serve as a solid foundation for longer-term financial health and growth, even under unusual water flow or power price conditions. The financial targets are intended to permit the District to obtain a sufficient rate of return on District assets, maintain acceptable debt service coverage ratios on the District’s outstanding indebtedness, gradually reduce the District’s debt ratio, and maintain adequate financial liquidity while paying down outstanding debt, building “rainy day” reserves and avoiding large, sudden rate adjustments. As part of its 2010 Strategic Plan, the District has adopted targets with respect to its debt ratio, debt coverage, rates of return on District assets and liquidity. Since the adoption of the 2010 Strategic Plan, the District has made significant progress towards meeting its established financial targets. During 2012, the District continued to focus on increasing efficiency and sustainability to better position the District to meet any long-term challenges. In 2013, the District intends to make it a priority to extend beyond 2014 the planning horizon under the 2010 Strategic Plan.

The District determines its debt ratio based on (i) total debt, divided by (ii) total debt plus net position (on a combined basis). The District currently has a debt ratio target of 60% by 2015. The District can achieve this target by making regularly scheduled payments on its existing Consolidated System, Rock Island System and Rocky Reach System indebtedness, including on the 2008B Bonds. The District may also retire some of its outstanding Senior Consolidated System Bonds, Bonds and Subordinate Consolidated System Obligations ahead of their scheduled maturity dates. See Table 14, “Senior Consolidated System, Consolidated System, Subordinate Consolidated System and Large Hydro Systems Outstanding Long-Term Indebtedness.” The District currently does not anticipate issuing any new Consolidated System indebtedness to finance capital requirements of the Consolidated System or the Large Hydro Systems through at least 2017. Instead, the District anticipates funding any such capital requirements with available funds of the District. See “FINANCIAL INFORMATION—Capital Requirements. The District intends to continue monitoring its outstanding Consolidated System debt for refunding opportunities.

As part of the 2010 Strategic Plan, the District has also adopted targets with respect to debt service coverage. The combined debt service coverage target (the “Combined Debt Service Coverage Target”) is determined taking into account all of the District’s outstanding indebtedness and the individual coverage requirements set forth in the various resolutions of the District pursuant to which it issues debt. The District’s current Combined Debt Service Coverage Target beginning in 2012 is 2.25x. For a discussion of the required Bond Coverage Ratio for the Bonds, see “SECURITY FOR THE 2008B BONDS—Rate Covenant.”

The District has also adopted targets with respect to the rate of return (the “Rate of Return”) on the District’s assets. The Rate of Return is the change in the District’s net position divided by the net utility plant (on a combined basis). The District’s current annual target range for Rate of Return is between 4% and 6%.

Consistent with the 2010 Strategic Plan, on January 24, 2011, the Commission adopted Resolution No. 11-13616 to establish a financial policy to maintain a minimum reserve of \$150 million of “primary liquidity,” consisting of unrestricted cash and investments of the District, and a minimum reserve of \$175 million of “total liquidity,” including the minimum of \$150 million of “primary liquidity” and additional “secondary liquidity,” consisting of other internal District sources of funds, such as certain Rock Island and Rocky Reach System funds, if available, and general bank lines, letters of credit or other similar instruments. The District has established targets for “total liquidity” through 2016 based on a detailed liquidity requirements methodology that takes into account the District’s current policy to have in place readily available operating reserves, contingency reserves and planning reserves to address certain costs or events, including, among other things, operating and maintenance expenses for a specified period, potential collateral requirements associated with its electricity hedging policies and capital requirements. As of September 30, 2012, the District’s “total liquidity” targets for 2012 through 2016 based on the liquidity requirements methodology were \$192 million, \$196 million, \$176 million, \$188 million and \$175 million, respectively.

On April 1, 2011, the District and Bank of America entered into the Credit Agreement with an available commitment of \$50 million, which is part of the District's secondary liquidity under the District's financial policy. The District may either draw on the Credit Agreement directly or request that Bank of America issue a letter of credit. The District may use the proceeds of any draws on the Credit Agreement or on any letters of credit issued under the Credit Agreement to (i) to satisfy any collateral requirements of the District in connection with any electricity hedges, (ii) to make swap termination payments, or (iii) upon receipt of the prior written consent of Bank of America (which consent may not be unreasonably withheld), for other general purposes of the District. The initial term of the Credit Agreement expires on April 1, 2014, but the term may be extended for up to an additional three years. The District's obligations under the Credit Agreement are payable from and secured by a pledge of Revenues subordinate to the lien and pledge thereon of the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations, to make required debt service reserve fund deposits with respect thereto, and to make regularly scheduled Payment Agreement Payments. As of February \_\_, 2013, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit, and the District currently does not anticipate making any such draws or requests. See "FINANCIAL INFORMATION—Consolidated System Liquidity."

### **Outstanding Debt**

Table 14 on the following page presents long-term debt of the District's Consolidated System, Rock Island System and the Rocky Reach System payable from Revenues of the Consolidated System, revenues of the Rock Island System and revenues of the Rocky Reach System, respectively, outstanding as of December 31, 2012. The information in Table 14 is based on unaudited information and is subject to year-end adjustment.

Table 14 does not reflect the optional redemption of \$23,565,000 principal amount of 2008B Bonds on February 6, 2013.

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**Table 14**  
**Senior Consolidated System, Consolidated System, Subordinate Consolidated System**  
**and**  
**Large Hydro-Systems**  
**Outstanding Long-Term Debt as of December 31, 2012**  
**(\$000)**

<b>Date of Bonds</b>	<b>Final Maturity Date</b>	<b>Series of</b>	<b>Original Principal Amount</b>	<b>Scheduled Retirement<sup>(1)</sup></b>	<b>Actual Retirement<sup>(2)</sup></b>	<b>Principal Amount Outstanding</b>	<b>Accumulated for Retirement<sup>(3)</sup></b>
<b>SENIOR CONSOLIDATED SYSTEM</b>							
4/29/2004	7/1/2024	2004C <sup>(4)</sup>	\$ 15,000	\$ -	\$ -	\$ 15,000	\$ 7,500
4/5/2005	1/1/2039	2005A <sup>(4)</sup>	25,430	-	-	25,430	6,358
<b>Total Senior Consolidated System</b>			<u>\$ 40,430</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 40,430</u>	<u>\$ 13,858</u>
<b>CONSOLIDATED SYSTEM</b>							
5/31/2007	7/1/2042	2007B	\$ 8,370	\$ -	\$ -	\$ 8,370	\$ 418
5/31/2007	7/1/2037	2007C	25,590	2,265	2,265	23,325	1,239
2/28/2008	7/1/2024	2008A	47,075	4,060	4,060	43,015	15,342
3/7/2008	7/1/2032	2008B <sup>(5)</sup>	92,880	4,065	4,065	88,815	3,491
8/11/2009	7/1/2019	2009C	6,545	1,660	1,660	4,885	243
8/11/2009	7/1/2039	2009D	27,015	-	-	27,015	1,800
6/1/2011	7/1/2026	2011A	107,500	7,380	7,380	100,120	5,244
6/1/2011	7/1/2026	2011B	72,220	4,960	4,960	67,260	3,377
11/9/2011	7/1/2026	2011C	164,425	6,000	6,000	158,425	5,351
<b>Total Consolidated System</b>			<u>\$ 551,620</u>	<u>\$ 30,390</u>	<u>\$ 30,390</u>	<u>\$ 521,230</u>	<u>\$ 36,505</u>
<b>SUBORDINATE CONSOLIDATED SYSTEM</b>							
7/22/2009	7/1/2014	2009A <sup>(6)</sup>	\$ 20,630	\$ -	\$ -	\$ 20,630	\$ 1,355
7/22/2009	7/1/2014	2009B <sup>(6)</sup>	8,340	-	-	8,340	527
<b>Total Subordinate Consolidated System</b>			<u>\$ 28,970</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 28,970</u>	<u>\$ 1,882</u>
<b>ROCK ISLAND SYSTEM</b>							
3/17/1997	6/1/2029	1997A <sup>(7)</sup>	\$ 135,944	\$ 76,450	\$ 76,450	\$ 252,659	\$ 32,026
8/11/2009	7/1/2034	2009A	14,000	1,025	1,025	12,975	608
<b>Total Rock Island System</b>			<u>\$ 149,944</u>	<u>\$ 77,475</u>	<u>\$ 77,475</u>	<u>\$ 265,634</u>	<u>\$ 32,634</u>
<b>ROCKY REACH SYSTEM</b>							
12/4/2008	7/1/2014	2008A	\$ 7,415	\$ 4,585	\$ 4,585	\$ 2,830	\$ 268
8/11/2009	7/1/2034	2009A	15,895	1,050	1,050	14,845	764
<b>Total Rocky Reach System</b>			<u>\$ 23,310</u>	<u>\$ 5,635</u>	<u>\$ 5,635</u>	<u>\$ 17,675</u>	<u>\$ 1,032</u>
<b>Grand Total</b>			<u>\$ 794,274</u>	<u>\$ 113,500</u>	<u>\$ 113,500</u>	<u>\$ 873,939</u>	<u>\$ 85,911</u>

<sup>(1)</sup> Amount of serial bonds matured as of December 31, 2012 plus scheduled minimum redemption of term bonds to have been retired from mandatory sinking funds.

<sup>(2)</sup> Amount of serial bonds matured as of December 31, 2012 plus actual retirement of term bonds retired from mandatory sinking funds, reserve accounts and optional purchases

<sup>(3)</sup> Amounts accumulated as cash and investments in various principal accounts, sinking funds and reserve accounts available for the future retirement of bonds. Investments are represented at book value.

<sup>(4)</sup> The 2004C Bonds are subject to mandatory tender for purchase on July 1, 2014 and the 2005A Bonds are subject to mandatory tender for purchase on July 1, 2015 upon the expiration of their respective current fixed-term interest rate periods. The District intends to retire such bonds at that time; however, the District may elect to remarket some or all such Senior Consolidated System Bonds in new interest rate periods.

<sup>(5)</sup> Does not reflect the redemption of \$23,565,000 principal amount of 2008B Bonds optionally redeemed on February 6, 2013.

<sup>(6)</sup> Represents Subordinate Consolidated System Obligations that mature in whole on July 1, 2014 with semi-annual interest payments. These Subordinate Consolidated System Obligations are not subject to redemption prior to maturity.

<sup>(7)</sup> Represents capital appreciation bonds on which interest is compounded. Thus, the accreted value reported as "Amount Outstanding" may exceed "Original Principal Amount" less "Actual Retirements."

Source: The District.

## **Interfund and Intersystem Loans**

### ***Interfund Loans***

The District established an Internal Service Fund to account for and allocate the cost of facilities and services that are used jointly by separate systems and divisions of the District. The Distribution Division, the Lake Chelan Project, the Water System, the Wastewater System and the Fiber and Telecommunications System are all accounted for separately, although they are all part of the Consolidated System. Proceeds of the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations have been advanced to these separate systems and divisions through interfund loans. As all of these interfund loans are within the Consolidated System, however, they have no effect on the Revenues of the Consolidated System and are for internal accounting purposes only.

### ***Intersystem Loans to the Rock Island and Rocky Reach Systems***

The District adopted the Loan Resolutions to provide for lending a portion of the proceeds of the Senior Consolidated System Bonds and the Bonds to the Rocky Reach System and the Rock Island System, respectively, and the repayment of those loans by such Large Hydro Systems to the Consolidated System. Each loan to the Large Hydro Systems is repaid through periodic principal and interest payments made from the respective Large Hydro System to the Consolidated System.

The obligations of the Rocky Reach System and the Rock Island System to make loan payments to the Consolidated System are subordinate to the obligation of such Large Hydro Systems to pay operation and maintenance expenses and debt service on revenue bonds payable from revenues of such Large Hydro Systems. The loan payments made by the Large Hydro Systems to the Consolidated System are part of the total costs of those Large Hydro Systems payable by the respective purchasers of power from the Large Hydro Systems, including the District's Distribution Division. The payments made by the Consolidated System's Distribution Division to the respective Large Hydro Systems for such power constitute a purchased power cost, and thus an operating expense, of the Distribution Division. As such, under the Master Resolution, these purchased power costs are payable prior to debt service on the Senior Consolidated System Bonds and the Bonds.

The revenues of the Rocky Reach System and the Rock Island System do not constitute Revenues of the Consolidated System and are not pledged to secure the payment of the Senior Consolidated System Bonds or the Bonds, including the 2008B Bonds; however, the loan repayments made from those revenues to the Consolidated System do constitute Revenues of the Consolidated System and are available to pay the principal and purchase price of and premium, if any, and interest on the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations.

### ***Other Intersystem Obligations***

The District currently has a number of other intersystem obligations, accounts receivable, accounts payable and rental arrangements in place. The Rock Island System, Rocky Reach System and Consolidated System (including its Internal Service Fund) pay for the use of equipment and facilities of the other systems.

Table 15 on the following page presents a summary of the outstanding intersystem loans as of December 31, 2012 to the Rocky Reach and Rock Island Systems and the interfund loans to funds and components of the Consolidated System. The information in Table 15 is based on unaudited information and is subject to year-end adjustment.



**Table 15**  
**Consolidated System Loans**  
**as of December 31, 2012**  
**(\$000)**

	<b>Allocated Principal Amount of Bonds Outstanding<sup>(1)</sup></b>	<b>Adjustments to Loans Outstanding<sup>(2)</sup></b>	<b>Net Loans Outstanding</b>
Rocky Reach System	\$ 223,151	\$ 14,049	\$ 237,200
Rock Island System	149,273	(1,423)	147,850
Consolidated System <sup>(3)</sup>	218,206	(92,790)	125,416
<b>Total</b>	<b>\$ 590,630</b>	<b>\$ (80,164)</b>	<b>\$ 510,466</b>

<sup>(1)</sup> Represents aggregate principal amounts of Senior Consolidated System Bonds, Bonds and Subordinate Consolidated System Obligations allocated to intersystem and interfund loans.

<sup>(2)</sup> Consists primarily of prior loan repayments. Also includes adjustments for unamortized original issue discounts, issuance costs and amounts payable to and (receivable) from other systems.

<sup>(3)</sup> Includes bond proceeds advanced to various funds and components of the Consolidated System for capital purposes.

Source: *The District*.

### **Annual Debt Service**

Table 16 on the following page shows aggregate annual debt service on all outstanding Senior Consolidated System Bonds, Bonds and Subordinate Consolidated System Obligations as of December 31, 2012.

Table 16 also shows the aggregate annual loan payments from the Rock Island and Rocky Reach Systems to the Consolidated System with respect to outstanding intersystem loans to those Large Hydro Systems from the Consolidated System as of December 31, 2012. See “—Interfund and Intersystem Loans” under this heading. The total amount of such loan payments through 2044 is equal to 91% of aggregate annual debt service on the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations over the same period. The loan payments to the Consolidated System will be made by the respective Large Hydro Systems from payments received from the respective purchasers of power from those Systems, including the District’s Distribution Division. The Prior Power Sales Contracts pursuant to which such loan payments previously were made by the power purchasers expired in 2011 and 2012, respectively; however, a similar payment obligation continues under both of the Power Sales Contracts and is expected to be included in any future such contracts with other parties. See “THE CONSOLIDATED SYSTEM—Puget Sound Energy Sales Contract” and “—Alcoa Power Sales Contract.”

**Table 16**  
**Senior Consolidated System, Consolidated System and Subordinate Consolidated System Debt Service and**  
**Large Hydro System Loan Payments**  
**as of December 31, 2012**

Year	Senior Consolidated System Bonds, Bonds and Subordinate Consolidated System Obligations			Large Hydro System Annual Loan Payments <sup>(1)</sup>		
	Aggregate Annual Debt Service			Rocky Reach	Rock Island	Total Loan Payments
	Principal <sup>(2)</sup>	Interest <sup>(3)</sup>	Total			
2013	\$ 15,200,000 <sup>(4)</sup>	\$ 22,643,695	\$ 37,843,695	\$ 30,449,522	\$ 18,609,909	\$ 49,059,431
2014	84,732,990 <sup>(4)</sup>	22,179,332	106,912,322	30,802,564	18,939,194	49,741,758
2015	47,820,000 <sup>(4)</sup>	18,120,937	65,940,937	30,852,463	17,817,875	48,670,338
2016	17,855,000 <sup>(4)</sup>	16,092,983	33,947,983	30,404,740	16,395,606	46,800,346
2017	43,790,000 <sup>(4)</sup>	15,375,679	59,165,679	29,214,359	16,131,129	45,345,488
2018	28,855,000	14,391,558	43,246,558	22,110,177	14,823,818	36,933,995
2019	32,832,400	13,302,948	46,135,348	19,884,836	14,640,997	34,525,833
2020	32,405,000	12,024,951	44,429,951	18,682,912	14,704,160	33,387,072
2021	29,000,000	10,732,500	39,732,500	16,995,034	13,966,042	30,961,076
2022	30,290,000	9,532,044	39,822,044	16,995,986	13,784,472	30,780,458
2023	31,695,000	8,234,023	39,929,023	16,928,190	13,778,138	30,706,328
2024	30,788,183	6,812,688	37,600,871	16,872,091	13,305,762	30,177,853
2025	34,840,000	5,303,174	40,143,174	14,732,661	12,851,979	27,584,640
2026	22,533,353	3,744,526	26,277,879	13,050,225	12,792,367	25,842,592
2027	2,930,000	2,059,260	4,989,260	11,627,056	12,791,571	24,418,627
2028	3,875,000	1,958,477	5,833,477	10,208,263	13,409,100	23,617,363
2029	2,345,000	1,854,454	4,199,454	8,878,935	8,566,986	17,445,921
2030	2,450,000	1,748,606	4,198,606	7,463,981	9,899,917	17,363,898
2031	2,565,000	1,635,821	4,200,821	6,054,618	9,387,546	15,442,164
2032	44,209,442	1,443,452	45,652,894	4,803,146	8,249,877	13,053,023
2033	2,800,000	1,245,779	4,150,004	4,045,779	8,193,662	12,414,294
2034	2,930,000	1,116,864	4,046,864	3,961,897	8,345,171	12,307,068
2035	3,065,000	986,615	4,051,615	2,638,751	7,726,901	10,365,652
2036	3,195,000	850,364	4,045,364	1,388,256	7,567,744	8,956,000
2037	2,101,027	708,335	2,809,362	289,191	7,303,721	7,592,912
2038	1,905,000	559,859	2,464,859	289,191	6,488,326	6,777,517
2039	194,940	474,457	669,397	146,202	3,091,288	3,237,490
2040	-	385,020	385,020	-	1,033,001	1,033,001
2041	-	385,020	385,020	-	928,704	928,704
2042	7,951,826	385,020	8,336,846	-	649,708	649,708
2043	-	-	-	-	410,126	410,126
2044	-	-	-	-	19,601	19,601
<b>Total</b>	<b>\$565,154,161</b>	<b>\$196,288,442</b>	<b>\$761,442,603</b>	<b>\$369,945,879</b>	<b>\$326,604,398</b>	<b>\$696,550,277</b>

<sup>(1)</sup> Represents loan payment obligations of the Large Hydro Systems to the Consolidated System with respect to intersystem loans from the Consolidated System.

<sup>(2)</sup> Includes serial and balloon payments reduced by funds held in Debt Service Reserve Accounts at the time of final maturity. The District may elect to utilize the Debt Service Reserve Accounts other than as assumed depending on market conditions and limitations contained in the governing resolutions. The District anticipates that most balloon payments will be made as scheduled on or prior to the dates they become due; however the District may elect to refinance balloon payments.

<sup>(3)</sup> Interest is net of Build America Bond (BAB) direct payment federal subsidy for certain Bonds.

<sup>(4)</sup> Includes scheduled mandatory sinking fund redemptions of the 2008B Bonds. The District intends to apply the principal amount of the 2008B Bonds optionally redeemed on February 6, 2013 against such mandatory sinking fund redemptions. See "DESCRIPTION OF THE 2008B BONDS—2008B Bonds During a Weekly Interest Rate Period—*Redemption of 2008B Bonds.*"

Source: The District.

## Capital Requirements

The District has prepared projections of the capital requirements for the five-year period 2013 through 2017. These projections are in accordance with the District's best estimates and long-range planning. As such, some anticipated projects are still undergoing feasibility studies. The District periodically reviews its capital improvement program and modifies it as appropriate to reflect changing conditions. As a result, amounts currently forecasted for the future are subject to modification as the Commission directs. Table 17 below presents the District's projected capital requirements, based on expenditure levels relative to budget which are consistent with prior experience.

**Table 17**  
**Consolidated System and Large Hydro Systems**  
**Projected Capital Requirements**  
**(\$000)**

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Distribution Division	\$ 16,709	\$ 15,109	\$ 17,029	\$ 23,298	\$ 14,303
Fiber and Telecommunications System	1,742	2,345	2,275	2,465	1,306
Water/Wastewater Systems	651	928	1,592	2,945	2,956
Internal Service System	9,095	8,758	1,924	5,573	3,282
Rocky Reach System	8,571	14,246	12,230	8,386	3,046
Rock Island System	4,541	7,853	8,720	13,502	15,138
Lake Chelan Project	100	357	1,928	2,467	2,079
Total Capital Requirements	<u>\$ 41,409</u>	<u>\$ 49,596</u>	<u>\$ 45,698</u>	<u>\$ 58,636</u>	<u>\$ 42,110</u>

The District focus for Distribution Division capital improvements continues to be on replacement programs such as underground cable replacements and line improvements. Major planned capital improvements for the Distribution Division also include transmission reliability and compliance upgrades and substation upgrades and replacements, such as rebuilding a substation in Cashmere beginning in 2014 and, if growth remains at current rates, building a new substation in Wenatchee. Major planned expenditures also include replacing two mobile substations, one in 2013 and one in 2016. Internal Service System projects include upgrades and replacements for trunked radio communication sites and equipment, information technology services and hardware and vehicles/equipment purchases. Both Rock Island System and Rocky Reach System capital projects include upgrading and replacing generator control and monitoring equipment. Additional Rocky Reach System capital projects include upgrading parks as required by the Rocky Reach Project license and upgrading crane systems and controls. The District is monitoring changes to FERC's dam safety regulations, including to its Seismic Design Standards. At this time, the District cannot predict what impact any such changes will have on the District's capital requirements although such impact may be significant.

Table 18 below presents the projected amounts and sources of funds for the Consolidated System, the Rocky Reach System and the Rock Island System based on the capital requirements set forth in Table 17 above.

**Table 18**  
**Consolidated System and Large Hydro Systems**  
**Projected Sources of Funds**  
**(\$000)**

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Proceeds of New Bond Issues	\$ -	\$ -	\$ -	\$ -	\$ -
Other Available Funds <sup>(1)</sup>	41,409	49,596	45,698	58,636	42,110
Total	<u>\$ 41,409</u>	<u>\$ 49,596</u>	<u>\$ 45,698</u>	<u>\$ 58,636</u>	<u>\$ 42,110</u>

<sup>(1)</sup> Includes other internal funds such as revenue fund cash, unspent proceeds of prior bond issues, contributions in aid of construction, and intersystem loan obligations. Also includes additional amounts available under the Power Sales Contracts, including Debt Reduction Charges and Capital Recovery Charges paid by the Power Purchasers and the District's Distribution Division and available for subsequent use by the Rock Island and Rocky Reach Systems.

### *Financing Capital Improvements*

The District intends to fund the majority, if not all, of its renewals, replacements, improvements and additions to plant from non-debt related sources for the next five-year period. Projected sources of funds include net revenues, contributions in aid of construction, grants, additional amounts available under the Power Sales Contracts and other accumulated cash held by the District.

### **Consolidated System Liquidity**

The District currently maintains a high level of liquidity, including the amounts held in the funds of the District set forth in Table 19 below, which presents various fund balances for the Consolidated System as of September 30, 2012. The information in Table 19 is based on unaudited information.

**Table 19**  
**Consolidated System**  
**Unrestricted and Restricted Fund Balances<sup>(1)</sup>**  
**as of September 30, 2012**  
**(\$000)**

	<b>Utility Services<sup>(2)</sup></b>	<b>Lake Chelan Project</b>	<b>Financing Facilities<sup>(3)</sup></b>	<b>Internal Service Fund</b>	<b>Total</b>
Unrestricted Funds					
Revenue Fund <sup>(4)</sup>	\$ 26,303	\$ 799	\$ 2,273	\$ 10,936	\$ 40,311
Available Funds:					
Rate Stabilization Fund	50,000	-	-	-	50,000
Operating Reserve Fund	57,729	-	-	-	57,729
Contingency Reserve Fund	9,954	-	-	-	9,954
Other Unrestricted Funds: <sup>(5)</sup>	2,414	7,556	47,848	7,082	64,900
Total Unrestricted Funds	<u>146,400</u>	<u>8,355</u>	<u>50,121</u>	<u>18,018</u>	<u>222,894</u>
Restricted Funds <sup>(6)</sup>	<u>61,518</u>	<u>309</u>	<u>42,625</u>	<u>6,026</u>	<u>110,478</u>
Total Fund Balances	<u>\$ 207,918</u>	<u>\$ 8,664</u>	<u>\$ 92,746</u>	<u>\$ 24,044</u>	<u>\$ 333,372</u>

<sup>(1)</sup> Amounts reflect both cash and book value of investments.

<sup>(2)</sup> Includes Distribution Division, Fiber and Telecommunications, Water and Wastewater Systems and Treasury Services Fund.

<sup>(3)</sup> Financing Facilities is an internal service fund of the District's Consolidated System used to account for various financing related activities, including holding Consolidated System debt service reserve funds.

<sup>(4)</sup> Unencumbered funds of the District held in the Revenue Fund.

<sup>(5)</sup> Includes all other Unrestricted Funds such as Board Designated Construction Funds and Reserves.

<sup>(6)</sup> Includes all Restricted Funds such as Consolidated System Bond Proceeds, Bond Reserves and other Reserves.

Source: *The District.*

The "Rate Stabilization Fund" was established by the District for the purpose of stabilizing rates and charges for retail customers of the Distribution Division. See "SECURITY FOR THE 2008B BONDS—Rate Stabilization Fund."

The "Operating Reserve Fund" was established for the purpose of mitigating unexpected fluctuations in revenues and operating expenses of the Consolidated System. See "SECURITY FOR THE 2008B BONDS—Operating Reserve Fund."

The "Contingency Reserve Fund" was established by the District to provide a special reserve account for emergency operating conditions and liquidity for the District's Consolidated System bonds. The District's current goal is to maintain this fund at \$10 million.

The District has established a governing financial policy to maintain a minimum of \$150 million of unrestricted reserves and a minimum of \$175 million of total reserves, in accordance with Resolution No. 11-13616, adopted by the Commission on January 24, 2011. See "FINANCIAL INFORMATION—Strategic Planning."

On April 1, 2011, the District and Bank of America entered into the Credit Agreement with an available commitment of \$50 million. See “FINANCIAL INFORMATION--Strategic Planning.”

As part of its 2010 Strategic Plan, the District has adopted total liquidity targets through 2016. As of September 30, 2012, the District’s targets for available total liquidity for the years ended December 31, 2012, 2013, 2014, 2015 and 2016 were \$192 million, \$196 million, \$176 million, \$188 million and \$175 million, respectively.

## **Investment Policies**

All cash and investments are managed by the Treasurer according to the District’s currently adopted investment policies, most recently amended on December 17, 2012. Investments can be made specific to a particular fund, or to take advantage of economies, the District may pool cash and invest the resultant pool. Under the District’s current investment policies, the Treasurer may invest cash, depending on individual fund restrictions and diversification limits specified by policy, in one or more of the following investments: (1) U.S. Treasury bills, notes or bonds; (2) U.S. Government agency securities; (3) repurchase agreements, which must be collateralized with a third party at a minimum of 102%; (4) savings or time deposits, including insured or collateralized certificates of deposit, with institutions approved as qualified public depositories by the State of Washington Public Deposit Protection Commission (“PDPC”); (5) banker’s acceptances issued by banks approved by the Washington State Treasurer; (6) commercial paper having received the highest rating of any two nationally recognized statistical ratings organizations at the time of purchase (P-1 (Moody’s Investors Service (“Moody’s”)), A-1 (Standard & Poor’s Ratings Inc. (“S&P”)), F-1 (Fitch Ratings, Inc. (“Fitch”))); (7) bonds of the State of Washington and any local government of the State of Washington, which at the time of investment have one of the three highest credit ratings of a nationally recognized rating agency; (8) general obligation bonds of a state other than the State of Washington and general obligation bonds of a local government of a state other than the state of Washington, which at the time of investment have one of the three highest credit ratings of a nationally recognized rating agency; (9) the State Investment Pool; (10) bonds of U.S. domiciled banks, savings and loan associations, mutual savings banks, savings and loan service corporations operating with approval of the federal home loan bank, and corporate mortgage companies, which bonds are insured or guaranteed by an agency of the federal government; (11) mutual funds and money market funds only for District funds that are subject to the arbitrage provisions of Section 148 of the Code; and (12) any other investment permitted under the laws of the State of Washington.

In accordance with GASB Statement No. 31, U.S. Treasury bills, notes or bonds, U.S. Government agency securities, bankers’ acceptances, commercial paper, and municipal bonds that had a remaining maturity at the time of purchase of greater than one year are recorded at fair value. U.S. Treasury bills, notes or bonds, U.S. Government agency securities, bankers’ acceptances, commercial paper, and municipal bonds that had a remaining maturity at the time of purchase of one year or less are recorded at amortized cost. Repurchase agreements and certificates of deposit are also recorded at amortized cost.

Investments of the District are held in the District’s name by banks or trust companies as the District’s agent. The remainder of the District’s funds consists of cash on deposit that is insured by a combination of federal depository insurance or depositories qualified by the PDPC. Cash and investments are considered risk category one under the guidelines of GASB Statement No. 3.

## **Changes in Accounting Principles**

### ***Regulatory Deferrals***

The Commission has the authority to establish the level of rates charged for all District services. As a regulated entity, the District is subject to the general standards of accounting for the effects of regulation as defined by GASB 62, which requires that the effects of the District’s rate-making process be recorded in the District’s financial statements. Accordingly, certain expenses and credits, normally reflected in changes in net assets as incurred, are recognized when included in rates and recovered from, or refunded to, customers. The District records various regulatory assets and credits to reflect rate-making actions of the Commission.

The Commission has taken various regulatory actions that result in differences between recognition of revenues and expenses for rate-making purposes and their treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and regulatory liabilities, which are described below. Changes to the balances, and their inclusion in rates, occur only at the direction of the Commission.

**Investment Derivative Instruments.** The District has entered into various derivative instrument contracts (the Payment Agreements and forward purchase agreements) that are subject to the fair value reporting requirements of GASB Statement No. 53. The fair value of these contracts is recorded on the balance sheet. A number of these are considered investment derivative instruments and as such, any change in fair value would normally be reflected in net increase (decrease) in net position for the period. Derivative instruments are reflected in rates as cash settlements occur in accordance with the terms of the contracts. The Commission has approved resolutions that allow the change in fair value during the period to be deferred and recorded as regulatory assets and/or regulatory liabilities, which have no impact on operating results. Regulatory asset deferrals amounted to \$21.0 million and \$23.3 million as of December 31, 2011 and 2010, respectively. As of September 30, 2012, regulatory asset deferrals amounted to \$22.3 million.

**Swap Termination Payments.** The District terminated three interest rate swap agreements during 2011, incurring swap termination fees in the amount of \$24.6 million. The termination fees, along with \$0.2 million of unamortized costs related to the swap transactions, would normally be reflected as a non-operating expense in 2011; however, the Commission has approved a resolution allowing for the deferral of the termination fees and related swap costs as a regulatory asset to be amortized over a period of up to 15 years to match the expense with the period in which the payments will be recovered through rates. The remaining unamortized regulatory asset balance was \$19.7 million as of September 30, 2012 and \$22.4 million as of December 31, 2011. In 2010, the District did not record any regulatory deferrals of swap termination payments.

**Contributions in Aid of Construction.** Individual contributions exceeding \$1 million are deferred as regulatory liabilities and amortized over the life of the related contributed depreciable plant assets. The Commission has approved resolutions that require this treatment to offset the earnings effect of these large non-exchange transactions and align the District's recognition of these credits with the periods in which the amounts will be reflected for rate-making purposes. In 2011 and 2010, the District recorded deferrals of contributed capital in the amount of \$5.9 million and \$2.3 million, respectively. As of September 30, 2012, deferred contributions in aid of construction amounted to \$6.8 million.

**Conservation Program Expenditures.** With conservation investments, the District is considered to be buying an energy resource from its customers. The District's conservation program also supports compliance with I-937. The Commission has approved resolutions that require these program costs to be deferred and recorded as regulatory assets, to be amortized and included in rates over the benefit period. As of December 31 2011, the District recorded regulatory deferrals of conservation program expenditures in the amount of \$1.1 million. In 2010, the District did not record any regulatory deferrals of conservation program expenditures. As of September 30, 2012, deferred conservation program expenditures amounted to \$1.9 million.

### **Consolidated System Payment Agreements**

Pursuant to the Master Resolution, the District may enter into one or more Payment Agreements with respect to all or a portion of a Series of Bonds. A Payment Agreement is defined in the Master Resolution as any financial instrument that (i) is entered into by the District with a party that is a Qualified Counterparty (as defined in the Master Resolution) at the time the instrument is entered into; (ii) is entered into with respect to all or a portion of a Series of Bonds; (iii) is for a term not extending beyond the final maturity of the Series of Bonds or portion thereof to which it relates; (iv) provides that the District shall pay to such Qualified Counterparty an amount accruing at either a fixed rate or a variable rate, as the case may be, on a notional amount equal to or less than the principal amount of the Series of Bonds or portion thereof to which it relates, and that such Qualified Counterparty shall pay to the District an amount accruing at either a variable rate or fixed rate, as appropriate, on such notional amount; (v) provides that one party shall pay to the other party any net amounts due under such instrument; and (vi) which has been designated by the District as a Payment Agreement with respect to such Bonds. The Qualified Counterparty must be rated in one of the three top rating categories by at least two rating agencies. The Master Resolution provides that, if and to the extent provided in any Supplemental Resolution authorizing the issuance of a Series of Bonds, Payment Agreement Payments may be paid directly out of the account or accounts in the Bond Fund established with respect to such Series of Bonds, and thus on a parity with debt service on the Bonds.

**2009 Payment Agreement; 2009 Reversal Payment Agreement.** On April 13, 2006, the District competitively bid and executed an interest rate swap payment agreement (the "2009 Payment Agreement") pursuant to which the District receives payments from the counterparty at a variable rate with respect to its 2009A/B Bonds (the "Swapped 2009 Bonds") and the District pays to the counterparty a fixed rate. The aggregate notional amount of

the 2009 Payment Agreement is equal to \$30,355,000. The variable rate the District is to receive under the 2009 Payment Agreement was intended to approximate the variable rate the District expected to pay on the Swapped 2009 Bonds. The 2009 Payment Agreement is scheduled to terminate on July 1, 2034. The regularly scheduled payments of the District under the 2009 Payment Agreement are additionally secured by a financial guaranty insurance policy issued by Assured Guaranty Municipal Corp. (“Assured”). As of February 19, 2013, Assured was rated A2 and AA- by Moody’s and S&P, respectively. Assured is not rated by Fitch. Due to uncertainty in the financial markets in 2009, however, the District purchased and is holding in trust the Swapped 2009 Bonds for a period of up to five years. In connection with the issuance of the Swapped 2009 Bonds, the District bid out and executed an interest rate swap payment agreement (the “2009 Reversal Payment Agreement”) pursuant to which the District will receive payments from the counterparty at a fixed rate with respect to the notional amount of the 2009 Payment Agreement and the District will pay to the counterparty a variable rate. The 2009 Reversal Payment Agreement is scheduled to terminate on July 1, 2014.

**2013 Payment Agreement.** On April 13, 2006, the District competitively bid and executed a forward starting interest rate payment agreement (the “2013 Payment Agreement” and together with the 2009 Payment Agreement and the 2009 Reversal Payment Agreement, the “Consolidated System Payment Agreements”) in connection with the expected issuance of Bonds in 2013 to refund certain outstanding Senior Consolidated System Bonds. The District subsequently refunded such Senior Consolidated System Bonds and is considering various options with respect to the 2013 Payment Agreement. The Payment Agreement Payments to be made by the District to the counterparty pursuant to the 2013 Payment Agreement are to be payable on a parity with the Bonds. The regularly scheduled payments of the District under the 2013 Payment Agreement are expected to be secured by financial guaranty insurance policies to be issued by Assured.

**Additional Terms.** The Payment Agreement Payments with respect to the Consolidated System Payment Agreements, other than any payments due upon the early termination of any such Payment Agreements, are payable on a parity with the Bonds. The Consolidated System Payment Agreements each include a unilateral option on the part of the District to terminate the agreement at any time at its then-current market value. The Consolidated System Payment Agreements require the counterparties to post collateral in the event their credit ratings fall below the two highest long-term ratings categories. The District is not required to post collateral under the Consolidated System Payment Agreements; however, if the District’s Credit Support Provider under a Consolidated System Payment Agreement did not maintain a credit rating of “A-” or above from S&P and “A3” or above from Moody’s and if the District’s credit ratings were reduced below “BBB+” by S&P and below “Baa1” by Moody’s, to avoid termination of the Consolidated System Payment Agreements, the District would have the option to post collateral under such Consolidated System Payment Agreements.

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Table 20 below summarizes the Consolidated System Payment Agreements of the District as of December 31, 2012.

**Table 20**  
**Chelan County Public Utility District No. 1**  
**Consolidated System Payment Agreements of the District**

<b>Associated Bonds</b>	<b>Effective Date</b>	<b>Initial Notional Amount</b>	<b>Counterparty/Guarantor</b>	<b>Counterparty Credit Ratings (Moody's/S&amp;P)<sup>(1)</sup></b>	<b>District Receives</b>	<b>District Pays</b>	<b>Mark to Market Value<sup>(2)</sup></b>	<b>Expiration Date</b>
<b>2009 Bonds</b>	June 1, 2009	\$30,355,000	JPMorgan Chase Bank, N.A.	Aa3/A+	70% of BBA LIBOR	4.031%	(\$11,700,618)	July 1, 2034
<b>2009 Bonds</b>	July 22, 2010	\$30,355,000	The Bank of New York Mellon	Aa1/AA-	1.760%	70% of BBA LIBOR	\$755,263	July 1, 2014
<b>2013 Bonds</b>	May 30, 2013	\$28,815,000	Goldman Sachs Mitsui Marine Derivative Products, L.P./The Goldman Sachs Group Inc.	Aa2/AAA	70% of BBA LIBOR	4.085%	(\$10,217,293)	July 1, 2032
TOTAL		\$89,525,000						

<sup>(1)</sup> As of December 31, 2012.

<sup>(2)</sup> As of December 31, 2012.



## AGREEMENTS, PROCEEDINGS AND LAWS AFFECTING THE DISTRICT

### Coordination Agreements

#### *Canadian Entitlement Allocation and Extension Agreement*

In 1961, the United States and Canada signed a treaty relating to cooperative development of the water resources of the Columbia River Basin (the “Canadian Treaty”). The Canadian Treaty required Canada to build storage facilities in Canada and outlined the manner in which these Canadian Storage Projects are to be operated, with the goals of optimizing flood control and power benefits downstream of the projects. Power benefits that result from the operation of the Canadian Storage Projects are shared between the United States and Canada. Under the terms of the Canadian Treaty, Canada is entitled to receive from the United States one-half of the annual average usable energy and one-half of the dependable capacity that can be realized in the United States each year as a result of the coordinated use of the Canadian storage projects (the “Canadian Entitlement”). See “THE CONSOLIDATED SYSTEM—Consolidated System Energy Resources.”

The most recent agreement between the United States and Canada regarding the Canadian Entitlement, signed in 1997, established the parameters for determining the District’s obligations to return energy to Canada generated by the Rock Island and Rocky Reach Projects attributable to the Canadian storage projects, via Bonneville, continuing until September 15, 2024. The District’s current obligations are approximately 32 MW for the Rock Island Project and 68 MW for the Rocky Reach Project, in each case delivered over high load hours, Monday through Saturday.

Beginning in 2014, either country may terminate the Canadian Treaty by providing ten years’ prior notice to the other country. Regional discussions within the Northwest and led by Bonneville have been initiated with the goal of providing to the U.S. State Department a recommendation in 2013 regarding whether the Canadian Treaty should continue or be terminated. BC Hydro, the U.S. Army Corps of Engineers, Bonneville and other entities within the United States, including the District, are in the process of considering options available after 2024 for power operations and flood control. The District cannot predict what requirements may be agreed to for the period after 2024.

#### *Pacific Northwest Coordination Agreement*

The Canadian Treaty assumes coordination among the producers of power in the Pacific Northwest and the Canadian facilities subject to the Canadian Treaty. In 1964, the Pacific Northwest Coordination Agreement (the “1964 PNCA”) was executed by those entities, including the District, that operate major electric plants and systems that serve the Pacific Northwest. The 1964 PNCA coordinated the operations of the parties’ facilities, among other things, to achieve economies and additional firm power resources for the Pacific Northwest.

The 1964 PNCA expired in 2003. A new PNCA (the “1997 PNCA”) became effective August 1, 2003 and continues until July 31, 2024.

#### *Mid-Columbia Hourly Coordination Agreement*

In 1973, the District entered into the Mid-Columbia Hourly Coordination Agreement to provide for moment by moment coordination of the seven federal and non-federal hydroelectric projects on the mid-Columbia River, including the Rock Island and Rocky Reach Projects. This coordination reduces the fluctuation of reservoir levels at each dam and allows operation of the reservoirs at a higher average level and with more total power production. The agreement has existed as a series of one-, five-, ten- and 20-year agreements, with the latest 20-year agreement scheduled to terminate on June 30, 2017. Other signatories to the agreement include Bonneville; U.S. Army Corps of Engineers; U.S. Bureau of Reclamation; U.S. Department of the Interior; City of Seattle, Washington; City of Tacoma, Washington; City of Eugene, Oregon; City of McMinnville, Oregon; Grant PUD; Douglas PUD; Public Utility District No. 1 of Cowlitz County, Washington; Puget Sound Energy; Portland General Electric Company; PacifiCorp; Avista; and Colockum Transmission Company, Inc.

## Endangered Species Act

### *General*

The Endangered Species Act of 1973 (16 U.S.C. 1531 *et seq.*), as amended (the “ESA”), makes it unlawful for any person subject to the jurisdiction of the United States to “take” a listed species. The term “take” means “to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any such conduct.” Violations of the ESA can be enforced by governmental and citizen suits and are subject to both civil and criminal penalties, which may include, among other things, the imposition of monetary fines. Civil penalties may include the imposition of requirements to prevent the takings.

The ESA, however, provides mechanisms to permit “takes” that would otherwise violate the ESA. An “incidental take” in compliance with an “incidental take permit” or an “incidental take statement” authorized by the National Marine Fisheries Service (“NMFS”), which for purposes of this section of the Remarketing Memorandum includes the National Oceanic and Atmospheric Administration Fisheries Service (the “NOAA Fisheries”), or the U.S. Fish and Wildlife Services (“USFWS”) is not an ESA violation. An “incidental take” is a take that “is incidental to, and not the purpose of, the carrying out of any otherwise lawful activity.” NMFS may also authorize direct take “for scientific purposes or to enhance the propagation or survival of the affected species.”

The U.S. Secretary of Commerce and the U.S. Secretary of Interior, as appropriate (either, the “Secretary”), have the authority to permit nonfederal applicants to incidentally take listed species under such terms and conditions as the Secretary prescribes in an incidental take permit. The Secretary may issue an incidental take permit if the applicant submits to the Secretary a conservation plan that specifies: (1) the impact that will likely result from such taking; (2) what steps the applicant will take to minimize and mitigate the impacts and the funding that will be available to implement the steps; (3) the alternatives to the taking that the applicant considered and why those alternatives were rejected; and (4) other measures that the Secretary may require as being necessary or appropriate for purposes of the plan. The Secretary is required to issue the permit if, after opportunity for public comment, the Secretary finds that: (1) the taking will be incidental; (2) the applicant will, to the maximum extent practicable, minimize and mitigate the impacts of such taking; (3) the applicant will ensure that adequate funding will be provided for the plan; (4) the taking will not appreciably reduce the likelihood of the survival and recovery of the species in the wild; (5) the other necessary and appropriate measures required by the Secretary will be met; and (6) the Secretary has received such other assurances as the Secretary may require that the plan will be implemented.

Upon the listing of a species, the ESA requires the listing agency to define the species’ “critical habitat.” Critical habitat designations require federal agencies to ensure that any action they authorize, fund or carry out is not likely to destroy or adversely modify designated critical habitat. Operation of the Rocky Reach and Rock Island Projects has resulted and may result in the future, based on new listings or information, in federal agencies taking actions that could trigger new or additional critical habitat consultation under the ESA. These consultations must address the effects of the proposed action on the listed species and on its critical habitat and typically result in the issuance of an incidental take statement.

### *Listings*

There are several fish, wildlife and plant species that have been listed or are proposed for listing that exist in the area of the Rocky Reach and Rock Island Projects. Some listings have had no material effect on the operation of the Rocky Reach and Rock Island Projects, while other listings, such as anadromous fish listings, have had implications for operation of the Rocky Reach and Rock Island Projects. Listed anadromous fish and other selected species within the vicinity of the Rocky Reach and Rock Island Projects are discussed below. The listings include naturally spawned fish, as well as fish produced in artificial propagation programs.

**Steelhead—Upper Columbia DPS.** In 1997, NMFS listed the Upper Columbia River Steelhead distinct population segment (“DPS”) as endangered under the ESA. The Upper Columbia Steelhead DPS was reclassified as threatened on January 5, 2006, and then reinstated as endangered in June 2007. In June 2009, the Upper Columbia Steelhead DPS was again reclassified as threatened. On July 26, 2011, NMFS issued its 5-year status review findings and concluded that the Upper Columbia River steelhead DPS should remain listed as threatened. The DPS includes all naturally-spawned anadromous steelhead populations below natural and man-

made impassable barriers in streams in the Columbia River Basin upstream from the Yakima River, Washington, to the U.S.-Canada border, as well as six artificial propagation programs.

In 2005, NMFS designated portions of the Columbia River mainstem and tributaries as critical habitat of the Upper Columbia River Steelhead DPS. The District's Rocky Reach and Rock Island Projects lie within Columbia River mainstem reaches designated as critical habitat.

**Steelhead—Mid-Columbia DPS.** In 1999, NMFS listed the Middle Columbia River Steelhead DPS as threatened under the ESA, and in 2006 reaffirmed the listing. This DPS includes all naturally-spawned anadromous steelhead populations below natural and man-made impassable barriers in streams from above the Wind River, Washington, and the Hood River, Oregon (exclusive), upstream to, and including, the Yakima River, Washington, excluding steelhead from the Snake River Basin, as well as seven artificial propagation programs.

The District's Rocky Reach and Rock Island Projects lie upstream of the Middle Columbia River Steelhead DPS. In 2005, NMFS designated critical habitat for the Middle Columbia River Steelhead DPS downstream of those Projects.

**Spring Chinook—Upper Columbia ESU.** In 1999, NMFS listed the Upper Columbia River Spring Run Chinook Salmon Evolutionarily Significant Unit ("ESU") as an endangered species under the ESA. In 2005, NMFS published the final rule reaffirming the ESU's endangered status. The ESU includes naturally-spawned populations of spring Chinook salmon in all river reaches accessible to spring Chinook salmon in Columbia River tributaries upstream of Rock Island Dam and downstream of Chief Joseph Dam in Washington as well as six artificial propagation programs.

On July 26, 2011, NMFS issued the 5-year status review findings and concluded that the Upper Columbia River Spring-Run Chinook salmon should remain listed as endangered. In 2005, NMFS designated critical habitat for the Upper Columbia Spring Chinook ESU.

**Upper Columbia River Salmon and Steelhead Recovery Plan.** The NOAA Fisheries adopted the Upper Columbia River Salmon and Steelhead Recovery Plan in 2007 (the "2007 Plan"). Recovery plans describe actions beneficial to the conservation and recovery of species listed under the ESA. The ESA generally requires the development of recovery plans for listed species. The 2007 Plan is a guide to be used by federal and state agencies charged with species recovery. In and of itself, the 2007 Plan is not a regulatory document. That is, the District is not obligated to adhere to the 2007 Plan but works closely with other agencies and Native American tribes on its implementation.

**Bull Trout—Columbia Basin DPS.** The USFWS listed the bull trout in all DPSs as threatened in 1999. The USFWS considers the Columbia River population as one of five DPSs. The USFWS developed the Bull Trout Draft Recovery Plan covering five western states in 2002. The USFWS is currently drafting a new recovery plan based on distinct recovery units. Under the biological opinions issued to the District by the USFWS, the District is required to participate in the regional recovery planning efforts. Bull trout in the Middle Columbia constitute one portion of the total Columbia River population. Following litigation, the USFWS issued a final rule designating revised critical habitat on October 17, 2010. The revised critical habitat designation includes the mainstem Columbia River including the Rocky Reach and Rock Island reservoirs. It also includes the Chelan River in the natural river channel up to the first natural passage barrier, which includes the Lake Chelan powerhouse tailrace.

**Other Species.** The NMFS and the USFWS (collectively, the "Services") considered and found that listing was not warranted in the region for several other fish species. These include the Upper Columbia Summer and Fall Run Chinook salmon ESU, the Okanogan River and Lake Wenatchee sockeye salmon ESUs, Pacific Lamprey and coastal and westslope cutthroat trout.

The District cannot predict the outcome of consideration by the Services of new listings, de-listings or critical habitat designations for listed species and related litigation. For example, the USFWS currently considers

the Pacific lamprey as a “species of concern.” The USFWS also currently considers the Washington/lower Columbia River DPS of coastal cutthroat trout a “species of concern.”

### ***Effects of Listings and Critical Habitat Designations on Rocky Reach and Rock Island Projects***

As a result of the listings under the ESA, the Services may require minimization and mitigation measures to address potential effects of the Hydro-Electric Projects’ operations on the listed species or their habitats. The District could be required to alter operations at the Rock Island and the Rocky Reach Projects, which could result in possibly substantial reductions in power generation at the Hydro-Electric Projects, thereby increasing the unit cost of power from the Hydro-Electric Projects. The steps being taken by the District to minimize the effects of the listings are discussed below.

### ***Rocky Reach and Rock Island Anadromous Fish Agreements and Habitat Conservation Plans***

In late 1994, the District, Grant PUD and Douglas PUD (collectively, “Mid-Columbia PUDs”) initiated discussions with the Services and Washington Department of Fish and Wildlife (“WDFW”) to develop a Mid-Columbia Habitat Conservation Plan to manage the aquatic species (fish, plants and animals) that inhabit the Mid-Columbia River Basin. The Mid-Columbia PUDs sponsored extensive studies and submitted the first draft of the plan to the parties in May 1996.

The District, along with Douglas PUD, the Services, WDFW, the Colville Tribes and the Yakama Nation, thereafter developed and signed the Anadromous Fish Agreements and Habitat Conservation Plans (“HCPs”) for the Rocky Reach, Rock Island and Wells Projects. The HCPs apply to spring, summer and fall Chinook salmon, sockeye salmon, coho salmon and steelhead (collectively, the “Plan Species”). The HCPs provide that “No Net Impact” (“NNI”) will be achieved on a specified schedule and maintained for the duration of the agreements for each Plan Species affected by the Rocky Reach, Rock Island and Wells Projects. NNI has two components: (1) 91% combined adult and juvenile project survival achieved within the geographic area of each project by project improvement measures for juveniles and adults; and (2) 9% compensation for unavoidable project mortality provided through hatchery and tributary programs, with 7% compensation provided through hatchery programs and 2% compensation provided through tributary programs. With the HCPs in place, NMFS issued incidental take permits to the District for listed Upper Columbia River Spring-run Chinook salmon and Upper Columbia River steelhead, as well as the unlisted Upper Columbia River sockeye and summer/fall Chinook salmon. These permits ensure that the District can continue to operate the Rock Island and Rocky Reach Projects even though listed species are present and ensure continued operations of the Rock Island and Rocky Reach Projects if additional ESA listings occur for any species covered by the HCPs.

The District agreed to be responsible for achieving 91% combined adult and juvenile project survival through improvements to the Rock Island and Rocky Reach Projects. The District is also responsible for (1) funding the 2% tributary conservation plan, (2) providing capacity and funding for up to 7% hatchery compensation plan and (3) making capacity and funding adjustments necessary to reflect and compensate future hatchery program modifications.

In 2004, FERC issued orders amending the operating licenses for the Rocky Reach and Rock Island Projects to incorporate the terms of the HCPs. The District is currently engaged in full implementation of the programs outlined in the HCPs.

### ***Site-Specific ESA Section 10 Permits***

In 2003, NMFS issued separate biological opinions evaluating the issuance of permits under ESA section 10 for the Upper Columbia River spring Chinook hatchery program and the Upper Columbia River steelhead hatchery program, and in 2004, re-consulted regarding the Upper Columbia River spring Chinook program to evaluate proposed permit amendments. Based on these consultations, NMFS concluded that the specific hatchery activities authorized by the permits, which also included programs administered by Douglas PUD and WDFW, were not likely to jeopardize listed salmon and steelhead species.

In 2007, NMFS consulted on HCP-related hatchery activities in the context of evaluating FERC's relicensing of the Rocky Reach Project, including continued implementation of the HCP and a comprehensive settlement agreement executed by the District, NMFS and USFWS, among others. NMFS's biological opinion validated its prior programmatic analysis of the HCP hatchery mitigation actions related to the Rocky Reach Project and concluded that such actions would not destroy or adversely modify Upper Columbia River spring Chinook or Upper Columbia River steelhead critical habitat. As in NMFS's 2003 biological opinions, the 2007 biological opinion noted that specific HCP hatchery mitigation actions would undergo separate ESA consultations in which NMFS would consider potential effects at a site-specific level. In their 2004 biological opinion, USFWS was clear that future HCP-related hatchery actions would require additional ESA consultation at a site-specific level.

NMFS is currently considering the issuance of new permits for the District's HCP-related hatchery programs for Upper Columbia River spring Chinook and Upper Columbia River steelhead. The District formally submitted the final Hatchery Genetics and Management Plans (HGMPs) for NMFS' review in October 2009. In March 2010, NMFS issued a public notice in the Federal Register pursuant to ESA Section 10(c) indicating that NMFS would evaluate the HGMPs as applications for new ESA Section 10 permits, review the associated documents and any comments received, and determine whether the HGMPs meet the applicable requirements of ESA Section 10. NMFS will also initiate consultation with USFWS regarding the effects, if any, of the issuance of new HGMP permits on bull trout. These regulatory processes will result in the issuance of new Section 10 permits with new terms and conditions, governing the operations of the District's Chiwawa spring Chinook and Wenatchee steelhead hatchery programs.

### ***HCP Implementation***

From 2002 to 2006, the District conducted survival studies on all four Plan Species as part of the first phase of the Rock Island HCPs. In 2006, the District satisfied the 3-year study requirements under the Plan. Juvenile survival for all three spring migrants (sockeye, steelhead and spring Chinook) exceeded the 93% juvenile survival standard. The District thus has satisfied a major component of the NNI requirement under the HCPs for the Rock Island Project.

From 2007 to 2010, the District conducted tests at the Rock Island Project to determine if survival levels could still be met under reduced spill levels. At the end of the testing cycle, all three spring migrant species exceeded the 93% juvenile survival standard. The District's satisfaction of the survival standards means that it is likely that no additional survival studies will be conducted until 2020.

The District completed survival studies at the Rocky Reach Project for steelhead in 2006, for sockeye in 2009 and for spring Chinook in 2011. Juvenile steelhead and sockeye exceeded the 93% survival standard and spring Chinook exceeded the 91% combined adult and juvenile survival standard. The District thus has satisfied a major component of the NNI requirement under the HCP for the Rocky Reach Project. It is unlikely that any additional survival studies will need to be performed at Rocky Reach until 2021.

In 2012, the District analyzed the adult passage data at the Rock Island and Rocky Reach Projects for years 2010 through 2012 and determined that adult survival rates for spring Chinook, steelhead, and sockeye all exceeded 98%, and when combined with the previously documented juvenile survival rates for the same species, resulted in meeting or exceeding the HCP Combined Adult-Juvenile Survival rate of 91%. This result fully satisfies both adult and juvenile survival rates for spring Chinook, steelhead, and sockeye at the Rock Island and Rocky Reach Projects.

The survival of summer migrants (summer/fall sub-yearling Chinook) currently cannot be studied due to the limitations of existing technologies because of their small size and because some fish do not migrate to the ocean in their first year, but instead remain in the project reservoirs. The District has committed to continue monitoring technological advances to determine whether survival studies can be undertaken for sub-yearling Chinook. While the HCP requires the District to meet NNI for all Plan Species by 2013, it also states that the inability to determine whether a survival standard has been satisfied because of technological limitations does not constitute a failure to meet the NNI requirement. The District will continue to monitor technological advances until such time as effective survival studies for this Plan Species can be undertaken.

### ***Bull Trout***

In May 2004, the USFWS issued biological and conference opinions (“Opinions”) and incidental take statements regarding the anticipated effect to bull trout from FERC’s proposed amendments incorporating the District’s HCPs into the Rocky Reach and Rock Island Project licenses. The Opinions required the development of bull trout management plans in collaboration with various federal and state agencies and relevant Native American tribes. The District worked closely with USFWS to include measures that USFWS deemed necessary to protect the bull trout from adverse effects of continued operation of the Rock Island and the Rocky Reach Projects in the licensing settlement agreement.

The bull trout management plans were completed in February 2005, and implementation began in May 2005. The management plan was approved by FERC in April 2005. Implementation of the bull trout management plan has shown no adverse effects to bull trout from the operation of Rocky Reach and Rock Island Projects. In December 2008, the USFWS issued its Biological Opinion and Incidental Take Statement in connection with the District’s new Rocky Reach Project license, concluding that the Project is not likely to jeopardize the continued existence of bull trout. That biological opinion included a detailed analysis of site-specific hatchery activities and provided incidental take coverage for effects to bull trout associated with hatchery operations and maintenance, broodstock collection, and release of juvenile salmon and steelhead at the Rocky Reach, Turtle Rock Island, Eastbank, Chelan, Tumwater and Dryden hatchery facilities.

As noted above, USFWS issued a revised critical habitat designation for bull trout on October 17, 2010, which includes the mainstem Columbia River, including the Rocky Reach and Rock Island reservoirs. As a result, FERC is required to reinitiate consultation for the Rocky Reach and Rock Island Projects to consider the impact of the Projects on the critical habitat. This has not yet occurred, but the District expects USFWS and FERC to do so when they are able. It is possible that USFWS will request that FERC also enter into a new consultation for Lake Chelan to consider impacts to the bull trout critical habitat. The various consultations could result in the imposition of additional measures to minimize impacts of the Hydro-Electric Projects on bull trout and its critical habitat.

### ***Federal Columbia River Hydropower System - Biological Opinion***

The Federal Columbia River Hydropower System (the “FCRPS”) is comprised of federally owned dams and those federal agencies that operate, or market power from, those dams, namely, Bonneville, the U.S. Army Corps of Engineers and the Bureau of Reclamation. The FCRPS includes projects upstream and downstream from the Rocky Reach and Rock Island Projects on the Columbia River, as well as projects on the Snake River.

The various biological opinions issued over the past 18 years by NMFS for the FCRPS regarding various listed species have been the subject of an on-going series of lawsuits and additional regulatory proceedings. The biological opinion issued by USFWS in 2000 for the FCRPS regarding bull trout has not been litigated. Most recently, on July 2, 2011, a federal district court concluded that NMFS’s 2008 biological opinion, as supplemented by a 2010 biological opinion, did not violate the ESA, but remanded the biological opinion back to NMFS for further consideration. The biological opinion remains in place until December 31, 2013. NMFS must produce a new biological opinion that corrects the opinion’s reliance on certain mitigation measures.

Two of the most significant features of the biological opinions described above are (1) the requirement for substantial Columbia River storage and flow pattern changes to assist migration of juvenile salmon and steelhead and (2) water quality issues associated with water spilled for fish passage purposes at the upstream dams. Due to the location of the Rocky Reach and Rock Island Projects in relation to the FCRPS, these conditions may reduce the power output at the Rocky Reach and Rock Island Projects and will potentially change the seasonal timing of a significant amount of such generation. A reduction in output or changes in the timing of storage releases and resulting energy generation may increase the amount of water the Rocky Reach and Rock Island Projects must spill to aid fish passage, increase the unit cost of power from these Projects, require the District to replace the lost power from other higher-cost sources, and reduce District revenues from the sale of non-firm energy from these Projects.

### ***Pacific Northwest Power Planning and Conservation Act***

In 1980, Congress enacted the Pacific Northwest Power Planning and Conservation Act (the “Regional Power Act”). The Regional Power Act provides for the establishment and operation of the Pacific Northwest Electric Power and Conservation Planning Council (now referred to as the Northwest Power and Conservation Council), which is required to prepare and adopt a regional conservation and electric power plan and a program to protect, mitigate and enhance fish and wildlife, including related spawning grounds and habitat, of the Columbia River and its tributaries. The adoption of the District’s HCP and comprehensive settlement agreements under the FERC licenses has taken precedence over the Northwest Power and Conservation Council’s Fish and Wildlife Plans, but the District continues to coordinate with the Northwest Power and Conservation Council to ensure consistency with regional plans.

### ***Possible Effects***

The above-described regulatory actions and litigation and other current and potential future lawsuits and regulatory proceedings relating to threatened and endangered species listings and critical habitat designations under the ESA have had and are likely to continue to have both direct and indirect effects on the operations of hydro-electric projects in and near the Columbia River including the Hydro-Electric Projects. It is possible that operations of the Hydro-Electric Projects could be significantly constrained, although the District believes that this is unlikely given the progress to date on the HCPs and implementation of the Rocky Reach Project license. Further, additional minimization and mitigation measures could be imposed for species other than salmon or steelhead, resulting in a substantial increase in the District’s unit cost of production of power at the three Hydro-Electric Projects. The District believes the imposition of such additional measures is unlikely.

## **DEVELOPMENTS AFFECTING THE ELECTRIC UTILITY INDUSTRY**

### **General**

The electric utility industry in the United States is in a period of significant change, resulting in part from actions taken by legislative and regulatory bodies at the national, regional and state levels. Legislative and regulatory actions have fostered, among other things, increased wholesale competition and, in some states, competition at a retail level, as well as “open access” for certain transmission facilities. The industry also is being affected by a variety of other factors that can have an impact on the financial condition of electric utilities, including without limitation the following: (1) the effects of increased competition in certain sectors of the industry, including in the wholesale power markets; (2) changes in the availability and cost of fuels, including natural gas; (3) changes in the availability of and demand for power generally, as a result of economic, demographic, regulatory, weather and other factors; (4) climate change; (5) reliability standards; and (6) the costs and operational impacts of endangered species, environmental, safety, licensing and other federal, state and local laws and regulations.

Electric utilities are subject to continuing environmental regulation. Federal, state and local standards and procedures that regulate the environmental impact of electric utilities are subject to change. Consequently, there is no assurance that the facilities operated by the District will remain subject to the regulations currently in effect, will always be in compliance with future regulations or will always be able to obtain all required operating permits. An inability to comply with environmental or regulatory standards could result in reduced operating levels or the shutdown of facilities not in compliance.

The District cannot predict whether additional legislation or rules will be enacted which will affect the operations of the District, and if such laws or rules are enacted, what the costs to the District might be in the future because of such action.

The electric utility industry is also subject to changes in technologies. Recent and continuing advances in electrical generation may render electrical generation on a smaller scale more feasible or make alternative forms of generation more or less economic. Such technology would provide certain purchasers of the power generated by the District’s facilities with the ability to generate increased portions of their own electrical power needs and reduce the market price for power provided by the District. The District cannot predict the timing of the development or

availability of such technologies and the ultimate impact they would have on the Revenues of the Consolidated System.

The District cannot predict what effects such factors will have on its operations and financial condition, but the effects could be significant. Extensive information on the electric utility industry is available from the various regulatory bodies and other sources in the public domain. See “AGREEMENTS AND PROCEEDINGS AFFECTING THE HYDRO-ELECTRIC PROJECTS.”

### **Recent Market Conditions**

Power prices in the Pacific Northwest change over time depending on demand, weather conditions, fuel prices, supply availability, neighboring regional markets and other market drivers, many of which are beyond the control of the District. Recent decreases in natural gas prices, higher than normal runoff conditions, increased wind generation and slower economic conditions have led to lower prices. The District cannot predict future price movements.

With above normal flows on the Columbia River during 2011, the District was able to meet all of its retail load requirements during that time from its own resources. In addition, the District was able to sell power that exceeded its own needs in most months.

Due to much higher than normal Columbia River flows in 2012, the District was able to sell more surplus generation than in a typical run off year. According to the National Weather Service’s Northwest River Forecast Center, which is a part of the NOAA, the Columbia River at Grand Coulee (Jan-July 2012) was 128% of normal runoff.

### **Energy Policy Act of 2005**

The Energy Policy Act of 2005 (“EPAAct 2005”) made fundamental changes in the federal regulation of the electric utility industry, particularly with regard to transmission access, market behavior and mandatory reliable standards.

#### ***Open Access by Unregulated Transmitting Utilities***

In 1996, FERC issued Order 888, which had ordered pro forma, open-access mandatory transmission tariffs to be put into effect for all jurisdictional utilities. Order 888 did not apply to municipal utilities such as the District. However, FERC adopted a “reciprocity” provision in Order 888 that required non-jurisdictional utilities to offer “comparable” transmission services in return for using a jurisdictional utility’s open access transmission services. A non-jurisdictional utility could satisfy reciprocity by filing a safe-harbor tariff with FERC and receiving approval; entering into a bilateral agreement with the jurisdictional utility; or receiving a waiver from FERC.

In EPAAct 2005, Congress added section 211A to the FPA. The section authorized FERC to, by rule or order, require a non-jurisdictional utility to provide transmission services at rates that are comparable to those it charges itself and under terms and conditions (unrelated to rates) that are comparable to those it applies to itself, and that are not unduly discriminatory or preferential. In other words, EPAAct 2005 authorized FERC to require non-jurisdictional utilities to provide non-discriminatory open access for all transmission customers - even for transmission customers from whom the non-jurisdictional utility did not take service. This authority is subject to certain exemptions and to the limitation that it may not require a violation of a private activity bond rule for tax purposes.

After the rulemaking process, FERC issued a final Order 890 on February 15, 2007. In Order 890, FERC declined to adopt a generic rule to implement the new FPA section 211A. However, FERC stated it will apply the provisions of 211A on a case-by-case basis. For example, if a jurisdictional utility wants service from a non-jurisdictional utility, FERC could compel the non-jurisdictional utility to provide service “comparable” to what it provides itself and that is not unduly discriminatory or preferential.



FERC Order 890 also cited eight principles for increasing transparency in regional transmission planning. The principles included coordination, openness, transparency, information exchange, comparability, dispute resolution, regional participation, and congestion studies. While the specific requirements with regard to transmission planning are not formally applied to non-jurisdictional utilities, FERC clearly stated that it expects non-regulated transmission providers will participate in open and transparent regional planning processes.

Furthermore, FERC's Order 890 requires jurisdictional utilities, working through the North American Electric Reliability Corporation ("NERC"), to develop consistent methodologies for available transmission capacity calculations and to publish those methodologies to increase transparency. The District continues to evaluate the extent to which Order 890 will affect its relationships with jurisdictional utilities with which it does business.

On December 28, 2007, FERC issued Order 890-A, largely confirming Order 890. On June 19, 2008, FERC issued Order 890-B, largely reaffirming its rule on open access (Order 890) and its later rehearing order (Order 890-A). Order 890-B provided clarification and guidance on the rule. In these Orders, FERC reiterated its expectation that non-jurisdictional utilities participate in regional transmission planning.

The District is a member of ColumbiaGrid, a non-profit corporation formed in March 2006 to improve the operational efficiency, reliability, and planned expansion of the Northwest transmission grid. Members of ColumbiaGrid include Bonneville, public power utilities and investor-owned utilities. As to transmission planning and expansion, ColumbiaGrid provides a single-utility based transmission planning forum for the combined network of its participating utilities. The goal of the program is to resolve issues regarding determining whether transmission infrastructure should be expanded, what entities should be responsible for undertaking such expansion and what entities should be responsible for paying for such expansion. On February 7, 2007, the District signed ColumbiaGrid's Planning and Expansion Functional Agreement ("PEFA"). The investor-owned utilities filed the PEFA with FERC as part of their compliance to FERC Order 890 planning requirements. For the District, the PEFA is an integral part of meeting FERC's expectations for participating in regional transmission planning as a non-jurisdictional utility. The District is currently engaged with Douglas PUD, Grant PUD and Bonneville in a PEFA transmission expansion project that impacts on the District's transmission network. On July 2, 2012, the parties entered into a cost-sharing agreement.

On July 1, 2011, FERC issued Order 1000 on transmission planning and cost allocation. The new rule requires FERC regulated transmission providers to participate in regional planning processes that meet certain transmission planning and cost allocation requirements, including considering transmission planning processes that consider public policy requirements established by state or federal laws that may affect transmission needs (such as renewable portfolio standards). With respect to transmission cost allocation, Order 1000 requires, among other things, that regulated transmission providers establish principles for allocating the costs of new transmission in a manner "roughly commensurate with the distribution of benefits." Order 1000 impacts some non-jurisdictional transmission-owning public power utilities. While the District does not have a tariff on file with FERC, as a member of ColumbiaGrid it engages in consensus-based interregional planning processes. Potential impacts on the District are unknown at this time and could be less pronounced than on others in the industry because of the amount of transmission the District owns and operates. The parties to the PEFA have revised the PEFA to comply with the intra-regional portion of Order 1000. The jurisdictional transmission operators have made compliance filings which included an amended PEFA. The District continues to work with jurisdictional transmission operators on compliance with the inter-regional portion of Order 1000 while maintaining the District's status as a non-jurisdictional entity.

### ***Mandatory Reliability Standards***

EPA 2005 authorized FERC to certify and oversee, in coordination with governmental authorities in Canada, an Electric Reliability Organization ("ERO") for the purpose of establishing and enforcing mandatory reliability standards for all users, owners and operators of bulk power systems in North America. Under EPA 2005, the ERO can delegate enforcement authority to qualified regional reliability organizations ("RROs"). On July 20, 2006, FERC certified NERC as the ERO. In April 2007, the Western Electricity Coordinating Council ("WECC") became the RRO for the western interconnect. The western interconnect extends from Canada to Mexico and includes the provinces of Alberta and British Columbia, the northern portion of Baja California, Mexico and all or portions of the 14 western states in between.

NERC's reliability standards are developed in coordination with the electric industry and approved by the NERC Board of Trustees, which then submits the standards to FERC. New standards are frequently developed through NERC's standards development process. Utility experts provide input through the NERC Standards Committee, and each standard is voted on through a ballot pool. The District follows these processes closely and participates in standards developing and balloting processes as appropriate. Compliance with the approved standards is mandatory and enforceable, and NERC has the authority to levy fines for non-compliance. The District has a good record of compliance. Adoption of standards in the future could add to the District's costs of compliance with such standards.

The District has implemented an internal reliability compliance program. The work is independently reviewed and monitored by the District's Compliance Manager under the direction of the District's Chief Compliance Officer.

### ***Prohibition on Market Manipulation***

EPA 2005 prohibits entities, including municipalities such as public utility districts, from using any manipulative or deceptive device or contrivance, in connection with the purchase or sale of electric energy or the purchase or sale of transmission. In 2006, FERC issued a final rule implementing this section. The regulation specifically makes it unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to FERC jurisdiction: (1) to use or employ any device, scheme or artifice to defraud; (2) to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (3) to engage in any act, practice or course of business that operates or would operate as a fraud or deceit upon any entity. This regulation applies to the District to the extent it engages in conduct "in connection with" matters over which FERC has jurisdiction. The District has taken steps to demonstrate a culture of compliance, including compliance with anti-manipulation requirements. A compliance plan and training program have been implemented.

### ***Compliance and Risk Management***

The District is subject to various legal, regulatory and contractual compliance requirements. The District has a comprehensive ethics and compliance program that is designed to foster a culture of compliance. The culture of compliance means that all District employees are expected to learn, understand and follow the laws and regulations that affect their job responsibilities and that the District enforces this expectation in policies and procedures. The District has established a Compliance Office consisting of the General Counsel/Chief Compliance Officer and a Compliance Manager. This office is responsible for leading and coordinating the development, implementation and ongoing monitoring of the District's compliance programs. The Chief Compliance Office is independent from the compliance operational areas. In addition, the Chief Financial/Risk Officer is responsible for the District's enterprise risk management program and chairs the District's Power Risk Management Committee. See "THE DISTRICT—Management and Administration."

### ***Amendments to the Public Utility Regulatory Policies Act***

PURPA was enacted in 1978. Among other things, PURPA was intended to encourage (1) the conservation of energy supplied by electric utilities; (2) optimal efficiency of electric utility facilities and resources, and (3) equitable rates for electric consumers. The law has been amended several times, notably by the Energy Policy Act of 1992, the EPA 2005 and most recently by the Energy Independence and Security Act of 2007 ("EISA 2007"). EPA 2005 amended PURPA to require utilities to consider, and make a determination about whether it is appropriate to implement, five new federal standards relating to electric generation and efficiency. These federal standards are (1) net metering; (2) fuel diversity; (3) fossil fuel generation efficiency; (4) time-based metering and communications; and (5) interconnection.

EPA 2005 sets various deadlines for commencing and completing consideration of these standards. The Commission began consideration of three of these standards (net metering, time-based metering/communications and interconnection) in 2006.

The Commission determined that it is not in the best interest of the District to adopt the federal net metering standard. Instead, the Commission decided that the District's net metering practices should be updated in accordance with recent State legislation that increased net metering eligible systems from 25 kW to 100 kW. With regard to interconnection service, the Commission determined it is not in the best interest of the District to adopt the federal standard. Rather, the District continues to provide interconnection service to customer generators of up to 10 MW and has adopted the specific interconnection services developed by the Washington PUD Association Public Power Ad-hoc Interconnection Standards Committee for customer generators of 25 kW or less.

The Commission also declined to adopt federal standards for time-based rates and communications. Instead, District staff will continue to study and evaluate the benefits, technology and costs of time-based rates and communications (or smart metering) in conjunction with automated meter reading.

EPAct 2005 also required that the Commission complete a determination of the last two standards (fuel diversity and fossil fuel efficiency) by August 8, 2008. The Commission began consideration in July 2007, and the Commission determined not to adopt the fuel source diversity standard. Commissioners also declined to adopt the fossil fuel efficiency standard, finding it not applicable to the District.

EISA 2007 also added several new PURPA standards related to integrated resource planning; rate design to promote energy efficiency; and smart grid information. The District initiated consideration of these standards on August 11, 2008 in a public hearing. On November 3, 2008 the Commission held a public hearing to consider adopting proposed standards for two of the four standards, specifically smart grid investments and smart grid information. After considering the standards, the Commission elected not to adopt them, but directed staff to continue to evaluate possibilities for the future.

On November 16, 2009, the Commission held a public hearing to consider the two remaining EISA 2007 PURPA standards: (1) integrated resource planning/energy efficiency; and (2) rate design modifications to promote energy efficiency investments. The Commission also considered establishing 10- and two-year conservation targets as required under the voter-approved Energy Independence Act of 2006, codified as RCW Chapter 19.285 ("EIAAct 2006"). See "State Energy Legislation – Renewable Portfolio Standard" under this heading. At the November 16, 2009 public hearing, the Commission decided not to adopt the PURPA standards as written but instead to adopt a 10-year conservation plan and two-year conservation targets that identify cost-effective energy efficiency measures appropriate to the District and comply with the EIAAct 2006.

## **Climate Change and Renewables**

### ***General***

The District is attentive to the developing scientific knowledge and information regarding climate change which may result from greenhouse gas emissions and accumulations and from other factors. To the extent that regional warming increases the average temperature in the watershed that feeds the Columbia River, such warming could result in earlier run-off into the Columbia River, and thus affect the timing and/or amount of power generation at the District's Hydro-Electric Projects. The District is unable to predict whether any such climate changes will occur, the nature or extent thereof, or the effects they might have on the District's business operations and financial condition.

State and national policymakers are debating how to manage and mitigate for greenhouse gas emissions from many sectors of the economy, including electric generation. The District's three hydroelectric generating projects provide low-cost, clean, renewable power that does not generate greenhouse gas emissions. As an electric generator that relies on emission-free hydropower to serve its retail load plus provide energy to thousands of other Northwest customers, the District has a significant interest in the role that hydropower plays in climate change policy. District management and staff monitor the latest regional policy proposals. Current focus includes greenhouse gas developments at the state regulatory level. District staff also continues to monitor federal policy development.

### ***Chicago Climate Exchange***

The District has taken steps seeking to have hydropower generation recognized as part of the solution in the climate change debate. In December 2007, the Chicago Climate Exchange approved a portion of the hydropower generated at Rocky Reach Dam to be traded to offset greenhouse gas emissions from other sources. The Chicago Climate Exchange emission reduction program concluded following the completion of Phase II at the end of 2010, and the District's remaining offsets were deregistered. The revised offset registry program is to operate independently of the previous phases, and the District does not have offsets that qualify under the new program.

### ***Renewable Energy Markets***

The District has actively participated in the voluntary and compliance renewable energy markets. Renewable Energy Credits ("RECs") are the environmental attributes associated with one MWh of a qualifying renewable energy resource. Markets for RECs support both voluntary renewable energy programs and mandated state renewable portfolio standards. The District has sold a portion of the RECs associated with its hydro-electric power and wind power. As of September 30, 2012, over 175,000 of the District's RECs have been sold.

### ***Low Impact Hydropower Institute***

On January 24, 2008, the District's Lake Chelan Project was certified as "low impact" by the Low Impact Hydropower Institute, an independent non-profit organization ("LIHI"). In September 2012, the District applied for renewal of its five-year LIHI certification for the Lake Chelan Project, and in December 2012, the District received confirmation that its renewal application was approved. LIHI's mission is to reduce the impacts of hydropower dams through market incentives. Receiving certification as low-impact hydro means the dam and powerhouse are recognized for meeting criteria related to river flows, water quality, fish passage and protection, watersheds, threatened and endangered species, cultural resources, and public access and recreation. If any of the electricity generated at the Lake Chelan Project is ultimately certified as "green power," the energy or environmental values could potentially be sold in environmental markets. This product includes low impact hydropower from facilities certified by LIHI to have environmental impacts in key areas below levels LIHI considers acceptable for hydropower facilities. LIHI certification has been considered an important first step toward green certification.

### **Financial Services Reform**

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act allows the Commodity Futures Trading Commission (the "CFTC") to regulate clearing and exchange requirements for the purchase and sale of swaps, including some energy derivatives. The CFTC continues to address comments to proposed rules, to finalize rules and to develop its oversight responsibilities. The Dodd-Frank Act will continue to impact utilities that utilize derivatives and possibly other energy products as rules are finalized and become effective. On October 12, 2012, the CFTC finalized the rule that includes the definition of "swap" (a key term in the Dodd-Frank Act), which provides additional guidance regarding energy products that may qualify for a forward contract exclusion from the definition. On July 23, 2012, the rule defining "swap dealer" became effective. The rule provides for a de minimis threshold and a special entity sub-threshold for notional values of swap transactions before an entity is designated as a swap dealer. In response to concerns of representatives of the public power sector that entities might refrain from executing swap transactions with special entities (such as the District) because of the low threshold, the CFTC issued no-action relief that increased the sub-threshold to \$800 million and that narrowed the definition of qualifying swaps. Although an end-user of derivatives is exempt from mandatory clearing requirements if it is using a swap to hedge or mitigate commercial risk, there continues to be uncertainty in the industry regarding whether certain types of energy products are considered to be swaps and concerns that entities not wanting to be designated as "swap dealers" may refrain from entering into swap transactions with special entities. In addition, significant reporting requirements and record keeping obligations, for which rules are still being proposed, may ultimately raise costs for utilities, including the District.

As of December 31, 2012, the District has no credit support outstanding related to forward sales or purchases of energy or energy derivatives. At this time, the majority of the District's forward energy contracts are over-the-counter bilateral contracts that are physically delivered, and the District currently is not engaged in

financial only energy transactions. The District continues to evaluate its current energy transaction portfolio with regards to the swap definition and potential reporting requirements and will consider the implications of the Dodd-Frank Act when evaluating new types of transaction.

The District is a party to three interest rate swap agreements and is evaluating any historical reporting requirements that may be required under the Dodd-Frank Act and the rules promulgated thereunder. The District does not currently anticipate entering into any new interest rate swap agreements. See “FINANCIAL INFORMATION—Consolidated System Payment Agreements.”

## **Cyber Security**

Over the past several years, Congress has considered and ultimately rejected various pieces of cyber security legislation, ranging from H.R. 5026, the Grid Reliability and Infrastructure Defense Act (“GRID Act”), to S. 2105, the Cyber Security Act of 2012 (the “Cyber Security Act”). Political pressure to address perceived cyber security weaknesses is increasing, and governmental authorities generally believe that the electric sector is not doing enough to protect the grid. The electric industry opposed the GRID Act because, among other things, it would have given to FERC authority to issue emergency orders if the President determines that a “grid security threat” exists and to order specific measures to be taken by industry to address grid security vulnerabilities if FERC determined that the existing NERC standards were inadequate. Because FERC already has the authority to direct NERC to submit new or modified standards for approval, utilities were concerned that this new authority, if utilized by FERC, could undermine the NERC standards development process and result in FERC rewriting cyber security standards without using the NERC process to engage utility experts, which could potentially result in unworkable standards, given the diversity of the electric power system. The electric industry and other business interests also opposed the Cyber Security Act because of a provision which would have allowed the government, including the Department of Homeland Security (the “DHS”), to write voluntary cyber security standards that could later be adopted as mandatory by federal agencies with jurisdiction over critical electric infrastructure. Fundamentally, the electric industry is interested in preserving the current NERC standards development process, which protects the ability of utilities to provide input on the efficacy and appropriateness of proposed cyber security standards on critical electric infrastructure.

While opposing new regulatory frameworks, the electric industry has supported aspects of legislation that would encourage information sharing between the electric sector and the federal government to ensure that utilities can effectively act to protect against identified threats; however, attempts to pass information sharing legislation without broader regulatory mandates have thus far failed. In August 2012, the Senate Intelligence Committee Chair, Dianne Feinstein (D-Calif.), urged President Obama to issue an executive order “or take other appropriate action” to advance cyber security of critical infrastructure in the United States. It was expected that President Obama would issue an executive order in November 2012, but no such order has been publicly released.

The District continues to monitor these developments for potential effects on grid stability and new compliance and documentation requirements.

## **Electromagnetic Pulse Events**

The U.S. Congress and the DHS are considering the potential effects of natural and manmade electromagnetic pulse threats and vulnerabilities on the bulk-power system and electrical infrastructure. DHS has identified electrical control systems as vulnerable to disturbances caused by geomagnetic storms and electromagnetic pulse attack. Such events could interrupt power generation and delivery. Several bills have been introduced in Congress that addresses electromagnetic pulse vulnerabilities, including the 2010 GRID Act, which identified electromagnetic pulse as a grid security threat. In 2011, the Secure High-Voltage Infrastructure for Electricity from Lethal Damage Act (or “SHIELD Act”) was introduced with a provision requiring FERC to order NERC to submit reliability standards to adequately protect the bulk-power system from any reasonably foreseeable geomagnetic storm or electromagnetic pulse events.

The District is monitoring these developments. Depending on the legislative response to these concerns, mitigation plans to prepare for EMP events could be costly for the electricity industry.

## **Integration of Variable Energy Resources**

On November 18, 2010, FERC issued a notice of proposed rulemaking addressing the integration of variable energy resources, such as wind and solar, into the electric grid. The notice introduced three potential reforms intended to increase operational efficiencies in light of variable power output and to prevent undue discrimination of variable energy resources, including a proposed requirement for FERC-jurisdictional transmission providers to offer 15-minute intra-hourly transmission scheduling. Although the District is not a FERC-jurisdictional transmission provider, it is active in the wholesale market and may need to accommodate such scheduling to participate in the market place.

On June 21, 2012, FERC issued a final rule adopting changes to the pro forma Open Access Transmission Tariff (“OATT”) intended to facilitate the integration of variable energy resources (“VERs”). The final rule implements two changes initially proposed in November 2010. First, transmission providers are to amend their OATTs to permit customers to schedule transmission service at 15-minute intervals. The final rule permits transmission providers to submit alternative proposals that are consistent with or superior to FERC’s 15-minute scheduling requirement, provided that the alternative proposal offers an equal or greater opportunity for customers to mitigate generator imbalance penalties, and for the transmission provider to lower its reserve-related costs. Second, revisions are to be made to FERC’s pro forma Large Generator Interconnection Agreement to require generators using VERs to provide transmission owners with certain data (i.e., meteorological and operational data) to support power production forecasting and to help transmission providers more efficiently manage resource variability.

FERC declined to adopt the proposal advanced in the notice of proposed rulemaking that would have introduced a generic ancillary service rate schedule (Schedule 10 - Generator Regulation and Frequency Response Service) to the pro forma OATT under which transmission providers would offer generation regulation service (where physically feasible from resources available to them) to deliver energy from a generator within a transmission provider’s balancing authority area. FERC notes, however, that it will evaluate proposed charges for this service on a case-by-case basis, and that the final rule includes a framework for transmission providers to develop proposed changes.

FERC found that transmission customers are exposed to excessive imbalance service charges because they cannot adjust their service schedules within each operating hour, and that intra-hour scheduling gives customers the ability to manage cost exposure when generation output changes within the hour.

On October 19, 2012, Edison Electric Institute (“EEI”) filed a motion to extend the Order No. 764 compliance filing deadline from September 11, 2013 to November 12, 2013. EEI stated that the 62-day extension was necessary to “provide some flexibility in addressing any operational challenges that may arise during the transition to intra-hourly scheduling throughout summer peak conditions without jeopardizing reliability.” FERC has granted rehearing.

If FERC’s proposed requirement for 15-minute intra-hourly scheduling is not implemented in an incremental manner that takes existing business practices into account, there could be a financial impact to the District as new software and personnel may be needed to accommodate scheduling goals. The District continues to monitor any future developments on this issue.

## **State Energy Legislation**

### ***Renewable Portfolio Standard***

A ballot initiative known as I-937 was passed by the voters of the State of Washington in November 2006. Under the initiative, utilities with a retail load of more than 25,000 customers are required to use eligible renewable resources (excluding existing hydro-electric power) or acquire equivalent renewable energy credits, or a combination of both, to serve 3% of load by January 1, 2012; 9% by January 1, 2016; and 15% by January 1, 2020. The initiative also requires utilities to pursue all available conservation that is cost-effective, reliable, and feasible and impose deadlines for meeting conservation targets. Initiative 937 has been codified in the RCW as The Energy

Independence Act of 2006 (RCW 19.285). The Washington State Department of Commerce (“DOC”) adopted rules for implementing the requirements of the EIAAct 2006 as it pertains to consumer owned utilities on March 14, 2008.

The new law is specific about what types of renewable generation is eligible to meet the renewable portfolio standard (“RPS”). Existing hydropower is not eligible, but incremental hydropower is included as a renewable if it is produced as a result of efficiency improvements completed after March 30, 1999 to hydroelectric generation projects owned by a qualifying utility and located in the Pacific Northwest or to hydroelectric generation in irrigation pipes and canals located in the Pacific Northwest, where the additional generation in either case does not result in new water diversions or impoundments. Under the initiative, therefore, the District could count efficiency gains at its existing hydropower projects toward meeting the RPS. All of the District’s share of the Nine Canyon Wind Project would qualify for the RPS.

The District continues to evaluate the impacts of I-937 and other proposed changes to I-937, specifically to what extent the District’s current portfolio meets the RPS and how much additional renewable energy generation it may need to acquire at a future date to ensure compliance. In addition, the District is evaluating the potential for cost effective, reliable and feasible conservation measures that could be derived from more efficient energy use, production and distribution within its system. The Commission has adopted a 10-year conservation plan and two-year conservation targets in compliance with the EIAAct 2006.

The District has closely followed efforts by the Washington State Legislature to revise the law since 2009, when the Legislature was allowed to amend the citizen’s initiative by a simple majority vote. During the 2012 legislative session, the Legislature passed Senate Bill 6414 amending I-937 and providing some assistance to public utility districts and other entities regulated by the Washington Utility and Transportation Commission (“WUTC”). Senate Bill 6414 provides a pre-qualification review process through the DOC of electric generation and conservation projects to determine qualification of projects under I-937. This process provides more certainty that utilities and entities who are eligible for the review process and that make this type of investment will receive credit under the EIAAct 2006 by the Washington State Auditor’s office. In August 2012, the District received a favorable opinion from DOC that rehabilitation of Rocky Reach Project turbines, generators and transformers, plus spill avoided due to the juvenile fish bypass system, qualifies as incremental hydropower efficiency improvements under the Energy Independence Act. Future proposals to amend I-937 could expand eligible resources or could result in increased RPS targets for the District.

In addition, in March 29, 2011, the California Legislature adopted legislation that increased California's renewable portfolio standard for electric utilities from 20% to 33% by 2020. While not applicable to the District, the new requirement is expected to impact Northwest markets because it allows a percentage of eligible resources to be procured from sources outside California and delivered to a California balancing authority. A portion of the requirement may also be met by unbundled renewable energy credits. The District continues to review the legislation to determine potential positive and negative impacts to the District and regional energy markets.

### ***Integrated Resource Planning***

In 2006, the Legislature passed HB 1010 (RCW 19.280), which requires investor-owned and consumer-owned electric utilities with more than 25,000 customers to develop integrated resource plans (“IRPs”) and submit them to the DOC.

IRPs must include demand forecasts; assessment of commercially-available conservation and efficiency resources; assessments of commercially-available, utility scale renewable and nonrenewable generating technologies; a comparative evaluation of renewable and nonrenewable generating resources, including transmission and distribution delivery costs and conservation and efficiency resources, using “lowest reasonable cost” as a criterion; integration of demand forecasts and resource evaluations to identify how to meet current and projected needs at the lowest reasonable cost and risk to the utility and its ratepayers; and a short-term plan identifying specific actions to take consistent with the long-range IRP. Consumer-owned utilities must seek public input in development of their IRPs and progress reports and provide public notice and hearing. The initial IRPs were required to be submitted by September 1, 2008, with progress reports due at least every two years thereafter. An updated IRP must be developed at least every four years.

Following development of the District's initial IRP in 2008 and a progress report in 2010, the District completed its 2012 IRP as required by state law. The District's 2012 IRP was approved by the Commission on July 2, 2012 and submitted to the DOC shortly thereafter, following a public process in which no public comments were received. The 2012 IRP outlines the source of power needed to supply District customers through 2022. The District determined that it should retain its current mix of generating resources as well as continue to evaluate and implement conservation programs based on the work performed in a 2011 conservation potential assessment and carry on the evaluation and implementation of strategies for additional power sales contracts and ancillary services contracts consistent with District financial policies and the hedging strategy.

### *Cleaner Energy*

In 2007, the Legislature passed and the Governor signed HB1303, which would in part require all state agencies and local government subdivisions of the state to satisfy 100% of their fuel needs for operating publicly-owned vessels, vehicles and construction equipment with electricity or biofuels by 2015 (subsequently codified as RCW 43.19.648). The DOC is to adopt rules for implementation of this requirement "to the extent practicable." If the DOC finds it not practicable, the requirement can be suspended, delayed or modified until it is deemed practicable. The DOC issued a pre-proposal statement of inquiry in January 2012 for a possible determination of practicable goals for use of biofuels and electricity by all state agencies operating vessels, vehicles and construction equipment. Since January 2012, DOC has issued no other notices or findings on this issue. The District continues to monitor DOC findings and rulemaking on this issue.

### *Climate Change*

In 2008, the Legislature passed and the Governor signed E2SHB 2815, which requires reductions in greenhouse gas ("GHG") emissions, initiates GHG reporting requirements, and requires the Department of Ecology to make recommendations for the development of a market-based cap and trade system. Under the bill, the state must reduce over-all greenhouse gas emissions to 1990 levels by 2020; to 25% below 1990 levels by 2035; and to 50% below 1990 levels by 2050. In December 2008, the Department of Ecology provided a suite of recommendations to the Legislature regarding methods to reduce GHG emissions. Among these recommendations was continued participation as a partner in the Western Climate Initiative ("WCI"), which is finalizing design for a multisector market-based cap and trade system to reduce GHG emissions. The WCI was operational in some participating jurisdictions in 2012; however, the Washington State Legislature must pass authorizing legislation before such a system can be implemented in Washington State. Thus far, such legislation has not passed the Legislature, particularly as lawmakers focus on economic and budget priorities. The District continues to monitor WCI activity.

E2SHB 2815 also required the Department of Ecology to adopt rules requiring the reporting of GHG emissions. The original provisions would have required owners or operators of a fleet of on-road motor vehicles that emit at least 2,500 metric tons of direct GHG emissions annually in the state, or a source or combination of sources that emit at least 10,000 metric tons of direct GHG emissions annually in the state, to report their total annual GHG emissions beginning in 2010 for their 2009 emissions. The District contracted with a consulting firm to conduct analyses related to the District's carbon footprint using methods and procedures specified by The Climate Registry. Results of the inventory for years 2007 and 2008 indicated the District would have been below the reporting requirements and that no further action was necessary. The requirements of this reporting provision were subsequently superseded by ESSB 6373, passed by the Legislature and signed by the Governor in 2010, which aligned the Washington State GHG reporting protocols with federal regulations promulgated by the Environmental Protection Agency and overrode the reporting requirements of E2SHB 2815. This new approach made it even less likely that the District would be required to report GHG emissions. The new rule removed the requirement to report indirect emissions or emissions of a fleet of on-road motor vehicles that emit at least 2,500 metric tons of GHG. The District continues to monitor state and federal GHG reporting trends.

Finally, legislation enacted in 2009 added a new layer of climate considerations to current law. E2SSB 5560 required the development of an "integrated climate change response strategy" that will enable adaptation to the impacts of climate change. The DOE released its "Preparing for a Changing Climate" - Washington State's Integrated Climate Response Strategy in April 2012, which includes seven high priority, overarching response strategies to help Washington adapt to climate change and in recognition of the state's vulnerability to climate



change impacts. This District continues to monitor for any potential legislative proposals that may result from the recommendations in the report regarding water and fish management.

### ***Washington State Budget***

Like many other states, the State of Washington is facing a significant budget deficit for the biennium ending June 30, 2013. To close the budget gap, the Legislature is considering cutting services and expenditures of several identified programs. District operations interface contractually with the Washington State Parks and Recreation Commission (“WSP”), for which additional budget reductions are being considered. Additionally, the Legislature is considering increasing revenues, including fees for certain government permits and licenses, which may result in increased costs for permits that the District renews or obtains in the course of business operations, such as water rights or hydraulic approval permits. The District is currently monitoring the State budget discussions closely to assess the likelihood and potential impact of possible budget reductions for WSP and fee increases, but cannot predict whether such measures will be adopted or their exact magnitude. The District is proactively developing operational contingency plans (short-term and long-term) to address the operation of six District-owned parks that offer camping services, including three parks that WSP currently operates under contract with the District.

## **ECONOMIC AND DEMOGRAPHIC INFORMATION**

In 2009 through 2011, the Distribution Division sold approximately 34% of the power output of the Hydro-Electric Projects throughout an area coextensive with Chelan County, Washington, located in central Washington approximately 138 road miles east of Seattle and 165 road miles west of Spokane. Wenatchee, the county seat of the County, is located on east-west U.S. Highway 2 and within five miles of north-south U.S. Highway 97, and is on the Columbia River.

Agriculture is the mainstay of Chelan County. Due to the Wenatchee area’s soil and climate conditions, the area produces substantial crops of apples, pears and cherries. The three-county region of Chelan, Okanogan to the north and Douglas to the east produces a significant portion of the apple crop of the State.

Although Wenatchee’s economy is based primarily on agriculture, it is supported by the aluminum industry, with Alcoa being a major employer in the area. See “THE CONSOLIDATED SYSTEM—The Alcoa Sales Contract” and APPENDIX H—“DESCRIPTION OF THE MAJOR POWER PURCHASERS.” In addition to Alcoa, local industries include steel and machinery fabricating firms, food processors and garment manufacturing.

Over 3,000 businesses provide goods and services required by a four-county trade area of 240,000 people. The abundant outdoor recreation opportunities and close proximity of Wenatchee to the urban Puget Sound region have made Wenatchee a major year-round convention and recreation site within the State. The Greater Wenatchee Regional Events Center (the Town Toyota Center), a premier multi-purpose sports and entertainment venue, opened in October 2008. The facility is being financed through a partnership of the Greater Wenatchee Regional Facility District and the City of Wenatchee.

Wenatchee and East Wenatchee residents enjoy a wide range of educational, cultural and civic institutions. The Wenatchee and Eastmont school districts together provide three high schools, a junior high school, five middle schools and 12 elementary schools to the community’s young people. Also available are parochial school systems and the campus facilities of Wenatchee Valley College, an 8,000-student (including part-time students) two-year institution. Central Washington University in Ellensburg and Washington State University in Pullman maintain extension centers for students seeking four-year degrees as well as master’s certificate programs.

Tables 21 through 26 on the following pages present data regarding population, employment, income, retail sales, major employers and building permit activity.

**Table 21  
Population<sup>(1)</sup>**

<u>Year</u>	<u>Wenatchee</u>	<u>Chelan County</u>	<u>State of Washington</u>
2008	30,810	72,100	6,608,245
2009	30,960	72,600	6,672,159
2010	31,120	73,300	6,724,540
2011 <sup>(1)</sup>	32,090	72,700	6,767,900
2012 <sup>(1)</sup>	32,400	73,200	6,817,770

<sup>(1)</sup> Figures are estimates. Estimates are not revised based on information that becomes available after the estimate date.

Source: *Washington Office of Financial Management.*

**Table 22  
Average Annual Employment<sup>(1)</sup>**

<u>Chelan County</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Total Civilian Resident Labor Force	40,710	41,810	41,060	40,520	40,990
Employment	38,430	38,450	37,380	37,100	37,820
Unemployment	2,280	3,360	3,670	3,420	3,170
Unemployment Rate	5.6%	8.0%	9.0%	8.4%	7.7%
<b><u>State of Washington</u></b>					
Unemployment Rate	5.4%	9.4%	9.9%	9.2%	8.2%

<sup>(1)</sup> Annual averages, not seasonally adjusted.

Source: *Washington State Employment Security Department.*

**Table 23  
Per Capita Personal Income**

<u>Year</u>	<u>Chelan County</u>	<u>State of Washington</u>
2006	\$31,963	\$39,570
2007	34,217	42,192
2008	38,279	44,106
2009	36,356	41,504
2010	36,250	42,024
2011	37,619	43,878

Source: *U.S. Census Bureau.*

**Table 24  
Chelan County  
Taxable Retail Sales**

<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u> <sup>(1)</sup>
\$1,532,758,491	\$1,300,189,738	\$1,319,346,941	\$1,308,164,727	\$974,631,770

(1) Data as of the third quarter of 2012. Through the third quarter of 2011 taxable retail sales were \$970,538,506.

Source: Washington State Department of Revenue.

**Table 25  
Chelan County and Douglas County  
Major Employers**

<u>Employer</u>	<u>Project or Service</u>	<u>No. of Employees</u>
Stemilt Growers, LLC	Agriculture	3,024
Wenatchee Valley Medical Center	Healthcare	1,697
Central Washington Hospital	Healthcare	1,456
Wenatchee School District	Education	1,027
McDougall & Sons, Inc.	Agriculture	900
The District	Utilities	640 <sup>(1)</sup>
Eastmont School District	Education	610
Crunch Pak, LLC	Processing	500
Custom Apple Packers	Agriculture	497
Alcoa Inc.	Manufacturing	465
County of Chelan	Government	446
Blue Star Growers	Agriculture	405
Northern Fruit Co. Inc.	Agriculture	350
Wenatchee Valley College	Education	348
Campbell's Lodge, Inc.	Resort	300
Wal-Mart Stores, Inc. – Wenatchee	Retail	285
Blue Bird, Inc.	Agriculture	280
C & O Nursery	Agriculture	277
Washington State Department of Transportation	Transportation	259
Mission Ridge Ski Area	Recreation & Fitness	237
Lake Chelan Community Hospital	Healthcare	228
Pacific Aerospace & Electronics	Manufacturing	219
Cashmere Valley Bank	Finance	213
Columbia Valley Community Health	Healthcare	203
Peshastin Hi-Up	Agriculture	200

<sup>(1)</sup> As stated in “THE DISTRICT—Employees,” as of September 30, 2012 the total number of District employees was 710.  
Source: Port of Chelan County, December 2011.

**Table 26  
Chelan County  
Building Permits**

	<u>Permits Issued</u>	<u>Valuation</u>
2007	950	\$69,632,903
2008	805	67,130,520
2009	566	47,033,822
2010	569	30,441,094
2011	456	59,095,239
2012 <sup>(1)</sup>	497	36,168,435

<sup>(1)</sup> Through November 2012.

Source: *Port of Chelan County and Chelan County Building, Fire Safety and Planning, Building Division.*

### TAX MATTERS

On June 3, 2009, Orrick, Herrington & Sutcliffe LLP, San Francisco, California, Bond Counsel, delivered its opinion that, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2008B Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”) and Title XIII of the Tax Reform Act of 1986. Bond Counsel further opined that interest on the 2008B Bonds is not a specific preference item for purposes of the federal individual and corporate alternative minimum taxes, nor is it included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expressed no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2008B Bonds. A complete copy of the opinion of Bond Counsel concerning the 2008B Bonds rendered on June 9, 2009 (herein referred to as the “Original Bond Counsel Opinion”) is set forth as Appendix E attached hereto.

In connection with the execution and delivery of the 2008B Credit Facility, Bond Counsel will deliver its opinion to the effect that the execution and delivery of the 2008B Credit Facility will not adversely affect the exclusion of interest on the 2008B Bonds from gross income for federal income tax purposes (the “Credit Facility Opinion”). Bond Counsel’s Credit Facility Opinion is expressly limited to such matters. Bond Counsel has not reviewed, and has not been requested to review, any events other than those described above that have occurred since issuance of the 2008B Bonds and expresses no opinion with respect thereto. A complete copy of the proposed form of Credit Facility Opinion of Bond Counsel is set forth in Appendix F hereto.

The Original Bond Counsel Opinion has not been updated as of the date of this Remarketing Memorandum, and Bond Counsel is not rendering any opinion on the current status for tax purposes of the 2008B Bonds. Notwithstanding the foregoing, investors should be aware of the following information.

Title XIII of the Tax Reform Act of 1986 and Section 103 of the Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2008B Bonds. The District has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2008B Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2008B Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the 2008B Bonds. The Original Bond Counsel Opinion assumed, and the Credit Facility Opinion assumes, the accuracy of these representations and compliance with these covenants. Other than delivery of the 2008B Credit Facility described herein, Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) or any other matters coming to the attention of Bond Counsel after the date of original issuance of the 2008B Bonds may adversely affect the value of, or the tax status of interest on, the 2008B Bonds. Accordingly, neither the Original Bond Counsel

Opinion nor the Credit Facility Opinion is intended to be relied upon in connection with any such other actions, events or matters, nor may any opinion be relied upon in connection with any such other actions, events or matters.

Although the Original Bond Counsel Opinion stated that interest on the 2008B Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of interest on, the 2008B Bonds may otherwise affect a holder's federal, state or local tax liability. The nature and extent of these other tax consequences will depend upon the particular tax status of the holder or the holder's other items of income or deduction. Bond Counsel has expressed and will express no opinion regarding any such other tax consequences.

The Original Bond Counsel Opinion was based upon then-existing laws, regulations, rulings and court decisions. Events occurring after the delivery of the Original Bond Counsel Opinion, including subsequently enacted legislation, legislative proposals, if enacted into law, clarification of the Code or of Title XIII of the Tax Reform Act of 1986, or court decisions may cause interest on the 2008B Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent holders of 2008B Bonds from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such legislative proposals, clarification of the Code or of the Title XIII of the Tax Reform Act of 1986, or court decisions may also affect the market price for, or marketability of, the 2008B Bonds. Prospective purchasers of the 2008B Bonds should consult their own tax advisors regarding any past, pending or proposed federal or state tax legislation, regulations or litigation, and regarding the impact of future legislation, regulations or litigation, as to which Bond Counsel has expressed and will express no opinion.

The Credit Facility Opinion will be based on current legal authority, will cover certain matters not directly addressed by such authorities, and will represent Bond Counsel's judgment as to the proper treatment of the 2008B Bonds for federal income tax purposes. The Original Bond Counsel Opinion was based on legal authority as of June 3, 2009, covered certain matters not directly addressed by such authorities and represented Bond Counsel's judgment as to the proper treatment of the 2008B Bonds for federal income tax purposes. Neither the Original Bond Counsel Opinion nor the Credit Facility Opinion is or will be binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the activities of the District after the date on which the Original Bond Counsel Opinion was delivered or after the date on which the Credit Facility Opinion will be delivered, nor has Bond Counsel given any opinion or assurance about the effect of changes in the Code, Title XIII of the Tax Reform Act of 1986, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS after the date on which the Original Bond Counsel Opinion was delivered or after the date on which the Credit Facility Opinion will be delivered. The District has covenanted, however, to comply with the requirements of Title XIII of the Tax Reform Act and the Code.

Bond Counsel's original engagement with respect to the 2008B Bonds ended with the issuance of the 2008B Bonds on June 3, 2009. Bond Counsel's engagement with respect to the delivery of the 2008B Credit Facility will end on the delivery of the 2008B Credit Facility. Unless separately engaged, Bond Counsel is not obligated to defend the District or the holders of Bonds regarding the tax-exempt status of interest on the 2008B Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the District and their appointed counsel, including the holders of Bonds, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions, with which the District legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the 2008B Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues, may affect the market price for, or the marketability of, the 2008B Bonds, and may cause the District or the holders of Bonds to incur significant expense.

### **CONTINUING DISCLOSURE UNDERTAKING**

Pursuant to a certificate to be executed by the District prior to the remarketing of the 2008B Bonds (a "Continuing Disclosure Certificate"), the District will covenant for the benefit of the Owners and the "Beneficial Owners" (as defined in the Continuing Disclosure Certificate) of the 2008B Bonds to provide certain financial information and operating data relating to the District by not later than six months after the end of each of the District's fiscal years (presently, December 31), commencing with the report for the fiscal year ended December 31,

2013 (the “Annual Report”), and to provide notices of the occurrence of certain enumerated events with respect to the 2008B Bonds. The Annual Report will be filed by or on behalf of the District with the Municipal Securities Rulemaking Board. The specific nature of the information to be contained in the Annual Report and the notices of enumerated events are set forth in the proposed form of the Continuing Disclosure Certificate, which is included in its entirety in APPENDIX K. The District’s covenant will be made in order to assist the Underwriters in complying with Securities and Exchange Commission Rule 15c2-12. The District has complied in all material aspects with all prior written undertakings under the Rule.

### **APPROVAL OF LEGAL PROCEEDINGS**

Certain legal matters relating to the remarketing of the 2008B Bonds will be passed upon by Orrick, Herrington & Sutcliffe LLP, Seattle, Washington, Bond Counsel and Disclosure Counsel to the District. The proposed form of the Credit Facility Opinion of Bond Counsel is attached hereto as APPENDIX F. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Remarketing Memorandum. Certain legal matters will be passed on for the Remarketing Agent by its counsel, Hawkins Delafield & Wood LLP, New York, New York.

### **LIMITATIONS ON REMEDIES**

The ability of the District to comply with its covenants under the Resolution and to generate Revenues sufficient to pay the principal of and interest on the 2008B Bonds may be adversely affected by actions and events outside the control of the District, including without limitation by actions taken (or not taken) by voters or ratepayers. Furthermore, any remedies available to the owners of the 2008B Bonds upon the occurrence of an event of default under the Resolution are in many respects dependent upon judicial actions which are in turn often subject to discretion and delay and could be both expensive and time-consuming to obtain.

In addition to the limitations on remedies contained in the Resolution, the rights and obligations under the Bonds and the Resolution may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors’ rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to limitations on legal remedies against public utility districts in the State. In the event the District fails to comply with its covenants under the Resolution or to pay principal or Purchase Price of or interest on the 2008B Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the 2008B Bonds.

### **Bankruptcy Considerations**

A municipality such as the District must be specifically authorized under state law in order to seek relief under Chapter 9 of the U.S. Bankruptcy Code (the “Bankruptcy Code”). A creditor, however, cannot bring an involuntarily bankruptcy proceeding against a municipality, including the District. The federal bankruptcy courts have broad discretionary powers under the Bankruptcy Code. The District is authorized under Washington law to file for bankruptcy protection under the Bankruptcy Code. Should the District become a debtor in a bankruptcy proceeding, the owners of the 2008B Bonds would continue to have a lien on Net Revenues after the commencement of the bankruptcy case so long as the Net Revenues constitute “special revenues” within the meaning of the Bankruptcy Code. “Special revenues” are defined under the Bankruptcy Code to include, among other things, receipts by local governments from the ownership, operation or disposition of projects or systems that are primarily used to provide utility services. While the District believes that Net Revenues constitute “special revenues,” no assurance can be given that a court would not determine otherwise. If Net Revenues do not constitute “special revenues,” there could be delays or reductions in payments by the District with respect to the 2008B Bonds.

### **INITIATIVE AND REFERENDUM**

Under the State Constitution, the voters of the State have the ability to initiate legislation and require a public vote on legislation passed by the State Legislature through the powers of initiative and referendum, respectively. Neither power may be used to amend the State Constitution. Initiatives and referenda are submitted to the voters upon certification of a petition signed by at least 8.0% (initiative) and 4.0% (referenda) of the number of

voters registered and voting for the office of Governor at the preceding regular gubernatorial election. Any law approved in this manner by a majority of the voters may not be amended or repealed by the Legislature within a period of two years following enactment, except by a vote of two-thirds of all the members elected to each house of the Legislature. After two years, the law is subject to amendment or repeal by the Legislature in the same manner as other laws.

It is possible that future initiatives could be approved by the voters from time to time, including without limitation initiatives that revise or restrict the powers of the District to increase rates and charges. The District is unable to predict whether any such initiatives might be submitted to or approved by the voters, the nature of such initiatives, or their potential impact on the District.

### **LITIGATION**

The District is not aware of any litigation pending or threatened in any court (either state or federal) to restrain or enjoin the remarketing of the 2008B Bonds, or questioning the creation, organization or existence of the District or the title to office of the members of the Commission or officers of the District or the proceedings for the issuance of the 2008B Bonds, or in any manner questioning the power and authority of the District to impose, prescribe or collect rates and charges for the services of the Consolidated System. The District is a party to other lawsuits arising out of its normal course of business, but the District does not believe that any of such lawsuits will have a material adverse effect upon the District or its ability to pay the 2008B Bonds.

### **INDEPENDENT ACCOUNTANTS**

The District's financial statements as of December 31, 2011 and December 31, 2010 and for the two years then ended, included as Appendix A in this Remarketing Memorandum, have been audited by PricewaterhouseCoopers LLP, independent accountants, as stated in their report appearing herein.

The preliminary financial data included in this Remarketing Memorandum has been prepared by, and is the responsibility of, the District's management. PricewaterhouseCoopers LLP has not audited or compiled the accompanying preliminary financial data. Accordingly, PricewaterhouseCoopers LLP does not express an opinion or any other form of assurance with respect thereto.

### **RATINGS**

Moody's, S&P and Fitch are expected to assign their ratings of "VMIG 1," "A-1" and "F1," respectively, to the 2008B Bonds, based upon the 2008B Credit Facility. Moody's, S&P and Fitch have assigned underlying ratings of "Aa3," "AA" and "AA+," respectively, to the 2008B Bonds. Such ratings reflect only the views of the rating agencies, and any explanation of the significance of each such rating should be obtained from the rating agency furnishing the same. Such ratings are not a recommendation to buy, sell or hold the 2008B Bonds. There is no assurance that any such ratings will be retained for any given period of time or that the same will not be revised downward or withdrawn entirely by the rating agency furnishing the same, if, in its judgment, circumstances so warrant. The District and the Remarketing Agent undertake no responsibility to oppose any such revision or withdrawal. Any such downward revision or withdrawal of a rating may have an adverse effect on the market price of the 2008B Bonds.

### **REMARKETING**

Barclays Capital Inc. (the "Barclays") has agreed, subject to certain conditions, to purchase the 2008B Bonds from the District at a purchase price of \$65,250,000, which is equal to the aggregate principal amount of the 2008B Bonds. The District has agreed to pay Barclays an underwriting fee in the amount of \$114,592 in connection with the purchase and remarketing of the 2008B Bonds on the Mandatory Tender Date.

Barclays's obligation to purchase the 2008B Bonds on the Mandatory Tender Date is subject to certain conditions precedent, and Barclays will be obligated to purchase all the 2008B Bonds, if any such 2008B Bonds are purchased.





**APPENDIX A—AUDITED FINANCIAL STATEMENTS OF THE DISTRICT  
FOR THE YEAR ENDED DECEMBER 31, 2011**

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## Report of Independent Auditors

To the Board of Commissioners of Public Utility District No.1 of Chelan County, Washington

In our opinion, the accompanying balance sheets and the related statements of revenue, expenses and changes in net assets and statements of cash flows present fairly, in all material respects, the financial position of the Public Utility District No. 1 of Chelan County, Washington (the "District") at December 31, 2011 and December 31, 2010, and its changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District's 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.

The management's discussion and analysis for the year ended December 31, 2011 on pages 13 through 18 and the Schedule of Funding Progress for Postretirement Health Benefits Program on page 47 are not required parts of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the District's financial statements taken as a whole. The Combining Schedules of Assets and Liabilities and Net Assets, of Revenues, Expenses and Changes in Net Assets, and of Cash Flows, as well as Note 11: Supplemental Disclosure of Telecommunication Services, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

*PricewaterhouseCoopers LLP*

April 20, 2012



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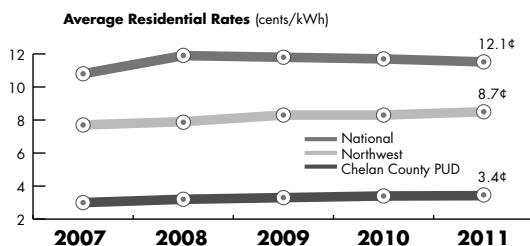
*The following discussion provides an overview and analysis of the financial activities of Public Utility District No. 1 of Chelan County (the District) for the years ended December 31, 2011 and 2010. This discussion and analysis is designed to be used in conjunction with the financial statements, notes and other supplementary information, which follow this section.*

## FINANCIAL HIGHLIGHTS

- Locking in predictable revenue by selling “slices” of the future output of Rock Island and Rocky Reach dams in up to five-year increments is proving to be successful in helping the District meet financial goals called for in its Strategic Plan. The power is auctioned under a new power sales strategy approved by the Board of Commissioners that allows the District to sell slices of clean, renewable hydropower output in advance in up to five-year blocks. A slice means that purchasers are not guaranteed a specific number of megawatts, but, in exchange for fixed payments to the District, they will receive a percentage under whatever generating conditions exist at the time. The District will still have adequate energy supplies to meet local load during this period, and, for most weather and water supply conditions, the District expects to have additional power to sell on the surplus market beyond what was auctioned. This should benefit customers by providing more rate stability and more certainty for District programs. In March 2011, the District locked in additional predictable revenue of \$86.4 million from November 2011 through the end of 2015, in exchange for a share of future power produced by Rock Island and Rocky Reach dams that is surplus to local needs. Fixed monthly payments began as soon as the power was delivered beginning in November 2011. This sale was the third of its kind. The previous two auctions raised \$129.0 million for output from December 2010 through 2014.
  - In May 2011, the District successfully marketed \$179.7 million in Consolidated System Revenue Bonds, Refunding Series 2011AB (AMT). The 2011AB bonds, issued as fixed-rate bonds, refunded \$200.8 million of existing debt at lower interest rates. In conjunction with the refinancing, a forward starting swap negotiated in 2006 scheduled to go live June 1, 2011, was terminated. Net Present Value (NPV) savings associated with the refinancing were used to offset the termination fee. Factoring in the termination fee, the NPV savings on the refinancing was \$36.4 million.
  - In October 2011, the District successfully marketed \$164.4 million in Consolidated System Revenue Bonds, Refunding Series 2011C. The 2011C bonds were issued as fixed-rate, taxable bonds. The 2011C bonds refunded \$164.4 million of existing debt at lower interest rates. The District was also able to secure more favorable repayment terms, shortening the average life of the debt. The NPV savings associated with the refinancing was \$31.4 million.
  - As part of refinancing a portion of existing PUD bonds for better terms, three bond rating agencies – Standard and Poor’s Ratings Services, Fitch Ratings and Moody’s Investor Service – affirmed the District’s strong overall bond ratings.
- Standard and Poor’s affirmed the District’s previous bond rating of AA with a stable outlook, while Fitch maintained its AA+ rating but changed the outlook to negative. Moody’s affirmed the Aa2 bond rating with a negative outlook. All three firms mentioned the District’s new financial principles as positive but noted the need to see continued positive results in order to maintain the strong ratings.
- In November 2011, new power sales contracts with Puget Sound Energy (PSE) and Alcoa for the output of power from Rocky Reach Dam went into effect. The new contracts benefit all parties and extend power sales to PSE and Alcoa through 2031 and 2028, respectively. Under the new contracts, PSE receives 25 percent of the output from Rocky Reach and Alcoa receives energy equivalent to 27.5 percent of the output from Rocky Reach in exchange for PSE and Alcoa paying 25 percent and 27.5 percent, respectively, of costs associated with the project, including capital, operation and maintenance and debt service costs. Once the new power sales contracts for the output of power from Rock Island Dam become effective on July 1, 2012, PSE and Alcoa will receive 25 percent and energy equivalent to 26 percent, respectively, of the combined output of the Rocky Reach and Rock Island dams. The contracts allow the District to pay down debt and to pay for some future capital improvements at the hydro projects without borrowing. In addition, PSE made an \$89.0 million payment and Alcoa made a \$22.9 million payment to the District in 2006 and 2008, respectively. The payments represented deferred wholesale power sales revenue, which will be recognized as earnings over the life of the new power sales contracts.
  - In 2011, commissioners approved a combination of steps to help bring District debt balances down by over \$300 million through 2015. The steps included refinancing a portion of existing District bond issues for better terms and terminating some interest rate swaps. The goals of the financing plan were to maintain the District’s strong bond ratings and financial position, to reduce the complexities of the District’s financial portfolio and meet Financial Policy targets established in the latest Strategic Plan. The targets, incorporating what the District heard from customers, are intended to: provide a sufficient rate of return for the District so assets can be replaced over time and there will be sufficient income to meet District obligations, even under unusual (low water/low price) conditions; maintain an adequate debt-service coverage ratio to demonstrate that the District clearly has the resources to meet debt obligations, even under unusual conditions; gradually reduce the debt ratio (percentage of utility assets financed by debt) from approximately 75 percent to below 60 percent by 2015; and provide financial liquidity (cash reserves and other sources) to cover risks and provide additional financial stability.
  - The District met an important milestone in its fish protection efforts at Rock Island Dam. Studies over the last three years show that spilling 10 percent of the river flow for spring fish migration downstream is as effective at meeting survival targets as spilling 20 percent. Those results have earned the District approval from agencies and tribes to continue

operating the dam for the next 10 years in much the same way it is operated today. That will add more certainty to District budgeting and help stabilize rates for customer-owners. Fewer fish-survival studies will be needed. The ability to refine the District's approach to fish protection at Rock Island Dam is one of the innovative aspects of the Habitat Conservation Plan (HCP) that is part of the District's federal license to operate both Rocky Reach and Rock Island Dams.

- The District was also recognized by fisheries agencies and participating tribes as achieving the survival standard for endangered spring Chinook salmon as part of the District's HCP for Rocky Reach Dam. The achievement means the District has now reached the HCP survival standard for all spring migrating salmon and steelhead at both Rocky Reach and Rock Island Dams. Reaching the goals for spring migrants means the District can maintain its existing hydro project operations and fish protection measures for the next 10 years when another check-in on survival will take place. By combining survival methods with habitat restoration work and hatchery programs, the District is on track for achieving its HCP goal of no net impact on salmon and steelhead by 2013. This is a positive reflection of the HCP and its outcome-based design. The HCP lets the District choose various tools and methods to use as long as the fish survival goals are achieved.
- The temporary electric rate surcharge of 9-percent that had been in place since May 2009, after record-low river flows, expired at the end of December 2011. Even with the temporary surcharge, average residential rates for District power were approximately 3.4 cents per kilowatt hour, among the lowest rates in the nation. The Pacific Northwest average rate was 8.7 cents per kwh, and the national average was 12.1 cents per kwh. In October 2011, the commissioners approved a new residential flat rate, effective January 2012. In addition to a basic charge, residential customers will now be charged a flat 2.7 cents per kilowatt-hour for all the energy they use. The move to a flat rate will make it easier for customers to understand their bill and calculate the impact of adding new appliances or reducing energy use. The new electrical rates will result in 2.5 percent more retail electric revenue for the District, but with the end of the 9-percent surcharge, customers should see an overall average decrease of 6.5 percent in bills. The average residential rate in 2012 is expected to be approximately 3.2 cents per kilowatt hour, still among the lowest in the nation.



- The District's conservation programs for residential, commercial and industrial customers in 2011 and 2010 saved

enough electricity to power approximately 1,700 homes. The expected savings of 3.2 to 3.6 average megawatts (aMW) will exceed the target of 3.1 aMW, which was set under the requirements of Washington State Initiative 937, the Energy Independence Act. The savings of 1.72 aMW for 2010 alone is the largest amount of conservation achieved for any year in District history. One aMW serves about 500 Northwest homes. State law requires utilities with 25,000 or more customers to acquire all cost-effective conservation. The District's philosophy is that conservation is an energy resource, which will help meet future demand. The District must reset conservation targets every two years, as well as its 10-year plan for achieving those savings.

- Faced with higher costs and a longer construction schedule than originally estimated, commissioners stood by the District's Strategic Plan and decided in April 2011 to withdraw from participating in a federal grant that was designed to extend the District's fiber-optic network. Commissioners also rescinded a 2-percent electric rate increase approved in 2010 to cover the District's share of matching dollars for the grant. Money received since December 2010 was used to cover costs for bidding contracts and materials, design and other work on the project. The original grant would have provided the District \$25 million to extend fiber over three years to areas of Chelan County not yet served by any high-speed broadband. Strategic planning is currently under way to determine a long-term plan for the District's fiber system, with the goal of putting the system on sound financial footing for the future.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This section of the Annual Report consists of the Independent Auditors' Report, Management's Discussion and Analysis (MD&A), Basic Financial Statements with accompanying notes, and Supplementary Information. The financial statements of the District are designed to provide readers with a broad overview of the District's finances similar to a private-sector business. They are prepared using the accrual basis of accounting in accordance with generally accepted accounting principles. Under this basis of accounting, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred, regardless of the timing of related cash flows. These statements offer short- and long-term financial information about District activities.

The Balance Sheets present information on all of the District's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The Statements of Revenues, Expenses and Changes in Net Assets provide the operating results broken into categories of operating revenues and expenses, non-operating revenues and expenses, as well as capital contributions.

The Statements of Cash Flows provide relevant information about the District's cash receipts and cash payments from operations as well as funds provided by and used in capital and related financing and investment activities.

The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

### FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

One of the most important questions asked about the District's finances is, "Is the District, as a whole, better off or worse off as a result of the year's activities?" The Balance Sheets and the Statements of Revenues, Expenses and Changes in Net Assets report information about the District's activities in a way that helps answer this question. These two statements report the net assets of the District and the changes in them. The District's Net Assets – the differences between assets and liabilities – is one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, customer growth and legislative mandates should also be considered.

In 2011, the overall financial position of the District improved. The District's total net assets increased by \$16.7 million. The increase

is due primarily to improved snow pack and stream flows, which resulted in a significant increase in generation at the District's hydro projects compared to 2010, reducing the need for purchases of energy and resulting in increased revenues as energy in excess of the District's load requirements was sold in the wholesale market. The increase in sales volume was partially offset by lower average wholesale power prices compared to the prior year. Lower market prices were somewhat buffered by the sale of slices of the District's hydro production at fixed prices. Continued cost containment efforts by the District contributed to the improvement in earnings, as well.

Despite cost-cutting efforts in 2010, the District experienced a \$13 million decrease in net assets. This was the second year in a row of keeping the District in preservation mode and restricting spending. Contributing to the loss were reduced net wholesale power revenues due primarily to lower-than-normal runoff in the spring of 2010 and low wholesale power prices. Spring and early summer rains helped the situation somewhat, but not enough.

The following analysis provides a three-year comparison of key financial information:

### CONDENSED COMPARATIVE FINANCIAL INFORMATION

(amounts in thousands)

	2011	2010	2009*	Increase (Decrease) 2011 - 2010
Current assets	\$ 196,741	\$ 194,736	\$ 201,680	\$ 2,005
Net utility plant	1,090,933	1,095,308	1,096,518	(4,375)
Other non-current assets	286,970	316,382	315,828	(29,412)
<b>Total assets</b>	<b>1,574,644</b>	<b>1,606,426</b>	<b>1,614,026</b>	<b>(31,782)</b>
Current liabilities	99,978	84,703	76,579	15,275
Long-term debt	912,037	992,219	1,010,158	(80,182)
Other liabilities	174,561	158,164	142,894	16,397
<b>Total liabilities</b>	<b>1,186,576</b>	<b>1,235,086</b>	<b>1,229,631</b>	<b>(48,510)</b>
Invested in capital assets, net of related debt	220,126	208,355	212,686	11,771
Restricted	110,692	106,766	107,501	3,926
Unrestricted	57,250	56,219	64,208	1,031
<b>Total net assets</b>	<b>\$ 388,068</b>	<b>\$ 371,340</b>	<b>\$ 384,395</b>	<b>\$ 16,728</b>

\* The District's 2009 Balance Sheet was restated for the impacts of the required retroactive implementation of GASB Statement No. 53 (SGAS 53), "Accounting and Financial Reporting for Derivative Instruments," which became effective for the District in 2010. Implementation of the statement had no impact on the District's operating results or net cash flows for any year presented.

MANAGEMENT'S DISCUSSION AND ANALYSIS - cont.  
December 31, 2011 and 2010

	2011	2010	2009	Increase (Decrease) 2011 - 2010
Operating revenues	\$ 238,543	\$ 216,355	\$ 202,760	\$ 22,188
Less				
Operating expenses	177,092	183,487	176,053	(6,395)
Other income and expenses	46,608	49,379	44,712	2,771
Net income (loss) before capital contributions	14,843	(16,511)	(18,005)	31,354
Capital contributions	1,885	3,456	2,886	(1,571)
Change in net assets	16,728	(13,055)	(15,119)	29,783
Total net assets – beginning of year	371,340	384,395	399,514	(13,055)
Total net assets – end of year	\$ 388,068	\$ 371,340	\$ 384,395	\$ 16,728

### ASSETS

Current assets increased by \$2.0 million in 2011, primarily due to an increase in accounts receivable as a result of the implementation of the new power sales contracts and the current portion of deferred regulatory charges which will be amortized in 2012. These increases were offset by a net decrease in the District's cash and investment balances primarily as a result of payments made related to the termination of interest rate swap agreements with three counterparties.

On the other hand, current assets decreased \$6.9 million in 2010, primarily due to negative operating results and a shift in investment strategy given market conditions and projected liquidity requirements resulting in increased long-term investments.

As of December 31, 2011, the District had approximately \$1.1 billion invested in a variety of capital assets (see Note 3). Net utility plant decreased \$4.4 million in 2011, reflecting additional investments in utility plant assets, including significant additions related to the hydro fisheries and hatchery projects, transmission corridor upgrades and hydro modernization projects at Rock Island, which were more than offset by the cumulative effect of 12 months' worth of depreciation. As of December 31, 2010, the District had approximately \$1.1 billion invested in a variety of capital assets (see Note 3). Net utility plant decreased \$1.2 million in 2010, reflecting additional investments in utility plant assets, including significant additions related to the hydro modernization projects at Rock Island and Lake Chelan, substation improvements and a new water reservoir, which were more than offset by the annual depreciation.

Other non-current assets decreased \$29.4 million in 2011 primarily as a result of a net decrease in restricted assets and long-term investments offset somewhat by an increase in deferred regulatory charges. Restricted assets and long-term investments decreased primarily as a result of a reduction in balances used to fund capital expenditures combined with the early retirement of existing debt. Deferred regulatory charges increased primarily

as a result of the termination of the 2008B and 2011 swaps in 2011. The 2008B and 2011 swaps were terminated in March and May 2011, respectively, and the termination payments were recognized as regulatory assets. Other non-current assets increased slightly in 2010 primarily as a result of a net increase in long-term investments combined with changes in fair market value of the District's interest rate swaps. These increases were offset by lower restricted construction funds as balances were spent on capital projects, including significant additions related to the hydro modernization projects at Rock Island and Lake Chelan as well as substation improvements and a new water reservoir.

### LIABILITIES

Current liabilities increased \$15.3 million in 2011, primarily as a result of increases in the current portions of long-term obligations and deferred wholesale power sales, offset somewhat by a reduction in accrued interest. The increase in current portion of long-term obligations is due primarily to refunding existing debt as the average life of the debt was shortened in order to secure more favorable repayment terms. With the implementation of the new power sales contracts, unearned revenue previously received from the power purchasers will now be recognized over the life of the contracts. The change in current portion represents a full year's unearned revenue to be recognized in 2012. The decrease in accrued interest is due primarily to refunding of existing debt at lower interest rates combined with the retirement of existing debt. Balances on which interest is calculated are down, and interest rates are down, as well.

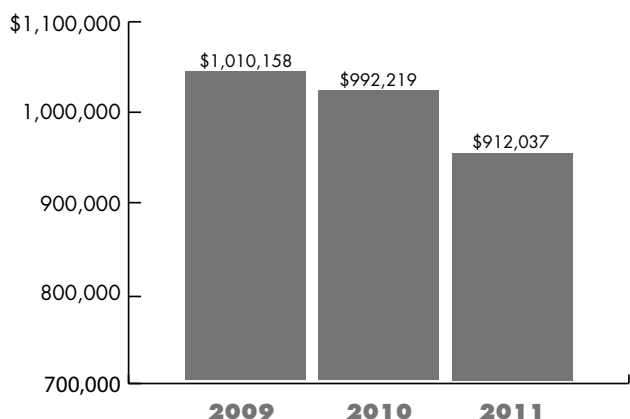
Current liabilities increased \$8.1 million in 2010, primarily as a result of an increase in the current portion of long-term obligations combined with an increase in warrants and accounts payable. The increase in current portion of long-term obligations is due to the expiration of the prepaid escrow for the 2009 and 2010 senior lien debt service. In 2009, the District set aside funds in an escrow account to cover obligated senior Chelan Hydro Consolidated System debt-service payments related to the non-hydro systems for 2009 and 2010. As of December 31, 2009, any senior lien debt



payments due within 12 months were to be paid out of the funded escrow account. As of December 31, 2010, any scheduled senior lien debt service payments are reflected in the current portion of long-term debt. Warrants and accounts payable increased primarily as the result of a large accrual for the final payment on the hydro modernization project at Lake Chelan combined with the reclassification of the Rocky Reach working capital obligation from long-term to short-term as the contract end date was October 31, 2011.

During 2011, the District successfully marketed \$344.1 million in Consolidated System Revenue Bonds, refunding existing debt at lower interest rates and securing more favorable repayment terms, shortening the average life of the debt. In addition to the refunding, the District was able to make advance repayment of several bond issues during 2011, contributing to the \$80.2 million decrease in the long-term debt balance compared to the prior year.

**LONG-TERM DEBT\***  
(amounts in thousands)



\*Net of premiums, discounts and deferred refunding losses

The District did not refinance or issue additional bonds in 2010.

For more information regarding the long-term debt activity see Note 6.

Other liabilities increased \$16.4 million in 2011 primarily as a result of the implementation of the new long-term power sales contracts and the accrual of various initial charges which are deferred and will be recognized in wholesale revenue systematically over the periods in which the charges are earned. This was offset somewhat by a decrease in derivative instrument liability as a result of the termination of the 2008B and 2011 swaps combined with changes in the fair market value on the District's remaining interest rate swaps. Other liabilities increased \$15.3 million in 2010 as a result of changes in the fair market value of the District's interest rate swaps.

**NET ASSETS**

Invested in capital assets, net of related debt, increased \$11.8 million in 2011, and decreased \$4.3 million in 2010. The increase

in 2011 reflects a reduction in debt primarily as a result of early retirements and downsizing offset somewhat by lower restricted construction funds as compared to the prior year. The decrease in 2010 reflects somewhat reduced growth in net utility plant combined with no additional debt proceeds as compared to the prior year. Restricted net assets represent resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements. Restricted net assets increased \$3.9 million in 2011 due to funds that are restricted by the new Rocky Reach power sales agreement that became effective November 1, 2011, and decreased \$700,000 in 2010. Unrestricted net assets are not restricted for the purpose of debt covenants or other legal requirements and can be used to finance the day-to-day operations of the District. In 2011 and 2010, unrestricted net assets increased approximately \$1.0 million and decreased approximately \$8.0 million, respectively, due primarily to increased earnings in 2011 and decreased earnings in 2010.

**STATEMENT OF REVENUES AND EXPENSES**

In 2011, retail energy sales increased \$2.2 million compared to 2010 as a result of an increase to more "normal" usage levels during the winter. Retail sales in 2010 were lower than average due to mild weather conditions. Wholesale power sales increased \$19.3 million in 2011 compared to 2010. Significantly increased generation at the District's hydros combined with retaining a higher percentage of generation at Rocky Reach under the new power sales contracts resulted in a higher volume of surplus energy available for sale into the wholesale market. The increase in volume was partially offset by lower average market prices. Purchased power costs decreased \$8.5 million in 2011 compared to 2010, primarily corresponding to a combination of reduced purchase volume and lower average purchase prices. Operating expenses came in \$6.4 million lower in 2011 than in 2010, primarily as a result of decreased purchased power costs and cost containment efforts. Other expenses, which include net interest expense and income, decreased \$2.8 million primarily as a result of decreased interest on long-term debt due to a combination of reduced debt balances as a result of some early retirements during 2011 and the issuance of refunding bonds at lower interest rates. The decrease in interest expense was offset somewhat by amortization of swap termination payments made in 2011 and losses on early retirements of debt. Capital contributions decreased \$1.6 million compared to 2010 due primarily to a couple of large projects recognized in the prior year. There were no similar projects in 2011. Net income before capital contributions improved by \$29.8 million compared to 2010 due primarily to increased operating revenues combined with decreased purchased power costs as a result of increased generation and the implementation of the new power sales contracts.

In 2010, retail energy sales decreased \$1.5 million compared to 2009 as a result of less usage during the mild winter weather. Wholesale power sales increased \$15.4 million in 2010 compared to 2009 driven by a combination of higher average market prices than in 2009 and the resale of energy bought back for credit risk mitigation purposes. Purchased power costs increased \$4.2 million in 2010 compared to 2009, primarily corresponding to the same higher average market prices and the buyback of power previously sold in order to mitigate credit risk with a particular

counterparty. Operating expenses came in \$7.4 million higher in 2010 than in 2009 despite significant cost-cutting measures taken by the District, primarily as a result of increased purchased power costs and depreciation. Other expenses, which include net interest expense and income, increased in 2010 by \$4.7 million due primarily to reduced investment earnings as a result of declining market investment yields. Some individual investments which were earning higher investment yields matured during the year and were reinvested at much lower rates. Balances available for investments also declined somewhat during 2010 as a result of capital spending. Capital contributions increased \$570,000 compared to 2009 as a result of a couple of large projects which were partially offset by a reduction in line extension activity as a result of slower growth due to the current economic conditions. Net loss before capital contributions improved by \$1.5 million compared to 2009 due primarily to continued cost-cutting efforts.

### OTHER SIGNIFICANT MATTERS

We are proud of the District's many accomplishments in 2011. This was the third year of keeping the District in preservation mode and restricting spending. By remaining disciplined in its financial policies and capitalizing on a good water year, the District was able to exceed budgeted expectations in 2011 by \$14.0 million. Combined improvement in net assets for the District was \$16.7 million, compared to a budgeted amount of \$2.7 million.

The focus for 2011 was on keeping the District strong and reliable. In line with its Strategic Plan, which incorporates what the District has heard from customers regarding financial priorities, the District is on track to build up reserves for a rainy day, continue reducing debt and maintaining low rates and reliable service by keeping its assets in good shape.

- The 9-percent electric rate surcharge imposed in May 2009 was extended through April 2011 and then again through December 2011. As of January 2012, the electric rate surcharge has been replaced with a 2.5-percent increase from where rates stood in 2008. The average residential rate for 2012, of 3.2 cents per kilowatt hour, remains among the lowest in the nation.
- To reduce financial risk and decrease year-to-year revenue volatility, the District also locked in predictable revenue by selling slices of surplus hydropower in up to five-year increments through a competitive bidding process.

Providing additional encouragement for 2012 is the end of the long-term power sales contract at Rock Island Dam that expires in

June 2012, to be replaced by restructured contracts with Alcoa and Puget Sound Energy that will run for nearly another 20 years. With that change, continued cost-containment and average snowpack, the District expects to end 2012 with a positive bottom line.

### CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

The financial report is designed to provide a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. Questions concerning any of the information provided in this report should be directed to the District at P.O. Box 1231, Wenatchee, WA 98807.



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**BALANCE SHEETS**  
**December 31, 2011 and 2010**  
(amounts in thousands)

<b>ASSETS</b>	<b>2011</b>	<b>2010</b>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 55,968	\$ 65,470
Investments	76,192	39,236
Accounts receivable, net	25,843	21,476
Accrued interest receivable	1,535	1,446
Materials and supplies	10,595	10,362
Prepayments and other	747	1,260
Current portion of deferred regulatory charges	3,508	-
	<u>174,388</u>	<u>139,250</u>
<b>RESTRICTED ASSETS - CURRENT</b>		
Cash and cash equivalents	9,978	32,901
Investments	12,375	22,585
	<u>22,353</u>	<u>55,486</u>
<b>TOTAL CURRENT ASSETS</b>	<u>196,741</u>	<u>194,736</u>
<b>UTILITY PLANT</b>		
In service, at original cost	1,804,366	1,769,796
Construction work in progress	34,645	28,533
Less-accumulated depreciation	(748,078)	(703,021)
	<u>1,090,933</u>	<u>1,095,308</u>
<b>RESTRICTED ASSETS - NONCURRENT</b>		
Cash and cash equivalents	36,847	58,886
Investments	131,770	121,425
	<u>168,617</u>	<u>180,311</u>
<b>DEFERRED CHARGES AND OTHER ASSETS</b>		
Deferred financing costs	7,391	10,499
Fish protection costs	856	1,776
Long-term receivables, net	1,772	3,323
Long-term investments	53,691	79,003
Deferred regulatory charges, net	40,978	23,296
Derivative instrument asset	7,375	3,948
Deferred outflow of resources- derivatives	-	8,370
Other	6,290	5,856
	<u>118,353</u>	<u>136,071</u>
<b>TOTAL ASSETS</b>	<u>\$ 1,574,644</u>	<u>\$ 1,606,426</u>

*The accompanying notes are an integral part of these statements.*

<b>LIABILITIES AND NET ASSETS</b>	<b>2011</b>	<b>2010</b>
<b>CURRENT LIABILITIES</b>		
Current portion of long-term obligations	\$ 46,778	\$ 35,401
Current portion of deferred wholesale power sales	6,703	-
Accounts payable	18,322	17,900
Accrued taxes	4,385	3,389
Accrued interest	11,935	16,585
Accrued vacation and other	11,855	11,428
	<u>99,978</u>	<u>84,703</u>
<b>LONG-TERM DEBT</b>		
Revenue bonds and notes payable, less current portion	912,037	992,219
<b>OTHER LIABILITIES</b>		
Deferred wholesale power sales revenue, less current portion	113,061	111,941
Long-term contract customer deposit	18,500	-
Derivative instrument liability	21,012	31,664
Deferred inflow of resources - derivatives	7,375	3,948
Licensing obligation, less current portion	8,046	7,858
Regulatory liabilities	5,886	2,277
Other liabilities	681	476
	<u>174,561</u>	<u>158,164</u>
<b>TOTAL LIABILITIES</b>	<u>1,186,576</u>	<u>1,235,086</u>
<b>COMMITMENTS AND CONTINGENCIES</b> (see Note 13)		
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	220,126	208,355
Restricted	110,692	106,766
Unrestricted	57,250	56,219
	<u>388,068</u>	<u>371,340</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 1,574,644</u>	<u>\$ 1,606,426</u>

*The accompanying notes are an integral part of these statements.*

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**For the years ended December 31, 2011 and 2010**  
(amounts in thousands)

	2011	2010
<b>OPERATING REVENUES</b>		
Retail sales	\$ 56,469	\$ 54,256
Wholesale sales	179,363	160,042
Other operating revenues	2,711	2,057
	<u>238,543</u>	<u>216,355</u>
<b>OPERATING EXPENSES</b>		
Purchased power and water	14,731	23,193
Generation	67,542	69,613
Utility services	30,050	28,806
Taxes	7,403	6,284
Depreciation and amortization	48,468	49,025
Other operation and maintenance	8,898	6,566
	<u>177,092</u>	<u>183,487</u>
<b>OPERATING INCOME</b>	61,451	32,868
<b>OTHER INCOME (EXPENSE)</b>		
Interest on long-term debt	(50,140)	(55,520)
Amortization of deferred debt costs	(1,186)	(1,123)
Investment income	9,461	7,692
Federal subsidy income	630	630
Other	(5,373)	(1,058)
	<u>(46,608)</u>	<u>(49,379)</u>
<b>INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS</b>	14,843	(16,511)
<b>CAPITAL CONTRIBUTIONS</b>	<u>1,885</u>	<u>3,456</u>
<b>CHANGE IN NET ASSETS</b>	16,728	(13,055)
<b>TOTAL NET ASSETS</b>		
Beginning of year	<u>371,340</u>	<u>384,395</u>
<b>TOTAL NET ASSETS</b>		
End of year	<u>\$ 388,068</u>	<u>\$ 371,340</u>

*The accompanying notes are an integral part of these statements.*

**STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2011 and 2010**  
(amounts in thousands)

	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 261,406	\$ 213,975
Payments to suppliers	(60,925)	(64,826)
Payments to employees	(66,003)	(64,606)
Net cash provided by operating activities	<u>134,478</u>	<u>84,543</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Additions to plant	(44,463)	(41,525)
Proceeds from sale of plant	463	81
Proceeds of new debt	362,660	-
Principal paid on debt	(444,415)	(31,999)
Interest paid on debt	(39,736)	(39,919)
Capital contributions	5,322	2,470
Other	(27,108)	1,725
Net cash used in capital and related financing activities	<u>(187,277)</u>	<u>(109,167)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments	(203,014)	(195,557)
Proceeds from sales and maturities of investments	194,078	184,611
Interest on investments	6,527	7,720
Long-term receivables	1,551	471
Other, net	(807)	873
Net cash used in investing activities	<u>(1,665)</u>	<u>(1,882)</u>
<b>NET DECREASE IN CASH &amp; CASH EQUIVALENTS</b>	(54,464)	(26,506)
<b>CASH &amp; CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>157,257</u>	<u>183,763</u>
<b>CASH &amp; CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 102,793</u>	<u>\$ 157,257</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income	\$ 61,451	\$ 32,868
Depreciation and amortization	48,468	49,025
(Increase) decrease in operating assets:		
Accounts receivable, net	(4,367)	(2,380)
Materials and supplies	(233)	(3)
Prepayments	513	2,580
Other	(1,112)	-
Increase (decrease) in operating liabilities:		
Accounts payable	1,105	1,778
Accrued taxes	996	(301)
Accrued vacation and other	426	976
Deferred wholesale revenue	8,774	-
Long-term contract customer deposits	18,457	-
Net cash provided by operating activities	<u>\$ 134,478</u>	<u>\$ 84,543</u>
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES</b>		
Construction costs included in accounts payable	\$ (683)	\$ 614
Capital contributions	116	2,538

The accompanying notes are an integral part of these statements.

## NOTE 1: SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

### Reporting Entity and Operations of the District

Public Utility District No. 1 of Chelan County, Washington (the District) is a municipal corporation of the State of Washington established in 1936. The District owns and operates electric generation, electric and water distribution, wastewater properties and a wholesale telecommunication system. The District is governed by an elected five-member Board of Commissioners (Commissioners). The Commissioners' responsibilities are to appoint the General Manager, approve budgets for the District's Systems and set policies and guiding principles for the operations included in these financial statements. The District has no component units. The District's operations consist of the Rocky Reach Hydroelectric System, the Columbia River-Rock Island Hydroelectric System, the Lake Chelan Hydroelectric System (the Hydro Systems); a retail electric distribution system, a water system, a wastewater system, a fiber-optic telecommunication system (Utility Services); and some internal service systems.

### Accounting Policies

The accompanying financial statements of the District conform to accounting principles generally accepted in the United States of America (GAAP) applicable to a municipal utility. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," requires that governments' proprietary activities apply all GASB pronouncements as well as the pronouncements of the Financial Accounting Standards Board (FASB) and its predecessors issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. As allowed by GASB Statement No. 20, the District has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

In June 2010, GASB Issued Statement No. 59, "Financial Instruments Omnibus." Statement No. 59 updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This statement was effective for periods beginning after June 15, 2010. Implementation of Statement No. 59 did not have a material impact on the District's financial results.

### Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and 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. The District has used significant estimates in the determination of fair value of derivatives, regulatory assets and liabilities, depreciable lives of utility plant, license obligations, unbilled revenues, self-insurance reserves, incurred but not reported self-insurance liabilities, allowance for uncollectible accounts receivable and payroll related liabilities.

### Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits at commercial banks and investments with maturities of ninety days or less when purchased.


### Revenues and Expenses from Operations

Revenues of the District are recognized when earned and are comprised of sales of power, sales of electric, water, wastewater and wholesale telecommunication services and sales of environmental attributes. The accompanying financial statements include estimated unbilled revenues for energy and wholesale telecommunication services delivered to customers between the last billing date and the end of the year. Estimated unbilled revenues amounted to \$2.5 million in 2011 and \$2.6 million in 2010. The amounts are included in accounts receivable.

Revenues from the Rocky Reach and Columbia River-Rock Island hydroelectric production facilities represent sales of power generated under firm "take-and-pay" power sales contracts or sales directly to the retail electric distribution system. Revenues under these contracts are cost-based, including debt service costs. The long-term contract under which the Rocky Reach System had sold its output for the last 50 years expired in October 2011, and the Columbia River-Rock Island System's current contract expires in June 2012.

In January 2006, the District entered into a 20-year power sales contract with Puget Sound Energy (PSE) for 25% of the output of the Rocky Reach and Columbia River-Rock Island projects, starting in 2011 and 2012, respectively, when the prior power sales contracts expire. PSE will generally be responsible to pay 25% of costs associated with the projects, including capital, operation and maintenance and debt service costs. Under the terms of the contract, the District received an advance payment of \$89.0 million during 2006,





which was deferred and will be recognized as revenue over the term of the new contract.

In July 2008, the District entered into a 17-year power sales contract with Alcoa for output equivalent to 27.5% of the Rocky Reach project effective November 2011, and 26% of both Rocky Reach and Columbia River-Rock Island projects, effective July 2012, when the prior power sales contracts expire. Alcoa will generally be responsible to pay 26% and 27.5% of costs associated with the projects, including capital, operation and maintenance and debt service costs beginning November 2011 and July 2012, respectively. Under the terms of the contract, the District received an advance payment of \$22.9 million of an \$89.0 million capacity reservation charge during 2008, which was deferred and will be recognized as revenue over the term of the new contract. The balance of the capacity reservation charge will be deferred as long as the plant continues to operate and waived if the plant continues to operate under the terms of the contract for the entire contract term.

Revenues from the sale of environmental attributes associated with a portion of the District's hydroelectric and wind generation are recorded as delivered and earned.

As of December 31, 2011, the District's share of power produced by the Rocky Reach, Lake Chelan and Rock Island Systems is sold to the retail electric distribution system on a cost-of-service basis. The Rocky Reach, Lake Chelan and Rock Island Systems sell 41.96%, 100% and 50%, respectively, of their output to the retail electric distribution system, which is in turn sold to retail customers or sold on the wholesale market if in excess of the District's retail load.

Electric, water and wastewater customers and telecommunication service providers are billed on a cyclical basis under rates established by the District's Commission. Revenues from the sale of electric, water, wastewater and telecommunication services are recorded as delivered and earned.

For the years ended December 31, 2011 and December 31, 2010, the District had two significant customers (greater than 10% of operating revenues), Puget Sound Energy and Alcoa, collectively comprising total revenue of \$123.0 million and \$94.5 million, respectively.

The District accounts for expenses on an accrual basis. Expenses for the costs of production from the Rocky Reach, Columbia River-Rock Island and Lake Chelan hydroelectric production facilities are recovered under firm power sales contracts or sales directly to the retail electric distribution system.

In 2009, the District issued taxable Build America Bonds (BABs) to finance capital projects that otherwise could be financed with tax-exempt bonds as permitted under the American Recovery and Reinvestment Act of 2009. The District receives periodic subsidy payments from the federal government equal to 35 percent of the interest paid on the BABs. The District recognized non-operating revenues of \$0.6 million in 2011 and in 2010.

Intradistrict revenues and expenses are eliminated in the Statement of Revenues, Expenses and Changes in Net Assets.

### **Regulatory Deferrals**

The Commissioners have the authority to establish the level of rates charged for all District services. As a regulated entity, the District's financial statements are prepared in accordance with FASB ASC 980, "Regulated Operations", which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in the Statement of Revenues, Expenses and Changes in Net Assets as incurred, are recognized when included in rates and recovered from, or refunded to, customers. The District records various regulatory assets and credits to reflect rate-making actions of the Commissioners. See Note 5.

### **Power Marketing**

To balance the District's anticipated power resources and demand for those power resources, the District enters into forward physical power sales agreements when resources exceed expected demand and forward physical power purchase agreements when expected demand exceeds the resources estimated to be available.

To help manage risk and keep future rates stable and affordable, the District has implemented a comprehensive forward energy hedging strategy. A key component of this strategy includes the execution of market based products such as physical block transactions and slice output contracts over a rolling forward horizon of up to 60 months beyond the current year. The execution of this strategy helps to mitigate the risks the District faces related to power marketing while securing revenue for the future. Forward physical block transactions are used to mitigate market price risk the District faces related to its long or short positions. The execution of slice output contracts, which provide a counterparty a percentage share of hydropower production for a fixed payment, also help mitigate price risk, as well as volumetric risk related to river flows and production risk related to the District's ability to generate power.

All power risk management activities are subject to the Power Risk Management Policy requirements and oversight

by the District's Power Risk Management Committee, which monitors the District's exposure to various power related risks using a series of industry standard methodologies. The Power Risk Management Policy includes credit management provisions under which individual limits are assigned to counterparties based upon specific predetermined criteria utilizing an industry standard credit-scoring model. Active counterparties are reviewed on a regular basis to evaluate whether the assigned limits need to be adjusted. In addition, daily monitoring of financial and market information is performed to identify any developing counterparty credit risk. Transactions are limited accordingly when deemed necessary. Credit exposure reports are reviewed by the Power Risk Management Committee on a weekly basis.

The District requires that a collateral annex be executed in conjunction with any slice output contract. Currently, the District is requiring that all posting requirements be met with a Letter of Credit. For higher rated counterparties, the District will accept Performance Assurance in the form of cash.

All of the District's forward power contracts are derivative instruments. As of December 31, 2011 and 2010, the District has reviewed its various contractual agreements and concluded that all forward power contracts constitute normal purchases and sales under GASB Statement No. 53 and as such, are excluded from fair value reporting requirements. All forward power contracts are recognized over the duration of the contracts as a component of Operating Revenues and Purchased Power Operating Expenses in the Statement of Revenues, Expenses and Changes in Net Assets.

#### **Fish Protection Costs**

Costs associated with projects for research and development of fish protection measures are expensed in the period in which they are incurred. When successful fish protection systems are developed and permanently installed at a hydro project, all appropriate costs are capitalized to utility plant and depreciated over their estimated useful lives. In accordance with power sales contracts, certain fish protection costs incurred prior to 1995 have been deferred and are being amortized over a period of 5 to 20 years to match the contractual revenues received.

#### **Deferred Financing Costs**

Costs associated with the issuance of bonds are amortized to expense over the term of the related debt. Amortization expense is calculated under the straight-line method or effective interest method, depending on the maturity schedule of the related bonds.

#### **Allowance for Uncollectible Accounts Receivable**

A reserve is established for uncollectible accounts receivable based upon actual historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. The allowance for uncollectible accounts was \$144,000 and \$127,000 at December 31, 2011 and 2010, respectively.

#### **Capital Contributions**

A portion of the District's utility plant has been financed through contributions from federal and state agencies and from assessments of local property owners. The District also records contributions from customers and developers, primarily relating to the District's Utility Services System, in accordance with the District's line extension policy. In-kind contributions are recognized based on the donor's actual costs. Capital contributions are recorded as Non-Operating Revenues in the Statements of Revenues, Expenses and Changes in Net Assets. For rate-making purposes, individual contributions in excess of \$1 million are deferred when received and included in revenues to match the estimated useful lives and amortized costs of the related facilities. See Note 5.

#### **Materials and Supplies Inventory**

Materials and supplies consist of hydroelectric generation, transmission, distribution, water and wastewater assets, and fiber-optic cable and fiber-related supplies. Inventories are valued at average cost.

#### **Compensated Absences**

Employees of the District accrue a personal leave benefit based upon a years of service schedule. Personal leave may be used for vacation and sick leave purposes. The District records personal leave as an expense and a liability as earned. Unused personal leave may be accumulated up to a maximum of 1,350 hours for non-bargaining unit personnel and 1,200 hours for bargaining unit employees. Upon resignation, retirement or death, 90% of accumulated personal leave is deposited into a personal Voluntary Employees' Beneficiary Association (VEBA) account. The remaining 10% of accumulated personal leave is cashed out.

#### **NOTE 2: CASH AND INVESTMENTS**

Investments of the District are held by banks or trust companies as the District's agent and in the District's name. The remainder of the District's funds consists of uninvested cash that is protected against loss by a combination of federal depository insurance and being on deposit with qualified public depositories of the Washington Public Deposit Protection Commission (WPDPC).

Cash and investments are recorded in accounts as required by the District's bond indentures. Restricted assets represent accounts that are restricted by bond covenants or third party contractual agreements. Accounts that are allocated by resolution of the Commissioners are considered to be board designated accounts. Board designated accounts are a component of unrestricted assets as their use may be redirected at any time by approval of the Commissioners. Generally, when both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first as appropriate, then unrestricted resources as they are needed.

As of December 31, the District's unrestricted, board designated and restricted assets included on the Balance Sheets as cash and cash equivalents, investments and long-term investments, consisted of the following:

<b>(amounts in thousands)</b>	<b>2011</b>	<b>2010</b>
Unrestricted assets		
Unrestricted	\$ 51,570	\$ 21,787
Board designated	134,281	161,922
Total unrestricted assets	185,851	183,709
Restricted assets	190,970	235,794
	<u>\$ 376,821</u>	<u>\$ 419,503</u>

As of December 31, 2011 and 2010, the District had the following cash and investments:

<b>(amounts in thousands)</b>	<b>Investment Maturities (in Years)</b>				
	<b>Fair Value 2011</b>	<b>Less than 1</b>	<b>1 - 2</b>	<b>3 - 4</b>	<b>More than 4</b>
<b>Investment Type</b>					
U.S. Treasuries	\$ 45,056	\$ 5,352	\$ 13,561	\$ 6,795	\$ 19,348
U.S. Agency Notes	69,791	35,626	28,249	5,916	-
U.S. Agency Bills	19,033	19,033	-	-	-
Municipal Bonds	56,827	17,672	21,255	9,813	8,087
TLGP Bank Bonds	36,820	36,820	-	-	-
State Investment Pool	26,537	26,537	-	-	-
Financial Institution Deposits	51,978	43,978	4,000	4,000	-
Cash	70,779	70,779	-	-	-
	<u>\$ 376,821</u>	<u>\$ 255,797</u>	<u>\$ 67,065</u>	<u>\$ 26,524</u>	<u>\$ 27,435</u>

<b>(amounts in thousands)</b>	<b>Investment Maturities (in Years)</b>				
	<b>Fair Value 2010</b>	<b>Less than 1</b>	<b>1 - 2</b>	<b>3 - 4</b>	<b>More than 4</b>
<b>Investment Type</b>					
U.S. Treasuries	\$ 27,113	\$ 7,020	\$ 5,407	\$ 3,461	\$ 11,225
U.S. Agency Notes	52,494	22,162	15,104	6,009	9,219
U.S. Agency Bills	27,009	27,009	-	-	-
Municipal Bonds	48,769	7,865	14,466	20,338	6,100
TLGP Bank Bonds	53,083	26,043	27,040	-	-
State Investment Pool	58,827	58,827	-	-	-
Financial Institution Deposits	77,869	39,869	30,000	4,000	4,000
Cash	74,339	74,339	-	-	-
	<u>\$ 419,503</u>	<u>\$ 263,134</u>	<u>\$ 92,017</u>	<u>\$ 33,808</u>	<u>\$ 30,544</u>

U.S. Treasury bills, notes or bonds, U.S. Government agency securities, municipal bonds, TLGP bank bonds and bankers' acceptances that had a remaining maturity at the time of purchase of greater than one year are recorded at fair value. U.S. Treasury bills, notes or bonds, U.S. Government agency securities, municipal bonds, TLGP bank bonds, bankers' acceptances and commercial paper that had a remaining maturity at the time of purchase of one year or less are recorded at amortized cost. Non-negotiable certificates of deposit are recorded at amortized cost. The fair value of investments recorded at amortized cost does not differ materially from the recorded value.

The fair value of investments is based on quoted market

prices for those investments. It is generally the District's policy to hold investments to maturity.

**Interest rate risk.** The District's investment policy limits direct investments in securities to those with maturities of five years or less, or as designated in specific bond resolutions, with the exception of reserve funds which may be invested in securities exceeding five years if the maturity of such investments is made to coincide with the expected use of the funds. The District may collateralize its repurchase agreements using longer dated investments. The District may also invest in variable rate securities with final maturities beyond five years, as long as the time period between rate changes is less than five years.

**Credit risk.** The District pools a portion of each of the Systems' cash and investments. The District's Treasurer directs the investment of any temporary cash surplus in accordance with the District's investment policy and guided by State of Washington statute. The Treasurer may invest such surplus, depending on individual fund restrictions, in one or more of the following investments in accordance with the current District investment policy: 1) U.S. Treasury bills, notes or bonds; 2) U.S. Government agency securities, limited to 30% of the qualifying portfolio and no more than 10% of the total assets invested with a single issuer; 3) repurchase agreements, which must be collateralized with a third party at 102%, limited to \$10 million with any financial institution; 4) savings or time deposits, including insured or collateralized certificates of deposit, with institutions approved as qualified public depositories by the WPDPC, amount held by each issuer limited to 15% for certificates of deposit and 20% for savings and other deposit accounts, of the District's investment portfolio; 5) bankers' acceptances with the highest short-term credit rating of any two nationally recognized statistical ratings organizations at the time of purchase, limited to no more than 30% of the qualifying portfolio and no more than \$5 million invested in a single banker's acceptance; 6) commercial paper having received the highest short-term credit ratings of any two nationally recognized statistical ratings organizations at the time of purchase, limited to no more than 25% of the qualifying portfolio and no more than 5% of the total assets invested with a single issuer; 7) bonds of the State of Washington or any local government in the State of Washington, which bonds have, at the time of investment, one of the three highest credit ratings of a nationally recognized rating agency, limited to no more than 30% of the qualifying portfolio and no more than 5% of the total assets invested with a single issuer; 8) the State Investment Pool, limited to no more than 15% of the qualifying portfolio; 9) general obligation bonds of a state other than the State of Washington and general obligation bonds of a local government of a state other than the State of Washington, which bonds have, at the time of investment, one of the three highest credit ratings of a nationally recognized rating agency; 10) mutual funds having received one of the four highest credit ratings of a nationally recognized rating agency, and money market funds as authorized under the laws of the State of Washington, limited to 10% of the qualifying portfolio; 11) notes, bonds or debentures that are insured or guaranteed by an agency of the federal government limited to no more than 30% of the qualifying portfolio and no more than 10% of the total assets invested with a single issuer; 12) and any other investment permitted under the laws of the State of Washington.

As of December 31, 2011 and 2010, investments in debt securities had credit quality ratings as follows:

<b>(amounts in thousands)</b>				
<b>Investment Rating (S&amp;P)</b>	<b>2011</b>		<b>2010</b>	
Long Term				
AAA	\$	18,582	\$	64,244
AA+		53,211		16,591
AA		327		5,462
AA-		16,715		14,751
A+		4,812		-
Short Term				
SP-1+		-		804
	\$	93,647	\$	101,852

**Concentration of credit risk.** The District's investment policy requires that investments are diversified by security type and institution. Investments in an individual issuer of commercial paper or bankers' acceptances are limited to no more than 5% of the District's total investment portfolio. The aggregate amount of savings, demand deposits and certificates of deposit are limited to 75% of portfolio and 20% per institution.

As of December 31, 2011 and 2010, 5% or more of the District's total investment portfolio was invested with each of the following issuers:

<b>Issuer</b>	<b>S&amp;P Credit Rating</b>	<b>Percentage of Portfolio</b>	
		<b>2011</b>	<b>2010</b>
Federal National Mortgage Association	AA+	8%	6%
Federal Home Loan Bank	AA+	7%	2%
CitiBank NA – FDIC Insured	AA+	1%	5%
Federal Farm Credit Bureau	AA+	6%	7%

## Derivative Instruments – Forward Purchase Agreements

**Objective and Terms.** As a tool to achieve a fixed rate of return on certain District bond reserves, the District has entered into a forward purchase agreement for the purchase of investment securities. Under the terms of the agreement, the provider must tender qualified securities with maturities of six months or less to the District on the semi-annual debt service dates at a price that produces at least the guaranteed rate of return under the agreement.

The terms, including the counterparty credit ratings of the outstanding forward purchase agreement, as of December 31, 2011, are provided below.

### Forward Purchase Agreements

Counterparty	Credit Rating by Moody's/S&P/Fitch	Guaranteed Yield	Notional Amount	Effective Date	Maturity	12/31/11 Fair Value	12/31/10 Fair Value
Wells Fargo Bank, N.A.	Aa3/AA-/AA-	6.630%	\$ 18,820,179	12/21/1999	6/1/2029	\$ 7,374,771	\$ 3,846,121

As of December 31, 2011 and 2010, the agreement is considered a hedging derivative instrument and the fair value is recorded on the Balance Sheet as a Deferred Inflow of Resources.

**Fair value.** Due to declining interest rates, the forward purchase agreement had a positive fair value to the District as of December 31, 2011 and 2010. The fair value takes into consideration the prevailing investment rate environment and the specific terms and conditions of the transaction. The fair value was estimated using the par value method.

**Credit risk.** The District is exposed to credit risk in the amount of the positive fair value of the forward purchase agreement. The credit ratings of the counterparty are noted in the table above.

**Interest rate risk.** The District is exposed to interest rate risk if the counterparty to the forward purchase agreement defaults or if the agreement is terminated.

**Termination risk.** The District or the counterparty may terminate a forward purchase agreement if the other party fails to perform under the terms of the respective contracts. If at the time of termination the agreement has a negative fair value, the District would be liable to the counterparty for a payment equal to the agreement's fair value.

**NOTE 3: UTILITY PLANT**

Utility plant is stated at original cost, which includes both direct and indirect costs of construction or acquisition, including an allowance for funds used during construction (AFUDC) for major non-hydro system projects. The District charges the cost of repairs and minor renewals to maintenance expense and the cost of renewals and replacement of property units that meet the District's capitalization threshold to utility plant. The cost, less net salvage, of property units retired is charged to accumulated depreciation. The District's capitalization threshold is

\$5,000. As the District constructs various major projects, costs accumulate in construction work in progress and are capitalized to utility plant after the projects have been completed and placed into service.

Provision for depreciation is computed using the straight-line method by applying rates based upon the estimated service lives of the related plant, ranging from 5 to 90 years.

A summary of utility plant in service for the years ended December 31, 2011 and 2010 are as follows:

(amounts in thousands)	January 1, 2011	Additions	Reductions	December 31, 2011
Hydroelectric generation	\$ 1,149,509	\$ 20,904	\$ (2,863)	\$ 1,167,550
Transmission	111,961	5,978	(147)	117,792
Distribution	204,625	4,251	(535)	208,341
General plant	117,963	2,600	(305)	120,258
Intangible	32,805	686	-	33,491
Telecommunications	82,486	3,629	-	86,115
Water/Wastewater	70,447	372	-	70,819
	<u>1,769,796</u>	<u>38,420</u>	<u>(3,850)</u>	<u>1,804,366</u>
Construction work in progress	28,533	42,917	(36,805)	34,645
Accumulated depreciation	(703,021)	(47,551)	2,494	(748,078)
	<u>\$ 1,095,308</u>	<u>\$ 33,786</u>	<u>\$ (38,161)</u>	<u>\$ 1,090,933</u>

(amounts in thousands)	January 1, 2010	Additions	Reductions	December 31, 2010
Hydroelectric generation	\$ 1,121,732	\$ 31,170	\$ (3,393)	\$ 1,149,509
Transmission	108,208	3,956	(203)	111,961
Distribution	199,608	5,510	(493)	204,625
General plant	116,308	1,655	-	117,963
Intangible	32,296	509	-	32,805
Telecommunications	79,567	2,919	-	82,486
Water/Wastewater	65,084	5,466	(103)	70,447
	<u>1,722,803</u>	<u>51,185</u>	<u>(4,192)</u>	<u>1,769,796</u>
Construction work in progress	33,214	43,129	(47,810)	28,533
Accumulated depreciation	(659,499)	(47,623)	4,101	(703,021)
	<u>\$ 1,096,518</u>	<u>\$ 46,691</u>	<u>\$ (47,901)</u>	<u>\$ 1,095,308</u>

Plant assets include land of \$71.4 million and \$71.4 million as of December 31, 2011 and 2010, respectively.

associated with licensing the projects have been included in the District's Utility Plant balance as Intangible Assets and are being amortized over the lives of the associated licenses.

**NOTE 4: LICENSING**

The Lake Chelan, Rocky Reach and Rock Island hydroelectric projects are licensed under the Federal Power Act of 1920 and subsequent amendments. The District received a 50-year license for the Lake Chelan Project in November 2006 and a 43-year license for the Rocky Reach Project in February 2009 and is implementing license measures for both projects. The Rock Island Project license was issued in January 1989 and expires in December 2028. The costs

The Rock Island Project license contains various operational requirements and environmental protections. Primary measures include continuation of maintenance and operation of the Wenatchee Confluence, Kirby Billingsley Hydro, Wenatchee Riverwalk and Walla Walla parks. As also required in the license, the District manages cultural, shoreline, recreation and wildlife resources. All costs associated with the ongoing fulfillment of these Rock Island license measures are recognized in the year incurred.

The 50-year license for the Lake Chelan Project was issued by the Federal Energy Regulatory Commission (FERC) in November 2006. The license requires detailed management plans for fish, operations, wildlife and recreation resources. In accordance with the FERC approved fish plan, the District constructed three major capital projects, a low-level outlet structure at the dam, a pump station adjacent to the Lake Chelan Project tailrace and four acres of fish spawning habitat in the lower Chelan River and Project tailrace. These projects were successfully completed in October 2009, and spawning and rearing monitoring studies were completed during 2010. In accordance with the approved Recreation Plan, the District completed construction of a trail link between the newly constructed Reach 1 Trail and Riverwalk Loop Trail located in Chelan. Additionally, the third-year study on whitewater boating was conducted during 2011. The Lake Chelan Project settlement agreement and license contains some measures that will be carried out by various agencies using funds provided by the District. The present value of these accrued funding obligations was \$9.6 million and \$9.3 million as of December 31, 2011 and 2010, respectively.

A summary of accrued licensing obligations, accounted for as intangible assets, for the years ended December 31, 2011 and 2010 are as follows:

<b>(amounts in thousands)</b>	<b>2011</b>	<b>2010</b>
Licensing obligation - beginning of year	\$ 9,287	\$ 9,183
Additions	686	509
Reductions	(369)	(405)
Licensing obligation - end of year	<u>\$ 9,604</u>	<u>\$ 9,287</u>

In February 2009, the District received a 43-year FERC license to continue operating the Rocky Reach Hydroelectric Project. The license is based on a settlement agreement submitted to FERC in March 2006, between the District and stakeholders, including local communities, state and federal agencies, Tribes and environmental groups.

The Washington State Department of Ecology issued its final water quality certification for the Rocky Reach Project in March 2006. The issuance of this water quality certification was not appealed. In August 2006, the FERC issued a final environmental impact statement ("FEIS") for the Rocky Reach Project. In July 2007, National Oceanic and Atmospheric Administration ("NOAA") issued its Biological Opinion for the Rocky Reach Project evaluating how the new license may affect listed species in the area - specifically, salmon and steelhead and endorsed continuation of the Habitat Conservation Plan (HCP). In December 2008, U.S. Fish and Wildlife Service filed its Biological Opinion for the Rocky

Reach Project concluding that the Project is not likely to jeopardize the continued existence of bull trout or destroy or adversely modify designated critical habitat. The U.S. Fish and Wildlife Biological Opinion provided conditions through an incidental take statement and requires five reasonable and prudent measures be implemented to minimize the incidental take of bull trout.

The Rocky Reach Project license contains various operational requirements and environmental protections. Primary measures include continuation of the HCP for salmon and steelhead, measures to protect and enhance white sturgeon, bull trout and pacific lamprey, upgrades to Entiat, Daroga and Lincoln Rock parks and new trails. As also required in the license, the District finalized detailed management plans for operations, recreation and wildlife resources. These plans are now being implemented. Future costs of implementing the license requirements cannot be reasonably estimated; therefore, no obligation has been recorded and all related costs are recognized in the year incurred.

#### **NOTE 5: REGULATORY DEFERRALS**

The Commission has taken various regulatory actions that result in differences between recognition of revenues and expenses for rate-making purposes and their treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and liabilities, which are summarized below. Changes to the balances, and their inclusion in rates, occur only at the direction of the Commission.

**Investment Derivative Instruments.** The District has entered into various derivative instrument contracts (interest rate swaps and forward purchase agreements) that are subject to the fair value reporting requirements of GASB Statement No. 53. The fair value of these contracts is recorded on the balance sheet. A number of these are considered investment derivative instruments, and as such any change in fair value would normally be reflected in Net Increase (Decrease) in Net Assets for the period. Derivative instruments are reflected in rates as cash settlements occur in accordance with the terms of the contracts; therefore, the Commission has approved resolutions that allow the change in fair value during the period to be deferred and recorded as regulatory assets and/or liabilities, which have no impact on operating results.

**Swap Termination Payments.** The District terminated three interest rate swap agreements during 2011, incurring swap termination fees in the amount of \$24.6 million. The termination fees, along with \$0.2 million of unamortized costs related to the swap transactions, would normally be reflected as a non-operating expense in 2011; however,

the Commission has approved a resolution allowing for deferral of the termination fees and related swap costs as a regulatory asset to be amortized over a period of up to 15 years to match the expense with the period in which the payments will be recovered through rates.

**Conservation Expenses.** The District's conservation plans include a significant increase in program expenditures to support compliance with the Energy Independence Act. The District defers conservation expenditures as incurred and amortizes them over the estimated benefit period. The Commission has approved resolutions that require this treatment in order to match the expense with the periods in which the benefit is received and will be reflected in rates.

**Contributed Capital.** Individual contributions exceeding \$1 million are deferred as regulatory liabilities and amortized over the life of the related contributed depreciable plant assets. The Commission has approved resolutions that require this treatment in order to offset the earnings effect of

these large non-exchange transactions and align the District's recognition of these credits with the periods in which the amounts will be reflected for rate-making purposes.

The following regulatory balances are as of December 31, 2011 and 2010.

<u>(amounts in thousands)</u>	<u>2011</u>	<u>2010</u>
Regulatory Assets:		
Investment derivative instruments	\$ 21,012	\$ 23,294
Swap termination payments	22,358	-
Conservation Expenses	1,115	-
	<u>\$ 44,485</u>	<u>\$ 23,294</u>
Regulatory Liabilities:		
Contributed Capital	<u>\$ 5,886</u>	<u>\$ 2,277</u>

**NOTE 6: LONG-TERM DEBT**

**Revenue Bonds and Notes Payable**

<u>(amounts in thousands)</u>	<u>January 1, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2011</u>	<u>Due Within One Year</u>
Rocky Reach Revenue Bonds, 3% to 5%, due July 1, 2012, to July 1, 2034 (net unamortized premiums of \$505)	\$ 21,620	\$ 9	\$ (1,738)	\$ 19,891	\$ 1,720
Rock Island Revenue Bonds, 3% to 6.05%, due June 1, 2012, to July 1, 2034 (net unamortized premiums of \$106)	272,156	15,416	(22,940)	264,632	20,015
Notes Payable, 0.5% to 5.25%, due July 1, 2012, to October 1, 2027 (net unamortized premiums of \$1,483)	93,537	1,180	(1,551)	93,166	676
Chelan Hydro Consolidated System Revenue Bonds, 5% to 5.14%, due July 1, 2012, to January 1, 2015 (net unamortized premiums of \$3)	441,789	4,463	(405,010)	41,242	1,250
Consolidated System Revenue Bonds, 0.52% to 6.897%, due July 1, 2012, to July 1, 2042 (net unamortized premiums of \$15,578)	197,090	363,357	(22,120)	538,327	21,560
	<u>\$ 1,026,192</u>	<u>\$ 384,425</u>	<u>\$ (453,359)</u>	<u>\$ 957,258</u>	<u>\$ 45,221</u>



## Revenue Bonds and Notes Payable

(amounts in thousands)	January 1, 2010	Additions	Reductions	December 31, 2010	Due Within One Year
Rocky Reach Revenue Bonds, 3% to 5%, due July 1, 2011, to July 1, 2034 (net unamortized premiums of \$588)	\$ 23,261	\$ 13	\$ (1,654)	\$ 21,620	\$ 1,655
Rock Island Revenue Bonds, 3% to 6.05%, due June 1, 2011, to July 1, 2034 (net unamortized premiums of \$136)	279,290	15,633	(22,767)	272,156	22,910
Notes Payable, 0.5% to 5.25%, due July 1, 2011, to October 1, 2027 (net unamortized premiums of \$2,240)	94,888	144	(1,495)	93,537	733
Chelan Hydro Consolidated System Revenue Bonds, 4% to 6.05%, due June 1, 2011, to January 1, 2039 (net unamortized discounts of \$1,252, unamortized premiums of \$1,338)	444,308	891	(3,410)	441,789	5,605
Consolidated System Revenue Bonds, 3.5% to 6.897%, due July 1, 2011, to July 1, 2042 (net unamortized discounts of \$347, unamortized premiums of \$544)	199,285	782	(2,977)	197,090	3,070
	<u>\$ 1,041,032</u>	<u>\$ 17,463</u>	<u>\$ (32,303)</u>	<u>\$ 1,026,192</u>	<u>\$ 33,973</u>

In June 2011, the District issued \$179.7 million of subordinate Consolidated System Revenue Bonds, Refunding Series 2011AB (AMT). The 2011A and 2011B bonds in the amount of \$107.5 million and \$72.2 million, respectively, were issued as fixed rate bonds with interest rates ranging from 2% to 5.5% and annual maturities between July 1, 2012, and July 1, 2026. The proceeds, together with other available funds, were used to refund various debt issues to obtain an economic gain (the difference between the present values of the old and new debt service payments) in excess of \$54 million, excluding related swap termination payments. In conjunction with the refinancing, a forward starting swap entered into in 2006 with an effective start date June 1, 2011, was terminated.

In November 2011, the District issued \$164.4 million of subordinate Consolidated System Revenue Bonds, Refunding Series 2011C. The 2011C bonds were issued as fixed-rate, taxable bonds with interest rates ranging from 0.52% to 4.253% and annual maturities between July 1, 2012, and July 1, 2026. The proceeds, together with other available funds, were used to refund various debt issues to obtain an economic gain in excess of \$31 million.

The difference between the reacquisition price and the net carrying amount of the old debt is reported in the accompanying financial statements as a deduction from bonds payable and is being amortized over the shorter of the remaining life of the old debt or the life of the new debt.

A summary of scheduled debt service requirements to maturity is as follows:

**Principal and Interest**  
(amounts in thousands)

	Principal	Interest	Estimated Debt Service
2012	\$ 45,221	\$ 25,412	\$ 70,633
2013	94,416	26,819	121,235
2014	112,196	23,579	135,775
2015	72,006	19,427	91,433
2016	42,076	17,358	59,434
2017-2021	288,473	71,476	359,949
2022-2026	288,778	37,970	326,748
2027-2031	112,290	11,893	124,183
2032-2036	65,385	6,488	71,873
2037-2041	7,240	2,513	9,753
2042-2046	8,370	385	8,755
Total	<u>\$ 1,136,451</u>	<u>\$ 243,320</u>	<u>\$ 1,379,771</u>

Estimated principal retirements are based on the assumption that all bonds are called or purchased at par. Principal retirements of \$1.1 billion also include \$151 million of future appreciation on Capital Appreciation Bonds (CABs).

The subordinate Consolidated System Revenue Bonds, Series 2008B, in the outstanding amount of \$89.9 million at December 31, 2011, were issued as variable rate bonds and have a reset of interest rates every seven days. In conjunction with the 2008B bonds, the District entered into a standby bond purchase agreement (the "Credit Facility") with US Bank National Association (the "Bank"). The Credit Facility requires the Bank to provide funds, subject to the satisfaction of certain conditions precedent, for the purchase of the 2008B bonds that have been tendered or deemed tendered and not remarketed. As of December 31, 2011, the Bank does not hold any un-remarketed 2008B bonds. The District pays the Bank a commitment fee of 15 basis points as prescribed in the Credit Facility. If any 2008B bonds are purchased and held by the Bank, the bonds will bear interest at a fluctuating annual rate equal to LIBOR plus 200 basis points multiplied by a factor as specified by the Credit Facility. In addition, any 2008B bonds purchased and held under the Credit Facility are subject to special mandatory redemption over a five-year period in ten equal semi-annual principal installments. The Credit Facility will expire on the later of March 7, 2013, or the last day of any extension of such date pursuant to the Credit Facility.

The District has covenanted in bond resolutions that it will establish, maintain and collect rates and charges for electric power and energy and other services, facilities and commodities sold, furnished or supplied through the facilities of the Chelan Hydro Consolidated System, which

shall provide Distribution Division and other non-hydro systems net receipts, less the Distribution Division Senior Debt Service Requirement, in each fiscal year equal to at least (a) 100% of annual debt service in such fiscal year on the Distribution Division bonds then outstanding and (b) together with available funds with respect to the Distribution Division bonds, 115% of annual debt service in such fiscal year on the Distribution Division bonds then outstanding and net receipts, together with available funds, less the Senior Debt Service Requirement, in each fiscal year equal to at least (i) 100% of Annual Debt Service in such fiscal year on all bonds then outstanding, plus (ii) 15% of the interest coming due in such fiscal year on all bonds then outstanding.

The senior Chelan Hydro Consolidated System lien is now closed and the District has covenanted in a subordinate Consolidated System resolution that it will establish, maintain and collect rates and charges for electrical power and energy, water, wastewater, fiber-optic networks and other services, facilities and commodities sold, furnished or supplied by or through the Consolidated System adequate net revenues sufficient to pay at least (a) 100% of annual debt service in such fiscal year and (b) together with available funds, 125% of annual debt service in such fiscal year on both the senior Chelan Hydro Consolidated System Bonds and the subordinate Consolidated System Bonds.

The District also adopted a resolution subordinate to the Consolidated System resolution, with the primary intent of creating a third lien to allow for short-term notes to be issued with a lien status subordinate to both the senior Chelan Hydro Consolidated System Bonds and the subordinate Consolidated System Bonds. The District has covenanted in this resolution to fix, establish, maintain and collect rates and charges for electric power and energy, water, wastewater, fiber-optic networks and other services, facilities and commodities sold, furnished or supplied by or through the Consolidated System, adequate net revenues together with available funds sufficient to pay 100% of total Consolidated System annual debt service in such fiscal year.

The District has adopted two additional resolutions confirming and continuing both the Rocky Reach Hydroelectric System and the Rock Island Hydroelectric System. The District has covenanted in these resolutions to fix, establish, maintain and collect rates and charges for electric power and energy, and other services, facilities and commodities sold, furnished or supplied by or through the Rocky Reach System and the Rock Island System, adequate net revenues in each system sufficient to pay 100% of annual debt service in such fiscal year.

As of December 31, 2011 and 2010, the District was in compliance with all debt covenants. In 2009, the District set aside funds in an escrow account to cover obligated senior

Consolidated System debt-service payments related to the non-hydro systems for 2009 and 2010. Setting aside the funds in escrow effectively eliminated the District's Coverage requirement for these years as the principal and interest payments were made from the escrow account.

### Derivative Instruments – Interest Rate Swaps

**Objective of the swaps.** In order to protect against the potential of rising interest rates associated with the issuance of variable rate bonds, the District entered into forward starting

pay-fixed, receive-variable interest rate swaps. The District has also entered into a pay-variable, receive-fixed interest rate swap for the purpose of offsetting the JP Morgan swap that became effective in June 2009, as the District determined it was not financially attractive to issue the variable rate bonds that the JP Morgan swap was intended to hedge.

**Terms.** The terms, including the counterparty credit ratings of the outstanding swaps, as of December 31, 2011, are included below.

### Swap Portfolio

Related Bonds	Counterparty	Credit Rating by Moody's/S&P/Fitch	District Pays	District Receives	12/31/11 Notional Amount	Call Option	Effective Date	Maturity	12/31/11 Fair Value	12/31/10 Fair Value
Series 2009AB	The Bank of New York Mellon	Aaa/AA-/AA-	70% of LIBOR	1.76%	\$ 30,355,000	No	7/22/2009	7/1/2014	\$ 1,046,779	\$ 827,771
Series 2009AB	JP Morgan Chase Bank, NA	Aa1/A+/AA-	4.031%	70% of LIBOR	30,355,000	No	6/1/2009	7/1/2034	(12,343,888)	(6,034,967)
Series 2013	Goldman Sachs Mitsui Marine Derivative Products, LP	Aa1/AAA/NR*	4.085%	70% of LIBOR	28,815,000	No	5/30/2013	7/1/2032	(9,715,030)	(3,297,940)
Total					<u>\$ 89,525,000</u>				<u>\$(21,012,139)</u>	<u>\$ (8,505,136)</u>

\*Not rated

During 2011 and 2010, the net cash outflows related to the swaps were \$1.6 million and \$3.9 million, respectively.

In August 2005, the District elected to enter into a 70% of London Inter-bank Offered Rate (LIBOR) floating-to-fixed interest rate swap to hedge the anticipated issuance of \$93.8 million of variable rate Series 2007 Bonds in May of 2007. In May 2007, the 2007 swaps became effective with the issuance of the 2007A Bonds. Those 2007A Bonds were subsequently refinanced and are now the 2008B Bonds. In April 2006, the District elected to enter into three additional 70% of LIBOR floating-to-fixed interest rate swaps to hedge the anticipated issuance of \$30.4 million of variable rate bonds in 2009, \$78.4 million of variable rate bonds in 2011 and \$28.8 million of variable rate bonds in 2013. The combination of variable rate bonds and floating-to-fixed rate swaps creates synthetic fixed-rate debt for the District. The transactions allowed the District to create synthetic fixed rates on the bonds in advance of issuance, protecting the District against potential increases in long-term interest rates.

In June 2009, the JP Morgan 2009 swap became effective. The District had originally intended to issue variable rate bonds in relation to the JP Morgan 2009 swap at the time

it was entered into in 2006. However, due to turmoil in the financial markets and other related risks, issuing variable rate bonds was financially unattractive. In July 2009, the District issued its fixed-rate Series 2009AB Notes which were used to purchase and hold the 2009AB Bonds in trust. The Series 2009AB swaps are connected to the Series 2009AB Bonds. Rather than terminating the JP Morgan 2009 swap, an offsetting five-year fixed-to-floating rate 2009 swap payment agreement was entered into with the Bank of New York Mellon. Upon maturity of the 2009AB Notes and Bank of New York Mellon 2009 swap, the District will determine the best course of action in regards to the remaining term of the original JP Morgan 2009 swap. Both 2009 swaps are investment derivative instruments as they do not qualify for hedge accounting. However, the transactions are included in the District's rates; therefore, any changes in fair value are reported on the Balance Sheet as Regulatory Assets or Regulatory Liabilities. See Note 5.

In March 2011, the District paid \$4.9 million, including accrued interest, to Bear Stearns Capital Markets, Inc and \$2.2 million, including accrued interest, to the Bank of New York Mellon to terminate the Series 2008 swaps associated with the 2008B Bonds. The termination payments were

deferred as regulatory assets and will be amortized over the period of time which the payments will be included in rates. See Note 5.

In May 2011, the District paid \$17.6 million to Goldman Sachs Mitsui Marine Derivative Products, LP to terminate the Series 2011 forward starting swap. The termination payment was deferred as a regulatory asset and will be amortized over the period of time which the payment will be included in rates. See Note 5.

Due to continued turmoil in the financial markets and other related risks, the District will evaluate if it will issue variable rate bonds in 2013 as intended when the associated swap was entered into. Therefore, the forward starting 2013 interest rate swap is considered an investment derivative instrument. The change in fair value of the 2013 swaps is to be recognized in the Statement of Revenues, Expenses and Changes in Net Assets as Investment Income; however, the transaction is subject to regulatory accounting requirements, therefore, any changes in fair value are reported on the Balance Sheet as Regulatory Assets or Regulatory Liabilities. See Note 5.

**Fair values.** Because interest rates have declined since the execution dates, the swaps net fair values were negative to the District as of both December 31, 2011 and 2010. The fair values as of December 31, 2011 and 2010, are included in the table on the previous page. The fair values take into consideration the prevailing interest rate environment and the specific terms and conditions of a given transaction. The fair values were estimated using the zero-coupon discounting method. This method calculates the future payments required by the swaps, assuming the current forward rates implied by the LIBOR swap yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement on the swaps.

**Credit risk.** The District is exposed to credit risk in the amount of any net positive swap fair values. The District nets termination values for swaps with the same counterparty when determining credit risk exposure. As of December 31, 2011, the District had net credit risk of \$1.0 million related to the Bank of New York Mellon on the Series 2009AB swap. The credit ratings of the counterparties are noted in the table on the previous page.

The swap agreements contain collateral agreements with the counterparties. The swaps require collateralization of the positive fair value of the swap, inclusive of any call option, in excess of the notional amount by \$250,000 for swaps with The Bank of New York Mellon as counterparty and \$100,000 for all others. For the District's swap

counterparties, this requirement only applies to those that do not have a credit rating within the two highest long-term investment grade rating categories from at least two nationally recognized rating agencies. As of December 31, 2011, no swap counterparties were required to post collateral. For the District, no collateralization is required as long as the District's Credit Support Providers (Swap Insurers) maintain a financial strength rating from S&P that is at or above "A-" and a claims paying ability rating from Moody's that is at or above "A3". In the event a Swap Insurer's rating drops below these levels and the District does not find a substitute Credit Support Provider acceptable to the counterparty, the District may be required to post collateral if the District's long-term senior unsecured debt rating from S&P's and Moody's drops below BBB+ or Baa1, respectively. As of December 31, 2011, the District's ratings were Aa2/AA/AA+ from Moody's, S&P and Fitch Ratings, respectively. The District's Swap Insurers' ratings as of December 31, 2011, were as follows:

**Swap Insurers**

Related Bonds	Credit Support Provider	Credit Rating by Moody's/S&P/Fitch	Notional Amount
Series 2009	Assured Guaranty Municipal Corp.	Aa3/AA-NR*	\$ 30,355,000
Series 2013	Assured Guaranty Municipal Corp.	Aa3/AA-NR*	28,815,000
Total			<u>\$ 59,170,000</u>
*Not rated			

**Interest rate risk.** The District is exposed to interest rate risk only if the counterparty to the swap defaults or if the swap is terminated.

**Basis risk.** Basis risk is the risk that the interest rate paid by the District on underlying variable rate bonds to bondholders temporarily differs from the variable swap rate received from the applicable counterparty. The District bears basis risk on its swaps. The swaps have basis risk since the District receives a percentage of LIBOR to offset the actual variable bond rate the District pays on its bonds. The District is exposed to basis risk if the floating rate that it receives on a swap is less than the actual variable rate the District pays on the bonds. Depending on the magnitude and duration of any basis risk shortfall, the expected cost of the basis risk may vary.

**Tax risk.** Tax risk is a specific type of basis risk. Tax risk is a permanent mismatch between the interest rate paid on the District's underlying variable rate bonds and the rate received on the swaps caused by a reduction or elimination

in the benefits of the tax exemption for municipal bonds, e.g. a tax cut that results in an increase in the ratio of tax-exempt to taxable yields. The District is receiving 70% of LIBOR (a taxable index) on the swaps and would experience a shortfall relative to the rate paid on its bonds if marginal income tax rates decrease relative to expected levels, thus increasing the overall cost of its synthetic fixed rate debt.

**Termination risk.** The District or the counterparty may terminate a swap if the other party fails to perform under the terms of the respective contracts. If a swap is terminated, the associated variable rate bonds would no longer be hedged to a fixed rate. If at the time of termination the swap has a negative fair value, the District would be liable to the counterparty for a payment equal to the swap's fair value.

**Other material terms.** The District has the right to cancel any outstanding swap at the prevailing market price for swaps.

#### **NOTE 7: PURCHASED POWER SUPPLY**

A significant portion of the retail electric distribution system power is purchased from the Hydro projects on a cost-of-service basis, including debt service costs. However, a portion of the power purchased from the Rocky Reach project was on a cost-plus basis under new power sales contract terms effective November 2011. Of the total kilowatt-hours purchased by the retail electric distribution system during 2011, approximately 55% was provided by the Rocky Reach project, 29% by the Columbia River-Rock Island project, 8% by the Lake Chelan project and 8% from other sources.

A power sales contract with Alcoa for a 23% share of Rocky Reach output was effective through October 2011. Under a provision of the contract, during the operating period, the District remarketed the Surplus Rocky Reach Replacement Power (23% share of Rocky Reach output) that exceeded the energy requirements at the Wenatchee Works aluminum plant.

When Alcoa's energy requirements exceeded the Rocky Reach Replacement Power, the District made available up to 42 MW of additional firm energy, to the extent needed for use at Wenatchee Works. Alcoa paid average industrial rates for this power unless the average monthly load at Wenatchee Works exceeded a threshold of 189.15 aMW. Any portion of the additional 42 MW that was required to meet loads in excess of the threshold was sold to Alcoa at market price. The District purchased power at market prices daily as required to meet any shortfalls in energy supply to Wenatchee Works not met by the Rocky Reach Replacement Power and the 42 MW of firm energy. Alcoa was responsible for all costs and counterparty risks associated with these market purchases.

#### **NOTE 8: EMPLOYEE BENEFIT PLANS**

##### **Pension Plan**

Substantially all of the District's full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing, multiple-employer public employee defined benefit retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at [www.drs.wa.gov](http://www.drs.wa.gov). The following disclosures are made pursuant to GASB Statements No. 27, "Accounting for Pensions by State and Local Government Employers" and No. 50, "Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27."

All Information on the website is the responsibility of the State of Washington. The District's independent auditor has not audited or examined such information, and does not express an opinion or any other form of assurance with respect thereto.

##### **Public Employees' Retirement System (PERS) Plans 1, 2 and 3**

###### **Plan Description**

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals and Superior courts (other than judges currently in the Judicial Retirement System); employees of legislative committees; community and technical colleges, college and university employees not participating in higher education retirement programs; judges of district and municipal courts; and employees of local governments. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS is a cost-sharing, multiple-employer retirement system comprised of three separate plans for membership purposes. Plans 1 and 2 are defined benefit plans, and Plan 3 is a defined benefit plan with a defined contribution component.

PERS members who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by either, February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. PERS members joining the system on or after March

1, 2002, for state and higher education employees, or September 1, 2002, for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service or at the age of 55 with 25 years of service. The monthly benefit is two percent of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60 percent of AFC. The monthly benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. A cost-of-living allowance (COLA) is granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA amount that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at three percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is \$350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is two percent of the AFC for each year of service reduced by two percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of living allowance was granted at age 66 based upon years of service times the COLA amount. This

benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at three percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is two percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

PERS Plan 2 members who have 30 or more years of service and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by three percent for each year before age 65.
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at three percent annually.

The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member's accumulated contributions.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a monthly benefit that is one percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, Plan 3 members are vested in the defined benefit portion of their plan after ten years

of service; or after five years if 12 months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have at least 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by three percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon contributions and the results of investment activities.

The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is two percent of the AFC per year of service. For Plan 3, the monthly benefit amount is one percent of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at three percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or

a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,197 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2010:

Retirees and beneficiaries receiving benefits	76,899
Terminated plan members entitled to but not yet receiving benefits	28,860
Active plan members vested	105,521
Active plan members nonvested	51,005
Total	<u>262,285</u>

#### Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies and local government unit employees and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates

range from 5 percent to 15 percent, based on member choice. Two of the options are graduated rates dependent on the employee's age. As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program.

The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2011, were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	7.25%**	7.25%**	7.25%***
Employee	6.00%****	4.64%****	*****

- \* The employer rates include the employer administrative expense fee currently set at 0.16%.
- \*\* The employer rate for state elected officials is 10.80% for Plan 1 and 7.25% for Plan 2 and Plan 3.
- \*\*\*Plan 3 defined benefit portion only.
- \*\*\*\* The employee rate for state elected officials is 7.5% for Plan 1 and 4.64% for Plan 2.
- \*\*\*\*\* Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the District and the employees made the required contributions. The District's required contributions for the years ending December 31, were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2011	\$ 77,606	\$ 2,734,289	\$ 549,967
2010	\$ 69,075	\$ 2,345,456	\$ 449,180
2009	\$ 153,035	\$ 2,951,314	\$ 562,500

**Deferred Compensation Plans**

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 (457 Plan). The 457 Plan, available to District employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

In accordance with the 457 Plan, the District has placed the 457 Plan assets into a separate trust for the exclusive benefit of plan participants and beneficiaries. Accordingly, plan assets and the corresponding liability are not included on the District's financial statements.

The District also offers its employees a 401(a) employer

matching plan. The 401(a) is a qualified, tax deferred plan that allows the District to match employee contributions made to the 457 Plan. Under the 401(a) Plan, the District will match each employee's contribution to the 457 Plan at a rate of 50% with a cap of 5% of an employee's annual base salary up to a maximum of \$8,250 or up to a maximum of \$11,000 for employees age 50 years and over. The District's 401(a) Plan matching contributions for the years ending December 31, 2011 and 2010, were \$1.5 million and \$1.4 million, respectively. Matching contribution rates are at the District's discretion within the requirements of the current bargaining unit agreement.

**NOTE 9: POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS**

**Plan Description**

The District administers a single-employer defined benefit healthcare plan ("the retiree medical plan"). The plan provides healthcare insurance until the age of 65 for retirees and their spouses through the District's group health insurance plan, which covers both active and retired members. The retiree medical plan does not issue a publicly available financial report.

**Funding Policy**

The District's subsidy of the cost of 2011 and 2010 premiums for eligible retired plan members and their spouses amounted to \$129,000 and \$126,000, respectively. Plan members receiving benefits contributed 72% of the premium costs for years 2011 and 2010. For the years ended December 31, 2011 and 2010, total member contributions were \$330,000 and \$323,000, respectively. Future subsidies will be provided by the District at the 2007 level adjusted for inflation, with plan members contributing the remaining premium. Contribution rates may be adjusted at the District's discretion.

**Annual Other Postemployment Benefit Cost and Net Obligation**

The District's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year. The District's OPEB plan was fully funded as of both December 31, 2011, and December 31, 2010. As a result, the District's annual OPEB cost and net OPEB obligation were zero as of both December 31, 2011, and December 31, 2010.



The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2008 through 2011 were as follows:

Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/11	\$ -	0%	\$ -
12/31/10	-	0%	-
12/31/09	(50,000)	0%	-
12/31/08	50,000	0%	50,000

### Funded Status and Funding Progress

As of December 31, 2011 and 2010, the plan was fully funded. The covered payroll (annual wages of active employees covered by the plan) was \$48.6 million and \$48.1 million for 2011 and 2010, respectively. The ratio of the current ARC to the covered payroll was 0.0%.

Plan assets are held in an irrevocable trust by a third party fiduciary. Accordingly, plan assets and the corresponding liability are not included in the financial statements of the District.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. Actuarial valuations are as of the last actuarial report dated January 1, 2011.

### Methods and Assumption

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of the valuation and the sharing of benefit costs between the employer and plan members in effect at the time of the valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The following assumptions are integral to the actuarial calculations:

**Retirement age for active employees** – Based on assumptions used by Washington Public Employees' Retirement System (PERS).

**Mortality** – Life expectancies were based on the RP 2000 combined active/retiree healthy mortality table for males and females, projected using 50% of Scale AA.

**Inflation rate** – An inflation rate of 2.3% was used for 2011 and thereafter. Inflation rates are based upon the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).

**Discount rate** – The actuarial assumptions included a 7.0% investment rate of return based upon the investment allocation policy of the trust.

### NOTE 10: SEGMENT DISCLOSURE

The District has outstanding revenue bonds used to finance the Rocky Reach and Columbia River-Rock Island hydroelectric production facilities. Each project has an external requirement to be accounted for separately, and investors in the revenue bonds rely solely on the revenue generated by the individual projects for repayment. Summary financial information as of and for the years ended December 31, 2011 and 2010, for both projects is presented on the following pages. Included in operating revenues and expenses are intradistrict sales and rents which are eliminated in the Statement of Revenues, Expenses and Changes in Net Assets.

**CONDENSED BALANCE SHEETS**

(amounts in thousands)	Rocky Reach 2011	Columbia River- Rock Island 2011	Rocky Reach 2010	Columbia River- Rock Island 2010
<b>ASSETS</b>				
Current assets	\$ 12,256	\$ 6,582	\$ 7,397	\$ 5,196
Restricted assets – current	609	16,910	5,557	13,708
Total current assets	<u>12,865</u>	<u>23,492</u>	<u>12,954</u>	<u>18,904</u>
Utility plant, net	355,655	326,937	372,085	316,599
Restricted assets – noncurrent	16,305	36,473	23,388	57,853
Deferred charges and other assets	5,158	15,002	5,727	13,999
Total assets	<u>\$ 389,983</u>	<u>\$ 401,904</u>	<u>\$ 414,154</u>	<u>\$ 407,355</u>
<b>LIABILITIES AND NET ASSETS</b>				
Current liabilities	\$ 23,007	\$ 37,337	\$ 16,571	\$ 33,504
Revenue bonds payable, net of current portion	18,171	244,618	19,965	249,246
Intersystem loans payable, net of current portion	237,465	166,786	264,255	181,682
Other liabilities	11,178	12,506	-	5,120
Total liabilities	<u>289,821</u>	<u>461,247</u>	<u>300,791</u>	<u>469,552</u>
<b>Net Assets:</b>				
Invested in capital assets, net of related debt	349,231	75,049	366,594	73,821
Restricted	4,275	49,519	18,404	47,195
Unrestricted	<u>(253,344)</u>	<u>(183,911)</u>	<u>(271,635)</u>	<u>(183,213)</u>
Total net assets (deficit)	<u>100,162</u>	<u>(59,343)</u>	<u>113,363</u>	<u>(62,197)</u>
Total liabilities and net assets	<u>\$ 389,983</u>	<u>\$ 401,904</u>	<u>\$ 414,154</u>	<u>\$ 407,355</u>

**CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT)**

(amounts in thousands)	Rocky Reach 2011	Columbia River- Rock Island 2011	Rocky Reach 2010	Columbia River- Rock Island 2010
Operating revenues	\$ 77,541	\$ 77,217	\$ 75,278	\$ 80,582
Less:				
Operating expenses	40,558	36,675	40,777	40,321
Depreciation and amortization	<u>16,968</u>	<u>10,577</u>	<u>17,477</u>	<u>10,744</u>
Operating income	20,015	29,965	17,024	29,517
Other expense	<u>16,869</u>	<u>27,128</u>	<u>17,617</u>	<u>26,636</u>
Income (loss) before capital contributions and interfund equity transfers	3,146	2,837	(593)	2,881
Capital contributions	-	17	759	673
Interfund equity transfers	<u>(16,347)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in net assets (deficit)	<u>(13,201)</u>	<u>2,854</u>	<u>166</u>	<u>3,554</u>
Total net assets (deficit) – beginning of year	113,363	(62,197)	113,197	(65,751)
Total net assets (deficit) – end of year	<u>\$ 100,162</u>	<u>\$ (59,343)</u>	<u>\$ 113,363</u>	<u>\$ (62,197)</u>

## CONDENSED STATEMENTS OF CASH FLOWS

(amounts in thousands)	Rocky Reach 2011	Columbia River- Rock Island 2011	Rocky Reach 2010	Columbia River- Rock Island 2010
Net cash provided (used) by:				
Operating activities	\$ 52,939	\$ 39,963	\$ 34,522	\$ 40,013
Capital and related financing activities	(53,701)	(60,364)	(35,927)	(53,964)
Investing activities	1,194	(8,094)	(3,243)	5,669
Net increase (decrease)	432	(28,495)	(4,648)	(8,282)
Beginning cash and cash equivalents	8,650	39,367	13,298	47,649
Ending cash and cash equivalents	<u>\$ 9,082</u>	<u>\$ 10,872</u>	<u>\$ 8,650</u>	<u>\$ 39,367</u>

### NOTE 11: SUPPLEMENTAL DISCLOSURE OF TELECOMMUNICATION SERVICES (unaudited)

The District has developed a fiber-optic network to provide a backbone for the District's utility communication use, as well as infrastructure over which to provide wholesale telecommunications services in accordance with the authority granted to PUDs by state law. Private service providers deliver services over the District's infrastructure, including high-speed internet access, telephone and television to end-users. These private firms set final end-user pricing and are directly responsible for billing each end-user. The District bills the service providers for wholesale telecommunications services.

Following is a summary of the results of operations of the District's fiber-optic activities, included in the accompanying financial statements. Included in operating revenues and expenses are intradistrict sales and rents which are eliminated in the Statements of Revenues, Expenses and Changes in Net Assets.

(amounts in thousands)	2011	2010
<b>Operating revenues</b>		
Wholesale fiber services	\$ 4,541	\$ 4,109
Fiber leasing	505	487
Intradistrict revenues	1,937	1,984
Total operating revenues	<u>6,983</u>	<u>6,580</u>
<b>Operating expenses</b>		
Administrative and general	1,637	1,522
Repairs and maintenance	1,115	1,043
Other operating	2,613	1,400
Depreciation expense	5,545	5,170
Total operating expense	<u>10,910</u>	<u>9,135</u>
Operating loss	(3,927)	(2,555)
Other expenses	4,882	4,856
Net loss before capital contributions	(8,809)	(7,411)
Capital contributions	21	5
Interfund equity transfers	337	94
Change in net assets	<u>\$ (8,451)</u>	<u>\$ (7,312)</u>

Following is a summary of the District's fiber-optic balance sheets as of December 31, 2011 and 2010.

(amounts in thousands)	2011	2010
<b>ASSETS</b>		
Current assets	\$ 3,350	\$ 3,108
Utility plant, net and other assets	57,365	60,888
Total assets	<u>\$ 60,715</u>	<u>\$ 63,996</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities	\$ 523	\$ 3,231
Intersystem loans	98,978	91,100
Total liabilities	99,501	94,331
Net assets (deficit)*	(38,786)	(30,335)
Total liabilities and net assets	<u>\$ 60,715</u>	<u>\$ 63,996</u>

\*Includes \$18 million interfund equity transfer in 2007.

The District's capital investment in telecommunications plant and equipment for 2011 and 2010 was \$2.1 million and \$4.3 million, respectively. The District's cumulative capital investment in telecommunications plant and equipment as of December 31, 2011, was \$87.9 million. The capital investment, as well as cumulative net losses, has been funded by intersystem loans and an interfund equity transfer.

### NOTE 12: SELF-INSURANCE

The District is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; workers compensation; and health care of its employees. The District has elected to cover these risks primarily through self-insurance programs. Secondly, the District has purchased commercial excess liability insurance for claims beyond the deductible amounts. The accrual and payment of claims for the years ended December 31, 2011 and 2010, is summarized in the following table for each insurance program:

	Property & Liability	Workers Compensation	Medical & Health	Dental
Claims Liability as of January 1, 2011	\$ -	\$ 151,000	\$ 1,050,000	\$ 132,426
Claims accrued	318,366	729,109	8,470,539	946,825
Claims paid	(318,366)	(671,109)	(8,250,539)	(936,793)
Claims Liability as of December 31, 2011	<u>\$ -</u>	<u>\$ 209,000</u>	<u>\$ 1,270,000</u>	<u>\$ 142,458</u>

Commercial Insurance Deductible	Up to \$2,000,000 depending on line of coverage	\$500,000 per incident	N/A	N/A
Funds Held Including Reserves	\$ 1,500,000	\$ 1,100,000	\$ 2,000,000	\$ 75,000

	Property & Liability	Workers Compensation	Medical & Health	Dental
Claims Liability as of January 1, 2010	\$ 135,000	\$ 97,000	\$ 1,364,899	\$ 142,815
Claims accrued	16,982	547,353	7,303,437	936,793
Claims paid	(151,982)	(493,353)	(7,618,336)	(958,073)
Claims Liability as of December 31, 2010	<u>\$ -</u>	<u>\$ 151,000</u>	<u>\$ 1,050,000</u>	<u>\$ 132,426</u>

Commercial Insurance Deductible	Up to \$2,000,000 depending on line of coverage	\$500,000 per incident	N/A	N/A
Funds Held Including Reserves	\$ 1,500,000	\$ 1,100,000	\$ 2,000,000	\$ 75,000

**NOTE 13: COMMITMENTS AND CONTINGENCIES**


**Environmental Matters**

In June 2004, the Federal Energy Regulatory Commission (FERC) ordered the incorporation of the Anadromous Fish Agreements and Habitat Conservation Plan Agreements (HCPs) into the licenses for the Rocky Reach and Rock Island projects. The Rocky Reach project HCP was included in the new FERC license issued in February 2009. The 50-year HCPs provide a framework for long-term resolution of certain fish issues at the projects. The 50-year plans had been signed by the District, the U.S. Fish and Wildlife Service (USFWS), NOAA Fisheries, the Washington State Department of Fish and Wildlife (WDFW), the Confederated Tribes of the Colville Reservation and the Yakama Nation. NOAA Fisheries completed biological opinions for the HCPs and issued Incidental Take Permits (ITPs) under Section 10 of the Endangered Species Act (ESA) in 2003. The incorporation of the HCPs and ITPs into the current FERC licenses provides greater certainty for continued operation of the District's hydroelectric systems while meeting requirements to prevent jeopardy to certain listed and unlisted species of salmon and steelhead. The District's commitments under the HCPs include expenditures

to improve fish passage, to provide capacity for and fund hatchery operations and to rehabilitate and protect habitat through conservation projects.

The Upper Columbia River spring Chinook are listed as endangered and Upper Columbia River steelhead are listed as threatened under the ESA. The HCPs cover the District's obligations under the ESA for these species and in addition, protect other anadromous salmon including sockeye salmon, summer/fall Chinook, and coho salmon. Collectively, these five species are known as the "Plan Species." In addition to the ESA, the HCPs are also intended to satisfy the projects' obligations for all Plan Species under the Federal Power Act, the Fish and Wildlife Coordination Act, the Essential Fish Habitat provisions of the Magnuson-Stevens Fishery Conservation and Management Act, the Pacific Northwest Electric Power Planning and Conservation Act and Title 77 RCW of the State of Washington. The HCPs also satisfy the projects' licensing requirements for the five species covered by the HCPs. The Rocky Reach project HCP is included in the new FERC license issued in February 2009.

The Columbia River Distinct Population Segment of bull



trout is listed by the USFWS as a threatened species under the ESA, and a Bull Trout Recovery Team has been established, of which the District is an active member. A draft Upper Columbia River Bull Trout Recovery Plan has been developed which contains recommendations for recovering bull trout in the Columbia River Basin. The District developed comprehensive Bull Trout Management Plans for the Rocky Reach and Rock Island projects in response to the USFWS's biological opinion on potential effects of the 2004 HCPs on bull trout, which are not covered by the HCPs. Implementation of the plans began in May 2005, but as part of the Rocky Reach Project relicensing, a Comprehensive Bull Trout Management Plan was developed as part of the Comprehensive Settlement Agreement that replaced the earlier management plan. The Bull Trout Management Plan was approved in the new license and provides for protection, mitigation and enhancement measures. Additionally, the USFWS filed its Biological Opinion for the Rocky Reach Project in December 2008 concluding that the Project is not likely to jeopardize the continued existence of bull trout or destroy or adversely modify critical habitat. The USFWS Biological Opinion provided terms and conditions of an incidental take permit and required five reasonable and prudent measures be implemented to minimize the incidental take of bull trout. In September 2010 the USFWS formally designated critical habitat for bull trout in the upper mid-Columbia river, including the project areas for Rock Island and Rocky Reach hydro's.

Revised Department of Ecology (DOE) water quality standards (WQS) became effective in December 2006. These standards are applicable to the Columbia River basin and address dissolved gas and temperature for the Columbia and Snake Rivers. As part of the relicensing process for the Rocky Reach and Lake Chelan projects, the District obtained Water Quality Certifications issued by the DOE that are consistent with the revised WQS. The DOE allows the District a ten-year window to demonstrate compliance with the new WQS and can require the District to conduct further studies, implement further operational changes or even, in a worst case event, provide structural changes to meet requirements. The District currently is meeting the revised WQS, but the Water Quality Certifications require that further studies be conducted to document continued compliance during the ten-year window. Based on current evaluations and testing results, the District believes that it can meet the revised WQS without the need for operational or structural changes. Actions to address water quality parameters would not affect generation levels.

#### **Capital Improvement Program**

During 2005, the District entered into a contract to rehabilitate the first of up to six generating units at Powerhouse 1 at Rock Island. A \$22.9 million contract was

executed for the design, manufacture, installation and testing of one generating unit. Construction was completed in May 2008. The first unit underwent one year of trial operation to prove and optimize the design. The original contract was amended to purchase two turbines for future units for a cost of \$5.5 million. The contract was amended again in June 2009 to add procurement and installation of a second unit. The contract price was increased by approximately \$16 million. As of December 31, 2011, the remaining construction commitment totaled approximately \$1.3 million.

The District will also be rehabilitating, upgrading and/or replacing other ancillary assets as part of the modernization project for Powerhouse 1 at Rock Island. In 2007, the District also entered into a \$12.1 million contract to replace stators for generating units at Rock Island. Four new stators were delivered as they were produced in 2009. One stator was installed, and work was completed in September 2009. A second stator was installed in March 2010. A third stator was installed in March 2011. The fourth stator is being installed starting approximately April 2012. As of December 31, 2011, the remaining construction commitment totaled approximately \$700,000.

#### **Power Marketing**

As of December 31, 2011, the District had entered into forward block contracts obligating it to deliver approximately 5,303,900 MWh of energy at various times during 2012, 2013, 2014, 2015 and 2016. The District expects to receive approximately \$241.8 million from the purchasers of this power. In addition, as part of the comprehensive forward energy hedging strategy implemented during 2010, the District has entered into several slice output contracts, which provide a counterparty a percentage share of hydropower production for a fixed payment. Under the slice output contracts, the District has committed to delivering varying percentages of the hydropower production of its Rocky Reach and Rock Island projects during 2012, 2013, 2014 and 2015, in exchange for approximately \$197.1 million.

The District has committed to purchase approximately 502,900 MWh of energy at a cost of approximately \$21.4 million to fulfill these power marketing obligations, meet District load requirements and mitigate credit risk. The District believes it has sufficient internal resources, or has acquired sufficient external resources to complete these transactions.

#### **Line of Credit**

In April 2011, the District and Bank of America, N.A. ("Bank of America") entered into a Line of Credit and Reimbursement Agreement (the "Credit Agreement") with an available commitment of \$50 million. The District may either draw on the Credit Agreement directly or request that

Bank of America issue a letter of credit. The District may use the proceeds of any draws on the Credit Agreement or on any letters of credit issued under the Credit Agreement to (i) to satisfy any collateral requirements of the District in connection with any electricity hedges, (ii) to make swap termination payments, or (iii) upon receipt of the prior written consent of Bank of America (which consent may not be unreasonably withheld), for other general purposes of the District. The initial term of the Credit Agreement expires on April 1, 2014, but the term may be extended for up to an additional three years. As of December 31, 2011, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit.

**Participation in Northwest Open Access Network, Inc. d.b.a. NoaNet**

The District, along with 12 other Washington State public entities, is a member of NoaNet, a Washington nonprofit mutual corporation. NoaNet was incorporated in February 2000 to provide a broadband communications backbone over Public Benefit Fibers leased from Bonneville Power Administration throughout the State of Washington. The network began commercial operation in January 2001.

In July 2001, NoaNet issued \$27 million in Telecommunications Network Revenue Bonds (taxable) to finance the repayment of the founding members and the costs of initial construction, operations and maintenance. In June 2011, NoaNet issued \$13.2 million in Telecommunications Network Revenue Refunding Bonds, 2011 (taxable), which fully refunded the remaining outstanding 2001 Revenue Bonds. The bonds become due beginning in December 2012 through December 2016, with interest due semi-annually at rates ranging from .75% to 3.0%. Each member of NoaNet has entered into a repayment agreement to guarantee the debt of NoaNet. The District's guarantee is limited to a maximum of 12.65%.

In August 2008, NoaNet opened a \$1.5 million non-revolving line of credit to fund upgrades and expansions of capital facilities. In June 2009, NoaNet opened an additional \$1.5 million line of credit to provide funding for improvements and expansions to capital facilities. Draws against the lines of credit totaled \$1.4 million and \$2.4 million as of December 31, 2011 and 2010, respectively. NoaNet may assess its members for their percentage share of principal and interest on the notes to the extent that NoaNet does not have sufficient funds to pay the notes.

In 2010, NoaNet accepted two federal stimulus broadband grants with total proposed project budget amount of \$184.5 million. The actual grant funds are \$138.8 million, and the remainder of the budget includes matches (in-kind and cash) by NoaNet and other subrecipients.

NoaNet's share of the cash match is \$2.7 million. The grants are through the Department of Commerce's National Telecommunications and Information Administration (NTIA), Broadband Technology Opportunities Program (BTOP). The stated purpose of the grants is to expand wholesale telecommunications facilities and services to serve 34 of Washington's 39 counties, which are either unserved or underserved and to complete NoaNet's system. The District is not a subrecipient of either grant. The District believes it has no obligation to NoaNet or otherwise with respect to the grants and the agreements that NoaNet has executed in connection with those grants, other than its percentage share of NoaNet's ongoing operating and other expenses that are not otherwise paid from NoaNet's ongoing revenues and the assessments imposed by a two-thirds majority of the board.

Under NoaNet's bylaws, members may be assessed in order to cover operating deficits. Member assessments totaled \$500,000 and \$921,000 for 2011 and 2010, respectively. The District's membership percentage in NoaNet is currently 11.71%. During 2011 and 2010, the District expensed \$51,000 and \$93,000, respectively, related to member assessments. NoaNet recorded changes in net assets of \$25.7 million and \$5.0 million during 2011 and 2010, respectively, based on the preliminary 2011 and 2010 financial reports. NoaNet financial results for 2011 are estimated, and any variance will not have a material impact on the District's financial position. The District's share of the changes in net assets is \$3.0 million and \$585,000 for the years ended December 31, 2011 and 2010, respectively. NoaNet had a net equity position for 2011 and 2010 of \$24.8 million and (\$1.3) million, respectively.

For the NoaNet final 2011 financial report, please write: NoaNet, 616 State Street, Centralia, Washington, 98531, or go to [www.noanet.net](http://www.noanet.net).

All information on the website is the responsibility of NoaNet. The District's independent auditor has not audited or examined any information on that website and accordingly, does not express an opinion or any other form of assurance with respect thereto.

**Energy Northwest**

In August 2001, District Commissioners voted to join seven other utilities in a 20-year contract to purchase power from Energy Northwest's Nine Canyon Wind Project (the Project). Energy Northwest, a municipal corporation and a joint operating agency of the State of Washington (formerly known as the Washington Public Power Supply System), was also a purchaser under the Power Purchase Agreement. Energy Northwest has since assigned its share of the Project to two additional utilities.

The Project was constructed in phases. The District is a participant in phases I and II of the Project, which have a combined generating capacity of 64 MW. In exchange for paying certain project costs after phase I and II commenced commercial operation, including debt service on the Wind Project Revenue Bonds issued by Energy Northwest to finance the construction of the Project, the District receives a 12.5% share of the total project output up to a maximum of 7.96 MW. As of December 31, 2011, the District's share of bond principal was \$8.4 million and was not to exceed \$10.5 million with the step-up provision. The power purchased under this contract is reported as a component of Purchased Power Operating Expenses.

The District declined to participate in phase III of the Project. In October 2006, the District signed a second amended power purchase agreement, reducing the District's share in the combined project to approximately 8.3% once phase III began commercial operation. The District's debt obligations related to phases I and II remain the same, but its share

of the combined project output and combined operation and maintenance costs were reduced as a result of not participating in phase III.

For complete financial statements for Energy Northwest including the Nine Canyon Project, please write: Energy Northwest, P.O. Box 968, Richland, Washington, 99352-0968.

The Report of Independent Auditors included with these financial statements relates solely to historical financial information of the District and does not relate to Energy Northwest or any other entity.

#### Claims and Litigation

The District is involved in various claims arising in the normal course of business. The District does not believe that the ultimate outcome of these matters will have a material impact on its financial position, results of operations or cash flows.

#### REQUIRED SUPPLEMENTARY INFORMATION (unaudited)

Schedule of Funding Progress for Postretirement Health Benefits Program

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
1/1/2011	\$ 2,186,952	\$ 1,417,889	\$ (769,063)	154%	\$ 48,550,921	(1.58)%
1/1/2009	\$ 1,791,487	\$ 1,573,100	\$ (218,387)	114%	\$ 49,003,415	(0.45)%
1/1/2007	\$ 2,177,526	\$ 2,177,526	\$ -	100%	\$ 46,311,261	0.00%



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**COMBINING SCHEDULE OF ASSETS AND LIABILITIES AND NET ASSETS**  
**As of December 31, 2011, with comparative totals for December 31, 2010**  
(amounts in thousands)

	Rocky Reach	Columbia River- Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra- District Trans- actions (1)	2011	2010
<b>CURRENT ASSETS</b>									
Cash and cash equivalents	\$ 3,817	\$ -	\$ 2,464	\$ 39,608	\$ 4,633	\$ 5,446	\$ -	\$ 55,968	\$ 65,470
Investments	4,748	-	3,065	55,840	5,764	6,775	-	76,192	39,236
Accounts receivable, net	1,259	6,180	8	18,366	-	30	-	25,843	21,476
Accrued interest receivable	93	172	28	844	321	77	-	1,535	1,446
Materials and supplies	2,047	-	-	8,249	-	299	-	10,595	10,362
Prepayments and other	292	230	37	183	-	5	-	747	1,260
Current portion of deferred regulatory charges	-	-	-	-	3,508	-	-	3,508	-
	12,256	6,582	5,602	123,090	14,226	12,632	-	174,388	139,250
<b>RESTRICTED ASSETS - CURRENT</b>									
Cash and cash equivalents	281	7,543	11	135	-	2,008	-	9,978	32,901
Investments	328	9,367	14	168	-	2,498	-	12,375	22,585
	609	16,910	25	303	-	4,506	-	22,353	55,486
<b>TOTAL CURRENT ASSETS</b>	12,865	23,492	5,627	123,393	14,226	17,138	-	196,741	194,736
<b>UTILITY PLANT</b>									
In service, at original cost	600,519	541,974	120,048	459,711	-	82,114	-	1,804,366	1,769,796
Construction work in progress	1,093	23,595	-	9,933	-	24	-	34,645	28,533
Less-accumulated depreciation	(245,957)	(238,632)	(22,752)	(183,863)	-	(56,874)	-	(748,078)	(703,021)
	355,655	326,937	97,296	285,781	-	25,264	-	1,090,933	1,095,308
<b>RESTRICTED ASSETS - NONCURRENT</b>									
Cash and cash equivalents	4,984	3,329	99	20,006	8,429	-	-	36,847	58,886
Investments	11,321	33,144	218	42,044	43,332	1,711	-	131,770	121,425
	16,305	36,473	317	62,050	51,761	1,711	-	168,617	180,311
<b>DEFERRED CHARGES AND OTHER ASSETS</b>									
Deferred financing costs	375	2,113	-	-	4,903	-	-	7,391	10,499
Fish protection costs	695	161	-	-	-	-	-	856	1,776
Long-term receivables, net	-	-	-	1,772	-	-	-	1,772	3,323
Long-term investments	3,251	-	2,098	39,757	3,947	4,638	-	53,691	79,003
Deferred regulatory charges, net	-	-	-	1,115	39,863	-	-	40,978	23,296
Derivative instrument asset	-	7,375	-	-	-	-	-	7,375	3,948
Deferred outflow of resources- derivatives	-	-	-	-	-	-	-	-	8,370
Other	837	5,353	7	8,397	-	6	(8,310)	6,290	5,856
	5,158	15,002	2,105	51,041	48,713	4,644	(8,310)	118,353	136,071
<b>TOTAL ASSETS</b>	\$ 389,983	\$ 401,904	\$ 105,345	\$ 522,265	\$ 114,700	\$ 48,757	\$ (8,310)	\$ 1,574,644	\$ 1,606,426

(1) Eliminating entries reduce assets and liabilities to account for intradistrict transactions.

**COMBINING SCHEDULE OF ASSETS AND LIABILITIES AND NET ASSETS - cont.**  
**As of December 31, 2011, with comparative totals for December 31, 2010**  
(amounts in thousands)

	Rocky Reach	Columbia River- Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra- District Trans- actions (1)	2011	2010
<b>CURRENT LIABILITIES</b>									
Current portion of long-term obligations	\$ 17,498	\$ 26,829	\$ 4,537	\$ 1,713	\$ (4,574)	\$ 775	\$ -	\$ 46,778	\$ 35,401
Current portion of deferred wholesale power sales	623	-	-	5,799	281	-	-	6,703	-
Accounts payable	4,213	5,450	253	4,014	90	4,302	-	18,322	17,900
Accrued taxes	1,603	794	109	1,619	-	260	-	4,385	3,389
Accrued interest	460	299	-	25	11,151	-	-	11,935	16,585
Intersystem payables (receivables)	(1,434)	3,915	(789)	9,053	(5,766)	(4,979)	-	-	-
Accrued vacation and other	44	50	4	60	-	11,697	-	11,855	11,428
	23,007	37,337	4,114	22,283	1,182	12,055	-	99,978	84,703
<b>LONG-TERM DEBT</b>									
Revenue bonds and notes payable	19,891	264,633	-	9,378	663,355	-	-	957,257	1,026,192
Intersystem loans payable (receivable)	253,243	173,600	80,993	65,088	(603,890)	30,966	-	-	-
Less-current maturities	(17,498)	(26,829)	(2,979)	(1,713)	4,574	(775)	-	(45,220)	(33,973)
	255,636	411,404	78,014	72,753	64,039	30,191	-	912,037	992,219
<b>OTHER LIABILITIES</b>									
Deferred wholesale power sales revenue, less current portion	11,178	-	-	105,176	5,017	-	(8,310)	113,061	111,941
Long-term contract customer deposit	-	-	-	18,500	-	-	-	18,500	-
Derivative instrument liability	-	-	-	-	21,012	-	-	21,012	31,664
Deferred inflow of resources - derivatives	-	7,375	-	-	-	-	-	7,375	3,948
Licensing obligation, less current portion	-	-	8,046	-	-	-	-	8,046	7,858
Regulatory liabilities	-	4,450	-	1,436	-	-	-	5,886	2,277
Other liabilities	-	681	-	-	-	-	-	681	476
	11,178	12,506	8,046	125,112	26,029	-	(8,310)	174,561	158,164
<b>TOTAL LIABILITIES</b>	289,821	461,247	90,174	220,148	91,250	42,246	(8,310)	1,186,576	1,235,086
<b>TOTAL NET ASSETS</b>	100,162	(59,343)	15,171	302,117	23,450	6,511	-	388,068	371,340
<b>TOTAL LIABILITIES AND NET ASSETS</b>	\$ 389,983	\$ 401,904	\$ 105,345	\$ 522,265	\$ 114,700	\$ 48,757	\$ (8,310)	\$ 1,574,644	\$ 1,606,426

1. Eliminating entries reduce assets and liabilities to account for intradistrict transactions.

**COMBINING SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**For the year ended December 31, 2011, with comparative totals for December 31, 2010**  
(amounts in thousands)

	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra-District Transactions (1)	2011	2010
<b>OPERATING REVENUES</b>									
Retail sales	\$ -	\$ -	\$ -	\$ 57,195	\$ -	\$ -	\$ (726)	\$ 56,469	\$ 54,256
Wholesale sales	77,260	77,018	11,431	101,937	711	-	(88,994)	179,363	160,042
Other operating revenues	281	199	340	2,896	-	15,556	(16,561)	2,711	2,057
	<u>77,541</u>	<u>77,217</u>	<u>11,771</u>	<u>162,028</u>	<u>711</u>	<u>15,556</u>	<u>(106,281)</u>	<u>238,543</u>	<u>216,355</u>
<b>OPERATING EXPENSES</b>									
Purchased power and water	-	-	-	101,787	-	-	(87,056)	14,731	23,193
Generation	39,027	35,903	4,624	-	-	-	(12,012)	67,542	69,613
Utility services	-	-	-	36,249	-	-	(6,199)	30,050	28,806
Other operation and maintenance	-	-	-	-	-	9,912	(1,014)	8,898	6,566
Taxes	1,531	772	105	4,995	-	-	-	7,403	6,284
Depreciation and amortization	16,968	10,577	1,896	14,619	-	4,408	-	48,468	49,025
	<u>20,015</u>	<u>29,965</u>	<u>5,146</u>	<u>4,378</u>	<u>711</u>	<u>1,236</u>	<u>-</u>	<u>61,451</u>	<u>32,868</u>
<b>OPERATING INCOME</b>									
	20,015	29,965	5,146	4,378	711	1,236	-	61,451	32,868
<b>OTHER INCOME (EXPENSE)</b>									
Interest on long-term debt	(952)	(15,735)	-	(57)	(33,576)	-	180	(50,140)	(55,520)
Interest on intersystem loans	(16,833)	(11,742)	(4,893)	(2,426)	37,649	(1,575)	(180)	-	-
Amortization of deferred debt costs	(390)	(330)	(90)	(182)	(185)	(9)	-	(1,186)	(1,123)
Investment income	455	1,966	130	2,794	3,776	340	-	9,461	7,692
Federal subsidy income	-	-	-	-	630	-	-	630	630
Other	851	(1,287)	615	(346)	(5,415)	209	-	(5,373)	(1,058)
	<u>3,146</u>	<u>2,837</u>	<u>908</u>	<u>4,161</u>	<u>3,590</u>	<u>201</u>	<u>-</u>	<u>14,843</u>	<u>(16,511)</u>
<b>INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS &amp; INTERFUND EQUITY TRANSFERS</b>									
	3,146	2,837	908	4,161	3,590	201	-	14,843	(16,511)
<b>CAPITAL CONTRIBUTIONS</b>									
	-	17	-	1,868	-	-	-	1,885	3,456
<b>INTERFUND EQUITY TRANSFERS</b>									
	(16,347)	-	(855)	2,205	15,026	(29)	-	-	-
<b>CHANGE IN NET ASSETS</b>									
	(13,201)	2,854	53	8,234	18,616	172	-	16,728	(13,055)
<b>TOTAL NET ASSETS</b>									
Beginning of year	113,363	(62,197)	15,118	293,883	4,834	6,339	-	371,340	384,395
<b>TOTAL NET ASSETS</b>									
End of year	<u>\$ 100,162</u>	<u>\$ (59,343)</u>	<u>\$ 15,171</u>	<u>\$ 302,117</u>	<u>\$ 23,450</u>	<u>\$ 6,511</u>	<u>\$ -</u>	<u>\$ 388,068</u>	<u>\$ 371,340</u>

1. Eliminating entries reduce operating revenues and expenses to account for intradistrict transactions.

## COMBINING SCHEDULE OF CASH FLOWS

For the year ended December 31, 2011, with comparative totals for December 31, 2010

(amounts in thousands)

	Rocky Reach	Columbia River- Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra- District Trans- actions (1)	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>									
Receipts from customers	\$ 93,004	\$ 75,767	\$ 11,769	\$ 182,227	\$ 6,009	\$ 15,655	\$ (123,025)	\$ 261,406	\$ 213,975
Payments to suppliers	(19,305)	(14,747)	(2,028)	(139,959)	137	(8,048)	123,025	(60,925)	(64,826)
Payments to employees	(20,760)	(21,057)	(2,801)	(20,506)	-	(879)	-	(66,003)	(64,606)
Net cash provided by operating activities	52,939	39,963	6,940	21,762	6,146	6,728	-	134,478	84,543
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>									
Additions to plant	(4,837)	(20,102)	(2,361)	(15,325)	-	(1,838)	-	(44,463)	(41,525)
Additions to pooled assets	(205)	(185)	(16)	-	-	406	-	-	-
Proceeds from sale of plant	1	386	-	13	-	63	-	463	81
Proceeds of new intersystem loans	7,134	-	-	(24)	(7,110)	-	-	-	-
Proceeds of new third party debt	-	-	-	1,036	361,624	-	-	362,660	-
Principal paid on debt & intersystem loans	(29,564)	(31,179)	(3,614)	(10,907)	(366,052)	(3,099)	-	(444,415)	(31,999)
Interest paid on debt & intersystem loans	(26,639)	(12,176)	(7,325)	(3,646)	13,299	(3,249)	-	(39,736)	(39,919)
Capital contributions	-	3,654	-	1,668	-	-	-	5,322	2,470
Other	409	(762)	610	(435)	(27,138)	208	-	(27,108)	1,725
Net cash used in capital & related financing activities	(53,701)	(60,364)	(12,706)	(27,620)	(25,377)	(7,509)	-	(187,277)	(109,167)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>									
Investments, net	866	(10,178)	2,820	(9,552)	8,466	(1,358)	-	(8,936)	(10,946)
Interest on investments	328	1,879	156	2,647	1,212	305	-	6,527	7,720
Long-term receivables	-	-	-	1,551	-	-	-	1,551	471
Other, net	-	205	-	(965)	(47)	-	-	(807)	873
Net cash provided by (used in) investing activities	1,194	(8,094)	2,976	(6,319)	9,631	(1,053)	-	(1,665)	(1,882)
<b>NET (DECREASE) INCREASE IN CASH &amp; CASH EQUIVALENTS</b>									
	432	(28,495)	(2,790)	(12,177)	(9,600)	(1,834)	-	(54,464)	(26,506)
<b>CASH &amp; CASH EQUIVALENTS, BEGINNING OF YEAR</b>									
	8,650	39,367	5,364	71,926	22,662	9,288	-	157,257	183,763
<b>CASH &amp; CASH EQUIVALENTS, END OF YEAR</b>									
	\$ 9,082	\$ 10,872	\$ 2,574	\$ 59,749	\$ 13,062	\$ 7,454	\$ -	\$ 102,793	\$ 157,257

1. Eliminating entries reduce operating receipts and payments to account for intradistrict transactions.

COMBINING SCHEDULE OF CASH FLOWS (cont.)

For the year ended December 31, 2011, with comparative totals for December 31, 2010

(amounts in thousands)

	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra-District Transactions (1)	2011	2010
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>									
Operating income	\$ 20,015	\$ 29,965	\$ 5,146	\$ 4,378	\$ 711	\$ 1,236	\$ -	\$ 61,451	\$ 32,868
Depreciation and amortization	16,968	10,577	1,896	14,619	-	4,408	-	48,468	49,025
(Increase) decrease in operating assets:									
Accounts receivable, net	3,662	(1,451)	(1)	(6,676)	-	99	-	(4,367)	(2,380)
Materials and supplies	(92)	-	-	(116)	-	(25)	-	(233)	(3)
Prepayments and other	43	13	(3)	460	-	-	-	513	2,580
Other	-	-	-	(9,484)	-	-	8,372	(1,112)	-
Increase (decrease) in operating liabilities:									
Accounts payable	(246)	19	43	602	90	597	-	1,105	1,778
Accrued taxes	515	178	7	237	-	59	-	996	(301)
Accrued vacation and other	273	662	(148)	(715)	-	354	-	426	976
Deferred wholesale revenue	11,801	-	-	-	5,345	-	(8,372)	8,774	-
Customer deposits	-	-	-	18,457	-	-	-	18,457	-
Net cash provided by operating activities	\$ 52,939	\$ 39,963	\$ 6,940	\$ 21,762	\$ 6,146	\$ 6,728	\$ -	\$ 134,478	\$ 84,543
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES</b>									
Construction costs included in accounts payable	177	1,271	(1,859)	(425)	-	153	-	(683)	614
Capital contributions	-	-	-	116	-	-	-	116	2,538

1. Eliminating entries reduce operating revenues and expenses to account for intradistrict transactions.

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**APPENDIX B—PRELIMINARY UNAUDITED FINANCIAL DATA OF THE DISTRICT  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012**

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**CONDENSED COMBINING STATEMENTS OF REVENUES,  
EXPENSES AND CHANGES IN FUND NET POSITION (Unaudited)**

Nine months ended September 30, 2012  
(in thousands)

	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra-District Transactions (1)	9 Months Ended 09/30/12	9 Months Ended 09/30/11
<b>OPERATING REVENUES</b>	\$ 64,050	\$ 62,325	\$ 9,089	\$ 199,203	\$ 4,656	\$ 11,436	\$ (117,783)	\$ 232,976	\$ 170,282
<b>OPERATING EXPENSES</b>	39,243	36,551	4,445	167,503	-	11,884	(117,783)	141,843	128,614
<b>NET OPERATING INCOME (EXPENSE)</b>	24,807	25,774	4,644	31,700	4,656	(448)	-	91,133	41,668
<b>OTHER INCOME (EXPENSE) (2)</b>	(11,505)	(20,180)	(3,232)	(59)	3,975	(775)	-	(31,776)	(33,568)
<b>CAPITAL CONTRIBUTIONS</b>	-	86	-	2,023	-	-	-	2,109	1,367
<b>INTERFUND EQUITY TRANSFERS</b>	(4,000)	10,203	-	4,848	(11,051)	-	-	-	-
<b>CHANGE IN NET POSITION</b>	\$ 9,302	\$ 15,883	\$ 1,412	\$ 38,512	\$ (2,420)	\$ (1,223)	\$ -	\$ 61,466	\$ 9,467

**CONDENSED COMBINING BALANCE SHEETS (Unaudited)**

September 30, 2012  
(in thousands)

ASSETS	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra-District Transactions (1)	09/30/12	09/30/11
<b>TOTAL CURRENT ASSETS</b>	\$ 11,237	\$ 17,959	\$ 5,968	\$ 122,146	\$ 38,511	\$ 16,898	\$ -	\$ 212,719	\$ 231,764
<b>NET UTILITY PLANT</b>	345,515	318,153	95,921	294,425	-	23,415	-	1,077,429	1,083,725
<b>RESTRICTED ASSETS - NONCURRENT</b>	21,026	35,275	308	61,271	42,625	1,891	-	162,396	156,083
<b>DEFERRED CHARGES &amp; OTHER ASSETS</b>	4,916	20,035	2,623	72,045	58,400	5,659	(17,111)	146,567	136,653
<b>TOTAL ASSETS</b>	\$ 382,694	\$ 391,422	\$ 104,820	\$ 549,887	\$ 139,536	\$ 47,863	\$ (17,111)	\$ 1,599,111	\$ 1,608,225
<b>LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION</b>									
<b>CURRENT LIABILITIES</b>	\$ 21,528	\$ 34,280	\$ 4,879	\$ 67,812	\$ 79,986	\$ 17,305	\$ -	\$ 225,789	\$ 87,671
<b>INTERSYSTEM PAYABLE (RECEIVABLE) - CURRENT</b>	(596)	(345)	(201)	4,820	6	(3,685)	-	(1)	-
<b>LONG-TERM DEBT</b>	241,587	375,471	75,627	15,895	5,204	28,955	-	742,739	954,773
<b>DEFERRED REVENUES</b>	10,711	11,301	-	100,826	10,976	-	(17,111)	116,703	146,112
<b>OTHER LIABILITIES</b>	-	5,647	7,932	19,905	22,334	-	-	55,818	31,233
<b>TOTAL LIABILITIES</b>	273,230	426,354	88,237	209,258	118,506	42,575	(17,111)	1,141,049	1,219,789
<b>DEFERRED INFLOWS OF RESOURCES</b>	-	8,528	-	-	-	-	-	8,528	7,629
<b>TOTAL NET POSITION</b>	109,464	(43,460)	16,583	340,629	21,030	5,288	-	449,534	380,807
<b>TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES &amp; NET POSITION</b>	\$ 382,694	\$ 391,422	\$ 104,820	\$ 549,887	\$ 139,536	\$ 47,863	\$ (17,111)	\$ 1,599,111	\$ 1,608,225

<b>ELECTRIC</b> As of September 30	2012	2011
Number of Customers	48,444	48,250
Number of Residential Customers	36,040	35,864
YTD Average Residential Rate (Cents/kWh)	3.23	3.45

<b>POWER GENERATION (MWh) (000)</b> 9 months ended September 30	2012	2011
Lake Chelan	286	359
Rocky Reach	5,660	5,790
Rock Island	2,599	2,616

<b>HYDRO PRODUCTION COST/MWH GENERATED (\$/MWh)</b> 9 months ended September 30	2012	2011
Lake Chelan	\$ 24	\$ 22
Rocky Reach	9	10
Rock Island	22	21

**NOTES TO CONDENSED STATEMENTS**

(1) Intra-District transactions are eliminated.

(2) Consists primarily of investment income and interest expense on long-term debt.

Chelan County Public Utility District No.1 (Chelan County PUD) has prepared condensed financial statements in accordance with generally accepted accounting principles. Condensed financial statements should be read in conjunction with the notes to the financial statements included in Chelan County PUD's Annual Report as of December 31, 2011. This information is provided for general information. Not all the information is intended for nor should it be relied upon for making investment decisions by current or prospective investors.

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**APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE  
SENIOR CONSOLIDATED SYSTEM RESOLUTION**

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## APPENDIX C - SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR CONSOLIDATED SYSTEM RESOLUTION

The following is a summary of certain provisions of Resolution No. 99-11303, adopted by the Commission on November 1, 1999, as amended and supplemented (the "Senior Consolidated System Resolution" and referred to in this Summary as the "Master Resolution"). This summary does not purport to be complete and is qualified in its entirety by reference to the foregoing document for a complete statement of the provisions of such document.

### DEFINITIONS

**"Accreted Value"** means, with respect to any Capital Appreciation Bond, the principal amount thereof plus the interest accrued thereon from its delivery date, compounded at the approximate interest rate thereof on each date specified therein, to the date of calculation.

**"Annual Debt Service"** means, as of any date of calculation, for any Fiscal Year (or other designated twelve-month period) the amount of principal and interest becoming due and payable on all Bonds such Fiscal Year (or other designated twelve-month period); provided, however, that for the purposes of computing Annual Debt Service:

- (a) Excluded Principal Payments will be excluded from such calculation and Assumed Debt Service will be included in such calculation;
- (b) if the Bonds are Variable Rate Obligations and (i) are secured pursuant to a Credit Facility which, if drawn upon, would create a repayment obligation which has a lien and charge on Revenues subordinate to the lien and charge of the Bonds, or (ii) are not secured by any Credit Facility, the interest rate on such Bonds for periods when the actual interest rate has not yet been determined will be assumed to be equal to the interest rate on the Bonds on a date selected by the District and occurring within 30 days prior to the issuance of such Bonds or, if such Bonds are not currently Outstanding, the interest rate that such Bonds would likely bear if they were Outstanding on such date, as certified in writing by a Financial Advisor within 30 days prior to the date of calculation;
- (c) if the Bonds are Variable Rate Obligations and are secured pursuant to a Credit Facility which, if drawn upon, would create a repayment obligation which has a lien and charge on Revenues on a parity with the lien and charge of the Bonds, the interest rate on such Bonds for periods when the actual interest rate has not yet been determined will be assumed to be equal to the lesser of (i) the then current rate which would be borne by such Bonds or under such Credit Facility with respect to Bonds purchased or paid by the Credit Facility Provider, and (ii) the maximum rate, if any, permitted on such Bonds;
- (d) notwithstanding paragraphs (b) and (c) of this definition, if a Qualified Swap Agreement is in effect pursuant to which the District is obligated to pay a fixed rate of interest with respect to any Bonds constituting Variable Rate Obligations, the interest rate on such Bonds during the period such Qualified Swap Agreement is scheduled to be in effect will be assumed to be the interest rate specified in such Qualified Swap Agreement;
- (e) notwithstanding paragraphs (b) and (c) of this definition, if a Qualified Swap Agreement is in effect pursuant to which the District is obligated to pay a variable rate of interest with respect to any Bonds, such Bonds will be assumed to be Variable Rate Obligations during the period such Qualified Swap Agreement is scheduled to be in effect, and interest on such Bonds will be calculated as provided in paragraph (b) above;
- (f) if any Bonds are Paired Obligations, the interest rate on such Bonds will be assumed to be the aggregate fixed interest rate to be paid by the District with respect to such Paired Obligations;
- (g) principal and interest payments on Bonds will be excluded to the extent such payments are to be made from amounts on deposit (and investment earnings thereon), as of the date of calculation, with the

District, the Fiscal Agent or any other fiduciary in an escrow or other account irrevocably dedicated therefor, including without limitation interest payments that are to be paid from the proceeds of Bonds held by the District, the Fiscal Agent or any other fiduciary; and

(h) in determining the principal amount of Bonds due in each Fiscal Year, payment will be assumed to be made in accordance with the maturity schedules therefor, including any Mandatory Sinking Account Payments with respect to the scheduled redemption of such Bonds prior to maturity (unless a different subsection of this definition applies for purposes of determining assumed principal maturities or amortization).

**“Assumed Debt Service”** means, with respect to any Excluded Principal Payment for any Fiscal Year (or other designated twelve-month period), the amount of principal and interest which would be payable in such Fiscal Year (or other designated twelve-month period) if that Excluded Principal Payment were amortized from the date of calculation substantially (subject to the provision below) on a level debt service basis over a 30-year period (or, at the election of the District, over such other period as will be equal to the estimated weighted average service life of the assets acquired or expected to be acquired from the proceeds of such Bonds, as certified in writing by a Consulting Engineer), assuming that interest only will be paid on such Bonds until the estimated weighted average in-service date of the assets acquired or expected to be acquired from the proceeds of such Bonds, and calculated based on the rate of interest on such Bonds on the date of calculation or, if such Bonds are not currently Outstanding, the rate of interest such Bonds would likely bear if they were Outstanding on such date, as certified in writing by a Financial Advisor within 30 days prior to the date of calculation.

**“Authorized Investments”** means any obligations or investments in which the District may legally invest its funds.

**“Authorized Representative”** means any officer or employee of the District authorized by the Commission to act as an Authorized Representative hereunder.

**“Available Funds”** means, as of any date of calculation, any unencumbered amounts, including cash and the book value of investments, held in funds of the Chelan Hydro Consolidated System, which the District reasonably expects to be available to pay principal and interest on Bonds, but excluding amounts held for working capital and contingency purposes pursuant to the Master Resolution, all as shown by a Certificate of the District or a Consulting Engineer.

**“Bond”** or **“Bonds”** means the bonds, notes, or other evidences of indebtedness, including without limitation installment purchase or lease purchase obligations, of the issue created and established by the Resolution.

**“Bond Obligation”** means, as of any date of calculation, (i) with respect to any Outstanding Current Interest Bond, the principal amount of such Bond, and (ii) with respect to any Outstanding Capital Appreciation Bond, the Accreted Value thereof as of the date on which interest on such Capital Appreciation Bond is compounded next preceding such date of calculation (unless such date of calculation is a date on which such interest is compounded, in which case, as of such date).

**“Bondowners’ Trustee”** has the meaning set forth in “THE SENIOR CONSOLIDATED SYSTEM RESOLUTION—Remedies” below.

**“Bond Counsel”** means at any time a firm of attorneys appointed by the District with recognized experience and expertise in the field of municipal finance law and federal and state tax laws related thereto.

**“Bond Register”** means the Bond Register as described in the Resolution.

**“Business Day”** means any day other than (i) a Saturday, Sunday, or a day on which banking institutions in the State or the State of New York are authorized or obligated by law or executive order to be closed, (ii) for purposes of payments on Bonds secured by a Credit Facility, a day on which commercial banks located in the city in which the office of the Credit Facility Provider at which demands for payment under the Credit Facility are required

to be presented are authorized or obligated by law or executive order to be closed, and (iii) if specified in a Supplemental Resolution, a day on which the principal office of the District is authorized or required by law to be closed.

**“Capital Appreciation Bonds”** means any Bonds the interest on which is compounded and not scheduled to be paid until the maturity or prior redemption thereof, or the conversion thereof to Current Interest Bonds.

**“Certificate,” “Statement,” “Request,” “Requisition”** and **“Order”** of the District means, respectively, a written certificate, statement, request, requisition or order signed by an Authorized Representative.

**“Chelan Hydro Consolidated System”** means the “Chelan Hydro Consolidated System” ratified, confirmed, approved and continued by the Senior Consolidated System Resolution and ratified, confirmed, approved and continued by the Master Resolution, and any and all additions, improvements, betterments, renewals, replacements and repairs thereto and extensions thereof, and will include all generation, transmission, distribution and other facilities, property and rights, tangible and intangible, purchased prior to or after the date of adoption of the Master Resolution, constructed or otherwise acquired by the District from the proceeds of Bonds or from Revenues, but will not include such generation, transmission, distribution and other facilities, property and rights that may be purchased after the date of adoption of the Master Resolution, constructed or otherwise acquired by the District as a separate utility system the revenues derived from the ownership and operation of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire such separate utility system. The term “Chelan Hydro Consolidated System” will also include any other separate utility system of the District and any other facilities or systems which the District is authorized by law to own and operate if the District by resolution of its Commission determines to consolidate such separate utility system or other facilities or systems with and add them to the Chelan Hydro Consolidated System.

**“Commission”** means the Commission of the District, or any successor thereto as provided by law.

**“Consulting Engineer”** means at any time a consulting engineer or engineering firm appointed by the District with recognized experience and expertise in the area of electric utility consulting.

**“Credit Facility”** means a letter of credit, line of credit, or other credit or liquidity facility provided by a financial institution or insurance company, or other form of credit enhancement, including, but not limited to, municipal bond insurance and guarantees, executed by or delivered to the Fiscal Agent for a Series of Bonds or portion thereof, which provides for payment, in accordance with the terms thereof, of the principal, Accreted Value, premium, interest and/or purchase price of or on such Series of Bonds or portion thereof. A Credit Facility may be comprised of one or more credit facilities provided by one or more financial institutions or insurance companies.

**“Credit Facility Provider”** means the financial institution or insurance company that is providing a Credit Facility.

**“Current Interest Bonds”** means any Bonds, other than Capital Appreciation Bonds, which pay interest at least annually to the Owners thereof commencing within 18 months from the date of issuance thereof.

**“Distribution Division Bonds”** means any Series of Bonds or portion thereof which are not Hydro System Bonds.

**“Distribution Division Net Receipts”** means, for any period of calculation, Net Receipts less the sum of (i) Net Receipts properly allocable to any Hydro System which has been fully consolidated into the Chelan Hydro Consolidated System pursuant to the Master Resolution, and (ii) any intersystem payments or intrasystem transfers to the Chelan Hydro Consolidated System on or with respect to any Loans.

**“Distribution Division Senior Debt Service Requirement”** means, for any period of calculation, that portion of the Senior Debt Service Requirement which does not constitute the Hydro System Senior Debt Service Requirement.

**“District”** means Public Utility District No. 1 of Chelan County, a municipal corporation of the State of Washington, constituted as of the date of adoption of the Master Resolution or thereafter, or the corporation, authority, board, body, commission, department or office succeeding to the principal functions of the District or to whom the powers vested in the District will be given by law.

**“Event of Default”** has the meaning set forth in “THE SENIOR CONSOLIDATED SYSTEM RESOLUTION—Events of Default” below.

**“Excluded Principal Payment”** means (i) the Final Compounded Amount of any Capital Appreciation Bonds designated as an “Excluded Principal Payment” in the Supplemental Resolution authorizing the issuance thereof, (ii) the principal amount of any Tender Obligations, and (iii) as of the date of calculation, that portion of the principal amount of any Series of Bonds which is not required to be amortized by purchase or redemption prior to maturity, and which is designated as an Excluded Principal Payment in a Supplemental Resolution. No such determination will affect the obligation of the District to pay such amounts when otherwise due.

**“Federal Securities”** means direct obligations of, or obligations the timely payment of the principal of and interest on which is unconditionally guaranteed by, the United States of America.

**“Final Compounded Amount”** means the Accreted Value of any Capital Appreciation Bond on its maturity or conversion date.

**“Financial Advisor”** means at any time a person or firm of persons selected by the District with recognized financial experience and expertise in the area of municipal finance.

**“Fiscal Agent”** means, with respect to any Series of Bonds, the fiscal agent (which may be the Treasurer) appointed pursuant to the Supplemental Resolution authorizing the issuance of such Series of Bonds.

**“Fiscal Year”** means the twelve-month period selected by the District as the official fiscal year of the District.

**“Hydro System Bonds”** means any Series of Bonds or portion thereof the proceeds of which are to be loaned to or used by a Hydro System pursuant to one or more Loans.

**“Hydro System Senior Debt Service Requirement”** means, as of any date of calculation, for any Fiscal Year (or other designated twelve-month period) the amount of principal and interest becoming due and payable in such Fiscal Year (or other designated twelve-month period) on the Senior Consolidated System Bonds or portions thereof the proceeds of which were loaned to the Hydro Systems to finance or refinance the costs of additions, extensions or improvements to the Hydro Systems, calculated based on the assumptions set forth in the definitions of “Annual Debt Service” and “Assumed Debt Service,” including the defined terms used therein, as applied to the Senior Consolidated System Bonds.

**“Hydro Systems”** means the facilities, properties and rights which constitute or would constitute the Lake Chelan Project, the Rock Island System and the Rocky Reach System, respectively.

**“Information Services”** means Financial Information, Inc.’s “Daily Called Bond Service,” 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 07302, Attention: Editor; Kenny Information Services’ “Called Bond Service,” 65 Broadway, 16th Floor, New York, New York 10006; Moody’s “Municipal and Government,” 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Standard & Poor’s “Called Bond Record,” 25 Broadway, 3rd Floor, New York, New York 10004; or, in accordance with then-current guidelines of the Securities and Exchange Commission, such other addresses and such other services providing information with respect to called bonds as the District may designate in a Request of the District delivered to a Fiscal Agent.

**“Loan”** means a loan or use of the proceeds of all or a portion of a Series of Bonds to or by the Lake Chelan Project, the Rock Island System, the Rocky Reach System or any other separate system of the District.



**“Mandatory Sinking Account Payment”** means, with respect to Bonds of any Series and maturity, an amount required by the Supplemental Resolution authorizing the issuance of such Series to be deposited in the bond fund created for such Series for the mandatory purchase or redemption of Term Bonds of such Series and maturity prior to the final maturity thereof.

**“Moody’s”** means Moody’s Investors Service and its successors and assigns, except that if such organization will be dissolved or liquidated or will no longer perform the functions of a securities rating agency, then the term “Moody’s” will be deemed to refer to any other nationally recognized securities rating agency selected by the District (other than Standard & Poor’s).

**“Municipal Obligations”** means municipal bonds, notes or other obligations for borrowed money, rated in the highest Rating Category by the Rating Agencies originally rating such municipal obligations, meeting the following conditions: (a) the municipal obligations are not subject to redemption prior to maturity, or the trustee, fiscal agent, paying agent or other fiduciary with respect to such obligations has been given irrevocable instructions concerning their calling and redemption; (b) the municipal obligations are secured by Federal Securities, which Federal Securities, except for provisions relating to surplus moneys not required for the payment of the municipal obligations and the substitution of such Federal Securities for other Federal Securities satisfying all criteria for Federal Securities, may be applied only to interest, principal and premium payments on such municipal obligations; (c) the principal of and interest on the Federal Securities (plus any cash in the escrow fund) are sufficient, without reinvestment, to pay interest, principal and premium payments on the municipal obligations; and (d) the Federal Securities serving as security for the municipal obligations are held by an escrow agent or trustee.

**“Net Receipts”** means, for any period of calculation, the Revenues, less the operating and maintenance expenses of the Chelan Hydro Consolidated System and taxes, or payments in lieu of taxes, if not included in such operating and maintenance expenses, payable from Revenues for that period (as specified in a Certificate of the District), but excluding any charges made during the same period to any depreciation account or any accounts for amortization of property values or property losses. The operating and maintenance expenses of the Rocky Reach System or the Rock Island System will not be included in the calculation of Net Receipts so long as revenues of the Rocky Reach System or the Rock Island System, respectively, are not directly available to pay and secure the payment of the Bonds.

**“Opinion of Bond Counsel”** means a written opinion of Bond Counsel.

**“Original Bonds”** means the Senior Consolidated System Bonds, the Rock Island Bonds and the Rocky Reach Bonds.

**“Original Resolutions”** means the Senior Consolidated System Resolution, the Original System Resolutions, the Water Resolutions and the Wastewater Resolutions, so long as the same will remain in effect.

**“Original System Resolutions”** means the Rocky Reach Resolution and the Rock Island Resolution.

**“Outstanding”** means (i) when used with respect to the Bonds, as of any date, Bonds issued pursuant to the Resolution, except such Bonds deemed to be no longer outstanding under the Resolution as provided in the Supplemental Resolution authorizing the issuance thereof, and (ii) when used with respect to any bond or obligation issued or incurred pursuant to the Original Resolutions, as of any date, any bond issued pursuant to any of such Original Resolutions, except such bonds or obligations deemed to be no longer outstanding under the resolution pursuant to which such bonds were issued.

**“Owner”** or **“Holder”** or **“Bondowner”** or **“Bondholder,”** whenever used in the Resolution with respect to a Bond, means the Person in whose name such Bond is registered in accordance with the Resolution, in the case of registered Bonds, or the holder of such Bond, in the case of bearer Bonds.

**“Paired Obligations”** means those portions of any one or more Series of Bonds (i) which are issued simultaneously, (ii) which are designated as Paired Obligations in a Certificate of the District at the time of issuance thereof, (iii) the principal amount of each portion of which is equal and which matures and is subject to mandatory

sinking fund redemption on the same dates and in the same amounts, and (iv) the interest rates on which, taken together, result in an irrevocable fixed interest rate obligation of the District until the maturity or prior redemption of such Bonds.

**“Person”** means an individual, corporation, firm, association, partnership, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

**“Prior Resolution”** means Resolution No. 95-10188, adopted on June 19, 1995, as supplemented and amended to the date of the Master Resolution.

**“Qualified Swap”** or **“Qualified Swap Agreement”** means any financial instrument that (i) is entered into by the District with a counterparty that is a Qualified Swap Provider at the time the instrument is entered into; (ii) is entered into with respect to all or a portion of a Series of Bonds; (iii) is for a term not extending beyond the final maturity of the Series of Bonds or portion thereof to which it relates; (iv) provides that the District will pay to such counterparty an amount accruing at either a fixed rate or a variable rate of interest, as the case may be, on a notional amount equal to or less than the principal amount of the Series of Bonds or portion thereof to which it relates, and that the Qualified Swap Provider will pay to the District an amount accruing at either a variable rate or fixed rate of interest, as appropriate, on such notional amount; (v) provides that one party will pay to the other party any net amounts due under such instrument; and (vi) which has been designated to the Trustee in a Certificate of the District as a Qualified Swap with respect to such Bonds. Notwithstanding anything in the Master Resolution to the contrary, unless the District obtains the prior written consent of the Rating Agencies, the payment obligations of the District under any Qualified Swap Agreement or other interest rate swap, hedge or similar instrument or agreement payable from Revenues will be junior and subordinate to the payment of principal, Accreted Value, purchase price, Redemption Price, interest and reserve fund requirements with respect to the Bonds.

**“Qualified Swap Provider”** means the counterparty to a Qualified Swap with the District or the Fiscal Agent.

**“Rating Agencies”** means either or both of Moody’s and Standard & Poor’s, and such other securities rating agencies providing a rating with respect to a Series of Bonds.

**“Rating Category”** means (i) with respect to any long-term rating category, all ratings designated by a particular letter or combination of letters, without regard to any numerical modifier, plus or minus sign, or other modifier and (ii) with respect to any short-term or commercial paper rating category, all ratings designated by a particular letter or combination of letters and taking into account any numerical modifier, but not any plus or minus sign or other modifier.

**“Redemption Price”** means, with respect to any Bond (or portion thereof), the principal amount or Accreted Value of such Bond (or portion) plus the applicable premium, if any, payable upon redemption thereof pursuant to the provisions of such Bond and the Resolution.

**“Refunding Bonds”** means all Bonds, whether issued in one or more Series, authorized pursuant to the Resolution, the proceeds of which are applied to pay or provide for the payment of Bonds or Original Bonds.

**“Resolution”** means the Master Resolution, as amended, modified or supplemented from time to time by any Supplemental Resolution.

**“Revenues”** means all revenues, rates and charges received or accrued by the District for electric power and energy and other services, facilities and commodities sold, furnished or supplied by the Chelan Hydro Consolidated System, together with income, earnings and profits therefrom (including without limitation interest earnings on the proceeds of any Bonds pending application thereof), subject to the terms, limitations restrictions and covenants of and existing (and, with respect to clause (iii) of this definition, future) liens and charges created and pledges made under (i) the Rocky Reach Resolution while bonds authorized thereunder remain Outstanding, (ii) the Rock Island Resolution while bonds authorized thereunder remain Outstanding, and (iii) any Water System Resolutions or Wastewater System Resolutions while bonds authorized thereunder remain outstanding. Revenues

will include, without limitation, payments to the Chelan Hydro Consolidated System on or with respect to Loans from any separate system maintained by the District. Revenues will not include amounts loaned to the Chelan Hydro Consolidated System, taxes, customer deposits while retained as such, contributions in aid of construction, gifts, grants or extraordinary insurance or condemnation proceeds.

**“Rock Island Bonds”** means any parity bonds issued and Outstanding under the Rock Island Resolution.

**“Rock Island Resolution”** means Resolutions Nos. 1137, 4950, 97-10671 and 97-10672 of the District, adopted by the Commission on December 20, 1955, June 19, 1974, February 27, 1992 and February 27, 1992, respectively, as such resolutions have been or may be amended or supplemented, and any successor thereto adopted in accordance therewith.

**“Rock Island System”** means the facilities, properties and rights constituting the Expanded Columbia River-Rock Island Hydro-Electric System, as defined in the Rock Island Resolution, together with all additions, improvements and betterments thereto and extensions thereof.

**“Rocky Reach Bonds”** means any parity bonds issued and Outstanding under the Rocky Reach Resolution.

**“Rocky Reach Resolution”** means Resolution No. 1412 of the District, adopted by the Commission on November 20, 1956, as such resolution has been or may be amended or supplemented, and any successor thereto adopted in accordance therewith.

**“Rocky Reach System”** means the facilities, properties and rights constituting the Rocky-Reach Hydro-Electric System as defined in the Rocky Reach Resolution, together with all additions, improvements and betterments thereto and extensions thereof.

**“Securities Depositories”** means the following: The Depository Trust Company, 711 Stewart Avenue, Garden City, New York 11530, Fax (516) 227-4039 or 4190; or, in accordance with then-current guidelines of the Securities and Exchange Commission, such other addresses and such other securities depositories as the District may designate in a Request of the District delivered to a Fiscal Agent.

**“Senior Consolidated System Bonds”** means all parity bonds issued and at any time Outstanding under the Senior Consolidated System Resolution.

**“Senior Consolidated System Resolution”** means Resolution No. 87-7925, adopted by the Commission of the District on December 21, 1987, as such resolution has been amended or supplemented.

**“Senior Debt Service Requirement”** means, with respect to Senior Consolidated System Bonds issued and Outstanding, as of any date of calculation, for any Fiscal Year (or other designated twelve-month period) the amount of principal and interest becoming due and payable in such Fiscal Year (or other designated twelve-month period) on such Senior Consolidated System Bonds, calculated based on the assumptions set forth in the definitions of “Annual Debt Service” and “Assumed Debt Service,” including the defined terms used therein, as applied to the Senior Consolidated System Bonds.

**“Serial Bonds”** means all Bonds other than Term Bonds.

**“Series”** means all of the Bonds designated by Supplemental Resolution as being of the same series, regardless of variations in maturity, interest rate, redemption and other provisions, and any Bonds thereafter authenticated and delivered upon transfer or exchange or in lieu of or in substitution for (but not to refund) such Bonds as provided in the Resolution.

**“Sinking Fund”** has the meaning set forth in “THE SENIOR CONSOLIDATED SYSTEM RESOLUTION—Covenants of the District—*Sinking Funds; Working Capital and Contingency Funds*” below.

**“Standard & Poor’s”** means Standard & Poor’s Ratings Services and its successors and assigns, except that if such organization will be dissolved or liquidated or will no longer perform the functions of a securities rating agency, then the term “Standard & Poor’s” will be deemed to refer to any other nationally recognized securities rating agency selected by the District (other than Moody’s).

**“State”** means the State of Washington.

**“Supplemental Resolution”** means any resolution duly adopted by the Commission, supplementing, modifying or amending the Resolution in accordance with the Master Resolution.

**“Take-or-Pay Contracts”** has the meaning set forth in “THE SENIOR CONSOLIDATED SYSTEM RESOLUTION—Series of Bonds; Terms of Supplemental Resolution—*Parity Bonds*” below.

**“Term Bonds”** means Bonds which are subject to mandatory purchase or redemption prior to their scheduled maturity date from Mandatory Sinking Account Payments established for that purpose and calculated to retire such Bonds on or before their scheduled maturity date.

**“Treasurer”** means the District, acting by and through its Treasurer. The Treasurer may serve as Fiscal Agent for a Series of Bonds if so designated in the Supplemental Resolution authorizing the issuance of such Series.

**“Variable Rate Obligations”** means any Bonds the interest rate on which is not fixed to maturity, as of the date of calculation, at a single numerical rate for the entire remaining term thereof.

**“Wastewater Resolutions”** means any resolutions adopted prior to or after the Master Resolution by the Commission pledging, or placing a lien or charge on, the revenues of the Wastewater System.

**“Wastewater System”** means the facilities, properties and rights of the District for the collection, treatment and handling of wastewater.

**“Water Resolutions”** means any resolutions adopted prior to or after the Master Resolution by the Commission pledging, or placing a lien or charge on, the revenues of the Water System.

**“Water System”** means the facilities, properties and rights of the District for the supply, distribution, storage and handling of water.

## **THE SENIOR CONSOLIDATED SYSTEM RESOLUTION**

### **General**

The Senior Consolidated System Resolution (referred to in this summary as the “Master Resolution”) authorizes the issuance of “Public Utility District No. 1 of Chelan County, Washington, Chelan Hydro Consolidated System Revenue Bonds,” which Bonds may be issued in multiple Series pursuant to Supplemental Resolutions adopted as provided in the Master Resolution.

### **Series of Bonds; Terms of Supplemental Resolutions**

The Commission may from time to time by Supplemental Resolution authorize one or more Series of Bonds, and the District may issue, and a Fiscal Agent may authenticate and deliver to the purchasers thereof, Bonds of any Series so authorized, in such principal amount as will be determined by the Commission, but only upon compliance by the District with the provisions of the Resolution and any additional requirements set forth in said Supplemental Resolution.

A Supplemental Resolution authorizing a Series of Bonds will specify (or provide the method for specifying), among other things: (i) the authorized principal amount and distinguishing designation of such Series; (ii) the general purpose or purposes for which such Series of Bonds is being issued, and the deposit, disbursement

and application of the proceeds of the sale of the Bonds of such Series; (iii) the date or dates, and the maturity date or dates of the Bonds of such Series, and the principal amount maturing on each maturity date and any Mandatory Sinking Account Payments for the Bonds of such Series, and whether such Bonds are Serial Bonds or Term Bonds; (iv) the interest rate or rates on the Bonds of such Series (which may be a rate of zero) and the interest payment date or dates therefor, and whether such interest rate or rates will be fixed, variable or a combination of both and, if necessary, the manner of determining such rate or rates; (v) the denominations of, and the manner of dating, numbering, and, if necessary, authenticating, the Bonds of such Series; (vi) the Fiscal Agent and any paying agent or paying agents for the Bonds of such Series and the duties and obligations thereof; (vii) the place or places of payment of the principal, Accreted Value, Redemption Price, if any, or purchase price, if any, or the interest on, the Bonds of such Series; (viii) the tender agent or tender agents for the Bonds of such Series, if any, and the duties and obligations thereof; (ix) the remarketing agent or remarketing agents for the Bonds of such Series, if any, and the duties and obligations thereof; (x) the form or forms of the Bonds of such Series and any coupons attached thereto, which may include but will not be limited to, registered form, bearer form with or without coupons, and book-entry form, and the methods, if necessary, for the registration, transfer and exchange of the Bonds of such Series; (xi) the terms and conditions, if any, for the redemption of the Bonds of such Series prior to maturity, including the redemption date or dates, the Redemption Price or Prices and other applicable redemption terms; (xii) the terms and conditions, if any, for the purchase of the Bonds of such Series upon any optional or mandatory tender for purchase prior to maturity, including the tender date or dates, the purchase date or dates, the purchase price or prices and other applicable terms; (xiii) if so determined by the Commission, the authorization of and any terms and conditions with respect to any Credit Facility for the Bonds of such Series and the pledge or provision of moneys, assets or security other than Revenues to or for the payment of the Bonds of such Series or any portion thereof; (xiv) the creation and maintenance of one or more special funds or accounts, if any, to provide for the payment or purchase of the Bonds of such Series and, if so determined by the Commission, any other special funds or accounts, including, without limitation, a reserve fund or account, for the Bonds of such Series and the application of moneys therein; and (xv) any other provisions which the Commission deems necessary or desirable in connection with the Bonds of such Series and not inconsistent with the terms of the Resolution.

### **General Provisions for the Issuance of Bonds**

The Bonds of each Series will be executed by the District and delivered to the Fiscal Agent for that Series and thereupon authenticated by the Fiscal Agent and delivered to the District or upon its order, but only upon receipt by that Fiscal Agent of the following: (a) a copy of the Resolution, including the Supplemental Resolution authorizing such Series, certified by the Secretary of the Commission; (b) a Opinion of Bond Counsel to the effect that (i) the Bonds of such Series are valid and binding limited obligations of the District enforceable against the District in accordance with their terms, and (ii) that the Resolution, including the Supplemental Resolution authorizing such Series, is a valid and binding obligation of the District enforceable in accordance with its terms; provided, that such opinions may be qualified to the extent that the enforceability of the Bonds and the Resolution, including the Supplemental Resolution authorizing such Series, may be limited by bankruptcy, insolvency, reorganization or similar laws affecting the enforcement of creditors' rights generally and by general equitable principles; (c) an Order of the District as to the delivery of such Series of Bonds; and (d) a Certificate of the District stating that (i) no default has occurred and is continuing under the Resolution as of the date of issuance of such Series of Bonds and (ii) the issuance of such Series of Bonds, in and of itself, will not cause a default under the Resolution.

### **Pledge of Revenues**

The Bonds of each Series are special limited obligations of the District and will be payable and secured, as to the principal and Accreted Value thereof, premium, if any, and interest thereon, and purchase price thereof, solely from and secured by a pledge of and lien and charge upon (i) the Revenues, and (ii) the other funds, assets and security described under the Resolution and under the Supplemental Resolution authorizing that Series. The District pledges and places a lien and charge upon all Revenues to secure the payment of the principal and Accreted Value of, premium, if any, and interest on, and purchase price of the Bonds in accordance with their respective terms without priority or distinction of one over the other, subject only to the provisions of the Resolution permitting the application thereof for the purposes and on the terms and conditions set forth in the Resolution, and the Revenues will constitute a trust for the security and payment of the principal and Accreted Value of, premium, if any, and interest on, and purchase price of the Bonds. The pledge of and lien and charge on the Revenues in the Resolution

made will be irrevocable until there are no Bonds Outstanding. The pledge of and lien and charge on the Revenues and other moneys and obligations will be valid and binding from the time made, and the Revenues or other moneys or obligations so pledged and thereafter received by the District will immediately be subject to the pledge, lien and charge of the Resolution without any physical delivery or further act, and such pledge, lien and charge will be valid and binding as against any parties having claims of any kind in tort, contract, or otherwise against the District irrespective of whether such parties have notice thereof.

Notwithstanding the foregoing, the pledge, lien and charge of the Senior Consolidated System Bonds on Revenues and the obligation of the District to deposit Revenues into the bond funds established in the Senior Consolidated System Resolution will have priority over the pledge, lien and charge of the Bonds on Revenues established under the Resolution.

### **Equality of Security**

In consideration of the acceptance of the Bonds by the Owners thereof from time to time, the Resolution will be deemed to be and will constitute a contract between the District and the Owners from time to time of the Bonds, and the covenants and agreements set forth in the Resolution to be performed by or on behalf of the District will be for the equal and proportionate benefit, security and protection of all Owners of the Bonds, without preference, priority or distinction as to security or otherwise of any Bond over any other Bond by reason of the Series, time of issue, sale or negotiation thereof or for any cause whatsoever, except as expressly provided therein or in the Resolution. Notwithstanding the foregoing, nothing in the Resolution will prevent additional security being provided for particular Bonds under any Supplemental Resolution.

### **Investment of Moneys in Funds and Accounts**

All moneys in any of the funds and accounts held by the Treasurer or any Fiscal Agent and established pursuant to the Resolution will be invested solely in Authorized Investments.

Except as otherwise provided in a Supplemental Resolution with respect to any fund or account created pursuant to that Supplemental Resolution, all interest, profits and other income received from the investment of moneys in any fund or account established pursuant to the Resolution or any Supplemental Resolution will be credited to such fund or account when received. Notwithstanding anything to the contrary contained in this paragraph, an amount of interest received with respect to any Authorized Investment equal to the amount of accrued interest, if any, paid as part of the purchase price of such Authorized Investment will be credited to the fund or account from which such accrued interest was paid.

Except as otherwise provided in a Supplemental Resolution with respect to any fund or account created pursuant to that Supplemental Resolution, the Treasurer and any Fiscal Agent may commingle any of the funds and accounts established pursuant to the Resolution in a separate fund or funds for investment purposes only; provided, that all funds or accounts held by the Treasurer or any Fiscal Agent under the Resolution will be accounted for separately as required by the Resolution. The Treasurer or any Fiscal Agent may sell at the best price obtainable, or present for redemption, any Authorized Investment so purchased whenever it will be necessary to provide moneys to meet any required payment, transfer, withdrawal or disbursement from the fund or account to which such Authorized Investment is credited.

The Treasurer and each Fiscal Agent will keep proper books of record and accounts containing complete and correct entries of all transactions made by each, respectively, relating to the receipt, investment, disbursement, allocation and application of the moneys related to the Bonds, including moneys derived from, pledged to, or to be used to make payments on the Bonds. Such records will specify the account to which each investment (or portion thereof) held by the Treasurer and each Fiscal Agent is to be allocated and will set forth, in the case of each Authorized Investment, (i) its purchase price, (ii) identifying information, including par amount, coupon rate, and payment dates, (iii) the amount received at maturity or its sale price, as the case may be, including accrued interest, (iv) the amounts and dates of any interest payments made with respect thereto, and (v) the dates of acquisition and disposition or maturity.

## Covenants

In the Master Resolution, the District makes the following covenants with the Owners (to be performed by the District or its proper officers, agents or employees) which covenants are necessary and desirable for the protection and security of the Owners; provided, however, that said covenants do not require or obligate the District to use any of its moneys other than the Revenues. Said covenants will be in effect so long as any of the Bonds issued under the Resolution are Outstanding and unpaid, or so long as provision for the full payment and discharge thereof at maturity or upon redemption thereof prior to maturity has not been made.

***To Maintain the Properties of the Chelan Hydro Consolidated System; To Keep the Chelan Hydro Consolidated System in Good Repair; To Maintain Licenses.*** The District will (i) at all times operate the properties of the Chelan Hydro Consolidated System and the business in connection therewith in an efficient and prudent manner, (ii) maintain, preserve and keep, or cause to be maintained, preserved and kept, the properties of the Chelan Hydro Consolidated System, and all additions and betterments thereto and extensions thereof, in good repair, working order and condition, and (iii) from time to time make, or cause to be made, all necessary and proper repairs, renewals, replacements, additions, betterments and extensions thereto, so that at all times the business carried on in connection therewith will be properly and advantageously conducted; provided, however, that nothing contained in the Resolution will prevent the District from discontinuing the operation and maintenance of any of such properties, or disposing of any of them, if such discontinuance or disposal is permitted by law and, in the judgment of the Commission, is desirable in the conduct of the business of the Chelan Hydro Consolidated System.

The District will at all times comply with the terms and conditions of any permits or licenses for the Chelan Hydro Consolidated System issued by any federal or state governmental agency or body having jurisdiction thereof and with the power to issue orders with respect thereto and enforce the same, and with any federal or state law or regulation applicable to the construction, operation, maintenance and repair of the Chelan Hydro Consolidated System. The District will use its best efforts to obtain renewals of such permits or licenses or obtain new permits or licenses unless such renewals or new permits or licenses are not, in the judgment of the Commission, in the best interest of the District.

***To Comply with Original Resolutions.*** With respect to each of the Original Resolutions, until such time as the obligations of the District under an Original Resolution have been discharged in accordance with the terms thereof, the District will comply in all respects with each of the provisions, covenants and agreements of or contained in that Original Resolution.

***To Protect Revenues; No Prior Indebtedness.*** The District is duly authorized under all applicable laws to create and issue the Bonds and to adopt the Resolution and to provide for the payment of the Bonds from Revenues in the manner and to the extent provided in the Resolution. The Bonds and the provisions of the Resolution are and will be valid and legally enforceable obligations of the District in accordance with their terms and the terms of the Resolution; provided, however, that the rights of the Bondholders under the Resolution and under the Bonds may be subject to judicial discretion and to bankruptcy, insolvency, reorganization, moratorium and other laws for the relief of debtors.

The District covenants that it will not issue or incur any additional indebtedness with a lien or charge on Revenues superior or prior to the lien or charge thereon of the Bonds and will not issue any series of Bonds or issue or incur any indebtedness with a lien or charge on Revenues on a parity with the lien or charge thereon of the Bonds except upon compliance with the provisions of the Resolution. Nothing contained in the Resolution will prevent the District from issuing or incurring any additional indebtedness with a lien or charge on Revenues junior to the lien or charge of the Bonds.

***To Pay Taxes, Assessments and Other Governmental Charges and Payments in Lieu Thereof; Payment of Claims.*** The District will from time to time duly pay and discharge, or cause to be paid and discharged, all taxes, assessments and other governmental charges, or payments made in lieu thereof, lawfully imposed upon the properties constituting the Chelan Hydro Consolidated System or the Revenues and other moneys derived by the District from the operation thereof when and as the same will become due, and all lawful claims for labor, materials and supplies, which taxes, assessments, charges and claims, if not paid, might become a lien or charge upon said properties, or any part thereof, or upon the Revenues and other moneys derived by the District from the operation

thereof, or which might in any way impair the security for the Bonds, except those taxes, assessments, charges or claims which the District will in good faith contest by proper legal proceedings.

***To Provide Financial Reports.*** The District will prepare and make available for inspection at the principal administrative office of the District and will provide to the Fiscal Agents, Rating Agencies and any Credit Facility Providers for any Series of Bonds or portion thereof, the most recent audited annual financial statements of the Chelan Hydro Consolidated System and the current unaudited financial reports of the Chelan Hydro Consolidated System.

***Rates and Charges.*** The District covenants in the Master Resolution to establish, maintain and collect rates and charges for electric power and energy and other services, facilities and commodities sold, furnished or supplied by the Chelan Hydro Consolidated System which will provide:

(a) Revenues in each Fiscal Year, together with Available Funds and other unencumbered moneys of the District available for such purposes, in an amount sufficient (i) to pay all costs for the proper operation and maintenance of the Chelan Hydro Consolidated System; (ii) to make all required payments in connection with the Senior Consolidated System Bonds, the Bonds and any other obligations of the Chelan Hydro Consolidated System for borrowed money payable from Revenues; (iii) to pay the costs of any repairs, renewals, additions, extensions and improvements to the Chelan Hydro Consolidated System which, at the election of the District, are to be paid from Revenues; and (iv) to pay any other obligations of the District payable from Revenues in such Fiscal Year;

(b) Distribution Division Net Receipts, less the Distribution Division Senior Debt Service Requirement, in each Fiscal Year equal to at least (i) 100% of Annual Debt Service in such Fiscal Year on the Distribution Division Bonds then Outstanding, and (ii) together with Available Funds with respect to Distribution Division Bonds, 115% of Annual Debt Service in such Fiscal Year on the Distribution Division Bonds then Outstanding; and

(c) Net Receipts, together with Available Funds, less the Senior Debt Service Requirement, in each Fiscal Year equal to at least (i) 100% of Annual Debt Service in such Fiscal Year on all Bonds then Outstanding, plus (ii) 15% of the interest coming due in such Fiscal Year on all Bonds then Outstanding.

***Sinking Funds; Working Capital and Contingency Funds.***

(a) With respect to each Excluded Principal Payment, at least three years prior to the maturity date or date of mandatory tender for purchase of such Bonds, the District will establish a sinking fund (each, a "Sinking Fund") for the payment of the maturing principal amount, Accreted Value or purchase price of such Bonds. The District will fund each such Sinking Fund either (i) by the deposit, from Revenues or other available funds, in four equal annual installments of one-fourth of such maturing principal amount, Accreted Value or purchase price commencing not less than three years prior to such payment date, or (ii) by obtaining a Credit Facility that provides for the payment of such maturing principal amount, Accreted Value or purchase price. Amounts in each such Sinking Fund are pledged in the Master Resolution and will be applied to the payment of such Bonds at maturity or upon mandatory tender for purchase, and will be subject to the lien and charge of the Resolution for the benefit of such Bonds. Any amounts in any such Sinking Fund not required on the maturity date or date of mandatory tender for purchase may be used for any lawful purpose of the District.

(b) The District will establish, by resolution of the Commission, and maintain such balances for (i) working capital in connection with the normal operating requirements of the Chelan Hydro Consolidated System, and (ii) contingency purposes in connection with extraordinary operating, capital or other requirements of the Chelan Hydro Consolidated System, in each case as is deemed necessary or appropriate by the Commission. Such required balances may be amended from time to time by the Commission in its sole discretion.

**Appointment; Duties of Fiscal Agent**

(a) The District may appoint a Fiscal Agent, which may be the Treasurer, for a Series of Bonds in the Supplemental Resolution pursuant to which such Bonds are issued. Each Fiscal Agent will act as the agent of the



District and will perform such duties and only such duties as are specifically set forth in the Resolution or the Supplemental Resolution pursuant to which it was appointed, and no implied covenants will be read into the Resolution or such Supplemental Resolution against the Fiscal Agent. Each Fiscal Agent will exercise only such rights and powers vested in it by the Resolution or the Supplemental Resolution pursuant to which it was appointed.

(b) The District may remove any Fiscal Agent at any time with or without cause. The District will remove any Fiscal Agent if at any time such Fiscal Agent will cease to be eligible in accordance with the Resolution, or will become incapable of acting, or will be adjudged bankrupt or insolvent, or a receiver of such Fiscal Agent or its property will be appointed, or any public officer will take control or charge of such Fiscal Agent or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each such case by giving written notice of such removal to such Fiscal Agent and to the Bondowners' Trustee and Credit Facility Provider with respect to such Series of Bonds, and thereupon will appoint a successor Fiscal Agent by an instrument in writing. Notwithstanding the foregoing, the Treasurer may only be removed as a Fiscal Agent by a resolution of the Commission.

(c) Each Fiscal Agent may at any time resign by giving 90 days prior written notice of such resignation to the District, the Bondowners' Trustee and Credit Facility Provider with respect to such Series of Bonds, and to the Owners of the Bonds of such Series by mail at the addresses shown on the Bond Register. Upon receipt of such notice of resignation, the District will promptly appoint a successor Fiscal Agent by an instrument in writing. Notwithstanding the foregoing, the Treasurer may only resign as a Fiscal Agent by a resolution of the Commission.

(d) Any removal or resignation of a Fiscal Agent and appointment of a successor Fiscal Agent will become effective only upon acceptance of appointment by the successor Fiscal Agent. If no successor Fiscal Agent will have been appointed and have accepted appointment within 45 days of giving notice of removal or notice of resignation as aforesaid, the resigning Fiscal Agent may petition any court of competent jurisdiction for the appointment of a successor Fiscal Agent, and such court may thereupon, after such notice (if any) as it may deem proper, appoint such successor Fiscal Agent. Any successor Fiscal Agent appointed under the Resolution, will signify its acceptance of such appointment by executing and delivering to the District and to its predecessor Fiscal Agent a written acceptance thereof, and thereupon such successor Fiscal Agent, without any further act, deed or conveyance, will become vested with all the rights, powers, duties and obligations of such predecessor Fiscal Agent under the Resolution, with like effect as if originally appointed Fiscal Agent under the Resolution. Upon request of the successor Fiscal Agent, the District and the predecessor Fiscal Agent will execute and deliver any and all instruments as may be reasonably required for more fully and certainly vesting in and confirming to such successor Fiscal Agent all such rights, powers, duties and obligations.

(e) Except as otherwise provided in a Supplemental Resolution, any successor Fiscal Agent appointed pursuant to the provisions of this section will be either the Treasurer or a trust company or a bank having the powers of a trust company, in each case doing business and having a corporate trust office in the State. Any such bank or trust company will be subject to supervision or examination by federal or state authority. In case at any time a Fiscal Agent will cease to be eligible in accordance with the provisions of the Resolution, such Fiscal Agent will resign immediately in the manner and with the effect specified in this section. If, by reason of the judgment of any court, a Fiscal Agent for a Series of Bonds or any successor Fiscal Agent is rendered unable to perform its duties under the Resolution, and if no successor Fiscal Agent will otherwise be appointed pursuant to this section, all of the rights, powers, duties and obligations of such Fiscal Agent will be assumed by and vest in the Treasurer.

(f) Upon merger, consolidation, or reorganization of a Fiscal Agent, the District will appoint a new Fiscal Agent, which may be the corporation or association resulting from such merger, consolidation or reorganization.

### **Liability of Fiscal Agent**

(a) The recitals of facts in the Resolution, in the Supplemental Resolution pursuant to which a Fiscal Agent is appointed and in the Bonds of such Series contained will be taken as statements of the District, and the Fiscal Agent for such Series assumes no responsibility for the correctness of the same (other than the certificate of authentication of such Fiscal Agent on each Bond), and makes no representations as to the validity or sufficiency of the Resolution or of the Bonds, as to the sufficiency of the Revenues or the priority of the lien of the Resolution

thereon, or as to the financial or technical feasibility of any Project, and will not incur any responsibility in respect of any such matter, other than in connection with the duties or obligations expressly in the Resolution or in the Bonds assigned to or imposed upon it. Each Fiscal Agent will, however, be responsible for its representations contained in its certificate of authentication on the Bonds. A Fiscal Agent will not be liable in connection with the performance of its duties under the Resolution, except for its own negligence, willful misconduct or breach of the express terms and conditions of the Resolution. A Fiscal Agent and its directors, officers, employees and agents may in good faith buy, sell, own, hold and deal in any of the Bonds of a Series for which it has been appointed Fiscal Agent and may join in any action which any Owner of a Bond may be entitled to take, with like effect as if such Fiscal Agent was not the Fiscal Agent for such Series of Bonds. Each Fiscal Agent may in good faith hold any other form of indebtedness of the District, own, accept or negotiate any drafts, bills of exchange, acceptances or obligations of the District and make disbursements for the District, and enter into any commercial or business arrangement with the District, without limitation.

(b) A Fiscal Agent will not be liable for any error of judgment made in good faith by a responsible officer unless it will be proved that such Fiscal Agent was negligent in ascertaining the pertinent facts. A Fiscal Agent may execute any of the rights or powers and perform the duties and obligations required of it under the Resolution by or through attorneys, agents, or receivers, and will be entitled to advice of counsel concerning all matters of trust and its duty under the Resolution, but such Fiscal Agent will be answerable for the negligence or misconduct of any such attorney, agent, or receiver selected by it; provided, that such Fiscal Agent will not be answerable for the negligence or misconduct of any attorney, agent or receiver selected by it with due care.

(c) No provision of the Resolution will require a Fiscal Agent to expend or risk its own funds or otherwise incur any financial liability in the performance or exercise of any of its duties thereunder or under the Supplemental Resolution pursuant to which it was appointed, or in the exercise of its rights or powers.

(d) A Fiscal Agent will not be required to ascertain, monitor or inquire as to the performance or observance by the District of the terms, conditions, covenants or agreements set forth in the Resolution or in the Supplemental Resolution pursuant to which it was appointed, other than the covenants of the District to make payments with respect to the Bonds when due as set forth in the Resolution and to file with such Fiscal Agent when due, such reports and certifications as the District is required to file with such Fiscal Agent under the Resolution.

(e) No permissive power, right or remedy (if any) conferred upon a Fiscal Agent under the Resolution will be construed to impose a duty to exercise such power, right or remedy.

(f) A Fiscal Agent will not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, coupon or other paper or document but a Fiscal Agent, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if a Fiscal Agent will determine to make such further inquiry or investigation, it will be entitled to examine the books, records and premises of the District, personally or by agent or attorney.

(g) Whether or not expressly so provided, every provision of the Resolution relating to the conduct or affecting the liability of or affording protection to any Fiscal Agent will be subject to the provisions of this section.

(h) The provisions of this section will not apply to the Treasurer when acting as Fiscal Agent for a Series of Bonds.

### **Amendments Permitted**

(a) ***Amendments with Bondholder Consent.*** The Resolution and the rights and obligations of the District, the Owners of the Bonds, each Fiscal Agent, the Bondowners' Trustee, and each Credit Facility Provider may be modified or amended from time to time and at any time by a Supplemental Resolution, adopted by the Commission with the written consent of the Owners of a majority in aggregate amount of Bond Obligation of the Bonds (or, if such Supplemental Resolution is only applicable to a Series of Bonds, the Bonds of that Series) then Outstanding; provided, that if such modification or amendment will, by its terms, not take effect so long as any

particular Bonds remain Outstanding, the consent of the Owners of such Bonds will not be required and such Bonds will not be deemed to be Outstanding for the purpose of any calculation of the aggregate amount of Bond Obligation of Bonds Outstanding under this section. Any such Supplemental Resolution will be filed with the Bondowners' Trustee, if any, and with each Fiscal Agent and Credit Facility Provider.

No such modification or amendment will (A) extend the fixed maturity of any Bond, or reduce the amount of Bond Obligation thereof, or extend the time of payment or reduce the amount of any Mandatory Sinking Account Payment provided for the payment of any Bond, or reduce the rate of interest thereon, or extend the time of payment of interest thereon, or reduce any premium or Redemption Price payable upon the redemption thereof, or change the purchase price thereof, or change the dates of redemption or purchase thereof, without the consent of the Owner of each Bond so affected, (B) reduce the aforesaid percentage of the aggregate amount of Bond Obligation of Bonds Outstanding the consent of the Owners of which is required to effect any such modification or amendment, or permit the creation of any lien or charge on the Revenues and other assets pledged under the Resolution prior to or on a parity with the lien and charge created by the Resolution, or deprive the Owners of the Bonds of the lien and charge created by the Resolution on such Revenues and other assets (in each case, except as expressly provided in the Resolution), without the consent of the Owners of all of the Bonds then Outstanding, or (C) modify any rights or obligations of any Fiscal Agent, the Bondowners' Trustee or any Credit Facility Provider without its consent.

It will not be necessary for the consent of the Bondholders to approve the particular form of any Supplemental Resolution, but it will be sufficient if such consent will approve the substance thereof. Promptly after the adoption by the Commission of any Supplemental Resolution pursuant to this subsection (a), the Fiscal Agent for each Series of Bonds that is affected by any such modification or amendment will mail a notice setting forth in general terms the substance of such Supplemental Resolution to the Owners of the Bonds of such Series at the addresses shown on the Bond Register. Any failure to give such notice, or any defect therein, will not, however, in any way impair or affect the validity of any such Supplemental Resolution.

(b) ***Amendments without Bondholder Consent.*** The Resolution and the rights and obligations of the District, each Fiscal Agent, the Owners of the Bonds, the Bondowners' Trustee, and each Credit Facility Provider may also be modified or amended from time to time and at any time by a Supplemental Resolution, adopted by the Commission without the consent of any Bondholders, but only to the extent permitted by law and only for any one or more of the following purposes; provided, that any such amendment or modification will not materially and adversely affect the interests of the Owners of any of the Bonds: (i) to add to the covenants and agreements of the District in the Resolution thereafter to be observed, to pledge or assign additional security for the Bonds (or any Series or portion thereof), or to surrender any right or power in the Resolution reserved to or conferred upon the District; (ii) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or curing or correcting any defective provision, contained in the Resolution, or in regard to matters or questions arising under the Resolution, as the Commission may deem necessary or desirable; (iii) to modify, amend or supplement the Resolution in such manner as to permit the qualification of the Resolution under the Trust Indenture Act of 1939, as amended, or any similar federal statute in effect after the date of the Master Resolution, and to add such other terms, conditions and provisions as may be permitted by said act or similar federal statute; (iv) to provide for the issuance of a Series of Bonds with such interest rate, payment, maturity and other terms as the District may deem desirable, subject to and in accordance with the provisions of the Resolution; (v) to provide for the issuance of Bonds in book-entry, registered or bearer form; (vi) to allow for a consolidation of other District systems or facilities as provided in the Resolution; (vii) if the District has covenanted in a Supplemental Resolution to maintain the exclusion of interest on a Series of Bonds from gross income for purposes of federal income taxation, to make such provisions as are necessary or appropriate in accordance therewith; and (viii) for any other purpose.

## **Defeasance**

***Discharge of Resolution.*** Except as may be provided in any Supplemental Resolution authorizing a Series of Bonds, all Bonds of any Series may be paid by the District in any of the following ways: (a) by paying or causing to be paid the principal and Accreted Value of, premium, if any, and interest on all Bonds Outstanding of such Series, as and when the same become due and payable; (b) by depositing with the Fiscal Agent for such Series, an escrow agent or other fiduciary, in trust, at or before maturity, money or securities in the necessary amount (as provided in the Resolution) to pay or redeem all Bonds Outstanding of such Series; or (c) by delivering to the Fiscal Agent for such Series, for cancellation by it, all Bonds then Outstanding of such Series.

If the District pays all Series of Bonds which are Outstanding under the Resolution and also pays or causes to be paid all other sums payable to any Credit Facility Provider under the Resolution by the District, then and in that case, at the election of the District (evidenced by a Certificate of the District, filed with each Fiscal Agent, signifying the intention of the District to discharge all such indebtedness and the Resolution), and notwithstanding that any Bonds will not have been surrendered for payment, the Resolution and the pledge of and lien and charge on Revenues and other assets made under the Resolution and all covenants, agreements and other obligations of the District under the Resolution will cease, terminate, become void and be completely discharged and satisfied. In such event, upon Request of the District, each Fiscal Agent will cause an accounting for such period or periods as the District may request to be prepared and filed with the District and will cause to be executed and delivered to the District all such instruments as may be necessary or desirable to evidence such discharge and satisfaction.

***Discharge of Liability on Bonds.*** Upon the deposit with the Fiscal Agent for a Series, an escrow agent or other fiduciary, in trust, at or before maturity, of money or securities in the amount necessary (as provided in the Resolution) to pay any Outstanding Bond (whether at maturity or upon the prior redemption thereof); provided, that, if such Bond is to be redeemed prior to maturity, irrevocable notice of such redemption will have been given as provided in the Resolution or provision satisfactory to such Fiscal Agent will have been made for the giving of such notice, then all liability of the District in respect of such Bond will cease, terminate and be completely discharged; provided, that the Owner thereof will thereafter be entitled to the payment of the principal and Accreted Value of, premium, if any, and interest on such Bond, and the District will remain liable for such payment, but only out of such money or securities deposited as aforesaid for their payment, subject, however, to the provisions of the Resolution concerning the payment of Bonds after the discharge of the Resolution and the continuing duties of the Fiscal Agent for such Series under the Resolution. Upon defeasance and discharge of any Bond as provided in this section, the Fiscal Agent will provide notice thereof to the Owner of such Bond.

The District may at any time surrender to the Fiscal Agent for a Series of Bonds, for cancellation by it, any Bonds previously issued and delivered which the District may have acquired in any manner whatsoever, and such Bonds, upon such surrender and cancellation, will be deemed to be paid and retired.

## **Events of Default**

Each of the following events will be an “Event of Default”:

- (a) Default by the District in the due and punctual payment of the principal of, premium, if any, or Accreted Value on any Bond (whether at maturity, upon acceleration, upon call for redemption, or otherwise);
- (b) Default by the District in the due and punctual payment of the interest on any Bond which is not remedied within three (3) Business Days, or on any Senior Consolidated System Bond;
- (c) Failure of the District to observe and perform any of its other covenants, conditions or agreements under the Resolution or in the Bonds for a period of 90 days after written notice from the Fiscal Agent, the Bondowners’ Trustee, or the Owners of twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding, specifying such failure and requesting that it be remedied, or in the case of any such default that cannot with due diligence be cured within such 90-day period, failure of the District to proceed promptly to cure the same and thereafter prosecute the curing of such default with due diligence;
- (d) (i) Failure of the District generally to pay its debts as the same become due, (ii) commencement by the District of a voluntary case under the Federal bankruptcy laws, as constituted on or after the date of the Master Resolution, or any other applicable Federal or state bankruptcy, insolvency or other similar law, (iii) consent by the District to the appointment of a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official for the District, the Chelan Hydro Consolidated System or any substantial part of the District’s property, or to the taking possession by any such official of the Chelan Hydro Consolidated System or any substantial part of the District’s property, (iv) making by the District of any assignment for the benefit of creditors, or (v) taking of corporate action by the District in furtherance of any of the foregoing;

(e) The entry of any (i) decree or order for relief by a court having jurisdiction over the District or its property in an involuntary case under the Federal bankruptcy laws, as constituted on or after the date of the Master Resolution, or any other applicable Federal or state bankruptcy, insolvency or other similar law, (ii) appointment of a receiver, liquidator, assignee, trustee, custodian, sequestrator or similar official for the District, the Chelan Hydro Consolidated System or any substantial part of the District's property, or (iii) order for the termination or liquidation of the District or its affairs; or

(f) Failure of the District within 90 days after the commencement of any proceedings against it under the Federal bankruptcy laws, as constituted on or after the date of the Master Resolution, or any other applicable Federal or state bankruptcy, insolvency or similar law, to have such proceedings dismissed or stayed.

Notwithstanding anything in this section to the contrary, the failure by the District to comply with the requirements of the Resolution concerning the establishment of rates and charges for services in any Fiscal Year will not constitute an Event of Default if the District, prior to the ninetieth day of the following Fiscal Year, will:

(A) Employ a Consulting Engineer to recommend changes in the District's rates and charges which are estimated to produce Revenues sufficient (once such rates and charges have been imposed by the District) to meet the requirements of the Resolution concerning the establishment of rates and charges for services; and

(B) Impose rates and charges at least as high as those recommended by such professional electric utility consultant.

## Remedies

***Appointment of Bondowners' Trustee.*** Upon the occurrence and continuation of an Event of Default, a Bondowners' trustee (the "Bondowners' Trustee") may be appointed by the Owners of not less than twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding, by an instrument or concurrent instruments in writing signed and acknowledged by such Owners or by their attorneys-in-fact duly authorized and delivered to such Bondowners' Trustee, with notification thereof being given to the District. Such appointment will become effective immediately upon acceptance thereof by the Bondowners' Trustee. Any Bondowners' Trustee appointed under the provisions of this section will be a bank or trust company organized under the laws of the State of Washington or the State of New York or a national banking association.

In the event that any Event of Default, in the sole judgment of the Bondowners' Trustee, is cured and the Bondowners' Trustee furnishes to the District and to each Fiscal Agent a certificate so stating, that Event of Default will be conclusively deemed to be cured and the District, the Bondowners' Trustee and the Owners of the Bonds will be restored to the same rights, powers and position which they would have held if no Event of Default had occurred.

***Acceleration.*** Upon the occurrence and continuation of an Event of Default specified in subsections (d), (e) or (f) of the section captioned "Events of Default" above, the Bondowners' Trustee or, if there is none, the Owners of twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding may, by written notice to the District and each Fiscal Agent, declare the entire unpaid principal and Accreted Value of the Bonds due and payable and, thereupon, the entire unpaid principal and Accreted Value of the Bonds will forthwith become due and payable. Upon any such declaration the District will forthwith pay to the Owners of the Bonds the entire unpaid principal and Accreted Value of, premium, if any, and accrued interest on the Bonds, but only from Revenues and other moneys specifically pledged in the Resolution for such purpose. If at any time after such declaration and before the entry of a final judgment or decree in any suit, action or proceeding instituted on account of such default or before the completion of the enforcement of any other remedy under the Resolution, the principal and Accreted Value of all Bonds that have matured or been called for redemption pursuant to any Mandatory Sinking Fund Payment provision and all arrears of interest have been paid and any other Events of Default which may have occurred have been remedied, then the Bondowners' Trustee or, if there is none, the Owners of twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding may, by written notice to the District and each Fiscal Agent, rescind or annul such declaration and its consequences. No such rescission or annulment will extend to or affect any subsequent default or impair any right consequent thereon.

**Actions by Bondowners' Trustee.** Any action, suit or other proceedings instituted by the Bondowners' Trustee under the Resolution will be brought in its name as trustee for the Bondowners, without the necessity of joining the Owners of the Bonds as parties thereto, and all such rights of action upon or under any of the Bonds or the provisions of the Resolution may be enforced by the Bondowners' Trustee without the possession of any of the Bonds and without the production of the same at any trial or proceedings relative thereto, except where otherwise required by law. Any such suit, action or proceeding instituted by the Bondowners' Trustee will be brought for the ratable benefit of all of the Owners of the Bonds, subject to the provisions of the Resolution. The respective Owners of the Bonds, by taking and holding the same, will be conclusively deemed irrevocably to appoint the Bondowners' Trustee the true and lawful trustee of the respective Owners of those Bonds, with authority to institute any such action, suit or proceeding; to receive as trustee and deposit in trust any sums becoming distributable on account of those Bonds; to execute any paper or documents for the receipt of money; and to do all acts with respect thereto that the Owner himself or herself might have done in person. Nothing in the Resolution will be deemed to authorize or empower the Bondowners' Trustee to consent to accept or adopt, on behalf of any Owner of the Bonds, any plan of reorganization or adjustment affecting the Bonds or any right of any Owner thereof, or to authorize or empower the Bondowners' Trustee to vote the claims of the Owners thereof in any receivership, insolvency, liquidation, bankruptcy, reorganization or other proceeding to which the District is a party.

**Application of Money Collected by Bondowners' Trustee.** Any money collected by the Bondowners' Trustee at any time pursuant to the Resolution will be applied in the following order of priority: (a) First, to the payment of the charges, expenses, advances and compensation of the Bondowners' Trustee and the charges, expenses, counsel fees, disbursements and compensation of its agents and attorneys; and (b) Second, to the payment to the persons entitled thereto of all installments of interest then due on the Bonds in the order of maturity of such installments and, if the amount available will not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon to the persons entitled thereto, without any discrimination or preference; and (c) Third, to the payment to the persons entitled thereto of the unpaid principal and Accreted Value of any Bonds which will have become due (other than Bonds previously called for redemption for the payment of which money is held pursuant to the provisions of the Resolution), whether at maturity or by proceedings for redemption or otherwise, in the order of their due dates and, if the amount available will not be sufficient to pay in full the principal or Accreted Value due on the same date, then to the payment thereof ratably, according to the principal or Accreted Value due thereon to the persons entitled thereto, without any discrimination or preference.

**Receiver.** Upon the occurrence and continuation of an Event of Default for a period of at least sixty (60) days, the Bondowners' Trustee or, if there is none, the Owners of twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding will be entitled to the appointment of a receiver upon application to any court of competent jurisdiction in the State of Washington. Any receiver so appointed may enter and take possession of the Chelan Hydro Consolidated System, operate, maintain and repair the same, to the extent permitted by law impose, and prescribe rates, fees and other charges, and receive and apply all Revenues thereafter arising therefrom in the same manner as the District itself might do. No bond will be required of such receiver.

**Other Remedies; Rights of Bondholders.** Upon the occurrence and continuation of an Event of Default, the Bondowners' Trustee may, and upon the written request of the Owners of not less than twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding, will proceed to protect and enforce their rights by mandamus or other suit, action or proceeding at law or in equity, including an action for specific performance of any covenant or agreement contained in the Master Resolution.

**Unconditional Rights To Receive Principal, Accreted Value, Premium and Interest.** Nothing in the Resolution will affect or impair the right of any Owner to enforce, by action at law or in equity, payment of the principal and Accreted Value of, premium, if any, or interest on any Bond at and after the maturity thereof, or on the date fixed for redemption, or upon the same being declared due prior to maturity as provided in the Resolution, or the obligation of the District to pay the principal and Accreted Value of, premium, if any, and interest on each of the Bonds issued under the Resolution to the respective Owners thereof at the time and place, from the source and in the manner expressed in the Resolution and in the Bonds.

**Suits by Individual Bondowners Restricted.** Neither the Owner nor the beneficial owner of any one or more of the Bonds will have any right to institute any action, suit or proceeding at law or in equity for the

enforcement of same unless: (a) an Event of Default has happened and is continuing; and (b) a Bondowners' Trustee has been appointed; and (c) such Owner previously will have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted; and (d) the Owners of twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding, after the occurrence of such Event of Default, have made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; and (e) there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and (f) the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time.

No Owner or beneficial owner of any Bond will have any right in any manner whatever by his or her action to affect or impair the obligation of the District to pay from the Revenues the principal and Accreted Value of, premium, if any, and interest on such Bonds to the respective Owners thereof when due.

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**APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF  
THE MASTER RESOLUTION AND THE 2008B SUPPLEMENTAL RESOLUTION**

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## APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF THE MASTER RESOLUTION AND THE 2008B SUPPLEMENTAL RESOLUTION

The following is a summary of certain provisions of the Master Resolution and the 2008B Supplemental Resolution. This summary does not purport to be complete and is qualified in its entirety by reference to the foregoing documents for a complete statement of the provisions of such documents. Certain terms and provisions of the 2008B Bonds applicable to such bonds during Interest Rate Periods other than the initial Weekly Interest Rate Period have been excluded from this summary, as they are not operative during the initial Weekly Interest Rate Period. Certain terms and provisions of the 2008B Bonds have been excluded from this summary.

### DEFINITIONS

**“Accreted Value”** means, with respect to any Capital Appreciation Bond, the principal amount thereof plus the interest accrued thereon from its delivery date, compounded at the accretion rate thereof on each date specified therein, to the date of calculation.

**“Act of Bankruptcy”** means (i) the filing of a petition in bankruptcy or the application for a receiver by or against the District under the Bankruptcy Code or under any similar act (federal or state) which may be enacted after the date of the Fourth Supplemental Resolution unless such petition shall have been dismissed and such dismissal shall be final and not subject to appeal, or (ii) the making by the District of an assignment for the benefit of creditors.

**“Adjusted Net Revenues”** in any Fiscal Year means:

- (a) Net Revenues in such Fiscal Year, plus
- (b) Withdrawals, if any, from the Rate Stabilization Fund that have been allocated to such Fiscal Year pursuant to the Resolution, less
- (c) Deposits, if any, into the Rate Stabilization Fund that have been allocated to such Fiscal Year made pursuant to the Resolution.

**“Annual Debt Service”** means:

(a) With respect to the Bonds, as of any date of calculation, for any Fiscal Year (or other designated twelve-month period) the amount of Principal and interest becoming due and payable on all Outstanding Bonds in such Fiscal Year (or other designated twelve-month period); provided, that for the purposes of computing Annual Debt Service:

(i) the interest rate on Variable Rate Bonds shall be assumed to be 80% of the 30-year Revenue Bond Index published in *The Bond Buyer* on such date of calculation (or, if *The Bond Buyer* ceases to be published or ceases to publish such index, any comparable successor nationally recognized financial publication or index designated by the District);

(ii) notwithstanding clause (i), if a Payment Agreement is in effect pursuant to which the District is obligated to pay a fixed rate with respect to any Variable Rate Bonds, the interest rate on such Variable Rate Bonds during the period such Payment Agreement is scheduled to be in effect shall be assumed to be the fixed rate specified in such Payment Agreement;

(iii) if a Payment Agreement is in effect with respect to any Bonds pursuant to which the District receives a fixed rate in exchange for paying a variable rate, the interest rate on such Bonds during the period such Payment Agreement is scheduled to be in effect shall be assumed to be the sum of (A) the interest rate on such Bonds determined as if such Bonds were Variable Rate Bonds, and (B) the difference, if any, between the fixed rate of interest borne by such Bonds and the fixed rate the District receives pursuant to such Payment Agreement;

(iv) notwithstanding clause (i), the interest rate on Paired Bonds shall be assumed to be the aggregate fixed interest rate to be paid by the District with respect to such Paired Bonds;

(v) the Principal of any Balloon Bonds shall be assumed to become due and payable in each Fiscal Year in an amount that would be sufficient to fully amortize such Principal, together with interest thereon at the rate such Bonds are otherwise assumed to bear for purposes of this definition (using semi-annual compounding and a year of 360 days), on a level debt service basis over a period commencing on the first day of the Fiscal Year next preceding the date of calculation and ending 30 years thereafter; and

(vi) the Principal and interest payments on Bonds shall be excluded to the extent such payments are to be made from amounts on deposit, as of the date of calculation, with the Trustee in an escrow or other account irrevocably dedicated therefor, including interest payments that are to be paid from the proceeds of Bonds held by the Trustee;

(b) With respect to the Senior Consolidated System Bonds, the same as for the Bonds, substituting the term "Senior Consolidated System Bonds" for the term "Bonds" in clause (a) and every defined term contained therein and definitions thereof.

**"Authorized Denominations"** means (i) with respect to 2008B Bonds in a Fixed-Term Interest Rate Period, \$5,000 and any integral multiple thereof, and (ii) with respect to 2008B Bonds in an Interest Rate Period other than a Fixed-Term Interest Rate Period, \$100,000 and integral multiples of \$5,000 in excess of \$100,000.

**"Authorized Investments"** means any obligations or investments in which the District may legally invest its funds.

**"Available Funds"** means, as of any date of calculation, any unencumbered funds of the Consolidated System, including cash and the book value of investments, held in the Rate Stabilization Fund, the Contingency Reserve Fund, and any other similar capital or operating reserve or contingency fund designated by the Commission after the adoption of the Master Bond Resolution, in each case that the District reasonably expects would be available, for all of the first full Fiscal Year following the date of calculation, to pay Principal of and interest on Bonds when due.

**"Balloon Bonds"** means the aggregate Principal of Bonds of a Series (including Capital Appreciation Bonds) that becomes due and payable, either at scheduled maturity, by Mandatory Sinking Fund Payment or by mandatory tender for purchase, in any Fiscal Year that constitutes 25% or more of the initial aggregate Principal of such Series of Bonds.

**"Bank"** means Union Bank, N.A., as the provider of the 2008B Credit Facility.

**"Bankruptcy Code"** means Title 11 of the United States Code or any similar federal act enacted after the adoption of the Fourth Supplement.

**"Beneficial Owner"** means, for any Bond held by a nominee, the owner of the beneficial interest in such Bond.

**"Bonds"** means the Public Utility District No. 1 of Chelan County, Washington Consolidated System Revenue Bonds issued pursuant to, under authority of and for the purposes provided in the Resolution.

**"Bond Counsel"** means a firm of attorneys appointed by the District with substantial experience and expertise in the field of municipal finance law and the federal and state tax laws related thereto whose legal opinions are widely recognized and accepted by the municipal finance markets.

**"Bond Fund"** means each fund of that name established pursuant to the Resolution.

**"Bond Register"** means the books maintained for the registration and transfer of Bonds.

**“Bond Retirement Account”** means each account of that name established pursuant to the Resolution.

**“Bond Year”** means, with respect to a Series of Bonds, the Bond Year set forth in the Supplemental Resolution authorizing the issuance of such Series of Bonds or in the applicable Tax Certificate.

**“Book-Entry Bonds”** means Bonds for which a Securities Depository or its nominee is the Owner.

**“Business Day”** means any day other than (a) a Saturday, Sunday, or a day on which banking institutions in the State or the State of New York are authorized or obligated by law or executive order to be closed, (b) a day upon which the principal office of the District or the Trustee is authorized or required by law to be closed, or (c) with respect to a Series of Bonds, any day so specified in the Supplemental Resolution authorizing the issuance of such Series of Bonds.

**“Capital Appreciation Bonds”** means any Bonds the interest on which is not scheduled to be paid until the maturity or prior redemption thereof, or the conversion thereof to Current Interest Bonds.

**“Certificate”** of the District means a written certificate signed by a duly authorized officer or employee of the District.

**“Chelan Hydro Consolidated System”** means the “Chelan Hydro Consolidated System” ratified, confirmed, approved and continued by the Senior Consolidated System Resolution.

**“Code”** means the Internal Revenue Code of 1986, as amended and supplemented, and any successor legislation thereto, and all regulations promulgated from time to time by the United States Department of the Treasury with respect thereto.

**“Commission”** means the Commission of the District.

**“Consolidated System”** means the “Consolidated System” established by and existing as of the date of the Resolution, and any and all additions, improvements, betterments, renewals, replacements and repairs thereto and extensions thereof, and shall include all (a) electric generation, transmission, distribution facilities, (b) water supply, treatment and distribution facilities, (c) wastewater collection, treatment and disposal facilities; (d) fiber optics network receipt, transmission and distribution facilities, and (e) other utility facilities, property and rights, tangible and intangible, purchased, constructed or otherwise acquired by the District after the adoption of the Master Bond Resolution from the proceeds of Bonds or from Revenues, including the Distribution Division, the Lake Chelan System, the Wastewater System, the Water System and the Fiber Optics System, and the funds and accounts established by the District with respect thereto. The Consolidated System shall not include any such facilities, property and rights that may be purchased, constructed or otherwise acquired by the District after the adoption of the Master Bond Resolution as a separate utility system the revenues derived from the ownership and operation of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire such separate utility system. The term “Consolidated System” shall also include any other separate utility system of the District and any other facilities or systems that the District is authorized by law to own and operate if (i) the District by resolution of the Commission determines to consolidate such separate utility system or other facilities or systems with and add them to the Consolidated System, (ii) immediately following the adoption of such resolution, the District shall be in compliance with the rates and charges covenant set forth in the Master Bond Resolution, after giving effect to the consolidation of such separate systems or facilities, and (iii) a Certificate of the District shall have been provided to the Trustee stating that, in each of the first three (3) full Fiscal Years following the adoption of such resolution, Adjusted Net Revenues as projected (a) plus Available Funds, will be at least 1.25 times the projected Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds, after giving effect to the consolidation of such separate systems or utilities, and (b) excluding Available Funds, will be at least 1.00 times the projected Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds, plus required deposits, if any, into the Reserve Fund and any debt service reserve fund for the Senior Consolidated System Bonds, after giving effect to the consolidation of such separate systems or utilities.

**“Construction Fund”** means each fund of that name established pursuant to the Resolution.

**“Consulting Engineer”** means an independent consulting engineering firm appointed by the District with substantial experience and expertise in the area of electric utility engineering consulting whose opinions and views are widely recognized and accepted in the municipal finance markets.

**“Contingency Reserve Fund”** means the fund of that name previously established within the Consolidated System by Resolution No. 94-10052, adopted on December 19, 1994, the moneys in which are held in reserve and available in extraordinary circumstances to pay Operation and Maintenance Expenses, Principal of and interest on Bonds, and other costs of the Consolidated System.

**“CP Interest Rate Period,”** for 2008B Bonds, means each period, comprised of CP Terms, for which the District has determined that all or any portion of such 2008B Bonds will bear interest at CP Term Rates.

**“CP Term”** means, with respect to each 2008B Bond subject to a CP Interest Rate Period, each period established in accordance with the 2008B Supplemental Resolution during which period such 2008B Bond shall bear interest at a CP Term Rate. Each CP Term shall not exceed 270 days.

**“CP Term Rate”** means with respect to each 2008B Bond subject to a CP Interest Rate Period, an interest rate on such 2008B Bonds established periodically in accordance with the 2008B Supplemental Resolution.

**“Credit Facility”** means a letter of credit, line of credit, or other credit or liquidity facility provided by a financial institution or insurance company, including municipal bond insurance and guarantees, delivered to the Trustee for a Series of Bonds or portion thereof, which provides for payment, in accordance with the terms thereof, of the Principal, Purchase Price and/or Redemption Price of and/or interest on such Series of Bonds or portion thereof.

**“Credit Facility Agreement”** means a written agreement between the District and a Credit Facility Provider pursuant to which a related Credit Facility is provided.

**“Credit Facility Provider”** means the financial institution or insurance company that is providing a Credit Facility.

**“Credit Facility Provider Bond”** means any 2008B Bond registered or eligible for registration in the name of and delivered to a Credit Facility Provider or any custodian, nominee, agent or depository designated by that Credit Facility Provider, or held by the Trustee for the account of that Credit Facility Provider or any of the foregoing designees of that Credit Facility Provider, acquired pursuant to a payment under a Credit Facility. Any such 2008B Bond shall cease to be a Credit Facility Provider Bond upon its remarketing or other transfer or deemed transfer from that Credit Facility Provider or its designee.

**“Credit Facility Provider Interest Rate,”** with respect to 2008B Bonds, means the interest rate or rates on Credit Facility Provider Bonds as set forth in the Credit Facility Agreement.

**“Current Interest Bonds”** means any Bonds, other than Capital Appreciation Bonds, which pay interest at least annually to the Owners thereof commencing within 18 months from the date of issuance thereof.

**“Daily Interest Rate”** means an interest rate established daily in accordance with the 2008B Supplemental Resolution.

**“Daily Interest Rate Period,”** for 2008B Bonds, means each period for which the District has determined that all or a portion of such 2008B Bonds will bear interest at a Daily Interest Rate.

**“Delivery Office”** means such address as may be designated in writing to the District by the Tender Agent, the Trustee, the Remarketing Agent and each Credit Facility Provider, as appropriate.

**“Distribution Division”** means the facilities, properties and rights constituting the Distribution Division of the District, together with all additions, improvements and betterments thereto and extensions thereof.

**“District”** means Public Utility District No. 1 of Chelan County, a municipal corporation of the State of Washington.

**“DTC”** means The Depository Trust Company, New York, New York, and its successors and assigns.

**“Event of Default”** means each event defined as such in “THE MASTER RESOLUTION—Events of Default” below.

**“Favorable Opinion of Bond Counsel”** means an opinion of nationally recognized bond counsel acceptable to the District and the Trustee, addressed to the District, the Trustee and the Credit Facility Provider, if any, which provided or will provide the Credit Facility for the 2008B Bonds which are the subject of the opinion, to the effect that the action proposed to be taken is authorized or permitted by the Master Bond Resolution and will not adversely affect the exclusion of interest on the 2008B Bonds that are Tax Exempt Bonds from gross income for federal income tax purposes.

**“Fiber Optics Resolution”** means Resolution No. 04-12554, adopted on May 24, 2004.

**“Fiber Optics System”** means the facilities, properties and rights of the District for the operation of its fiber optics networks formally established by the Fiber Optics Resolution.

**“Fifth Supplement”** or **“Fifth Supplemental Resolution”** means the Fifth Supplemental Resolution adopted by the District’s Commission on April 27, 2009, and any amendments, modifications or supplements thereto.

**“Fiscal Year”** means the twelve-month period selected from time to time by the District as the official fiscal year of the District.

**“Fitch”** means Fitch Ratings and its successors and assigns, except that if such organization shall be dissolved or liquidated or shall no longer perform the functions of a securities credit rating agency, then the term “Fitch” shall be deemed to refer to any other nationally recognized securities credit rating agency selected by the District.

**“Fixed-Term Interest Rate”** means an interest rate established periodically in accordance with the 2008B Supplemental Resolution.

**“Fixed-Term Interest Rate Period,”** for 2008B Bonds, means each period of at least 360 days for which the District has determined that all or a portion of such 2008B Bonds will bear interest at a Fixed-Term Interest Rate.

**“Fourth Supplement”** or **“Fourth Supplemental Resolution”** means the Fourth Supplemental Resolution adopted by the District’s Commission on February 11, 2008, and any amendments, modifications or supplements thereto.

**“Fund”** means any fund or account established under the Resolution.

**“GAAP”** means generally accepted accounting principles from time to time applicable to governmental entities such as the District.

**“Government Securities”** means direct obligations of, or obligations the timely payment of principal of and interest on which are unconditionally guaranteed by, the United States of America.

**“Interest Account”** means each account of that name established pursuant to the Resolution.

**“Interest Payment Date”** means in connection with the 2008B Tender Bonds (a) with respect to any Weekly Interest Rate Period, the first Wednesday of each calendar month, or, if such first Wednesday shall not be a

Business Day, the next Business Day, and the Business Day after the last day of such Weekly Interest Rate Period, (b) with respect to any Fixed-Term Interest Rate Period, each January 1 and July 1; provided, that if the last Interest Payment Date in any Fixed-Term Interest Rate Period would not be a Business Day, then the next Business Day, (c) notwithstanding anything in the foregoing to the contrary, with respect to any 2008B Tender Bond, the day on which that 2008B Tender Bond becomes a Credit Facility Provider Bond and, with respect to any Credit Facility Provider Bond, (i) the first Business Day of each calendar month, and (ii) the date on which such Credit Facility Provider Bond is remarketed pursuant to the 2008B Supplemental Resolution.

**“Interest Rate Period”** means any Daily Interest Rate Period, Weekly Interest Rate Period, CP Interest Rate Period, Fixed-Term Interest Rate Period or Auction Rate Period.

**“Lake Chelan System”** means the facilities, properties and rights constituting the Lake Chelan System of the District, together with all additions, improvements and betterments thereto and extensions thereof.

**“Letter of Representations”** means the blanket letter of representations executed by the District and delivered to DTC and any amendments thereto or successor blanket agreements between the District and any successor Securities Depository, relating to a system of Book-Entry Bonds to be maintained by the Securities Depository with respect to any bonds, notes or other obligations issued by the District.

**“Mandatory Sinking Fund Payment”** means, with respect to any Term Bond, an amount required by the Supplemental Resolution authorizing the issuance of the Series of Bonds of which such Term Bond is a part to be deposited in the Bond Retirement Account created for such Series of Bonds for the mandatory purchase or redemption of such Term Bond or portion thereof prior to the final maturity thereof.

**“Master Bond Resolution”** or **“Master Resolution”** means Resolution No. 07-13067, adopted by the District’s Commission on March 12, 2007, as amended by Resolution No. 07-13099, adopted by the District’s Commission on April 30, 2007, and as amended and supplemented by the First Supplemental Resolution, the Fourth Supplemental Resolution and the Fifth Supplemental Resolution.

**“Maximum Rate”** means with respect to each Series of 2008B Tender Bonds, the lower of (a) the maximum rate of interest covered by any Credit Facility provided for that Series and (b) the maximum rate of interest, if any, then provided by law.

**“Moody’s”** means Moody’s Investors Service, Inc. and its successors and assigns, except that if such organization shall be dissolved or liquidated or shall no longer perform the functions of a securities credit rating agency, then the term “Moody’s” shall be deemed to refer to any other nationally recognized securities credit rating agency selected by the District.

**“Net Revenues”** for any Fiscal Year (or other designated twelve-month period) means Revenues in such Fiscal Year (or other designated twelve-month period) less Operation and Maintenance Expenses for such Fiscal Year (or other designated twelve-month period).

**“Operation and Maintenance Expenses”** means the costs paid or accrued for the proper operation, maintenance and repair of the Consolidated System and taxes, assessments or other governmental charges lawfully imposed on the Consolidated System or the Revenues, or payments in lieu thereof, all as determined in accordance with GAAP as applied to governmental entities. The operation and maintenance expenses of the Rock Island System or the Rocky Reach System shall not constitute a part of Operation and Maintenance Expenses unless and until the Rock Island System or the Rocky Reach System, respectively, is consolidated into the Consolidated System. Operation and Maintenance Expenses shall not include depreciation or amortization expense or unrealized mark-to-market losses with respect to any property, investment, or financial or other agreement.

**“Order”** means a written order of the District signed by a duly authorized officer or employee of the District.



**“Original Bonds”** means the Rock Island Bonds, the Rocky Reach Bonds and the Senior Consolidated System Bonds.

**“Original Resolutions”** means the Rock Island Resolutions, the Rocky Reach Resolution, the Senior Consolidated System Resolution, the Water System Resolutions and the Wastewater System Resolutions, so long as the same shall remain in effect.

**“Outstanding”** means, as of any date, (a) when used with respect to the Bonds, all Bonds authenticated and delivered under the Resolution, except (i) Bonds theretofore cancelled or delivered to the Trustee for cancellation under the Resolution, (ii) Bonds in substitution for which other Bonds have been authenticated and delivered pursuant to the Resolution, (iii) Bonds that are deemed to be no longer outstanding in accordance with the provisions of the Resolution described in “THE MASTER RESOLUTION—Discharge and Defeasance” below and (iv) Bonds that are deemed to be no longer outstanding in accordance with the Supplemental Resolution pursuant to which such Bonds were issued; (b) when used with respect to Rock Island Bonds, the Rocky Reach Bonds, and bonds or other obligations for borrowed money of the Water System or the Wastewater System, all obligations issued pursuant to the Rock Island Resolutions, the Rocky Reach Resolution, and the resolution or trust agreement authorizing the issuance of such Water System or Wastewater System bonds or other obligations for borrowed money, respectively, in each case other than obligations deemed to be no longer outstanding pursuant to the terms of such resolutions or trust agreements; and (c) when used with respect to the Senior Consolidated System Bonds, all obligations issued pursuant to the Senior Consolidated System Resolution other than obligations deemed to be no longer outstanding pursuant to the terms of the Senior Consolidated System Resolution.

**“Owner,”** with respect to a Bond, means the Person in whose name such Bond is registered.

**“Paired Bonds”** means Bonds (a) that are issued simultaneously, (b) that are designated as Paired Bonds in the Supplemental Resolution authorizing the issuance thereof or in a Certificate of the District delivered at the time of issuance thereof, (c) the principal amount of each portion of which is equal and which matures and is subject to mandatory sinking fund redemption on the same date and in the same amount, and (d) the interest rates on which, taken together, result in an irrevocable fixed interest rate obligation of the District on the aggregate principal amount of such Bonds until the maturity or prior redemption of such Bonds.

**“Payment Agreement”** means any financial instrument that (a) is entered into by the District with a party that is a Qualified Counterparty at the time the instrument is entered into; (b) is entered into with respect to all or a portion of a Series of Bonds; (c) is for a term not extending beyond the final maturity of the Series of Bonds or portion thereof to which it relates; (d) provides that the District shall pay to such Qualified Counterparty an amount accruing at either a fixed rate or a variable rate, as the case may be, on a notional amount equal to or less than the principal amount of the Series of Bonds or portion thereof to which it relates, and that such Qualified Counterparty shall pay to the District an amount accruing at either a variable rate or fixed rate, as appropriate, on such notional amount; (e) provides that one party shall pay to the other party any net amounts due under such instrument; and (f) which has been designated by the District as a Payment Agreement with respect to such Bonds.

**“Payment Agreement Payments”** means the regularly scheduled net amounts required to be paid by the District to the Qualified Counterparty pursuant to a Payment Agreement.

**“Payment Agreement Receipts”** means the regularly scheduled net amounts required to be paid by a Qualified Counterparty to the District pursuant to a Payment Agreement.

**“Payment Obligations”** means any and all amounts payable to a Credit Facility Provider under a Credit Facility Agreement.

**“Person”** means an individual, corporation, firm, association, partnership, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

**“Power Purchase Agreement”** means a resolution, contract or agreement with a term of more than five (5) years pursuant to which the Consolidated System is obligated to purchase capacity or energy, including from a

separate system of the District, and is obligated to pay for such capacity or energy regardless of whether or not such capacity or energy is taken by or made available or delivered to the Consolidated System.

**“Principal”** means, as of any date of calculation, (a) with respect to any Current Interest Bond, the principal amount thereof, and (b) with respect to any Capital Appreciation Bond, the Accreted Value thereof as of the date on which interest on such Capital Appreciation Bond is compounded next preceding such date of calculation (unless such date of calculation is a date on which such interest is compounded, in which case, as of such date).

**“Purchase Date”** means each date on which Tendered Bonds are to be purchased in accordance with the terms of the 2008B Supplemental Resolution.

**“Purchase Price”** means, with respect to any 2008B Bond tendered for purchase or deemed tendered for purchase in accordance with the provisions of the 2008B Supplemental Resolution, 100% of the principal amount thereof, plus accrued interest, if any.

**“Qualified Counterparty”** means a party other than the District which is the party to a Payment Agreement and, at the time of execution and delivery of the Payment Agreement, (a)(i) whose senior debt obligations are or claims-paying ability is rated in one of the three highest rating categories of each of at least two Rating Agencies (without regard to any gradations within a rating category) or (ii) whose obligations under the Payment Agreement are guaranteed for the entire term of the Payment Agreement by a Person whose senior debt obligations are or claims-paying ability is rated in one of the three highest rating categories of each of at least two Rating Agencies (without regard to any gradations within a rating category) and (b) which is otherwise qualified to act as the party to a Payment Agreement with the District under any applicable law.

**“Rate Stabilization Fund”** means the fund of that name established pursuant to the Resolution.

**“Rating Agencies”** means Fitch, Moody’s and/or Standard & Poor’s or any other nationally recognized securities credit rating agency selected by the District.

**“Rebate Fund”** means each fund of that name established pursuant to the Resolution.

**“Record Date”** means in connection with the 2008B Tender Bonds (a) with respect to any Interest Payment Date during a Weekly Interest Rate Period, the Business Day before such Interest Payment Date, (b) with respect to any Interest Payment Date during a Fixed-Term Interest Rate Period, the 15th day of the month (or the first day of such Fixed-Term Interest Rate Period if such first day occurs after the 15th day of the month before such Interest Payment Date) before such Interest Payment Date.

**“Redemption Price”** means, (a) with respect to any Bond or portion thereof, the Principal of such Bond or portion thereof plus the applicable premium, if any, payable upon redemption thereof pursuant to the provisions of such Bond and the Supplemental Resolution authorizing the issuance of the Series of Bonds of which such Bond is a part, and (b) with respect to any other obligation for borrowed money or portion thereof, the principal or accreted value of such obligation or portion thereof plus the applicable premium, if any, payable upon redemption thereof pursuant to the provisions of such obligation and the resolution or resolutions authorizing the issuance or incurrence of such obligation.

**“Refunding Bonds”** means all Bonds issued pursuant to the provisions of the Master Bond Resolution described in “THE MASTER RESOLUTION—Conditions for Issuance of Refunding Bonds” below.

**“Registrar”** means the Person responsible for maintaining the Bond Register, which initially shall be the Trustee.

**“Remarketing Account”** means each account established pursuant to the provisions of the 2008B Supplemental Resolution described in “THE 2008B SUPPLEMENTAL RESOLUTION—Remarketing Account” below.

**“Remarketing Agent”** means, collectively, such remarketing agent or agents as may be appointed by the District from time to time and qualified pursuant to the 2008B Supplemental Resolution.

**“Remarketing Agreement”** means any Remarketing Agreement entered into between the District and the Remarketing Agent with respect to 2008B Bonds, as the same may be amended, modified or supplemented.

**“Reserve Account”** means each account of that name established pursuant to the Master Bond Resolution.

**“Reserve Account Credit Facility”** means a letter of credit, insurance policy, surety bond, or other credit facility provided to the Trustee by a bank, insurance company or other financial institution whose senior unsecured debt obligations are, or whose claims-paying ability is, rated in the highest rating category by each of at least two Rating Agencies, which provides for payment when due, in accordance with the terms thereof, of the Principal or Redemption Price of and/or interest on one or more Series of Bonds or portion thereof.

**“Reserve Fund”** means the fund of that name established pursuant to the Master Bond Resolution.

**“Reserve Requirement”** means, with respect to any Series of Bonds or portion thereof, unless otherwise specified in the Supplemental Resolution authorizing the issuance of such Series of Bonds, the least of (a) ten percent (10%) of the stated Principal amount of such Series of Bonds or portion thereof, (b) the maximum Annual Debt Service on such Series of Bonds or portion thereof, and (c) 125% of the average Annual Debt Service on such Series of Bonds or portion thereof.

**“Resolution”** means the Master Bond Resolution, as supplemented or amended pursuant to the Master Bond Resolution, together with any Supplemental Resolutions.

**“Revenue Fund”** means the “Revenue Fund” created and established by the District prior to the adoption of the Master Bond Resolution and continued pursuant to the Resolution.

**“Revenues”** means all revenues, rates and charges received or accrued by the District for electric power and energy, water, wastewater, fiber optics networks and other services, facilities and commodities sold, furnished or supplied by the Consolidated System, together with income, earnings and profits therefrom (including interest earnings on the proceeds of any Bonds pending application thereof), all as determined in accordance with GAAP as applied to governmental entities. The revenues of the Rock Island System and the Rocky Reach System shall not constitute a part of Revenues unless and until the Rock Island System or the Rocky Reach System, respectively, is consolidated into the Consolidated System. The revenues of the Water System and the Wastewater System shall not constitute a part of Revenues to the extent such revenues are pledged to the payment of bonds or other obligations for borrowed money of either of those respective Systems. Revenues shall include principal and interest payments to the Consolidated System on or with respect to loans made by the Consolidated System to any other separate system of the District that is not part of the Consolidated System. Revenues shall not include (a) proceeds from the issuance of any obligations for borrowed money, (b) amounts loaned to the Consolidated System, (c) Payment Agreement Receipts, (d) proceeds from taxes, (e) customer deposits while retained as such, (f) contributions in aid of construction, (g) gifts, (h) grants, (i) insurance or condemnation proceeds that are properly allocable to a capital account, (j) unrealized mark-to-market gains with respect to any property, investment or financial or other agreement, or (k) money received by the District as the proceeds of the sale of any portion of the properties of the Consolidated System.

Once all of the Bonds Outstanding under the Resolution as of August 11, 2009 (excluding the Consolidated System Revenue Bonds, Series 2009C and Series 2009D), are no longer Outstanding, the definition of “Revenues” will include the following sentence: “Federal and state grant moneys received by the District that do not constitute Contributions-in Aid-of Construction within the meaning of GAAP shall constitute Revenues if designated as such by the District.”

**“Rock Island Bonds”** means any bonds or other obligations for borrowed money issued and Outstanding under the Rock Island Resolutions.

**“Rock Island Resolutions”** means Resolutions Nos. 1137 and 97-10671, adopted on December 20, 1955, and February 27, 1997, respectively, as such resolutions have been or may subsequent to the adoption of the Master Bond Resolution be amended or supplemented, but in each case only for so long as any Rock Island Bonds remain Outstanding thereunder.

**“Rock Island System”** means the facilities, properties and rights constituting the Columbia River-Rock Island Hydro-Electric System, together with all additions, improvements and betterments thereto and extensions thereof, including the first and second powerhouses thereof.

**“Rocky Reach Bonds”** means any bonds or other obligations for borrowed money issued and Outstanding under the Rocky Reach Resolution.

**“Rocky Reach Resolution”** means Resolution No. 1412, adopted on November 20, 1956, as such resolution has been or may subsequent to the adoption of the Master Bond Resolution be amended or supplemented, but in each case only for so long as any Rocky Reach Bonds remain Outstanding thereunder.

**“Rocky Reach System”** means the facilities, properties and rights constituting the Rocky-Reach Hydro-Electric System as defined in the Rocky Reach Resolution, together with all additions, improvements and betterments thereto and extensions thereof.

**“Securities Depository”** means a Person registered as a clearing agency under Section 17A of the Securities Exchange Act of 1934, or any successor legislation, or whose business is confined to the performance of the functions of a clearing agency with respect to exempted securities, as defined in Section 3(a)(12) of such Act, or any successor legislation, for the purposes of Section 17A thereof.

**“Senior Consolidated System Bonds”** means all bonds issued and at any time Outstanding under the Senior Consolidated System Resolution.

**“Senior Consolidated System Resolution”** means Resolution No. 95-10188, adopted on June 19, 1995, as supplemented and amended, including as amended and restated by Resolution No. 99-11303, adopted on November 1, 1999.

**“Series”** means all of the Bonds issued and delivered on the same date which all are (a) payable from and secured by the same source of funds, and (b) and bear interest at either a Variable Rate or fixed-rate, regardless of individual variations in maturity, interest rate, redemption and other provisions, and any Bonds thereafter authenticated and delivered upon transfer or exchange or in lieu of or in substitution for (but not to refund) such Bonds as provided in the Master Bond Resolution.

**“Standard & Poor’s”** means Standard & Poor’s Ratings Services and its successors and assigns, except that if such organization shall be dissolved or liquidated or shall no longer perform the functions of a securities credit rating agency, then the term “Standard & Poor’s” shall be deemed to refer to any other nationally recognized securities credit rating agency selected by the District.

**“State”** means the State of Washington.

**“Subordinate Obligations”** means, collectively, bonds, notes or other obligations of the District for borrowed money payable from and secured by a pledge of and lien and charge on Revenues junior and inferior to the Bonds and the payments required to be made into the Bond Funds and the Reserve Fund.

**“Substitution Date”** means the date on which any Credit Facility is scheduled to be replaced by an alternate Credit Facility, which date must be at least 30 days after the date on which the Trustee gives the notice of termination or substitution of a Credit Facility required by the 2008B Supplemental Resolution.

**“Supplemental Resolution”** means any resolution duly adopted by the Commission after the adoption of the Master Bond Resolution, supplementing, modifying or amending the Resolution in accordance therewith.

**“Take-or-Pay Contract”** means a contract with a term of at least five (5) years between the District and a purchaser of capacity or energy from the Rock Island System, the Rocky Reach System and/or the Consolidated System, whereby such purchaser is obligated to make fixed payments or payments based on a percentage of cost for such capacity or energy whether or not such capacity or energy is taken by or made available or delivered to such purchaser.

**“Tax Certificate”** means, with respect to the 2008B Bonds, the certificate delivered by the District regarding compliance with applicable provisions of the Code in connection with the reissuance of the 2008B Bonds, as supplemented.

**“Tax-Exempt Bonds”** means Bonds, the interest on which in the opinion of Bond Counsel as of the date of issuance thereof is not includable in gross income for federal income tax purposes under Section 103(a) of the Code.

**“Tender Agent”** means such tender agent as may be appointed by the District from time to time and qualified pursuant to the 2008B Supplemental Resolution. Initially, the Trustee shall serve as the Tender Agent with respect to the 2008B Bonds.

**“Tendered Bonds”** means all 2008B Bonds or portions thereof which are properly tendered or deemed tendered on a Purchase Date.

**“Tenth Supplement”** or **“Tenth Supplemental Resolution”** means the Tenth Supplemental Resolution adopted by the District’s Commission on January 7, 2013, and any amendments, modifications or supplements thereto.

**“Term Bonds”** means Bonds that are subject to mandatory purchase or redemption prior to their scheduled maturity date or dates from Mandatory Sinking Fund Payments established for that purpose and calculated to retire such Bonds on or before their specified maturity date or dates.

**“Termination Date”** means the stated termination date (whether caused by a notice of termination delivered by the Credit Facility Provider or otherwise) or expiration date of any Credit Facility; provided, however, that the Termination Date shall not include any revocation, termination or cancellation wherein the Credit Facility does not provide for the purchase or payment of the 2008B Bonds supported thereby in connection with such revocation, termination or cancellation.

**“Treasurer”** means the District, acting by and through its Treasurer or Chief Financial Officer.

**“Trustee”** means the trustee with respect to the Bonds appointed pursuant to the provisions of the Resolution.

**“2008B Bond Fund”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Bond Fund” and any accounts therein established pursuant to the 2008B Supplemental Resolution.

**“2008B Bond Purchase Account”** means the account of that name established pursuant to the 2008B Supplemental Resolution.

**“2008B Bonds”** means, collectively, the District’s Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT) authorized pursuant to the 2008B Supplemental Resolution.

**“2008B Construction Fund”** means the “Public Utility District No. 1 of Chelan County Project Consolidated System Bonds, Refunding Series 2008B Construction Fund” and any accounts therein established pursuant to the 2008B Supplemental Resolution.

**“2008B Credit Facility”** means the Standby Bond Purchase Agreement, dated as of March 1, 2013, by and among the District, the Trustee and the Bank with respect to 2008B Bonds, as the same may be amended, modified or supplemented.

**“2008B Credit Facility Payment Fund”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Credit Facility Payment Fund,” established pursuant to the 2008B Supplemental Resolution.

**“2008B Credit Facility Purchase Account”** means a trust account of that name established pursuant to the 2008B Supplemental Resolution.

**“2008B Delivery Certificate”** means a Certificate or Order of the District delivered at the time of issuance of the 2008B Bonds setting forth certain terms with respect to the 2008B Bonds as provided in the Fourth Supplement.

**“2008B Reissuance Delivery Certificate”** means a Certificate or Order of the District delivered at the time of reissuance of the 2008B Bonds setting forth certain terms with respect to the 2008B Bonds as provided in the 2008B Supplemental Resolution.

**“2008B Remarketing Delivery Certificate”** means a Certificate or Order of the District delivered at the time of remarketing of the 2008B Bonds on the Mandatory Tender Date setting forth certain terms with respect to the 2008B Bonds as provided in the 2008B Supplemental Resolution.

**“2008B Rebate Fund”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Rebate Fund” established pursuant to the 2008B Supplemental Resolution.

**“2008B Reserve Account”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Reserve Account” and the accounts therein established pursuant to the 2008B Supplemental Resolution.

**“2008B Reserve Requirement”** means the maximum annual interest, unless otherwise specified in the 2008B Remarketing Delivery Certificate.

**“2008B Supplemental Resolution”** means the Fourth Supplemental Resolution, as amended and supplemented, including as amended and supplemented by the Fifth Supplemental Resolution and by the Tenth Supplemental Resolution.

**“2008B Tender Bonds”** means all 2008B Bonds bearing interest at an Interest Rate Period other than an Auction Period.

**“Variable Rate Bonds”** means any Bonds the interest rate on which is not fixed to the scheduled maturity date or prior mandatory tender or redemption date, as of the date of calculation, at a single numerical rate for the entire remaining term to maturity or mandatory tender or redemption thereof.

**“Wastewater System”** means the facilities, properties and rights of the District for the collection, treatment and handling of wastewater.

**“Wastewater System Resolutions”** means any resolutions heretofore or hereafter adopted by the Commission pledging, or placing a lien or charge on, the revenues of the Wastewater System with respect to obligations for borrowed money payable from such revenues.

**“Water System”** means the facilities, properties and rights of the District for the supply, distribution, storage and handling of water.

***“Water System Resolutions”*** means any resolutions heretofore or hereafter adopted by the Commission pledging, or placing a lien or charge on, the revenues of the Water System with respect to obligations for borrowed money payable from such revenues.

***“Weekly Interest Rate”*** means an interest rate established weekly in accordance with the 2008B Supplemental Resolution.

***“Weekly Interest Rate Period,”*** for 2008B Bonds, means each period for which the District has determined that such 2008B Bonds will bear interest at a Weekly Interest Rate.

## **THE MASTER RESOLUTION**

### **General**

The Master Resolution authorizes the issuance of “Public Utility District No. 1 of Chelan County, Washington Consolidated System Revenue Bonds,” which Bonds may be issued in multiple Series pursuant to Supplemental Resolutions adopted as provided in the Master Resolution.

### **Series of Bonds; Terms of Supplemental Resolutions**

The Commission may from time to time by Supplemental Resolution authorize one or more Series of the Bonds, and the District may issue and the Trustee will authenticate and deliver to the purchasers thereof any Bonds so authorized, in such principal amount as will be determined by the Commission, but only upon compliance by the District with the provisions of the Resolution and any additional requirements set forth in such Supplemental Resolution.

A Supplemental Resolution authorizing a Series of Bonds will specify (or provide the method for specifying) for such Series of Bonds, among other things: (i) the authorized principal amount and distinguishing designation; (ii) the general purpose or purposes for which such Series of Bonds are being issued, and the deposit, disbursement and application of the sale proceeds; (iii) the dated date or dates and the maturity date or dates, the principal amount maturing on each maturity date, any Mandatory Sinking Fund Payments and the interest payment date or dates; (iv) which of such Series of Bonds are Capital Appreciation Bonds, Current Interest Bonds and Term Bonds; (v) the interest rate or rates (which may be a rate of zero); (vi) the authorized denominations of and the manner of dating and numbering such Series of Bonds; (vii) the method and place or places of payment of the Principal, Purchase Price and Redemption Price of and interest on, such Series of Bonds; (viii) any permitted or required variations, legends, omissions and insertions in the form or forms of such Series of Bonds; (ix) the terms and conditions, if any, for the redemption of such Series of Bonds prior to maturity, including the date or dates fixed for redemption, the Redemption Price or Prices, whether such redemption is subject to rescission and other applicable redemption terms; (x) the terms and conditions, if any, for the optional or mandatory tender for purchase of such Series of Bonds prior to maturity, including the purchase date or dates, the Purchase Price or Prices and other applicable terms; (xi) the authorization of and any terms and conditions with respect to any Reserve Account Credit Facility or Facilities for such Series of Bonds; (xii) the pledge or provision of money, assets or security other than Revenues to or for the payment of such Series of Bonds or any portion thereof; (xiii) the creation and maintenance of one or more special funds or accounts, if any, to provide for the payment or purchase of such Series of Bonds and the application of money therein; (xiv) the tender agents, remarketing agents, auction agents and broker-dealers, if any, and the duties and obligations thereof; and (xv) any other provisions which the Commission deems necessary or desirable in connection with such Series of Bonds and not inconsistent with the terms of the Resolution.

### **General Provisions for the Issuance of Bonds**

Each Series of Bonds will be executed by the District and delivered to the Trustee and authenticated by the Trustee and delivered to the District or upon its order, but only (except with respect to Refunding Bonds) upon receipt by the Trustee of the following: (a) a copy of the Resolution, including the Supplemental Resolution authorizing the issuance of the Bonds such Series, certified by the Secretary of the Commission; (b) a written

opinion of Bond Counsel to the effect that (i) such Series of Bonds are valid and binding limited obligations of the District enforceable against the District in accordance with their terms and (ii) the Resolution, including the Supplemental Resolution authorizing the issuance of such Series of Bonds, is a valid and binding obligation of the District enforceable in accordance with its terms; provided, that such opinions may be qualified to the extent that the enforceability of the Bonds and the Resolution, including the Supplemental Resolution authorizing the issuance of such Series of Bonds, may be limited by bankruptcy, insolvency, reorganization or similar laws affecting the enforcement of creditors' rights generally and by general equitable principles; (c) an Order of the District as to the delivery of such Series of Bonds; (d) a Certificate of the District stating that (i) no Event of Default, nor any event or condition which with notice and/or the passage of time would constitute an Event of Default, has occurred and is continuing under the Resolution as of the date of issuance of such Series of Bonds and (ii) the issuance of such Series of Bonds, in and of itself, will not cause an Event of Default under the Resolution; (e) the deposit into the Reserve Account for such Series of Bonds of money, Authorized Investments, a Reserve Account Credit Facility or Facilities or any combination of the foregoing in an aggregate amount equal to the Reserve Requirement, if any, for such Series of Bonds; and (f) the additional bonds certification described below in "—Additional Bonds Certification."

### **Additional Bonds Certification**

In connection with the issuance of a Series of Bonds, the requirements of the Resolution may be fulfilled by either: (i) a Certificate of the District stating that, in each of the first three (3) full Fiscal Years following the last Fiscal Year during which any proceeds of the Bonds are scheduled to be used for the purpose of paying interest on such Series of Bonds, Adjusted Net Revenues as projected: (A) plus Available Funds, will be at least 1.25 times the projected Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds, after giving effect to the issuance of such Series of Bonds, and (B) excluding Available Funds, will be at least 1.00 times the projected Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds, plus required deposits, if any, into the Reserve Fund and any debt service reserve fund for the Senior Consolidated System Bonds, after giving effect to the issuance of such Series of Bonds; or (ii) a Certificate of the District stating that Adjusted Net Revenues for any twelve (12) consecutive months of the 24 months prior to the date of calculation: (A) plus Available Funds, were at least 1.25 times the projected Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds, after giving effect to the issuance of such Series of Bonds, and (B) excluding Available Funds, were at least 1.00 times the projected Annual Debt Service on the Outstanding Bonds and Senior Consolidated System Bonds, plus required deposits, if any, into the Reserve Fund and any debt service reserve fund for the Senior Consolidated System Bonds, after giving effect to the issuance of such Series of Bonds.

For purposes of the provisions of the Master Bond Resolution described in this section, the following adjustments may be made to Net Revenues for the latest Fiscal Year for which audited financial statements of the District are available, if so stated in the Certificate of the District: (i) an allowance for additional Revenues anticipated from any additions, extensions and improvements to the Consolidated System to be acquired or constructed from proceeds of such or a prior Series of Bonds, and for any changes in Operation and Maintenance Expenses resulting therefrom, that are not reflected in Net Revenues for such Fiscal Year, but only if such additional Revenues and changes in Operation and Maintenance Expenses represent a full twelve (12) months' change in Net Revenues attributable to such additions, extensions and improvements; and (ii) an allowance for additional Revenues attributable to any increase in the rates and charges imposed by the District that (A) was in effect prior to the issuance of such Series of Bonds but which, during all or part of such Fiscal Year, was not in effect, or (B) was adopted by the Commission prior to the issuance of such Series of Bonds and will be in effect within 90 days after such issuance, but in either case only if such additional Revenues represent a full twelve (12) months' change in Net Revenues attributable to such increase in rates and charges.

The District will include in any Certificate delivered pursuant to the provisions of the Master Bond Resolution described in this section a description of the assumptions, analyses, methodologies, and statistical and other information from the District or third persons used in producing its projections of Adjusted Net Revenues.



## Conditions for Issuance of Refunding Bonds

(a) A Series of Refunding Bonds may be issued by the District to provide funds sufficient for the payment of any or all of the following:

- (i) The Principal, Purchase Price or Redemption Price of the Bonds or Original Bonds to be refunded;
- (ii) All expenses incident to the purchase, call, redemption, retirement or payment of the Bonds or Original Bonds to be refunded;
- (iii) The costs of issuance of such Series of Refunding Bonds;
- (iv) Interest on the Bonds or Original Bonds to be refunded to the date such Bonds or Original Bonds will be purchase, redeemed, retired or paid;
- (v) Interest on such Series of Refunding Bonds from the date thereof to the date of purchase, redemption, retirement or payment of the Bonds or Original Bonds to be refunded; and
- (vi) Any other lawful payment obligations, costs or expenses in connection with the issuance of the Refunding Bonds and the purchase, redemption, retirement or payment of the Bonds or Original Bonds to be refunded.

(b) A Series of Refunding Bonds may be issued by the District only upon receipt by the Trustee of the following:

- (i) The documents specified in subsections (a), (b), (c) and (e) under “—General Provisions for the Issuance of Bonds”;
- (ii) Either (A) the additional bonds certification described above in “—Additional Bonds Certification”, or (B) a Certificate of the District stating that the issuance of such Series of Refunding Bonds (1) will not result in an increase in Annual Debt Service on the Bonds and the Senior Consolidated System Bonds (excluding for purposes of the provisions of the Master Bond Resolution described in this subsection paragraph (a)(v) of such definition) greater than \$1,000,000 in any Fiscal Year that such Series of Refunding Bonds is scheduled to be Outstanding, and (2) is reasonably expected to result in net present value savings to the District calculated using a discount rate equal to the yield to maturity on the Refunding Bonds;
- (iii) If any of the Bonds or Original Bonds to be refunded are to be purchased or redeemed prior to their stated maturity dates, irrevocable instructions (A) to the Trustee to give the applicable notice of purchase or redemption of such Bonds or (B) to the trustee for the owners of such Original Bonds to give the applicable notice of purchase or redemption of such Original Bonds; and
- (iv) An opinion of Bond Counsel that (A) all liability of the District in respect of the Bonds to be refunded has ceased, terminated and been discharged, pursuant to the terms of the Resolution and the Supplemental Resolution pursuant to which such Bonds were issued, and the Owners of such Bonds are entitled to payment of the Principal, Purchase Price or Redemption Price of and interest on such Bonds only out of the money or securities deposited with the Trustee for the payment of such Bonds or (B) all liability of the District in respect of the Original Bonds to be refunded has ceased, terminated and been discharged, pursuant to the terms of the resolution or resolutions pursuant to which such Original Bonds were issued, and the owners of such Original Bonds are entitled to payment of the principal, purchase price or redemption price of and interest on such Original Bonds only out of the money or securities deposited with the trustee for the owners of such Original Bonds for the payment of such Original Bonds.

## **Pledge of Revenues**

The Bonds are special limited obligations of the District payable from and secured by the Revenues, after payment of Operation and Maintenance Expenses. The Bonds will not in any manner or to any extent constitute general obligations of the District or of the State of Washington, or of any political subdivision of the State of Washington. The Bonds are not a charge upon the general fund or upon any moneys or other property of the District or of the State of Washington, or of any political subdivision of the State of Washington, other than the Net Revenues. Neither the full faith and credit nor the taxing power of the District, of the State of Washington, or of any political subdivision of the State of Washington, are pledged to the payment of the Bonds. The Bonds will not constitute indebtedness of the District within the meaning of the constitutional and statutory provisions and limitations of the State of Washington. In the Master Bond Resolution, the District pledges and places a lien and charge upon the Revenues, after payment of Operation and Maintenance Expenses, in the order of priority set forth in the Resolution as described in “SECURITY FOR THE 2008B BONDS—Flow of Funds” in the front portion of the Remarketing Memorandum, to secure the payment of the Bonds and, to the extent permitted by law, Payment Agreement Payments and other payments due under Payment Agreements, in accordance with their respective terms without priority or distinction of one over the other, subject only to the provisions of the Resolution permitting the application of such Revenues for the purposes and on the terms and conditions set forth therein and in the Master Bond Resolution, and the Revenues, after payment of Operation and Maintenance Expenses, will constitute a trust for the security and payment of the Bonds and Payment Agreement Payments and other payments due under Payment Agreements. The pledge of and lien and charge on the Revenues in the Master Bond Resolution made will be irrevocable until there are no Bonds Outstanding and until all Payment Agreement Payments and other payments due in accordance with the provisions of the Payment Agreements and the Resolution have been made. The pledge of and lien and charge on the Revenues and other money and obligations will be valid and binding from the time made, and the Revenues so pledged and thereafter received by the District will immediately be subject to the pledge, lien and charge of the Resolution without any physical delivery or further act, and such pledge, lien and charge will be valid and binding as against any parties having claims of any kind in tort, contract, or otherwise against the District irrespective of whether such parties have notice thereof.

Notwithstanding the foregoing, the pledge, lien and charge of the Senior Consolidated System Bonds on Revenues and the obligation of the District to deposit Revenues into the bond funds established under to the Senior Consolidated System Resolution will have priority over the pledge, lien and charge of the Bonds and Payment Agreement Payments on Revenues established under the Resolution.

## **Equality of Security**

In consideration of the acceptance of the Bonds by the Owners thereof from time to time, the Resolution will be deemed to be and will constitute a contract between the District and the Owners from time to time of the Bonds, and the covenants and agreements set forth in the Resolution to be performed by or on behalf of the District will be for the equal and proportionate benefit, security and protection of all Owners, without preference, priority or distinction as to security or otherwise of any Bond over any other Bond by reason of the Series, time of issue, sale or negotiation thereof or for any cause whatsoever, except as expressly provided therein or in the Master Bond Resolution. Notwithstanding the foregoing, nothing in the Master Bond Resolution will prevent additional security being provided for a particular Series of Bonds under any Supplemental Resolution.

## **Investment or Deposit of Funds**

All money on deposit in the Funds will be invested and reinvested by the Trustee or the District, as the case may be, in Authorized Investments that mature, or are subject to repurchase, withdrawal without penalty or optional redemption on or before the dates on which the amounts invested are reasonably expected to be needed for the purposes of the Resolution.

All purchases or sales of Authorized Investments made by the Trustee will be made at the direction of the District (given in writing or orally, confirmed in writing). In the absence of such direction, the Trustee will invest all money on deposit in the Funds held by the Trustee in Government Securities.

Any Authorized Investments held by the Trustee may be transferred by the Trustee, if required in writing by the District, from any of the Funds to any other Fund at the then current market value thereof without having to be sold and purchased or repurchased; provided, that after any such transfer or transfers, the Authorized Investments in each such Fund will be in accordance with the provisions of the Resolution, and whenever any other transfer or payment is required to be made from any particular Fund, such transfer or payment will be made from such combination of maturing principal, redemption premiums, liquidation proceeds and withdrawals of principal as the Trustee deems appropriate for such purpose.

The Trustee will not be accountable for any depreciation in the value of Authorized Investments or for any losses incurred upon any authorized disposition thereof.

Subject to the foregoing, the Trustee is expressly authorized to invest money in two or more Funds in a single investment, provided that the portion of the investment allocable to each such Fund, and all payments received with respect to such allocable portion, will be applied in accordance with the applicable provisions governing such Fund under the Resolution.

### **Certain Covenants**

In addition to the rate covenant described in the Remarketing Memorandum under the caption “SECURITY FOR THE 2008B BONDS—Rate Covenant,” the District makes the following covenants with the Owners (to be performed by the District or its proper officers, agents or employees) which covenants are necessary and desirable for the protection and security of the Owners. Said covenants will be in effect so long as any of the Bonds issued under the Resolution are Outstanding and unpaid, or so long as provision for the full payment and discharge thereof at maturity or upon redemption thereof prior to maturity has not been made.

***Operation and Maintenance of Consolidated System.*** The District will (i) at all times operate the properties of the Consolidated System and the business in connection therewith in an efficient manner and at reasonable cost, (ii) maintain, preserve and keep, or cause to be maintained, preserved and kept, the properties of the Consolidated System, and all additions and betterments thereto and extensions thereof, and every part and parcel thereof, in good repair, working order and condition, and (iii) from time to time make, or cause to be made, all necessary and proper repairs, renewals, replacements, additions, extensions and betterments thereto, so that at all times the business carried on in connection therewith will be properly and advantageously conducted.

The District will at all times comply with the terms and conditions of any permits or licenses for the Consolidated System, or any property or facilities constituting a part thereof, issued by any federal or state governmental agency or body having jurisdiction thereof and with the power to issue orders with respect thereto and enforce the same, and with any federal or state law or regulation applicable to the construction, operation, maintenance and repair of the Consolidated System. The District will use its best efforts to obtain renewals of such permits or licenses or obtain new permits or licenses unless such renewals or new permits or licenses are not, in the judgment of the Commission, in the best interests of the District.

***Original Resolutions.*** With respect to each of the Original Resolutions, until such time as the obligations under an Original Resolution have been discharged in accordance with the terms thereof, the District will comply in all respects with each of the provisions, covenants and agreements thereof or contained therein.

***Payment of Taxes and Claims.*** The District will from time to time duly pay and discharge, or cause to be paid and discharged, all taxes, assessments and other governmental charges, or required payments in lieu thereof, lawfully imposed upon the properties constituting the Consolidated System or the Revenues when the same will become due, and all lawful claims for labor and material and supplies which, if not paid, might become a lien or charge upon such properties, or any part thereof, or upon the Revenues, or which might in any way impair the security of the obligations issued by the District payable from the Revenues, including the taxes, assessments, charges or claims which the District will in good faith contest by proper legal proceedings.

***Take-or-Pay Contracts.*** So long as any Take-or-Pay Contract is in effect, the District will enforce the provisions of such Take-or-Pay Contract and will not waive any default or fail to declare any default under or in

connection with such Take-or-Pay Contract that would reduce the payments to the District required thereunder to an extent that would materially adversely affect the security of the Owners; provided, that the District may, in the event the purchaser under such Take-or-Pay Contract fails or refuses to take power and energy pursuant to such Take-or-Pay Contract, sell such power and energy to others at not less than the minimum rates specified in the Resolution.

***Power Purchase Agreements.*** The District will not enter into any Power Purchase Agreement payable from Revenues unless the District first delivers to the Trustee a Certificate of the District demonstrating compliance with the requirements set forth in the Resolution for the first three (3) full Fiscal Years following the Fiscal Year in which such Power Purchase Agreement will become effective.

***Not to Dispose of System Properties.*** The District will not sell, lease or otherwise dispose of, or cause the sale, lease or other disposition of, or permit to be sold, leased or otherwise disposed of, any real or personal properties constituting part of the Consolidated System unless:

(a) Such sale, lease or disposal is of property that in the judgment of the District has become unserviceable, inadequate, obsolete, unfit or is no longer needed for the efficient and economical operation of the properties of the Consolidated System; or

(b) Such sale, lease or disposal is of property having an aggregate fair market value in any Fiscal Year of less than one percent (1%) of the value of all real or personal properties constituting part of the Consolidated System; or

(c) As determined by a certificate of a Consulting Engineer, such sale, lease or disposal will not materially impair the ability of the District to comply with the rates and charges covenant set forth in the Resolution, as described in “SECURITY FOR THE 2008B BONDS—Rate Covenant” in the front portion of the Remarketing Memorandum, for a period of five (5) Fiscal Years after such sale, lease or disposal, and the District transfers the proceeds of such sale, lease or disposal to the Construction Fund to be established for the purpose of repairing or restoring the Consolidated System or to each Bond Retirement Account for all Series of Bonds then Outstanding in the same ratio as the initial Principal amount of each Series of Bonds then Outstanding bears to the aggregate initial Principal amount of all Series of Bonds then Outstanding.

***To Provide Financial Reports.*** The District will prepare and make available for inspection at the principal administrative office of the District and will provide to the Trustee and any Credit Facility Provider the most recent audited annual financial statements of the District, including any supplemental schedules showing the component units constituting a part of the Consolidated System, and the current unaudited financial reports of the District reflecting quarterly information, accompanied by a Certificate of the Treasurer to the effect that such current quarterly reports were prepared on a basis consistent with that of the most recent audited annual financial statements, except as otherwise set forth therein. The District will make available its audited annual financial statements within 150 days after the end of each Fiscal Year.

### **Appointment; Duties and Responsibilities of the Trustee**

The Commission will designate and appoint the initial Trustee with respect to the Bonds.

Prior to the occurrence of an Event of Default of which it has or is deemed to have notice under the Resolution, and after the curing or waiver of any Event of Default that may have occurred: (i) the Trustee undertakes to perform such duties and only such duties as are specifically set forth in the Resolution, and no implied covenants or obligations will be read into the Resolution against the Trustee; and (ii) in the absence of bad faith on its part, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Trustee that conform to the requirements of the Resolution; but the Trustee is under a duty to examine such certificates and opinions to determine whether they conform to the requirements of the Resolution.

In case an Event of Default of which the Trustee has or is deemed to have notice under the Resolution has occurred and is continuing, the Trustee will exercise such of the rights and powers vested in it by the Resolution,

and use the same degree of care and skill in their exercise, as a prudent person would exercise or use in the conduct of such person's own affairs.

No provision of the Resolution will be construed to relieve the Trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that: (i) the provisions of the Resolution described in this subsection will not be construed to limit the effect of the provisions of the Resolution described in the second paragraph of this section; (ii) the Trustee is not liable for any error of judgment made in good faith by an authorized officer of the Trustee, unless it is proven that the Trustee was negligent in ascertaining the pertinent facts; (iii) the Trustee is not liable with respect to any action it takes or omits to be taken by it in good faith in accordance with the direction of the Owners under any provision of the Resolution relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee under the Resolution; and (iv) no provision of the Resolution will require the Trustee to expend or risk its own funds or otherwise incur any liability in the performance of any of its duties under the Resolution, or in the exercise of any of its rights or powers, if it has reasonable grounds for believing that the repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured to it.

The Trustee will maintain proper books of record and accounts in which complete and correct entries will be made of all investments and disbursements of proceeds in the Funds through the date ending six (6) years following the date on which all the Bonds have been retired, and such records will be available for inspection by the District upon reasonable notice.

Whether or not expressly so provided, every provision of the Resolution relating to the conduct or affecting the liability of or affording protection to the Trustee is subject to the provisions of the Resolution described in this section.

#### **Certain Rights of the Trustee**

The Trustee may rely and is protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, approval, bond, debenture or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;

Any statement or certification of the District under the Resolution will be sufficiently evidenced by a Certificate of the District (unless other evidence thereof is specifically prescribed), any request, direction, order or demand of the District under the Resolution will be sufficiently evidenced by an Order of the District (unless other evidence thereof is specifically prescribed) and any resolution of the Commission may be sufficiently evidenced by a copy thereof certified by the Secretary of the Commission;

Whenever in the administration of the Resolution the Trustee deems it desirable that a matter be proved or established prior to taking, suffering or omitting any action under the Resolution, the Trustee (unless other evidence thereof is specifically prescribed) may, in the absence of bad faith on its part, rely upon a Certificate of the District;

The Trustee may consult with counsel and the written advice of such counsel or an opinion of counsel or of Bond Counsel will be full and complete authorization and protection for any action taken, suffered or omitted by it in good faith and in accordance with such advice or opinion;

The Trustee is under no obligation to exercise any of the rights or powers vested in it by the Resolution at the request or direction of any of the Owners unless the Owners have offered to the Trustee security or indemnity satisfactory to the Trustee as to its terms, coverage, duration, amount and otherwise with respect to the costs, expenses and liabilities which may be incurred by it in compliance with such request or direction, and the provision of such indemnity will be mandatory for any remedy taken upon direction of the Owners of a majority in aggregate Principal amount of the Outstanding Bonds;

The Trustee is not required to make any inquiry or investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, approval, bond, debenture or other paper or document but the Trustee, in its discretion, may make such further inquiry or

investigation into such facts or matters as it may see fit and, if the Trustee determines to make such further inquiry or investigation, it is entitled to examine the books, records and premises of the District, in person or by agent or attorney;

The Trustee may execute any of its trusts or powers or perform any duties under the Resolution either directly or by or through agents or attorneys, and may in all cases pay, subject to reimbursement as provided in the Resolution, such reasonable compensation as it deems proper to all such agents and attorneys reasonably employed or retained by it, and the Trustee will not be responsible for any misconduct or negligence of any agent or attorney appointed with due care by it;

The Trustee is not required to take notice or deemed to have notice of any default or Event of Default under the Resolution, except an Event of Default under the Resolution described in subparagraph (a) of “—Events of Default” below, unless an officer of the Trustee has actual knowledge thereof or has received notice in writing of such default or Event of Default from the District or the Owners of at least 25% in aggregate Principal amount of the Outstanding Bonds, and in the absence of any such notice, the Trustee may conclusively assume that no such default or Event of Default exists;

The Trustee is not required to give any bond or surety with respect to the performance of its duties or the exercise of its powers under the Resolution;

In the event the Trustee receives inconsistent or conflicting requests and indemnity from two or more groups of Owners, each representing less than a majority in aggregate Principal amount of the Outstanding Bonds, pursuant to the provisions of the Resolution, the Trustee, in its sole discretion, may determine what action, if any, will be taken;

The Trustee’s immunities and protections from liability and its right to indemnification in connection with the performance of its duties under the Resolution will extend to the Trustee’s officers, directors, agents, attorneys and employees. Such immunities and protections and right to indemnification, together with the Trustee’s right to compensation, will survive the Trustee’s resignation or removal, the defeasance or discharge of the Resolution and final payment of the Bonds;

The permissive right of the Trustee to take the actions permitted by the Resolution will not be construed as an obligation or duty to do so; and

Except for information provided by the Trustee concerning the Trustee, the Trustee will have no responsibility for any information in any offering memorandum or other disclosure material distributed with respect to the Bonds, and the Trustee will have no responsibility for compliance with any state or federal securities laws in connection with the Bonds.

### **Qualifications of the Trustee**

The Resolution requires that there at all times be a trustee thereunder which is required to be a corporation or banking association organized and doing business under the laws of the United States of America or of any state, authorized under such laws to exercise corporate trust powers, which has a combined capital and surplus of at least \$250,000,000, or is an affiliate of, or has a contractual relationship with, a corporation or banking association meeting such capital and surplus requirement which guarantees the obligations and liabilities of the proposed trustee, and which is subject to supervision or examination by federal or state banking authority. If such corporation or banking association publishes reports of condition at least annually, pursuant to law or the requirements of any supervising or examining authority above referred to, then for purposes of the Resolution, the combined capital and surplus of such corporation or banking association shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. If at any time the Trustee ceases to be eligible in accordance with the provisions of the Resolution, it is required to resign promptly in the manner and with the effect specified in the Resolution.

## **Resignation or Removal of the Trustee; Appointment of Successor Trustee**

(a) No resignation or removal of the Trustee and no appointment of a successor Trustee pursuant to the Resolution will become effective until the acceptance of appointment by the successor Trustee under the Resolution.

(b) The Trustee may resign at any time by giving written notice to the District. Upon receiving such notice of resignation, the District will promptly appoint a successor Trustee by an instrument in writing. If an instrument of acceptance has not been delivered to the resigning Trustee within 30 days after the giving of such notice of resignation, the resigning Trustee or any Owner of a Bond then Outstanding may petition a court of competent jurisdiction for the appointment of a successor Trustee.

(c) Prior to the occurrence and continuance of an Event of Default under the Resolution, or after the curing or waiver of any such Event of Default, the District or the Owners of a majority in aggregate Principal amount of the Outstanding Bonds may remove the Trustee and will appoint a successor Trustee. In the event there shall have occurred and be continuing an Event of Default under the Resolution, the Owners of a majority in aggregate Principal amount of the Outstanding Bonds may remove the Trustee and will appoint a successor Trustee. In each instance such removal and appointment will be accomplished by an instrument or concurrent instruments in writing signed by the District or such Owners, as the case may be, and delivered to the Trustee, the District and Owners of the Outstanding Bonds.

(d) If at any time: (i) the Trustee ceases to be eligible and qualified under the Resolution and fails or refuse to resign after written request to do so by the District or the Owner of any Bond, or (ii) the Trustee will become incapable of acting or will be adjudged insolvent, or a receiver of the Trustee or its property will be appointed, or any public officer shall take charge or control of the Trustee, its property or affairs for the purpose of rehabilitation, conservation or liquidation, then in either such case (A) the District may remove the Trustee and appoint a successor Trustee in accordance with the provisions of the Resolution described in subsection (c) of this Section; or (B) any Owner of a Bond then Outstanding may, on behalf of the Owners of all Outstanding Bonds, petition a court of competent jurisdiction for removal of the Trustee and appointment of a successor Trustee.

(e) The District is required to give written notice of each resignation or removal of the Trustee and each appointment of a successor Trustee to each Owner of Bonds then Outstanding as listed in the Bond Register. Each such notice is required to include the name and address of the applicable corporate trust office of the successor Trustee.

## **Trustee Not Responsible for Recitals**

The recitals contained in the Resolution and in the Bonds (other than the certificate of authentication on the Bonds) are statements of the District, and the Trustee assumes no responsibility for their correctness. The Trustee makes no representations as to the value, condition or sufficiency of any assets pledged or assigned as security for the Bonds, the right, title or interest of the District therein, the security provided thereby or by the Resolution or the tax status of interest on the Bonds. The Trustee is not accountable for the use or application by the District of any of the Bonds or the proceeds of the Bonds, or for the use or application of any money paid over by the Trustee in accordance with any provision of the Resolution.

## **Supplemental Resolutions Without Owner Consent**

The District may from time to time and at any time adopt a Supplemental Resolution, without the consent of or notice to any Owner, to effect any one or more of the following:

- (i) provide for the issuance of Bonds in accordance with the provisions of the Resolution;
- (ii) cure any ambiguity or defect or omission or correct or supplement any provision in the Master Bond Resolution or in any Supplemental Resolution;

(iii) grant to or confer upon the Trustee for the benefit of the Owners any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Owners or the Trustee that are not contrary to or inconsistent with the Resolution as then in effect or to subject to the pledge and lien of the Resolution additional revenues, properties or collateral;

(iv) add to the covenants and agreements of the District in the Resolution other covenants and agreements thereafter to be observed by the District or to surrender any right or power reserved in the Master Bond Resolution to or conferred upon the District that are not contrary to or inconsistent with the Resolution as then in effect;

(v) permit the appointment of a co-trustee under the Resolution;

(vi) modify, alter, supplement or amend the Resolution in such manner as will permit the qualification of the Resolution, if required, under the Trust Indenture Act of 1939 or, the Securities Act of 1933, as from time to time amended, or any similar federal statute hereafter in effect;

(vii) make any other change in the Master Bond Resolution that the Trustee determines will not be materially adverse to the interests of the Owners and which does not involve a change described in the Resolution requiring consents of specific Owners; or

(viii) amend, modify, alter or replace the Letter of Representations as provided in the Resolution or other provisions relating to Book-Entry Bonds.

### **Supplemental Resolutions Requiring Owner Consent**

The District, at any time and from time to time, may adopt a Supplemental Resolution for the purpose of making any modification or amendment to the Resolution, but only with the written consent, given as provided in the Resolution, of the Owners of a majority in aggregate Principal amount of the Outstanding Bonds at the time such consent is given, and in case less than all of the Bonds then Outstanding are affected by the modification or amendment, of the Owners of a majority in aggregate Principal amount of the Outstanding Bonds so affected at the time such consent is given; provided, that if such modification or amendment will, by its terms, not take effect so long as any Bonds so affected remain Outstanding, the consent of the Owners of such Bonds will not be required and such Bonds will not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under the Resolution. Notwithstanding the foregoing, no modification or amendment contained in any such Supplemental Resolution will permit any of the following, without the consent of each Owner whose rights are affected thereby: (a) a change in the terms of stated maturity or redemption of any Bond or of any interest thereon; (b) a reduction in the Principal, Purchase Price or Redemption Price of any Bond or in the rate of interest thereon or a change in the currency in which such Bond is payable; (c) the creation of a lien on or a pledge of any part of the money or assets pledged under the Resolution other than as permitted by the Resolution; (d) the granting of a preference or priority of any Bond over any other Bond; (e) a reduction in the aggregate Principal amount of Bonds of which the consent of the Owners is required to effect any such modification or amendment; or (f) a change in the provisions of the Master Bond Resolution regarding waiver of defaults. Notwithstanding the foregoing, the Owner of any Bond may extend the time for payment of the Principal, Purchase Price or Redemption Price of or interest on such Bond; provided, that upon the occurrence of an Event of Default, funds available under the Resolution for the payment of the Principal, Purchase Price or Redemption Price of and interest on the Bonds will not be applied to any payment so extended until all Principal, Purchase Price, Redemption Price and interest payments that have not been extended have first been paid in full. Notice of any Supplemental Resolution executed pursuant to the Resolution will be given to the Owners promptly following the adoption thereof by the District.

### **Discharge and Defeasance**

**Discharge.** If (a) the Principal of any Bonds and the interest due or to become due thereon together with any premium required by redemption of any of such Bonds prior to maturity will be paid, or is caused to be paid, or is provided for under the Resolution, at the times and in the manner to which reference is made in such Bonds, according to the true intent and meaning thereof, or such Bonds will have been paid and discharged in accordance



with the Resolution, and (b) and all Payment Agreement Payments and other payments due in accordance with the provisions of the Payment Agreements and the Resolution have been made and (c) all of the covenants, agreements, obligations, terms and conditions of the District under the Resolution will have been kept, performed and observed and there will have been paid to the Trustee all sums of money due or to become due to it in accordance with the terms and provisions of the Resolution, then the right, title and interest of the Trustee in all money and other property then held under the Resolution will thereupon cease and the Trustee, on request of and at the expense of the District, will release the Resolution and will execute such documents to evidence such release as may be reasonably required by the District and will turn over to the District, or to such other Person as may be entitled to receive the same, all balances remaining in any Funds except for amounts required to pay such Bonds or held pursuant to the provisions of the Resolution relating to unclaimed funds.

**Defeasance.** If the District deposits with the Trustee money or noncallable Government Securities which, together with the earnings thereon, are sufficient to pay the Principal, Purchase Price or Redemption Price of any particular Bond or Bonds, or portions thereof, becoming due, together with all interest accruing thereon to the due date or redemption date, and pays or makes provision for payment of all fees, costs and expenses of the Trustee due or to become due with respect to such Bonds, all liability of the District with respect to such Bond or Bonds (or portions thereof) will cease, such Bond or Bonds (or portions thereof) will be deemed not to be Outstanding under the Resolution and the Owner or Owners of such Bond or Bonds (or portions thereof) will be restricted exclusively to the money or Government Securities so deposited, together with any earnings thereon, for any claim of whatsoever nature with respect to such Bond or Bonds (or portions thereof), and the Trustee will hold such money, Government Securities and earnings in trust exclusively for such Owner or Owners and such money, Government Securities and earnings will not secure any other Bonds under the Resolution. In determining the sufficiency of the money and Government Securities deposited pursuant to the Resolution, the Trustee will receive, at the expense of the District, and may rely upon: (a) a verification report of a firm of nationally recognized independent certified public accountants or other qualified firm acceptable to the District and the Trustee; and (b) an opinion of Bond Counsel to the effect that (1) all conditions described in this section have been satisfied and (2) that defeasance of the Bonds will not cause interest on any Tax-Exempt Bonds to be includable in gross income for federal income tax purposes. Upon such defeasance all rights of the District, including its right to provide for optional redemption of Bonds on dates other than planned pursuant to such defeasance, will cease unless specifically retained by filing a written notification thereof with the Trustee on or prior to the date the Government Securities are deposited with the Trustee. When a Bond is deemed to be paid under the Resolution, as aforesaid, it will no longer be secured by or entitled to the benefits of the Resolution, except for the purposes of any such payment from such money or Government Securities and except for certain provisions of the Resolution and the District will continue to be subject to the provisions of the Resolution relating to Trustee compensation.

### **Events of Default**

Each of the following events will be an “Event of Default” under the Master Bond Resolution:

(a) The District will default in the payment of any Principal, Purchase Price (to the extent provided by Supplemental Resolution) or Redemption Price of or interest on any Bond or Senior Consolidated System Bond when the same becomes due and payable; or

(b) Subject to the provisions of the Resolution, default in the performance, or breach, of any covenant, warranty or representation of the District contained in the Resolution (other than a default described under subsection (a) of this section); or

(c) (i) The filing of a petition in bankruptcy (or other commencement of a bankruptcy or similar proceedings) by the District as debtor, under federal or state bankruptcy law; (ii) the filing of a petition in bankruptcy (or other commencement of a bankruptcy or similar proceedings) against the District as debtor, under federal or state bankruptcy law, which petition is not dismissed within 60 days after filing; (iii) the appointment of a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of the District or of any substantial portion of its property; or (iv) the ordering of the winding up or liquidation of the affairs of the District.

## **Remedies Upon Default**

(a) If an Event of Default under the Master Bond Resolution occurs and is continuing, the Trustee may, and upon the written request to the Trustee by the Owners of a majority in aggregate Principal amount of the Outstanding Bonds the Trustee will, subject to the requirements of the Master Bond Resolution, by written notice to the District, declare the Principal of the Bonds and all interest accrued thereon to the date of acceleration to be immediately due and payable.

(b) At any time after such a declaration of acceleration has been made and before the entry of a judgment or decree for payment of the money due, the Trustee may, or the Owners of a majority in aggregate Principal amount of the Outstanding Bonds, may by written notice to the District and the Trustee, and subject to the requirements of the Resolution, direct the Trustee to, rescind and annul such declaration and its consequences if:

(i) there has been paid to or deposited with the Trustee by or for the account of the District, or provision satisfactory to the Trustee has been made for the payment of a sum sufficient to pay: (A) all overdue installments of interest on the Bonds; (B) the Principal, Purchase Price, and Redemption Price of any Bonds that have become due other than by such declaration of acceleration and interest thereon; (C) to the extent lawful, interest upon overdue interest and redemption premium, if any; and (D) all sums paid or advanced by the Trustee under the Master Bond Resolution, together with the reasonable compensation, expenses, disbursements and advances of the Trustee and its agents and counsel prior to the date of notice of rescission; and

(ii) all Events of Default have been cured or waived, other than the nonpayment of Principal, Purchase Price or Redemption Price of and interest on the Bonds that occasioned such acceleration.

(c) No such rescission and annulment will affect any subsequent default or impair any consequent right.

(d) The Trustee, upon the occurrence of an Event of Default may, and upon the written request of the Owners of a majority in aggregate Principal amount of the Outstanding Bonds, and subject to the requirements of the Resolution, will proceed to protect and enforce its rights and the rights of the Owners of the Bonds under the Resolution by a suit or suits in equity or at law, either for the specific performance of any covenant or agreement contained in the Resolution or in aid of the execution of any power granted in the Master Bond Resolution or therein, or for the enforcement of any other appropriate legal or equitable remedy, and the Trustee in reliance upon the advice of counsel may deem most effective to protect and enforce any of the rights or interests of the Owners of the Bonds under the Bonds or the Resolution.

(e) Without limiting the generality of the foregoing, the Trustee will at all times have the power to institute and maintain such proceedings as it may deem expedient: (i) to prevent any impairment of the money and other property then held under the Resolution by any acts that may be unlawful or in violation of the Resolution, and (ii) to protect its interests and the interests of the Owners in the money and other property then held under the Resolution and in the issues, profits, revenues and other income arising therefrom, including the power to maintain proceedings to restrain the enforcement of or compliance with any governmental enactment, rule or order that may be unconstitutional or otherwise invalid, if the enforcement of, or compliance with, such enactment, rule or order would impair the money and other property then held under the Resolution or be prejudicial to the interests of the Owners or the Trustee.

## **Priority of Payment Following Event of Default**

(a) If at any time after the occurrence of an Event of Default the money held by the Trustee under the Resolution will not be sufficient to pay the Bonds as the same become due and payable, such money, together with any money then available or thereafter becoming available for such purpose, whether through the exercise of remedies described above or otherwise, will, subject to the provisions of the Master Bond Resolution described in subsections (b) and (c) of this section, be applied by the Trustee as follows: (i) First, to the payment of all amounts due the Trustee under the Resolution; (ii) Second, to the payment of Operation and Maintenance Expenses;

(iii) Third, so long as any Senior Consolidated System Bonds are Outstanding, to the payment thereof in accordance with the Senior Consolidated System Resolution; (iv) Fourth, to the payment of all interest on the Bonds and Payment Agreement Payments then due and payable in the order in which the same became due and payable, and, if the amount available will not be sufficient to make any payment in full, then to the payment, ratably, according to the amounts due with respect to such payments, without discrimination or preference; (v) Fifth, to the payment of the unpaid Principal amount of any of the Bonds that will have become due and payable, in the order of due dates (other than Bonds called for redemption or contracted to be purchased for the payment of which money is held pursuant to the provisions of the Resolution), with interest upon the Principal amount of the Bonds from the respective dates upon which they will have become due and payable, and, if the amount available will not be sufficient to pay in full the Principal of such Bonds due and payable on any particular due date, together with such interest, then to the payment first of such interest, ratably, according to the amount of Principal due on such date, without any discrimination or preference; (vi) Sixth, to the payment of the Redemption Price of Bonds called for optional redemption, if any; (vii) Seventh, to the payment under all reimbursement agreements with the providers of Reserve Account Credit Facilities of all amounts due and payable thereunder (and if there is not sufficient money to make all such payments, then on a pro rata basis to each provider); (viii) Eighth: (A) for the payment of principal and premium, if any, and interest on Subordinate Obligations; (B) for deposit into a reserve fund securing any Subordinate Obligations; (C) for Payment Agreement Payments pursuant to any Payment Agreements entered into by the District with respect to any Subordinate Obligations; and (D) for payment to any financial institution or insurance company providing any letter of credit, line of credit, or other credit or liquidity facility, including municipal bond insurance and guarantees, that secures the payment of principal of or interest on any Subordinate Obligations; in each case in any order of priority which may be established by the District after the adoption of the Master Bond Resolution; (ix) Ninth, for any payment under a Payment Agreement that does not constitute a Payment Agreement Payment; (x) Tenth, for any payment under a Power Purchase Agreement that does not constitute an Operation and Maintenance Expense; and (xi) Eleventh, to the payment of all other charges or obligations against the Revenues of whatever nature imposed thereon by law or contract as of the date of, and subsequent to, the adoption of the Master Bond Resolution, in any order of priority which may be hereafter established by the District.

(b) If the Principal of all Bonds will have become due and payable, subject to clause (i) of subsection (a) above regarding payment to the Trustee, all such money will be applied to the payment of the Principal and interest then due and unpaid upon the Bonds, without preference or priority of Principal over interest or of interest over Principal, or of any installment of interest over any other installment of interest, or of any Bond over any other Bond, ratably, according to the amounts due respectively for Principal and interest, without any discrimination or preference.

(c) Whenever money is to be applied pursuant to the provisions of the Master Bond Resolution described in this section, the Trustee may, in its discretion, establish and maintain a reserve for future fees and expenses, and may apply money to be distributed at such times, and from time to time, as the Trustee will determine, having due regard for the amount of such money available for application and the likelihood of additional money becoming available for such application in the future. Whenever the Trustee will apply such funds, it will fix a date (which will be an interest payment date unless it will deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of Principal to be paid on such dates, and for which money is available, will cease to accrue. The Trustee will also select a record date for such payment date. The Trustee will give such notice as it may deem appropriate of the deposit with it of any money and of the fixing of any such record date and payment date, and will not be required to make payment to the Owner of any Bond until such Bond will be presented to the Trustee for appropriate endorsement or for cancellation if fully paid.

### **Owners May Direct Proceedings**

The Owners of a majority in aggregate Principal amount of the Outstanding Bonds will, subject to the requirements of the Resolution, have the right, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings by the Trustee under the Resolution, provided that such direction will not be in conflict with any rule of law or the Resolution and that the Trustee will have the right to decline to follow any such direction which in the opinion of the Trustee would be unduly prejudicial to the rights of Owners not parties to such direction or would subject the Trustee to personal liability or expense. Notwithstanding the foregoing, the Trustee will have the right to select and retain counsel of its

choosing to represent it in any such proceedings. The Trustee may take any other action which is not inconsistent with any direction under the Resolution.

### **Limitations on Rights of Owners**

(a) No Owner will have any right to pursue any other remedy under the Resolution or the Bonds unless: (i) an Event of Default will have occurred and is continuing; (ii) the Owners of a majority in aggregate Principal amount of the Outstanding Bonds have requested the Trustee, in writing, to exercise the powers granted in the Master Bond Resolution or to pursue such remedy in its or their name or names; (iii) the Trustee has been offered indemnity satisfactory to it against costs, expenses and liabilities reasonably anticipated to be incurred; (iv) the Trustee has declined to comply with such request, or has failed to do so, within 60 days after its receipt of such written request and offer of indemnity; and (v) no direction inconsistent with such request has been given to the Trustee during such 60-day period by the Owners of a majority in aggregate Principal amount of the Outstanding Bonds.

(b) The provisions of the Master Bond Resolution described in subsection (a) of this section are conditions precedent to the exercise by any Owner of any remedy under the Resolution. The exercise of such rights is further subject to the provisions of the Resolution. No one or more Owners will have any right in any manner whatever to enforce any right under the Resolution, except in the manner provided in the Master Bond Resolution. All proceedings at law or in equity with respect to an Event of Default will be instituted and maintained in the manner provided in the Master Bond Resolution for the equal and ratable benefit of the Owners of all Bonds Outstanding.

### **Unconditional Right of Owners To Receive Payment**

Notwithstanding any other provision of the Resolution, the Owner of each Bond will have the absolute and unconditional right to receive payment of Principal and Redemption Price of and interest on such Bond on and after the due date thereof, and to institute suit for the enforcement of any such payment.

### **Restoration of Rights and Remedies**

If the Trustee or any Owner has instituted any proceeding to enforce any right or remedy under the Resolution, and any such proceeding has been discontinued or abandoned for any reason, or has been determined adversely to the Trustee or such Owner, then the District, the Trustee and the Owners will, subject to any determination in such proceeding, be restored to their former positions under the Resolution, and all rights and remedies of the Trustee and the Owners will continue as though no such proceeding had been instituted.

### **Rights and Remedies Cumulative**

No right or remedy conferred upon or reserved to the Trustee in the Master Bond Resolution is intended to be exclusive of any other right or remedy, but each such right or remedy will, to the extent permitted by law, be cumulative of and in addition to every other right or remedy given under the Resolution or existing at law, in equity or otherwise. The assertion or employment of any right or remedy under the Resolution will not prevent the concurrent assertion or employment of any other appropriate right or remedy.

### **Delay or Omission Not Waiver**

No delay or omission by the Trustee or any Owner to exercise any right or remedy accruing upon any Event of Default will impair any such right or remedy or constitute a waiver of such Event of Default. Every right and remedy given by the Master Bond Resolution with respect to defaults and remedies or by law to the Trustee or the Owners may be exercised from time to time, and as often as may be deemed expedient, by the Trustee or the Owners, as the case may be.

## **Waiver of Defaults**

(a) The Owners of a majority in aggregate Principal amount of the Outstanding Bonds may, by written notice to the Trustee and subject to the requirements of the Resolution, waive any existing default or Event of Default and its consequences, except an Event of Default described in subsection (a) of “—Events of Default” above. Upon any such waiver, the default or Event of Default will be deemed cured and will cease to exist for all purposes. No waiver of any default or Event of Default will extend to or effect any subsequent default or Event of Default or will impair any right or remedy consequent thereto.

(b) Notwithstanding any provision of the Resolution, in no event will any Person, other than all of the affected Owners, have the ability to waive any Event of Default under the Resolution if such event results or may result, in the opinion of Bond Counsel, in interest on any of the Tax-Exempt Bonds becoming includable in gross income for federal income tax purposes.

## **Credit Facility Provider Rights.**

Except as otherwise provided in the Supplemental Resolution authorizing the issuance of a Series of Bonds, if the Credit Facility Provider with respect to such Series of Bonds is not in default in respect of any of its obligations under the Credit Facility securing such Series of Bonds, the following will apply:

(a) Such Credit Facility Provider, and not the actual Owners, will be deemed to be the Owner of such Series of Bonds at all times for the purposes of (i) giving any approval or consent to the effectiveness of any Supplemental Resolution other than a Supplemental Resolution providing for (A) a change in the terms of redemption, purchase or maturity of the principal of any Outstanding Bond of such Series or any interest thereon or a reduction the Principal amount, Purchase Price or Redemption Price thereof or in the rate of interest thereon, or (B) a reduction in the percentage of Owners required to approve or consent to the effectiveness of any Supplemental Resolution, and (ii) giving any approval or consent or exercising any remedies in connection with the occurrence of an Event of Default.

(b) Any amendment to the Resolution requiring the consent of Owners of such Series of Bonds will also require the prior written consent of such Credit Facility Provider.

(c) Any amendment to the Resolution not requiring the consent of Owners of such Series of Bonds shall require the prior written consent of such Credit Facility Provider if its rights shall be materially and adversely affected by such amendment.

(d) The prior written consent of such Credit Facility Provider will be a condition precedent to the substitution by the District of any Reserve Account Credit Policy for cash deposited in any Reserve Account securing such Series of Bonds.

(e) In the event the maturity of the Bonds is accelerated, such Credit Facility Provider may elect, in its sole discretion, to pay the accelerated Principal of such Series of Bonds and interest thereon to the date of acceleration (to the extent unpaid by the District). Upon payment of such accelerated Principal and interest, the obligations of such Credit Facility Provider under such Credit Facility with respect to such Series of Bonds will be fully discharged.

(f) Such Credit Facility Provider will have the right to institute any suit, action or proceeding at law or in equity under the same terms as an Owner of such Series of Bonds in accordance with the Resolution.

(g) Such Credit Facility Provider will, to the extent it makes any payment of Principal or Purchase Price of or interest on such Series of Bonds, become subrogated to the rights of the recipients of such payments in accordance with the terms of such Credit Facility.

(h) The Principal or Purchase Price of or interest on such Series of Bonds paid by such Credit Facility Provider under such Credit Facility shall not be deemed paid for purposes of the Resolution, and the Bonds with

respect to which such payments were made shall remain Outstanding and continue to be due and owing until paid by the District in accordance with the Resolution.

(i) In the event of any defeasance of such Series of Bonds, the District will provide such Credit Facility Provider with copies of all documents required by the Resolution to be delivered to the Trustee.

(j) The District will not discharge the Resolution unless all amounts due or to become due to such Credit Facility Provider have been paid in full or duly provided for.

(k) The District will send or cause to be sent to such Credit Facility Provider copies of notices required to be sent to Owners or the Trustee under the Resolution.

(l) The District will observe any payment procedures under such Credit Facility required by such Credit Facility Provider as a condition to the issuance and delivery of the Credit Facility.

## THE 2008B SUPPLEMENTAL RESOLUTION

### General

The 2008B Supplemental Resolution authorized the issuance and the reissuance of the 2008B Bonds. Certain terms and provisions of the 2008B Bonds are contained in the 2008B Remarketing Delivery Certificate that will be executed on the Mandatory Tender Date (as defined in the front portion of this Remarketing Memorandum).

### Terms of the 2008B Bonds

**Interest Rates - Credit Facility Provider Bonds.** Notwithstanding anything to the contrary in the 2008B Supplemental Resolution, all Credit Facility Provider Bonds are to bear interest at the Credit Facility Provider Interest Rate for such 2008B Bonds, which rate is not limited by any provision contained in the 2008B Supplemental Resolution. No Owner other than the Credit Facility Provider (other than as described in the Credit Facility Agreement) will at any time be entitled to receive interest at the Credit Facility Provider Interest Rate. The Credit Facility Provider Interest Rate will be computed as set forth in the Credit Facility Agreement with respect to such 2008B Bonds. The Credit Facility Agreement is to require the Credit Facility Provider to compute the amount of interest due on Credit Facility Provider Bonds and to notify the Trustee and the Tender Agent (by telex or telecopy) of the rate and amount of interest due on Credit Facility Provider Bonds no later than the close of business, New York City time, on the day before any Interest Payment Date for such Credit Facility Provider Bonds. The Trustee and the Tender Agent will be entitled to rely on the information contained in such notification and will have no liability for failure to receive such notification or for any error in the computation of such interest; provided, however, that failure to give such notice will not affect the obligation of the District to pay to the Credit Facility Provider all such accrued interest, it being understood that the intention of the parties is to set forth the procedure for the computation of the accrued interest payable to the Credit Facility Provider and not to affect the obligation of the District to pay such interest. Notwithstanding anything to the contrary contained in the 2008B Supplemental Resolution, Credit Facility Provider Bonds are to be payable as to principal as set forth in the Credit Facility Agreement during any period in which they are Credit Facility Provider Bonds.

**Method of Payment.** The 2008B Supplemental Resolution provides that the principal of and redemption premium, if any, on any 2008B Bond will be payable to the Owner thereof by check or draft if such 2008B Bond is subject to a Weekly Interest Rate Period, at maturity or on the date fixed for redemption, as the case may be, upon the presentation and surrender of such 2008B Bond (i) at the Delivery Office of the Tender Agent or at the office of any successor Tender Agent while such 2008B Bond bears interest for a Weekly Interest Rate Period.

The 2008B Supplemental Resolution further provides that interest on 2008B Bonds will be payable by the Trustee on each Interest Payment Date while 2008B Bonds bear interest for a Weekly Interest Rate Period by check or draft mailed to each Owner as of the Record Date, at the most recent address shown on the Bond Register; provided, however, that payment of interest to each Owner who owns of record \$1,000,000 or more in aggregate principal amount of 2008B Bonds may be made to such Owner by wire transfer to such wire address within the

United States as that Owner may request in writing prior to the Record Date. The 2008B Supplemental Resolution further provides that payment of the principal of and interest on any Credit Facility Provider Bonds shall be made directly to the Credit Facility Provider by the District, or by the Trustee or the Tender Agent at the written direction of the District, in immediately available funds by the date and time specified in the Credit Facility Agreement.

### **Registrar; Bond Registration Books**

The Trustee is to be the Registrar for the 2008B Bonds during a Fixed Term Interest Rate Period extending to the final maturity date of the 2008B Bonds. At all other times, the Tender Agent is to be the Registrar. While any of the 2008B Bonds issued under the 2008B Supplemental Resolution are Outstanding, the Trustee or the Tender Agent, as the case may be, is to, on behalf of the District, keep and maintain the Bond Register (which will be kept at the corporate office of the Trustee or the Delivery Office of the Tender Agent, as the case may be). The Trustee or the Tender Agent, as the case may be, is to make the Bond Register available to the District for its inspection, during normal business hours.

### **Establishment and Application of 2008B Bond Fund**

The 2008B Supplemental Resolution establishes a special fund of the District to be known as the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Bond Fund” (the “2008B Bond Fund”) within the Debt Service Fund to be held in trust by the Trustee for the 2008B Bonds. Pursuant to the 2008B Supplemental Resolution, the Treasurer will from Revenues transfer to the Trustee funds for deposit into the 2008B Bond Fund for the 2008B Bonds in the amounts and at the times necessary to pay (i) the principal and Purchase Price of, premium, if any, and interest on the 2008B Bonds as the same will become due and payable on each Interest Payment Date, redemption date, Purchase Date or maturity date, and (ii) to reimburse any Credit Facility Provider of a Credit Facility for 2008B Bonds, as further described below.

On each Interest Payment Date, Purchase Date, redemption date or maturity date, the Trustee is to apply moneys in the 2008B Bond Fund (i) to pay the principal and Purchase Price of, premium, if any, and interest due on the 2008B Bonds on such date, or (ii) to the Credit Facility Provider of any Credit Facility for the 2008B Bonds, as further provided below.

The 2008B Bond Fund and the amounts on deposit therein and in any account therein will be subject to the pledge, lien and charge of the Master Bond Resolution for the benefit of the Owners of the 2008B Bonds payable therefrom.

Pursuant to the Master Bond Resolution, (i) deposits may be made by the District into the 2008B Bond Fund and the accounts therein for the purpose of providing for Payment Agreement Payments with respect to the 2008B Bonds, (ii) Payment Agreement Receipts may be deposited into the 2008B Bond Fund and the accounts therein, and (iii) Payment Agreement Payments may be made out of the 2008B Bond Fund and the accounts therein.

### **Establishment and Application of 2008B Rebate Fund**

To ensure proper compliance with the tax covenants contained in the 2008B Supplemental Resolution, the 2008B Supplemental Resolution requires that the District establish and maintain an account in the Rebate Fund separate from any other fund or account established and maintained under the 2008B Supplement or under the Master Bond Resolution to be known as the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Rebate Fund” (the “2008B Rebate Fund”). All money at any time deposited in the 2008B Rebate Fund in accordance with the provisions of the Tax Certificate is to be held by the District for the account of the District in trust for payment to the federal government of the United States of America, and neither the District nor the Owner of any 2008B Bonds will have any rights in or claim to such money. All amounts deposited into or on deposit in the 2008B Rebate Fund will be governed by the Master Bond Resolution and the 2008B Supplemental Resolution and by the Tax Certificate. The District is to invest all amounts held in the 2008B Rebate Fund in accordance with the Master Bond Resolution and the Tax Certificate. Money will not be transferred from the 2008B Rebate Fund except in accordance with the Master Bond Resolution and the Tax Certificate.

The 2008B Rebate Fund and the amounts on deposit therein will not be subject to the pledge, lien and charge of the Master Bond Resolution for the benefit of the Owners of the 2008B Bonds.

### **Establishment and Application of 2008B Construction Fund**

The 2008B Supplemental Resolution establishes a special fund of the District to be known as the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2008B Construction Fund” (the “2008B Construction Fund”) within the Construction Fund to be held by the District. All amounts on deposit in the 2008B Construction Fund are to be applied, first, to pay the costs of issuance of the 2008B Bonds, and second, at the option of the Treasurer of the District, for any other legal purposes of the District. The 2008B Construction Fund and the amounts on deposit therein will be subject to the pledge, lien and charge of the Master Bond Resolution for the benefit of the Owners of the 2008B Bonds.

### **Credit Facility**

The District may, at any time, cause to be delivered to the Tender Agent a Credit Facility to secure the payment of the principal of and/or interest on 2008B Bonds and/or the payment of the Purchase Price of 2008B Bonds pursuant to the 2008B Supplemental Resolution. Any Credit Facility provided under the 2008B Supplemental Resolution for 2008B Bonds must: (i) be the obligation of a financial institution; (ii) entitle the Tender Agent to draw upon or demand payment and receive funds to pay (A) principal of, premium, if any, and/or interest on such 2008B Bonds, and/or (B) the Purchase Price of such 2008B Bonds tendered for purchase as provided in the 2008B Supplemental Resolution; and (iii) have a term of not less than 364 days.

At least 35 days prior to the date of issuance of a Credit Facility for 2008B Bonds (other than a Credit Facility delivered simultaneously with the issuance of the 2008B Bonds), the District is to cause to be delivered to the Tender Agent: (i) confirmation from the Rating Agencies that the credit ratings assigned to such 2008B Bonds, after issuance of the Credit Facility, will be no lower than the credit ratings assigned by such agencies to such 2008B Bonds prior to such issuance; (ii) the commitment of the Credit Facility Provider to issue the Credit Facility; and (iii) a copy of the funding and reimbursement procedures or mechanisms proposed to be set forth in such Credit Facility, which funding and reimbursement procedures or mechanisms will be approved in writing by the Tender Agent.

### **Substitution of Credit Facility**

Pursuant to the 2008B Supplemental Resolution, the District may arrange to extend the term of any Credit Facility provided pursuant to the provisions of the 2008B Supplemental Resolution described above in “—Credit Facility” or of any alternate Credit Facility previously provided pursuant to the provisions of the 2008B Supplemental Resolution described under this subheading, or to renew such Credit Facility; provided, however, that the extended or renewed Credit Facility will have a term of not less than 364 days. The District is required under the 2008B Supplemental Resolution to give the Tender Agent notice of such extension or renewal, no later than 60 days preceding the Termination Date of the existing Credit Facility, and to cause the renewed or extended Credit Facility to be delivered to the Tender Agent no later than the expiration of the existing Credit Facility.

The 2008B Supplemental Resolution provides that upon satisfaction of the conditions described in this subsection, the District may, prior to the expiration of any Credit Facility provided for 2008B Bonds pursuant to the provisions of the 2008B Supplemental Resolution described above in “—Credit Facility” or any alternate Credit Facility previously provided pursuant to the provisions of the 2008B Supplemental Resolution described under this subheading, replace such Credit Facility then held by the Tender Agent, as applicable, with an alternate Credit Facility which will: (i) be the obligation of a financial institution; (ii) entitle the Tender Agent, as appropriate, to draw upon or demand payment and receive funds to pay (i) principal of, premium, if any, and/or interest on such 2008B Bonds, and/or (ii) the Purchase Price of such 2008B Bonds tendered for purchase as described in the front portion of this Remarketing Memorandum under “DESCRIPTION OF THE 2008B BONDS – 2008B Bonds during a Weekly Interest Rate Period – Demand Purchase of the 2008B Bonds” and “– 2008B Bonds during a Weekly Interest Rate Period – Mandatory Tender For Purchase”; and (iii) have a term of not less than 364 days.



Prior to the replacement of any Credit Facility for 2008B Bonds, the 2008B Supplemental Resolution requires that the following conditions will have been met: (i) the Tender Agent will have received from the District written notice of such replacement no later than 40 days prior to such replacement; (ii) the Tender Agent will have received the executed Credit Facility no later than 35 days prior to such replacement; (iii) the Tender Agent will have approved in writing the funding and reimbursement procedures or mechanisms set forth in the Credit Facility; and (iv) on the date of replacement (i) the Tender Agent will receive an opinion of counsel to the Credit Facility Provider issuing such replacement Credit Facility to the effect that such Credit Facility constitutes the legal, valid and binding obligation of the Credit Facility Provider, enforceable in accordance with its terms, in form and substance reasonably satisfactory to the Tender Agent and the Remarketing Agent, and a Favorable Opinion of Bond Counsel, (ii) the Tender Agent will receive evidence satisfactory to them that all Payment Obligations of the District to the Credit Facility Provider which issued the Credit Facility to be replaced will have been satisfied in full, (iii) the Tender Agent will receive evidence satisfactory to them that the Credit Facility Provider which issued the Credit Facility to be replaced will have received payment of the termination fee, if any, provided for in the Credit Facility Agreement, (iv) the Tender Agent will have returned the original, signed copy of the replaced Credit Facility to the Credit Facility Provider, and (v) the Tender Agent will have presented to the Credit Facility Provider the proper certificate necessary to terminate such Credit Facility, appropriately completed and duly executed by an authorized officer of the Tender Agent.

Pursuant to the 2008B Supplemental Resolution, at least 35 days prior to any Termination Date or Substitution Date for any Credit Facility provided for 2008B Bonds, the District will obtain from the Rating Agencies (i) certification or continuation of the rating or ratings assigned or to be assigned to such 2008B Bonds after such Termination Date or Substitution Date and (ii) confirmation that the termination or substitution of that Credit Facility will not, by itself, cause the ratings on such 2008B Bonds to be suspended, reduced or withdrawn. If the Tender Agent will not have received such certification or confirmation from the Rating Agencies that the credit ratings assigned to such 2008B Bonds after replacement of the Credit Facility then in effect will be no lower than the credit ratings assigned by such agencies to such 2008B Bonds prior to such replacement, the 2008B Bonds for which such Credit Facility was provided will be subject to mandatory purchase as described in the front portion of this Remarketing Memorandum in "DESCRIPTION OF THE 2008B BONDS – 2008B Bonds during a Weekly Interest Rate Period – Mandatory Tender For Purchase – Termination or Expiration of Credit Facility; Substitution of Credit Facility." The 2008B Supplemental Resolution further provides that if the Tender Agent will not have received confirmation of the ratings of such 2008B Bonds prior to mailing notice to the Owners, pursuant to the provisions of the 2008B Supplemental Resolution described in the next paragraph, of any Termination Date or Substitution Date for a Credit Facility provided for 2008B Bonds, then notwithstanding anything to the contrary contained in the 2008B Supplemental Resolution, there will be no remarketing of any 2008B Bonds on and after such Purchase Date until such confirmation is received. The 2008B Supplemental Resolution provides further, that upon receipt by the Tender Agent, as appropriate, of the alternate Credit Facility, the Tender Agent will immediately notify the issuer of the replaced Credit Facility that such Credit Facility has been replaced by a new Credit Facility whereupon the replaced Credit Facility will be surrendered to the issuer thereof for cancellation. The District will be required to cause copies of the new Credit Facility and the Credit Facility Agreement between the District and the Credit Facility Provider to be delivered to the Tender Agent and the Remarketing Agent.

The 2008B Supplemental Resolution provides that the Tender Agent will give notice by mail to the Owners of the 2008B Bonds secured by a Credit Facility on or before the 30th day preceding (i) the Termination Date thereof in accordance with its terms or (ii) the date on which that Credit Facility is scheduled to be replaced by an alternate Credit Facility if before the giving of such notice the Tender Agent has not received certification or confirmation that the credit ratings assigned to such 2008B Bonds secured by that Credit Facility after replacement of the Credit Facility then in effect will be no lower than the credit ratings assigned by such agencies to such 2008B Bonds prior to such replacement. Such notice will (i) describe generally the Credit Facility in effect prior to such Termination Date or Substitution Date, and the alternate Credit Facility, if any, in effect or to be in effect after such Termination Date or Substitution Date, (ii) state the Termination Date or Substitution Date, (iii) state that such 2008B Bonds will be purchased pursuant to the provisions of the 2008B Supplemental Resolution described in described in the front portion of this Remarketing Memorandum in "DESCRIPTION OF THE 2008B BONDS – 2008B Bonds during a Weekly Interest Rate Period – Mandatory Tender For Purchase – Termination or Expiration of Credit Facility; Substitution of Credit Facility" one Business Day preceding such Termination Date or Substitution Date, as the case may be, and that no Owner will have the right to retain his 2008B Bond or 2008B Bonds on such Purchase Date, and (iv) will state that the termination, expiration or substitution of the Credit Facility

will result in the reduction or withdrawal of the credit ratings assigned by the Rating Agencies to such 2008B Bonds.

### **Non-Presentation of 2008B Bonds**

In the event any 2008B Bond will not be presented for payment when the principal thereof becomes due, either at maturity, at the date fixed for redemption thereof or otherwise, if funds sufficient to pay any such 2008B Bond will have been made available to the Trustee for the benefit of the Owner thereof, all liability of the District (other than from the amounts held for such purpose) to the Owner thereof for the payment of such 2008B Bond will forthwith cease, terminate and be completely discharged and such 2008B Bond will no longer be deemed to be Outstanding under the 2008B Supplemental Resolution, and thereupon it will be the duty of the Trustee to hold such funds (subject to the provisions of the next paragraph), without liability for interest thereon, for the benefit of the Owner of such 2008B Bond, who will thereafter be restricted exclusively to such funds, for any claims of whatever nature on his or her part under the 2008B Supplemental Resolution or on, or with respect to, such 2008B Bond.

Any moneys deposited with the Trustee in trust for the payment of the Purchase Price, principal or Redemption Price of, or interest on any 2008B Bond and remaining unclaimed may be invested, at the written direction of the District, in direct obligations of the United States of America. If such moneys, including any investment earnings thereon, remain unclaimed for one year after such Purchase Price, principal, or Redemption Price of, or interest has become due and payable, such amounts will be paid to the District; provided, however, that before the Trustee may make any such payment to the District, the Trustee will, at the expense of the District, deliver notice, by first-class mail, to the Owner of any such 2008B Bond at the address shown on the Bond Register and to any Credit Facility Provider which has provided a Credit Facility, if any, to secure such 2008B Bond, that such money remains unclaimed and that, after a date specified therein, which will not be less than 30 days from the date of such notice, any unclaimed balance of such money then remaining will be repaid to the Credit Facility Provider which has provided a Credit Facility, if any, to secure such 2008B Bond, to the extent that an authorized representative of such Credit Facility Provider notifies the Trustee that any Payment Obligations are outstanding under the Credit Facility Agreement, and the remainder of such unclaimed balance will be paid to the District. After the payment of such unclaimed moneys to the District or to the Credit Facility Provider, the Owner of such 2008B Bond will thereafter look only to the District for the payment thereof, and all liability of the Trustee with respect to such money will thereupon cease.

### **Tax Covenants**

In order to maintain the exclusion from gross income of the interest on the 2008B Bonds for federal income tax purposes, the District covenants to comply with each applicable requirement of Section 103 and Sections 141 through 150 of the Code and the District agrees to comply with the covenants contained in, and the instructions given pursuant to, the Tax Certificate which is incorporated in the 2008B Supplemental Resolution by reference.

### **Events of Default**

In addition to the Events of Default set forth in the Master Bond Resolution, with respect to the 2008B Bonds, the term "Event of Default" will also mean a default in the due and punctual payment of the Purchase Price of any 2008B Bond when the same will become due and payable on the Purchase Date therefor (whatever the reason for such Event of Default and whether it will be voluntary or involuntary or be effected by operation of law or pursuant to any judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body).

If an Event of Default with respect to the 2008B Bonds occurs and is continuing, the Trustee and the Owners will have all of the rights and remedies set forth in the Master Bond Resolution.

### **Appointment of Tender Agent**

In the 2008B Supplemental Resolution, the Trustee is appointed by the District as the initial Tender Agent. The Trustee, as Tender Agent, and any successor Tender Agent is to deliver to the District and each Credit Facility

Provider a certificate signifying acceptance of its duties and responsibilities under the 2008B Supplemental Resolution.

### **Qualifications of Tender Agent**

The Tender Agent is to be a national banking association, commercial bank, trust company or a corporation (if such corporation is rated Baa or higher by Moody's Investors Service or BBB+ or higher by Fitch or Standard & Poor's), in each case with trust powers, duly organized under the laws of the United States of America or any state or territory thereof, having a combined capital stock, surplus and undivided profits of at least \$100,000,000 and authorized by law to perform all the duties imposed upon it by the 2008B Supplemental Resolution. The Tender Agent may at any time resign and be discharged of the duties and obligations created by the 2008B Supplemental Resolution by giving at least 30 days' notice to the District, the Trustee, the Remarketing Agent and each Credit Facility Provider. The Tender Agent may be removed at any time by an instrument signed by the District and filed with the Tender Agent, the Trustee, each Credit Facility Provider and the Remarketing Agent. Notwithstanding the foregoing, no such resignation or removal of the Tender Agent will take effect until the appointment of a successor pursuant to the 2008B Supplemental Resolution and the acceptance of such appointment by such successor. In the event of any proposed resignation or removal of the Tender Agent, the District promptly will appoint a successor Tender Agent.

Any corporation or association into which the Tender Agent may be converted or merged, or with which it may be consolidated, or to which it may sell or transfer its trust business and assets as a whole or substantially as a whole, or any corporation or association resulting from any such conversion, sale, merger, consolidation or transfer to which the Tender Agent is a party, will be and become the successor Tender Agent under the 2008B Supplemental Resolution, without the execution or filing of any instrument or any further act, deed or conveyance on the part of any of the parties to the 2008B Supplemental Resolution, notwithstanding anything to the contrary in the 2008B Supplemental Resolution.

In the event of the resignation or removal of the Tender Agent, the Tender Agent will deliver any 2008B Bonds and moneys held by it in such capacity to its successor.

### **Appointment of Additional or Co-Trustee**

It is the intent of the 2008B Supplemental Resolution that there will be no violation of any law of any jurisdiction denying or restricting the right of banking corporations or associations or trust companies to transact business as trustee or Trustee in such jurisdiction. In case of litigation under the 2008B Supplemental Resolution, and in particular in case of the enforcement of any remedy on default, or in case the Trustee deems that by reason of any present or future law of any jurisdiction it may not exercise any of the powers in the 2008B Supplemental Resolution granted to the Trustee or hold title to the properties, in trust, as granted in the 2008B Supplemental Resolution, or take any other action which may be desirable or necessary in connection therewith, it may be necessary that the Trustee appoint a separate institution as an additional Trustee or co-Trustee.

In the event that the Trustee appoints a separate institution as an additional Trustee or co-Trustee, each and every remedy, power, right, claim, demand, cause of action, immunity, estate, title, interest and lien expressed or intended by the Master Bond Resolution or the 2008B Supplemental Resolution to be exercised by or vested in or conveyed to the Trustee with respect to the 2008B Bonds will be exercisable by and vest in such additional Trustee or co-Trustee but only to the extent necessary to enable such additional Trustee or co-Trustee to exercise such powers, rights and remedies, and every covenant and obligation necessary to the exercise thereof by such additional Trustee or co-Trustee will run to and be enforceable by either of them. Such co-Trustee may be removed by the Trustee at any time, with or without cause.

Should any instrument in writing from the District be required by the additional Trustee or co-Trustee so appointed or removed by the Trustee for more fully and certainly vesting in and confirming to it such properties, rights, powers, trusts, duties and obligations, any and all such instruments in writing will, on request, be executed, acknowledged and delivered by the District. In case any additional Trustee or co-Trustee, or a successor to either, will become incapable of acting, resign or be removed, all the estates, properties, rights, powers, trusts, duties and

obligations of such additional Trustee or co-Trustee, so far as permitted by law, will vest in and be exercised by the Trustee until the appointment of a new Trustee or successor to such additional Trustee or co-Trustee.

### **Remarketing Agent**

Each Remarketing Agent is to signify its acceptance of the duties and obligations imposed upon it under the 2008B Supplemental Resolution by a written instrument of acceptance delivered to the District and the Trustee pursuant to which the Remarketing Agent will agree to perform the duties of the Remarketing Agent for the 2008B Bonds set forth in the 2008B Supplemental Resolution. The Remarketing Agent is to keep such books and records with respect to its actions and determinations under the 2008B Supplemental Resolution as will be consistent with prudent industry practice and will make such books and records available for inspection by the District, the Trustee and the Tender Agent, during regular business hours upon reasonable prior notice.

### **Qualifications of Remarketing Agent**

Each Remarketing Agent is to be a member of the National Association of Securities Dealers, Inc. having a capitalization of at least \$100,000,000 and authorized by law to perform all the duties imposed upon it by the 2008B Supplemental Resolution. A Remarketing Agent may at any time resign and be discharged of the duties and obligations created by the 2008B Supplemental Resolution by giving at least 60 days' written notice to the District, each Credit Facility Provider, the Trustee and the Tender Agent. Each Remarketing Agent may be removed at any time by an instrument in writing, signed by the District, and filed with each Remarketing Agent, each Credit Facility Provider, the Trustee and the Tender Agent at least 60 days prior to the date of removal. Notwithstanding the foregoing, except as otherwise provided in the Remarketing Agreement, no resignation or removal of a Remarketing Agent which would result in there being no Remarketing Agent for the 2008B Bonds are to take effect until the appointment of a successor by the District pursuant to the 2008B Supplemental Resolution and the acceptance of such appointment by such successor. In the event of any such proposed resignation or removal, the District will promptly appoint a successor Remarketing Agent unless all of the 2008B Bonds then bear interest for a Fixed-Term Interest Rate Period which extends to the final maturity of the 2008B Bonds. If the District is required to appoint a successor upon the resignation of a Remarketing Agent, it is required to use its best efforts to appoint such a successor within 60 days of receipt of a notice of resignation.

In the event of the resignation or removal of a Remarketing Agent, such Remarketing Agent is to pay over, assign and deliver any moneys and 2008B Bonds held by it in such capacity to its successor or, if there be no successor, to the Trustee.

### **Remarketing Account**

The Tender Agent is to establish and maintain as a separate trust account a remarketing account for the 2008B Bonds (the "Remarketing Account"). The Tender Agent is to deposit in each Remarketing Account moneys received by the Tender Agent as remarketing proceeds from the sales to persons other than the District of the 2008B Bonds for which such Remarketing Account was established. Moneys on deposit in a Remarketing Account will be used solely to pay the Purchase Price of 2008B Bonds for which such Remarketing Account was established in accordance with the provisions of the 2008B Supplemental Resolution. Upon written direction of the District, moneys in the Remarketing Account are to be invested by the Tender Agent in direct obligations of the United States of America maturing on the earlier of the dates on which such moneys are needed or 30 days after the deposit of such moneys in the Remarketing Account. In the 2008B Supplemental Resolution, the District disclaims all beneficial right, title and interest in and to amounts on deposit in each Remarketing Account.

### **2008B Credit Facility Purchase Account**

The Tender Agent is to establish and maintain as a separate trust account a credit facility purchase account for each Credit Facility which provides for payments thereunder to pay the Purchase Price of 2008B Bonds (the "2008B Credit Facility Purchase Account"). The Tender Agent is to deposit in each 2008B Credit Facility Purchase Account moneys received by it pursuant to payments under the Credit Facility in respect of which such 2008B Credit Facility Purchase Account was established. Moneys in a 2008B Credit Facility Purchase Account are to be

used pursuant to the 2008B Supplemental Resolution solely to pay the Purchase Price of 2008B Bonds secured by the Credit Facility for which such account was established. After providing for the payment of the Purchase Price of all 2008B Bonds payable from a 2008B Credit Facility Purchase Account on each Purchase Date, moneys remaining in the 2008B Credit Facility Purchase Account not claimed on a Purchase Date will promptly be returned to the Credit Facility Provider which provided such Credit Facility. Upon the written direction of the District, moneys in the 2008B Credit Facility Purchase Account are to be invested by the Tender Agent in direct obligations of the United States of America maturing on the earlier of the dates on which such moneys are needed or 30 days after the deposit of such moneys in that 2008B Credit Facility Purchase Account. In the 2008B Supplemental Resolution, the District disclaims all beneficial right, title and interest in and to amounts on deposit in each 2008B Credit Facility Purchase Account.

### **2008B Bond Purchase Account**

Upon delivery of a Credit Facility for 2008B Bonds, the Tender Agent is to establish and maintain a separate trust account to provide for the payment of the Purchase Price of such 2008B Bonds by the District (the "2008B Bond Purchase Account"). The Tender Agent is to deposit in the 2008B Bond Purchase Account all moneys received by the Tender Agent from the Trustee or the District which are to be used to purchase such 2008B Bonds on behalf of the District. Moneys in the 2008B Bond Purchase Account will be used pursuant to the 2008B Supplemental Resolution solely to pay the Purchase Price of 2008B Bonds. Upon the written direction of the District and in accordance with the Tax Certificate and the Master Bond Resolution, moneys in the 2008B Bond Purchase Account and any subaccount maintained therein are to be invested by the Tender Agent in direct obligations of the United States of America maturing on the earlier of the dates on which such moneys are needed or 30 days after the deposit of such moneys in the 2008B Bonds Account.

The District covenants and agrees that all amounts on deposit in the 2008B Bond Purchase Account will be trust funds in the hands of the Tender Agent and will be used and applied solely for the purpose of paying the Purchase Price on all 2008B Bonds, as and when the same will become payable under the 2008B Supplemental Resolution.

The 2008B Bond Purchase Account and the amounts on deposit therein will be subject to the pledge, lien and charge of the Master Bond Resolution for the benefit of Owners of the 2008B Bonds payable therefrom.

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**APPENDIX E—COPY OF ORIGINAL BOND COUNSEL OPINION**

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June 3, 2009

Public Utility District No. 1  
of Chelan County, Washington  
Wenatchee, Washington

Public Utility District No. 1 of Chelan County, Washington  
Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT)  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the Public Utility District No. 1 of Chelan County, Washington (the "District") in connection with the execution, sale and delivery on the date hereof of \$92,880,000 aggregate principal amount of its Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT) (the "Converted 2008B Bonds"), in accordance with Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington, Chapter 167 of the Laws of Washington, 1983, as amended and supplemented, constituting Chapter 39.46 of the Revised Code of Washington, and Chapter 138 of the Laws of Washington, 1965, extraordinary session, as amended and supplemented, constituting Chapter 39.53 of the Revised Code of Washington, and Resolution No. 07-13067, adopted by the Commission of the District (the "Commission") on March 12, 2007 (the "Master Resolution"), as amended and supplemented, including by Resolution No. 07-13099, adopted by the Commission on April 30, 2007 (the "First Supplemental Resolution"), by Resolution No. 08-13258, adopted by the Commission on February 11, 2008 (the "Fourth Supplemental Resolution"), as supplemented by the 2008B Delivery Certificate of the District, dated March 7, 2008 (the "2008B Delivery Certificate"), and by Resolution No. 09-13452, adopted by the Commission on April 27, 2009 (the "Fifth Supplemental Resolution"), as supplemented by the 2008B Reissuance Delivery Certificate of the District, dated June 3, 2009 (the "2008B Reissuance Delivery Certificate" and together with the Master Resolution, the First Supplemental Resolution, the Fourth Supplemental Resolution, the 2008B Delivery Certificate, and the Fifth Supplemental Resolution, the "Resolution"). U.S. Bank National Association (the "Trustee") serves as Trustee for the Converted 2008B Bonds pursuant to the Resolution. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Resolution.

In such connection, we have reviewed the Resolution; the Tax Certificate of the District, dated the date hereof (the "Tax Certificate"); opinions of counsel to the District and the Trustee;



O R R I C K

Public Utility District No. 1  
of Chelan County, Washington  
June 3, 2009  
Page 2

certificates of the District, the Trustee and others; and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this opinion speaks only as of its date and is not intended to, and may not, be relied upon in connection with any such actions, events or matters. Our engagement with respect to the Converted 2008B Bonds has concluded with their execution, sale and delivery, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the District. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Converted 2008B Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Converted 2008B Bonds, the Resolution and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against municipal corporations in the State of Washington. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or as subject to the lien of the Resolution or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such assets. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Remarketing Memorandum or other offering material relating to the Converted 2008B Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:



O R R I C K

Public Utility District No. 1  
of Chelan County, Washington  
June 3, 2009  
Page 3

1. The Converted 2008B Bonds constitute the valid and binding limited obligations of the District.

2. The Resolution has been duly adopted by, and constitutes the valid and binding obligation of, the District. The Resolution creates a valid pledge, to secure the payment of the principal of and interest on the Converted 2008B Bonds, of Revenues and certain other funds and accounts as provided by the Resolution, subject to the provisions of the Resolution permitting the application thereof for the purposes, in the order of priority, and on the terms and conditions set forth therein.

3. The Converted 2008B Bonds are special limited obligations of the District payable from and secured by Revenues, after prior payment of Operation and Maintenance Expenses and debt service and reserve requirements with respect to the Senior Consolidated System Bonds, and on a parity with Bonds heretofore and hereafter issued on a parity with the Converted 2008B Bonds. The Converted 2008B Bonds shall not in any manner or to any extent constitute general obligations of the District or the State of Washington, or any political subdivision of the State of Washington. The Converted 2008B Bonds are not a charge upon the general fund or upon any moneys or other property of the District or the State of Washington, or any political subdivision of the State of Washington, other than the Revenues. Neither the full faith and credit nor the taxing power of the District, the State of Washington, or any political subdivision of the State of Washington, are pledged to the payment of the Converted 2008B Bonds. The Converted 2008B Bonds shall not constitute indebtedness of the District within the meaning of the constitutional and statutory provisions and limitations of the State of Washington.

4. Interest on the Converted 2008B Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and Title XIII of the Tax Reform Act of 1986. Interest on the Converted 2008B Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, nor is it included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Converted 2008B Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per 

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**APPENDIX F—PROPOSED FORM OF OPINION OF BOND COUNSEL**

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[MANDATORY TENDER DATE]

U.S. Bank National Association,  
as Tender Agent and Trustee  
Seattle, Washington

Re: Public Utility District No. 1 of Chelan County, Washington  
Consolidated System Revenue Bonds  
Refunding Series 2008B (Non-AMT)

Ladies and Gentlemen:

Public Utility District No. 1 of Chelan County, Washington (the “Issuer”) originally issued on March 7, 2008 its Consolidated System Revenue Bonds, Refunding Series 2008B (Non-AMT), currently outstanding in the aggregate principal amount of \$65,250,000 (the “Bonds”), pursuant to Resolution No. 07-13067, adopted by the Commission of the District (the “Commission”) on March 12, 2007 (the “Master Resolution”), as amended and supplemented, including by Resolution No. 08-13258, adopted by the Commission on February 11, 2008 (the “Fourth Supplemental Resolution”), and the Certificate of the District, dated March 7, 2008 (the “2008B Delivery Certificate”), Resolution No. 09-13452, adopted by the Commission on April 27, 2009 (the “Fifth Supplemental Resolution”), and the Certificate of the District, dated June 3, 2009 (the “2008B Reissuance Delivery Certificate”), and by Resolution No. 13-13775, adopted by the Commission on January 7, 2013 (the “Tenth Supplemental Resolution”), and the Certificate of the District, dated March 6, 2013 (the “2008B Remarketing Delivery Certificate” and together with the Master Resolution, the Fourth Supplemental Resolution, the Fifth Supplemental Resolution, the Tenth Supplemental Resolution, the 2008B Delivery Certificate and the 2008B Reissuance Delivery Certificate, the “Resolution”). U.S. Bank National Association serves as Trustee and Tender Agent (the “Trustee”) for the Bonds pursuant to the Resolution. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Resolution.

Pursuant to Section 4.08 of the Fourth Supplemental Resolution, on the date hereof, the Issuer is delivering to the Tender Agent the Standby Bond Purchase Agreement, dated as of March 1, 2013 (the “2008B Credit Facility”), by and among the Issuer, the Trustee and Union Bank, N.A. (the “Bank”) with respect to the Bonds (the “Delivery”). In connection with the Delivery, as bond counsel to the Issuer, we have reviewed the Resolution, the 2008B Credit Facility, the opinion of Chapman and Cutler LLP dated the date of this letter, certificates of the Issuer, the Trustee, and others and such other documents, opinions and matters to the extent we deemed necessary to render the opinion set forth herein.

The opinion expressed herein is based on an analysis of existing laws, regulations, rulings and court decisions and covers certain matters not directly addressed by such authorities. Such opinion may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are

taken or omitted or events do occur or any other matters come to our attention after the date hereof, and we disclaim any obligation to update this opinion. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any party other than the Issuer. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution and the Tax Certificate (including any supplements or amendments thereto), including (without limitation) covenants and agreements compliance with which is necessary to assure that actions, omissions or events on and after the date of issuance of the Bonds have not caused and will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We have not undertaken to determine compliance with any of such covenants and agreements or any other requirements of law, and, except as expressly set forth below, we have not otherwise reviewed any actions, omissions or events occurring after the date of issuance of the Bonds or the exclusion of interest on the Bonds from gross income for federal income tax purposes. Accordingly, no opinion is expressed herein as to whether interest on the Bonds is excludable from gross income for federal income tax purposes or as to any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Nothing in this letter should imply that we have considered or in any manner reaffirm any of the matters covered in any prior opinion we rendered with respect to the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Remarketing Memorandum, dated February 20, 2013, or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that the Delivery is authorized under the Resolution and will not adversely affect any exclusion of interest on the Bonds that are Tax-Exempt Bonds from gross income for federal income tax purposes.



This opinion is furnished by us as bond counsel to the Issuer solely for purposes of Section 4.08 of the Fourth Supplemental Resolution. No attorney-client relationship has existed or exists between our firm and the Trustee or our firm and the Bank in connection with the Bonds or by virtue of this opinion, and we disclaim any obligation to update this opinion.

Very truly yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

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## APPENDIX G— BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company (“DTC”), New York, New York, will act as Securities Depository for the Public Utility District No. 1 of Chelan County, Washington Consolidated System Revenue Bonds, Series 2008B (Taxable) (the “2008B Bonds”). The 2008B Bonds will be issued initially in fully registered form and will be registered in the name of Cede & Co., DTC’s partnership nominee, or such other name as may be requested by an authorized representative of DTC. One fully registered Bond certificate will be issued for each series and maturity in the aggregate principal amount of such series and maturity and will be deposited with DTC. Capitalized terms used herein and not otherwise defined herein shall have the meanings set forth in the front portion of this Remarketing Memorandum or in Appendix C – “Summary of Certain Provisions of the Master Resolution and the 2008B Supplemental Resolution.”

**The following information has been provided by DTC, and neither the District nor the Remarketing Agent makes any representation as to its accuracy or completeness. For further information, Beneficial Owners should contact DTC in New York, New York.**

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com). The information contained in such website is not incorporated by reference herein.

Purchases of 2008B Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2008B Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (each a “Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2008B Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in 2008B Bonds, except in the event that use of the book-entry system for the 2008B Bonds is discontinued.

To facilitate subsequent transfers, all 2008B Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of 2008B Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2008B Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such 2008B Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the 2008B Bonds within a series and maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such series and maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to 2008B Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the District or to the Trustee as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts 2008B Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the 2008B Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the District or the Trustee on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of the DTC, the Trustee, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the District or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the 2008B Bonds at any time by giving reasonable notice to the District or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered.

The District may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered.

The foregoing description of the procedures and record-keeping with respect to beneficial ownership interests in the 2008B Bonds, payment of the principal, interest and other payments on the 2008B Bonds to DTC Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interests in such 2008B Bonds and other related transactions by and between DTC, the DTC Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the DTC Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters, but should instead confirm the same with DTC or the DTC Participants, as the case may be.

The District cannot and does not give any assurances that DTC will distribute to DTC Participants, or that DTC Participants or others will distribute to the Beneficial Owners, payments of principal, interest and premium, if any, with respect to the 2008B Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Remarketing Memorandum. The District is not responsible or liable for the failure of DTC or any DTC Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the 2008B Bonds or any error or delay relating thereto.

**THE ABOVE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE DISTRICT BELIEVES TO BE RELIABLE, BUT THE DISTRICT TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF. NEITHER THE DISTRICT NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO PARTICIPANTS OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES OR BENEFICIAL OWNERS WITH RESPECT TO DTC'S RECORD KEEPING, PAYMENTS BY DTC OR PARTICIPANTS,**

**NOTICES TO BE DELIVERED BY DTC, OR ANY OTHER ACTION TAKEN BY DTC AS REGISTERED OWNER OF THE 2008B BONDS.**

So long as Cede & Co. is the registered owner of the 2008B Bonds, as nominee of DTC, references herein to the Owners or registered Bondholders of the 2008B Bonds (other than under the heading "TAX MATTERS" in the front portion of this Remarketing Memorandum) shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the 2008B Bonds.

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## **APPENDIX H— DESCRIPTION OF MAJOR POWER PURCHASERS**

THE INFORMATION SET FORTH BELOW RELATING TO THE POWER PURCHASERS WHICH ARE SUBJECT TO THE INFORMATIONAL REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934 (THE “EXCHANGE ACT”) HAS BEEN OBTAINED FROM DOCUMENTS FILED BY SUCH POWER PURCHASERS WITH THE SECURITIES AND EXCHANGE COMMISSION (THE “SEC”). NONE OF THE POWER PURCHASERS, THE DISTRICT OR THE REMARKETING AGENT MAKES REPRESENTATION AS TO, NOR HAVE THEY ATTEMPTED TO VERIFY, THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION.

### **PUGET SOUND ENERGY, INC.**

Puget Energy, Inc. (“Puget Energy”) is an energy services holding company incorporated in the State of Washington in 1999. All of its operations are conducted through its subsidiary, Puget Sound Energy, Inc. (“Puget”), a utility company. Puget Energy has no significant assets other than the stock of Puget. Puget Energy and Puget are collectively referred to herein as “the Company.” The Company’s executive office is located in the PSE Building at 10885 NE 4th St., Bellevue, Washington 98004. Its telephone number is (425) 454-6363 and information can be found on the Company’s Internet web sites at: [www.pugetenergy.com](http://www.pugetenergy.com) and [www.pse.com](http://www.pse.com).

Puget Energy is the direct parent company of Puget, the oldest and the largest electric and natural gas utility headquartered in Washington State, primarily engaged in the business of electric transmission, distribution, generation and natural gas distribution. Puget Energy’s business strategy is to generate stable earnings and cash flow by offering reliable electric and natural gas service in a cost-effective manner through Puget. Puget Energy had no employees and Puget had approximately 2,800 full-time equivalent employees as of December 31, 2011.

Puget is a public utility incorporated in the State of Washington in 1960. Puget furnishes electric and natural gas service in a territory covering approximately 6,000 square miles, principally in the Puget Sound region of Washington State. As of December 31, 2011, Puget had approximately 1,086,300 electric customers, and approximately 760,900 natural gas customers.

On February 6, 2009, Puget Holdings LLC (Puget Holdings) completed its merger with Puget Energy. Puget Holdings is a consortium of long-term infrastructure investors including Macquarie Infrastructure Partners I, Macquarie Capital Group Limited, the Canada Pension Plan Investment Board and British Columbia Investment Management Corporation, and also includes Alberta Investment Management Corporation, Macquarie-FSS Infrastructure Trust and Macquarie Infrastructure Partners II. As a result of the merger, Puget Energy is a direct wholly-owned subsidiary of Puget Equico LLC (Puget Equico), which is an indirect wholly-owned subsidiary of Puget Holdings.

### **Available Information**

Puget is subject to the information requirements of the Exchange Act and in accordance therewith files reports, proxy statements and other information with the SEC. Such reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such material may also be obtained by mail from the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washington D.C. 20549 at prescribed rates. Such information may also be accessed electronically by means of the SEC’s home page on the Internet (<http://www.sec.gov>). In addition, such reports, proxy statements and other information concerning the Company may be inspected at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005, on which certain securities of the Company are listed.

### **Incorporation of Certain Documents by Reference**

The following documents, filed with the SEC by Puget Sound Energy, are incorporated by reference herein:

- Puget’s Annual Report on Form 10-K for the year ended December 31, 2011;
- Puget’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012;
- Puget’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2012;
- Puget’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012;
- Puget’s Current Reports on Form 8-K filed on November 9, 2012 and February 11, 2013 and any other such reports.

In addition, all documents filed by the Company pursuant to Section 13, 14 or 15(d) of the Exchange Act after the date of this filing shall be deemed to be incorporated by reference herein and to be a part hereof from the date of filing of such documents. Any statement contained in a document incorporated or deemed to be incorporated herein by reference shall be deemed to be modified or superseded for purposes of this filing to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated herein by reference modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this filing.

The Company will provide to each person to whom a copy of this filing has been delivered, on the written or oral request of any such person, a copy of any or all of the documents referred to above which have been or may be incorporated by reference herein, other than exhibits to such documents. Requests for copies of the documents referred to above, other than exhibits to such documents, may be directed to: Investor Services, Puget Energy, Inc., P.O. Box 97034, PSE-08S, Bellevue, Washington 98009-9734; telephone (425) 462-3898.

#### **ALCOA INC.**

Alcoa Power Generating, Inc. (“APGI”) is a wholly-owned subsidiary of Alcoa Inc. (formerly Aluminum Company of America) (“Alcoa”). Formed in 1888 under the laws of the Commonwealth of Pennsylvania, Alcoa’s principal offices are located at 390 Park Avenue, New York, New York, 10022-4608; the telephone number is (212) 836-2732.

Alcoa is the world leader in the production and management of primary aluminum, fabricated aluminum and alumina combined, through its active and growing participation in all major aspects of the industry: technology, mining, refining, smelting, fabricating and recycling. Total worldwide employment at year-end 2011 was approximately 61,000 people.

#### **Available Information**

Alcoa is subject to the informational requirements of the Exchange Act and in accordance therewith files reports and other information with the SEC. Information, as of particular dates, concerning Alcoa’s directors and officers, their remuneration, the principal holders of Alcoa’s securities and any material interest of such persons in transactions with Alcoa is disclosed in proxy statements distributed to shareholders of Alcoa and filed with the SEC. These reports, proxy statements and other information can be inspected and copied at the public reference facilities of the SEC at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549; 75 Park Place, New York, New York 10007; and 219 South Dearborn Street, Room 204, Chicago, Illinois 60604; and copies of such material can be obtained from the Public Reference Section of the SEC, Washington, D.C. 20549, at prescribed rates. Alcoa’s Common Stock is listed on the New York Stock Exchange, and reports, proxy material and other information concerning Alcoa can be inspected at the office of such exchange located at Room 401, 20 Broad Street, New York, New York.

#### **Incorporation of Certain Documents by Reference**

The following documents, filed with the SEC by Alcoa, are incorporated by reference herein:



- Alcoa's Annual Report on Form 10-K for the fiscal year ended December 31, 2012; and
- Alcoa's Amendment to Annual Report on Form 10-K/A for the fiscal year ended December 31, 2012.

In addition, all documents filed by Alcoa pursuant to Section 13, 14 or 15(d) of the Exchange Act after the date of this filing shall be deemed to be incorporated by reference herein and to be a part hereof from the date of filing of such documents. Any statement contained in a document incorporated or deemed to be incorporated herein by reference shall be deemed to be modified or superseded for purposes of this filing to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated herein by reference modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this filing.

Alcoa will provide to each person to whom a copy of this filing has been delivered, on the written or oral request of any such person, a copy of any or all of the documents referred to above which have been or may be incorporated by reference herein, other than exhibits to such documents. Requests for copies of the documents referred to above, other than exhibits to such documents, may be directed to: Secretary, Alcoa Inc., 390 Park Avenue, New York, New York, 10022-4608.

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**APPENDIX I— SUMMARY OF POWER SALES CONTRACT WITH PUGET SOUND ENERGY, INC.**

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## APPENDIX I - SUMMARY OF POWER SALES CONTRACT WITH PUGET SOUND ENERGY, INC.

The following is a summary of certain provisions of the New Power Sales Contract with Puget Sound Energy, Inc. This summary does not purport to be complete and is qualified in its entirety by reference to the foregoing document for a complete statement of the provisions of such document.

### DEFINITIONS

**“Adequate Assurance”** means assurances of continued performance by the Purchaser of its obligations under the New Power Sales Contract, in each case reasonably acceptable to the District.

**“Affiliate”** means, with respect to any Person, any other Person (other than an individual) that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such Person. For this purpose, “control” means the direct or indirect ownership of fifty percent (50%) or more of the outstanding capital stock or other equity interests having ordinary voting power.

**“Approval Date”** means the date FERC approves the New Power Sales Contract.

**“Assumed Debt Service”** means:

(i) with respect to any Debt Obligation issued after the Signing Date and before the first Project Availability Date, the amount for each applicable Contract Year calculated as of the date of issuance or incurrence thereof, that would be sufficient to fully amortize the original stated principal amount thereof, together with interest thereon at the Index Rate (using semi-annual compounding and a year of 360 days), for such Debt Obligation, on an annual level debt service basis over an amortization period commencing on the In Service Date of the Capital Improvements expected to be financed from the proceeds of such Debt Obligation and ending on the last day of such Capital Improvements’ Average Service Life.

(ii) with respect to any Debt Obligation issued on or after the first Project Availability Date, the amount for each applicable Contract Year calculated as of the issuance or incurrence thereof, that would be sufficient to fully amortize the original stated principal amount thereof, together with interest thereon at the Index Rate (using semi-annual compounding and a year of 360 days) for such Debt Obligation on an annual level debt service basis over an amortization period commencing on the date of issuance or incurrence of such Debt Obligation and ending on the Deemed Maturity thereof.

**“Average Service Life”** means, with respect to any Debt Obligation issued after the Signing Date, the estimated weighted average economic service life of the Capital Improvements that the District expects to finance from proceeds of such Debt Obligations issued or incurred after the Signing Date, as determined by the District on or as of the date of the issuance or incurrence thereof. For purposes of the foregoing, land will be deemed to have a weighted average economic service life of 25 years.

**“Biological Opinion”** means any opinion issued by a Government Authority authorized to do so under the Endangered Species Act (“ESA”) that reviews and assesses whether the operating plan submitted by BPA, the U.S. Army Corps of Engineers and the Bureau of Reclamation will jeopardize the survival of any creature or creatures that have been determined to be threatened or endangered pursuant to the ESA.

**“Black Start Capability”** means the ability of generators to self-start without any source of off-site electric power and maintain adequate voltage and frequency while energizing isolated transmission facilities and auxiliary loads of other generators.

**“Canadian Entitlement”** means the amount of energy and capacity that Rocky Reach and Rock Island are obligated to return to BPA in its capacity as the US Entity for the account of the Canadian government to fulfill obligations under the US-Canadian Columbia River Treaty of 1964.

**“Capacity”** means the generation potential of the Chelan Power System as adjusted for limitations and obligations in accordance with the provisions described in “THE NEW POWER SALES CONTRACT—Output and Scheduling” below.

**“Chelan Power System”** means, collectively, Rocky Reach and Rock Island, in each case as each such Project exists as of its respective Project Availability Date. The Chelan Power System will also include any expansion of the generating capacity of the existing Projects after their respective Project Availability Dates, including efficiency improvements and upgrades that become a part of the respective Project, but will not include any other power generation, transmission or distribution assets or rights, owned by the District as of the Effective Date or acquired by the District thereafter.

**“Chelan Power System Output”** includes adjustments for the following:

1. Canadian Entitlement
2. MCHC
3. PNCA
4. HCP
5. Biological Opinion
6. Hanford Reach Fall Chinook Protection Program
7. Immediate Spill Replacement

**“Chelan Transmission System”** means the District’s electric facilities, whether owned or leased, that are operated at voltages in excess of 100,000 volts, including all associated system protection and control facilities, and any other facilities, including land and access roads that may be classified as “transmission facilities” pursuant to the FERC Uniform System of Accounts. The Chelan Transmission System does not include (i) Project Transmission Facilities; (ii) any transmission facility, substation, or related equipment constructed and operated by the District for the sole use or benefit of a single customer pursuant to a written agreement between the District and that customer (“Direct Assignment Facility”); or (iii) any transmission facility or generator-interconnection facility constructed or acquired by the District after the Signing Date for the exclusive purpose of the District receiving power from a new power resource unrelated to the Chelan Power System.

**“Contract Year”** means the period commencing on the first Project Availability Date and ending on the next succeeding December 31, and each 12-month period thereafter, except for the 12-month period during which the expiration or termination date of the Agreement occurs, in which case the Contract Year means the period commencing on January 1 of such year and ending on such expiration or termination date.

**“Coverage Amount”** means the sum, as of the date of calculation, of (i) with respect to Debt Obligations outstanding on the Signing Date and identified in the New Power Sales Contract, an amount equal to fifteen percent (15%) of the maximum estimated aggregate amount of the Financing Costs described in “THE NEW POWER SALES CONTRACT—Determination of Chelan Power System Net Costs” below that will be payable in any Contract Year during the Term, as determined by the District as of the Signing Date for all Debt Obligations then outstanding, and (ii) with respect to all Debt Obligations issued after the Signing Date, an amount equal to fifteen percent (15%) of the maximum estimated aggregate amount (each amount included in such aggregate amount to be as determined by the District as of the date of issuance or incurrence of the applicable Debt Obligation) of Financing Costs with respect to such Debt Obligations as described in “THE NEW POWER SALES CONTRACT—Determination of Chelan Power System Net Costs” below, that will be payable in any Contract Year during the Term.

**“Cross Default Amount”** means, with respect to the Purchaser, two and one-half percent (2½%) of the Purchaser’s then current market capitalization (based on its share prices as quoted in the Wall Street Journal the Business Day prior to the date of calculation) and, with respect to the District, \$50,000,000, as adjusted in accordance with the Escalation Factor.

**“Debt Obligation”** means a bond, note (including a commercial paper note or bond anticipation note), installment purchase agreement, financing lease, inter-fund loan or any other obligation for borrowed money, or portion thereof, issued or incurred by or on behalf of the District for either or both Projects, the proceeds of which

were or will be applied to finance Capital Improvements with respect to such Project or Projects and which has been or is designated by the District in its discretion as a Debt Obligation with respect to such Project or Projects. For the avoidance of doubt, the obligations listed or referred to in Schedule A-1 to the New Power Sales Contract will constitute Debt Obligations for purposes of the New Power Sales Contract. Debt Obligations will not include any Refunding Obligations, or the principal portion of any obligations issued after the Signing Date that otherwise would fall within the definition of Debt Obligations, to the extent such principal portion is or was used to pay costs of issuance or to fund debt service reserves with respect to Debt Obligations, all as determined by the District in its discretion. To avoid double counting, if the District designates inter-fund loans from the District Enterprise Units of the District to the Chelan Power System as Debt Obligations, the corresponding third party obligations of the District will not be included as Debt Obligations for purposes of the New Power Sales Contract. For purposes of the New Power Sales Contract, “Debt Obligations” will include inter-fund loans from the District Enterprise Units that otherwise qualify as Debt Obligations; however, transfers from the District to the Chelan Power System derived from payments made by the Purchaser in respect of Capital Recovery Charges or Debt Reduction Charges, as determined by the District, will not be treated as Debt Obligations for purposes of the New Power Sales Contract. For purposes of the New Power Sales Contract, the principal amount of Debt Obligations issued after the Signing Date will be deemed to amortize in accordance with the Assumed Debt Service with respect thereto, and not on the actual principal amount of the District’s Debt Obligations that may be outstanding on the date of calculation.

**“Deemed Maturity”** means that date determined by the District as of the issuance or incurrence of a Debt Obligation, by adding to the date of issuance or incurrence of such Debt Obligation, the lesser of (a) twenty-five (25) years, or (b) the Average Service Life of the Capital Improvements expected to be financed by the District from the proceeds thereof, as determined by the District.

**“District Enterprise Units”** means and will include each utility, enterprise or operating system or unit of the District, exclusive of Rocky Reach and Rock Island, as the District may designate from time to time, that may make advances or inter-fund loans to the Chelan Power System as contemplated within the definition of Debt Obligations.

**“District System Emergency”** means a condition or situation that, in the judgment of the District and in conformance with guidelines of FERC, NERC, the WECC or other entities with regulatory jurisdiction (whether by contract or operation of Law) over the District concerning system emergencies, adversely affects or is likely to adversely affect: (i) public health, life or property; (ii) District’s employees, agents or property; or (iii) District’s ability to maintain safe and reliable electric service to its respective customers.

**“Downgrade Event”** means the Purchaser’s corporate debt rating (a) from S&P is withdrawn, suspended or reduced below “BBB-“ (or corresponding successor rating); or (b) from Moody’s is withdrawn, suspended or reduced below “Baa3” (or corresponding successor rating); or (c) from Fitch is withdrawn, suspended or reduced below “BBB-“ (or corresponding successor rating). If any Rating Agency has not assigned a rating to Purchaser as of the Signing Date, a Downgrade Event will not occur as to that Rating Agency until such a rating has been assigned and such rating is either at or below the respective level set forth above, or the initial higher rating is thereafter withdrawn, suspended or reduced below the respective level set forth above.

**“Dryden Facilities”** means the District’s dam, spillway, irrigation flume and related facilities located on the Wenatchee River near Dryden in Chelan County, Washington.

**“Effective Date”** of the New Power Sales Contract means the Signing Date.

**“Energy”** means the energy production, expressed in megawatt hours, of the Chelan Power System as measured in megawatts integrated over an hour and adjusted for limitations and obligations in accordance with the provisions described in “THE NEW POWER SALES CONTRACT—Output and Scheduling” below.

**“Entiat Facilities”** means the District’s diversion and irrigation facilities located in and adjacent to the Entiat River in Chelan County.

**“Environmental Attributes”** means any cash credits, tradable certificates or other transferable renewal energy credits made available to the District under state or Federal law that are intended to provide incentives to hydroelectric generation and are directly attributable to environmental benefits resulting from the generation and use of Output from the Chelan Power System.

**“Fish Spill”** means the required spill of water for the passage of fish past the Projects as required by FERC order, the District’s HCP, spill for studies, or other Regulatory Authorities.

**“Government Authority”** means any federal, state, local, territorial or municipal government and any department, commission, board, bureau, agency, instrumentality, judicial or administrative body thereof.

**“Habitat Conservation Plans (HCP)”** means the plans approved as part of the Rocky Reach and Rock Island licenses to protect anadromous fish passing upstream and downstream at the projects.

**“Hanford Reach Fall Chinook Protection Program (Vernita Bar)”** means the agreement which defines the Mid-Columbia projects’ (Grand Coulee, Chief Joseph, Wells, Rocky Reach, Rock Island, Wanapum, and Priest Rapids) operational obligations for the fresh water life cycle protection of the Hanford Reach Fall Chinook which has been signed by the District, National Oceanic and Atmospheric Administration’s Department of Fisheries (“NOAA Fisheries”), Washington Department of Fish and Wildlife, PUD No. 2 of Grant County, and PUD No. 1 of Douglas County.

**“Immediate Spill Replacement”** means the energy received from the Federal government for the purpose of moving spill from the Federal system to reduce total dissolved gas levels downstream from Federal reservoirs.

**“Independent Investment Banker”** means an investment banking firm selected by the District in its discretion that is nationally recognized for its knowledge and experience in the pricing and sale of debt securities and that has, or whose parent company has, a rating from at least two of the Rating Agencies of not less than “A-“ in the case of S&P and Fitch, and “A3” in the case of Moody’s.

**“Index Rate”** means, with respect to each Debt Obligation, as of the applicable date of calculation, the fixed interest rate, as determined by the District in consultation with an Independent Investment Banker as of the date of issuance or incurrence thereof, equal to 110% of the weighted average annual interest rate that such Debt Obligation would bear (i) based on the then current underlying long-term credit rating of the District; (ii) assuming that interest on such Debt Obligation would be includable in the income of the holders thereof for federal income tax purposes; and (iii) assuming that such Debt Obligation were amortized on a level debt service basis over the applicable amortization period described in the definition of “Assumed Debt Service.” In determining the Index Rate of any Debt Obligation, the District may consider interest indices and other market data generally available as of the date of calculation.

**“In Service Date”** means the estimated weighted average date the Capital Improvements expected to be financed from proceeds of a Debt Obligation are or are expected to be placed in service, as determined by the District.

**“Interconnection Agreement”** means the agreement between Purchaser and the District providing for the interconnection of the Purchaser’s electric transmission facilities with the Chelan Transmission System, as well as terms and conditions for the parallel operation of the Chelan Transmission System and Purchaser’s transmission system.

**“Law”** means any statute, law, order, rule or regulation imposed by a Regulatory Authority.

**“Load Following/Regulation”** means the ability to adjust generation within an hour (or pursuant to dynamic scheduling) to follow variations in load. Load Following/Regulation is limited and constrained by the number of Units available, any limitations on the Units, Ramp Rate, and any other power or non-power restrictions.



**“Mid-Columbia Hourly Coordination (MCHC)”** means the 1997 Agreement For The Hourly Coordination Of Projects On The Mid-Columbia River (or its successor agreement) is an agreement among the principal parties that own or have rights to generation relating to the seven mid-Columbia hydro projects (Grand Coulee, Chief Joseph, Wells, Rocky Reach, Rock Island, Wanapum, and Priest Rapids).

**“NERC”** means the North American Electric Reliability Council or its successor responsible for insuring a reliable, adequate and secure bulk electric system.

**“Non-Spinning Operating Reserves”** means those reserves that may be available at any time from all Units of the Chelan Power System not then connected to the system but capable of being connected and serving demand within a specified time.

**“Operational Constraints”** means constraints on the Units, or a Project’s operation that are needed to meet any requirement due to the HCP, regulations, Laws, court orders, authority, safety, or to minimize equipment wear, maintain equipment, or repair/replace equipment, or that are due to any other event or circumstance described in the New Power Sales Contract.

**“Output”** means an amount of Energy, Capacity and certain related rights available from the Chelan Power System, in each case to the extent described in and determined pursuant to the provisions described in “THE NEW POWER SALES CONTRACT—Output and Scheduling” below, and subject to the limitations set forth in the New Power Sales Contract.

**“Pacific Northwest Coordination Agreement (PNCA)”** means the agreement among Northwest parties for the coordinated operation of the Columbia River system on a seasonal and monthly basis. The PNCA defines the firm energy output of the Chelan Power System, as well as other rights and obligations, including provisional energy, interchange energy, in-lieu energy, and others defined in the contract. The PNCA does not allow resources above the head works of Bonneville Dam to be removed from coordination, and currently all Capacity and Energy of the Chelan Power System is included in PNCA planning. PNCA serves as a settlement of the Federal Power Act Section 10(f) obligation to reimburse upstream Federal projects for energy gains as a result of the storage provided, as well as a FERC approved settlement among all Non-Federal parties for upstream benefit payments. The Purchaser must become a signatory to PNCA or contract with another PNCA party to fulfill any and all of the obligations required by PNCA with respect to the Purchaser’s Percentage of Output.

**“Periodic Payments”** means the sum of the payments, costs and charges described or referred to in the New Power Sales Contract.

**“Permanently Retired”** means with respect to a Project, that such Project or specified Units of such Project, have been shut down and notice of permanent cessation of operations with respect thereto has been given by the District to the Purchaser.

**“Pond/Storage”** means the volume of water, expressed in MWH, that can be stored behind a Project between its minimum and maximum headwater elevations.

**“Prepayment Amount”** means the cumulative amounts paid by the Purchaser to the District pursuant to the New Power Sales Contract that have not been applied to satisfy the Purchaser’s payment obligations as described in clause (e) of “Payment—Payments and Charges.”

**“Project”** means each of Rock Island and Rocky Reach.

**“Project Availability Date”** means for Rocky Reach, 00:00 hours on November 1, 2011, and for Rock Island, 00:00 hours on July 1, 2012.

**“Project Transmission Facilities”** means those Project owned transmission facilities included in the Chelan Power System and listed in the New Power Sales Contract that are utilized to transmit Capacity and Energy from the Units to the Chelan Transmission System.

***“Prudent Utility Practice”*** means any of the practices, methods and acts engaged in, or approved by, a significant portion of the electric utility industry in the Western Interconnection for operating facilities of a size and technology similar to the Project during the relevant time period or any of the practices, methods and acts, which, in the exercise of reasonable judgment in light of the facts known, at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with applicable Laws, longevity, reliability, safety and expedition. Prudent Utility Practice is not intended to be limited to the optimum practice, method or act to the exclusion of all others, but rather to be a spectrum of commonly used practices, methods and acts.

***“Purchaser’s Percentage”*** means the percentage set forth in “THE NEW POWER SALES CONTRACT—Output—Output to be Made Available” below, as such amount may be adjusted from time to time pursuant to the terms of the New Power Sales Contract.

***“Purchaser’s Percentage of Output”*** means an amount for any period equal to the product of (i) the Purchaser’s Percentage, and (ii) the Output.

***“Ramp Rate”*** means the rate of change in the level of generation for a specified period within all applicable Operational Constraints. The maximum Ramp Rate is a variable quantity based upon these limitations.

***“Refinance,”*** or ***“Refinancing”*** when used with respect to an outstanding Debt Obligation or portion thereof, means to refund, refinance or remarket such Debt Obligation.

***“Refunding Obligations”*** means a bond, note (including a commercial paper note or bond anticipation note), installment purchase agreement, financing lease, inter-fund loan or any other obligation for borrowed money, or any portion thereof, issued or incurred by or on behalf of the District, for purposes of Refinancing a Debt Obligation or a Refunding Obligation. The term “Refunding Obligations” will not be included in the calculation of Debt Obligations.

***“Regional Transmission Organization (RTO)”*** will mean any regional transmission organization which governs loads, generation, ancillary services and transmission of both Parties. As of the Signing Date, there is no such RTO.

***“Regulatory Authority”*** means any Government Authority other than the District itself.

***“Related Power Sales Agreement”*** means a power sales agreement between a Share Participant and the District for the purchase and sale of a percentage of the Output of the Chelan Power System as so designated by the District and containing terms and conditions similar to the terms and conditions set forth in the New Power Sales Contract.

***“Remedial Action Schemes (RAS)”*** means any action implemented by the District utilizing the Chelan Power System to maintain the transfer capabilities and stability of the western electrical system.

***“Reserve and Contingency Fund”*** means the fund or funds created under the Project bond resolutions including the Rocky Reach Resolutions 1860 and 4198, and the Rock Island Resolutions 1137, 3443, 4950 and 97-10671, 97-10672. As long as bonds remain outstanding under such resolutions, deposit requirements into the appropriate Reserve and Contingency Fund may be made from the Capital Recovery Fund and/or the Debt Reduction Fund, and from Purchaser’s payments made in respect of Financing Costs allocated to that purpose under Schedule A-1. Required and authorized uses of the Reserve and Contingency Funds will be made in accordance with the appropriate Project bond resolution or, after the retirement of such bonds, for any other lawful Project purpose not inconsistent with the provisions of the New Power Sales Contract.

***“Rock Island”*** means (i) the District’s Rock Island Hydroelectric Project as currently licensed by FERC under license number 943, and any successor license, including any efficiency improvements and upgrades that increase generating capacity and any decommissioning of Units as contemplated in Section 6.03, in each case made by the District from time to time during the Term, together with (ii) the Dryden Facilities, the Entiat Facilities and the Tumwater Facilities.

**“Rocky Reach”** means the District’s Rocky Reach Hydroelectric Project as currently licensed by FERC under license number 2145, and any successor license, including any efficiency improvements and upgrades that increase generating capacity and any decommissioning of Units as contemplated in Section 6.03, in each case, made by the District from time to time during the Term.

**“Schedule”** or **“Scheduling”** means the actions or product of the District, Purchaser and/or their designated representatives, including each Party’s Transmission Providers, if applicable, of notifying, requesting and confirming to each other the quantity and type of Output to be delivered on any given day or days at a specified Transmission Point of Receipt and/or Transmission Point of Delivery.

**“Share Participant”** means a third party purchaser, unrelated to the District, who signs a Related Power Sales Agreement with the District for a share of Output of the Chelan Power System.

**“Spinning Operating Reserves”** means the difference at any time between total available Capacity of all Units of the Chelan Power System then on-line and the sum of the then current generation level of those on-line Units.

**“Spill”** means water that passes over a spillway without going through turbines to produce energy.

**“Spill Past Unloaded Units”** means Spill that occurs while Units are not all fully loaded.

**“Transmission Agreement”** means an agreement dated February 1, 2006 between the Purchaser and the District that provides terms and conditions for the transmission of the Purchaser’s Percentage of Project Output over the Chelan Transmission System from specified Transmission Point(s) of Receipt to Transmission Point(s) of Delivery.

**“Transmission Rights”** means the Purchaser has transmission rights up to the Purchaser’s Percentage of available Project Transmission Facilities as specified in the New Power Sales Contract.

**“Tumwater Facilities”** means the dam, spillway and related facilities owned and operated by the District, located on the Wenatchee River in Tumwater Canyon.

**“Uniform System of Accounts”** means the system of accounts for Public Utilities and Licensees as prescribed by FERC, constituting Part 101 of Title 18 of the Code of Federal Regulations, as supplemented and amended (the “Uniform System of Accounts”), used to account for the costs of generating projects, and any successor thereto and to the account designations thereunder.

**“Unit”** means each generating unit or collectively, the generating units at the Projects. The Units currently consist of the eleven generating Units C1 through C11 at Rocky Reach, the eleven generating Units BH (house Unit) and B1 through B10 at Rock Island Powerhouse One, and the eight generating Units U1 through U8 at Rock Island powerhouse Two. Unit may also include any other generating Units installed in the Chelan Power System (for example attraction water turbines).

**“Voltage Support / MegaVars (MVARs)”** means reactive power supplied or absorbed by the Chelan Power System as required to maintain voltage at adjacent switchyards.

**“WECC”** means the Western Electricity Coordinating Council or its successor, or such other entity or entities responsible for regional reliability as determined by the District.

## THE NEW POWER SALES CONTRACT

### Term and Termination

**Term.** The New Power Sales Contract will become effective as of the Signing Date. The Term, however, will commence as of the first Project Availability Date and will terminate as of the expiration or termination of the

New Power Sales Contract pursuant to its terms. Unless terminated or extended as provided in the New Power Sales Contract, the New Power Sales Contract will remain in effect until midnight on October 31, 2031. All obligations accruing or arising prior to the termination or expiration of the New Power Sales Contract will survive the termination or expiration of the New Power Sales Contract until satisfied in full.

***Condition Precedent to Effectiveness.*** The Parties agree and acknowledge that the respective rights and obligations of the Parties under the New Power Sales Contract with respect to the Output from Rocky Reach and Rock Island, respectively (including the District's obligation to deliver Output attributable to such Projects and the Purchaser's obligation to pay any Periodic Payments (other than the Capacity Reservation Charge and the other Up Front Payments referred to in the New Power Sales Contract) attributable to or arising out of such Projects) are contingent, in the District's sole discretion, upon the satisfaction as of each respective Project Availability Date for each such Project (00:00 Hours on November 1, 2011 for Rocky Reach and 00:00 Hours on July 1, 2012 for Rock Island) of the following conditions precedent: (1) no default will have occurred and be continuing, as of each respective Project Availability Date, under the current contract(s) between the Parties; (2) no Event of Default or Potential Event of Default exists under the New Power Sales Contract; (3) the representations contained in the New Power Sales Contract continue to be true; (4) the Existing Rocky Reach Power Sales Contract will have terminated prior to the Rocky Reach Project Availability Date; (5) the Existing Rock Island Power Sales Contract will have terminated prior to the Rock Island Project Availability Date; (6) no termination described in the New Power Sales Contract has occurred; and (7) the Parties have entered into a Transmission Agreement, in substantially the form attached to the New Power Sales Contract, and an Interconnection Agreement, in form and substance reasonably satisfactory to the District and the Purchaser.

If the conditions precedent set forth above are not satisfied or waived by the District on or within 90 days following each respective Project Availability Date, the District may terminate the New Power Sales Contract in accordance with its terms. Any such termination will apply to the New Power Sales Contract as a whole, and not severally as to the Output from Rocky Reach or Rock Island.

***Termination.*** The New Power Sales Contract may only be terminated (i) by mutual agreement of the Parties; (ii) by either Party if the Approval Date has not occurred by the first Project Availability Date, provided that the Party wishing to terminate the New Power Sales Contract pursuant to this clause (ii) will give the other Party written notice of such termination on or within three (3) Business Days prior to the first Project Availability Date; (iii) by the District pursuant to the provisions of the New Power Sales Contract, so long as any Event of Default is continuing and has not been cured within the applicable cure period (which termination event, at the District's discretion, may supersede a termination under the New Power Sales Contract); or (iv) by the District pursuant to the provisions of the New Power Sales Contract described above in "—Condition Precedent to Effectiveness." In the event the New Power Sales Contract is terminated pursuant to subsections (i), (ii) or (iv), neither Party will be liable to the other Party for damages due to such termination. Any termination of the New Power Sales Contract by a Party pursuant to the terms of the New Power Sales Contract will be effected by and effective only upon receipt of written notice of such termination by the other Party.

***Continued Effectiveness After Termination.*** After termination or expiration of the Term, any provisions that may be reasonably interpreted or construed as being intended to survive the termination or expiration of the Term or the New Power Sales Contract, and all unsatisfied billing and payment obligations that arose during the Term, will survive such termination or expiration.

***Forward Contract Merchant.*** Each Party acknowledges and agrees that the New Power Sales Contract is a "forward contract" and that each Party is either a "forward contract merchant" or "financial participant," in each case as those terms are used in the United States Bankruptcy Code.

## **Output**

### ***Output To Be Made Available.***

(a) Beginning at 00:00 hours on the respective Project Availability Date for each Project and continuing until midnight on the date on which the New Power Sales Contract is terminated or expires, the District will during each hour sell and make available for scheduling by and delivery (or cause to be delivered) to Purchaser,

at the Transmission Point(s) of Receipt, Purchaser's Percentage of Output attributable to such Project, and Purchaser will during each hour purchase and receive (or cause to be received), at the Transmission Point(s) of Receipt, the amount of Purchaser's Percentage of Output scheduled by Purchaser for every such hour. Purchaser's Percentage will at all times during the Term of the New Power Sales Contract be 25% of the Chelan Power System, as the same may be modified from time to time pursuant to the New Power Sales Contract.

(b) It is expressly acknowledged and agreed by the Parties that Output is dynamic and variable and is dependent upon a variety of factors including, without limitation, availability of water and operable generation Units of the Projects, electric system reliability requirements, federal and state laws, rules, regulations and orders affecting river flows and operation of the Projects regarding endangered species and other environmental matters, matters giving rise to curtailment described in the New Power Sales Contract and other restrictions on Output described in "—Output, Scheduling, Planning and Transmission" and set forth in Appendix B to the New Power Sales Contract, the terms of which Appendix B are incorporated in the New Power Sales Contract by reference. Output can and will vary substantially from hour-to-hour, season-to-season and year-to-year. Appendix B to the New Power Sales Contract, in conjunction with the Transmission Agreement, will also govern the delivery of the Output from the Chelan Power System to the Transmission Point(s) of Receipt, will define the scheduling procedures and scheduling requirements of the Output, will provide for the transmission of Output from the Transmission Point(s) of Receipt to the Transmission Point(s) of Delivery, will provide for management of the Purchaser's Percentage, will define the services included in Output, and will describe certain services and products offered by the District.

(c) IN THE NEW POWER SALES CONTRACT, THE PURCHASER ACKNOWLEDGES THAT, NOTWITHSTANDING ANY OTHER PROVISION OF THE NEW POWER SALES CONTRACT TO THE CONTRARY, THE DISTRICT'S OBLIGATION TO SELL AND DELIVER OUTPUT IS EXPRESSLY LIMITED TO PURCHASER'S PERCENTAGE OF ANY OUTPUT ACTUALLY PRODUCED BY THE CHELAN POWER SYSTEM AND AVAILABLE FOR DELIVERY AND THAT THE DISTRICT WILL NOT BE LIABLE TO THE PURCHASER FOR THE FAILURE TO DELIVER ANY OUTPUT THAT IS NOT OTHERWISE AVAILABLE FROM THE CHELAN POWER SYSTEM, REGARDLESS OF THE REASON FOR SUCH UNAVAILABILITY.

(d) Output will be made available to the Purchaser by the District in accordance with the provisions and limitations described in "—Output, Scheduling, Planning and Transmission," on and after each respective Project Availability Date, but with respect to each Project only from and after the respective Project Availability Date for each Project.

**Right to Resell.** Subject to the provisions of the New Power Sales Contract, Purchaser will have the right to resell or re-market the Output provided to Purchaser by District under the New Power Sales Contract and to retain the proceeds of such a sale.

**Mandatory Step-up.** If a Share Participant (a "Defaulting Participant") defaults under a Related Power Sales Agreement and the District elects to terminate that Defaulting Participant's entitlement to Output, the Purchaser will purchase from the District, commencing on a date fifteen (15) days following written notice from the District (such date, the "Step-Up Effective Date"), Purchaser's pro rata share of the Output to which the Defaulting Participant was entitled from and after the Step-Up Effective Date, on the terms and conditions set forth in the New Power Sales Contract (other than as described in clause (a) of "Payment—Payments and Charges"), for a term equal to the lesser of the Defaulting Participant's remaining contract term or the remaining term of the New Power Sales Contract; provided, that the Purchaser's Percentage as it may be increased pursuant to the New Power Sales Contract will not, without the written consent of Purchaser, exceed 40%.

For purposes of the Mandatory Step-Up provision of the New Power Sales Contract, the Purchaser's pro rata share of a Defaulted Participant's Output entitlement (referred to in the New Power Sales Contract as the "Purchaser's Step-up Percentage") will be determined based on the Purchaser's Percentage divided by the sum of Purchaser's Percentage, the percentage of Output shares held by other Share Participants excluding the Defaulting Participant, and the Output share retained by the District. For example, if the Purchaser's Percentage is 25%, the Defaulting Participant's share is 10%, the District's share is 40% and the other Share Participants' shares are 25%, the Purchaser's Step-Up Percentage under this section would be:

$$10\% \times [(25\% \div (25\% + 40\% + 25\%))] = 2.78\%, \text{ to be added to Purchaser's Percentage}$$

For the avoidance of doubt, Purchaser will not be liable for any amounts owed by the Defaulting Participant to the District prior to the Step-Up Effective Date (and Purchaser will have no obligation or liability to perform any of the obligations under the Related Power Sales Agreement and no liability for any default or breach thereunder), and any amounts for which the Purchaser will become liable under the Mandatory Step-Up provision of the New Power Sales Contract will be determined under the New Power Sales Contract and not under the Related Power Sales Agreement.

If as a result of a Share Participant's default under a Related Power Sales Agreement, the District imposes the mandatory step-up requirement pursuant to the terms of the Mandatory Step-Up provision of the New Power Sales Contract, a portion of the damages recovered by the District that were awarded to compensate the District for prospective losses, if any, directly attributable to the early termination of such Related Power Sales Agreement (net of costs and expenses), adjusted for the number of years remaining under the New Power Sales Contract (if less than the period for which such damages were measured), will be allocated to the Purchaser based on the Purchaser's Step-up Percentage and will be credited against all future payments due from Purchaser under the New Power Sales Contract that are attributable to Purchaser's Step-Up Percentage of such Output until such allocated recoveries have been exhausted. If the Purchaser contests its obligation to purchase the Purchaser's Step-up Percentage of the Defaulting Purchaser's share of Output, Purchaser's share of such recoveries will be held by the District until Purchaser assumes (by instrument in form and substance satisfactory to the District) its Step-Up Percentage, and will then be applied to future payment obligations in accordance with the preceding sentence.

### **Curtailment and Decommissioning**

***Curtailment.*** The District will have the right, in its sole discretion, to temporarily interrupt, reduce or suspend delivery (through manual operation, automatic operation or otherwise) of Output from the Projects during any one or more of the following circumstances: (i) to prevent damage to the District's system or to maintain the reliable and safe operation of the District's system; (ii) a District System Emergency; (iii) if suspension is required for relocation, repair or maintenance of facilities or to facilitate restoration of line outages; (iv) a force majeure event; (v) any Operational Constraints as further described in the New Power Sales Contract; (vi) negligent acts or intentional misconduct of Purchaser which are reasonably expected to present imminent threat of damage to property or personal injury; (vii) an Event of Default by the Purchaser, as provided in the New Power Sales Contract, or a Potential Event of Default by the Purchaser, or (viii) any other reason consistent with Prudent Utility Practice. Any available Output during each such interruption, reduction or suspension will be allocated pro rata among the District, the Purchaser and the other Share Participants, except and to the extent the District determines (or had determined at any time prior to such interruption, reduction or suspension) in its sole discretion that due to a District System Emergency such pro-rata allocation of remaining Output due to such interruption, reduction or suspension is impracticable or infeasible. The District will give advance notice, as circumstances permit, of the need for such suspension, reduction or interruption to employees of the Purchaser designated from time to time by the Purchaser to receive such notice. The District will not be responsible for payment of any penalty or cost incurred by the Purchaser during or as a result of such interruption, reduction or suspension. The provisions contained in the New Power Sales Contract will not limit or modify the scope of and limitations on the District's obligations under the New Power Sales Contract as otherwise set forth in the New Power Sales Contract.

***Restoration of Service.*** Purchaser and District will endeavor to restore deliveries of Output as promptly as is reasonably possible in the event of an interruption, reduction or suspension under the New Power Sales Contract.

***Decommissioning.*** Over the term of the New Power Sales Contract, the District may, in its sole discretion, cause components of the Project responsible for not more than 20% of the Output in the aggregate to be Permanently Retired. The District may also cause the Projects, or any components thereof, to be Permanently Retired if, as a result of the adoption or implementation of, or a change in, any Law, rule or regulation, or any policy, guideline or directive of, or any change in the interpretation or administration thereof by, any Regulatory Authority (in each case, having the force of Law) (collectively a "Change in Law"), the District would be required to make material modifications to such Projects or components in order to continue their operation, and the District determines in good faith that, absent such components being Permanently Retired, it would not be Commercially Reasonable, as otherwise in the New Power Sales Contract defined, to comply with such statutory or regulatory requirements. In each case, the District will give Purchaser as much advance written notice of its determination to Permanently Retire

Projects or components as reasonably possible. Decommissioning will not reduce Purchaser's payment obligations under the New Power Sales Contract.

## Payment

**Payments and Charges.** In consideration of the District's agreement to provide Purchaser with Purchaser's Percentage of Output, the Purchaser agrees in the New Power Sales Contract to pay the District the following charges at the times and in the amounts specified below:

(a) **Up Front Payments.** Within 30 days following the later to occur of the Approval Date and the Effective Date, Purchaser will pay the District by wire transfer in immediately available funds a non-refundable capacity reservation charge of \$89,000,000 (the "Capacity Reservation Charge").

(b) **Working Capital Charges.** The Purchaser will pay Working Capital Charges as follows:

(i) On the Project Availability Date of Rocky Reach, Purchaser will pay the District, by wire transfer in immediately available funds, an initial Working Capital Charge of \$2,500,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in the New Power Sales Contract to such Project Availability Date. Within fifteen (15) days following the commencement of each Contract Year thereafter, Purchaser will pay the District, by wire transfer in immediately available funds, an additional Working Capital Charge equal to the amount, if any, by which \$2,500,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in the New Power Sales Contract to the beginning of such Contract Year exceeds the sum of the Working Capital Charges previously paid pursuant to this subsection (i).

(ii) On the Project Availability Date of Rock Island, Purchaser will pay the District, by wire transfer in immediately available funds, a second Working Capital Charge of \$2,500,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in the New Power Sales Contract to such Project Availability Date. Within fifteen (15) days following the commencement of each Contract Year thereafter, Purchaser will pay the District, by wire transfer in immediately available funds, an additional Working Capital Charge equal to the amount, if any, by which \$2,500,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in the New Power Sales Contract to the beginning of such Contract Year exceeds the sum of the Working Capital Charges previously paid pursuant to this subsection (ii).

(iii) Each initial Working Capital Charge payment pursuant to subsections (i) and (ii) above constitutes the Purchaser's Percentage of the amount the District deems necessary as of the Signing Date to provide an adequate working capital balance for each respective Project.

(iv) From time to time during any Contract Year, Purchaser will pay to the District, by wire transfer in immediately available funds, upon demand by the District, an amount equal to the Purchaser's Percentage of any additional Working Capital Charge that is necessary to provide an adequate level of working capital for the Chelan Power System as determined by the District in accordance with Prudent Utility Practice.

(v) The payments described in this Section are sometimes referred to in the New Power Sales Contract as a "Working Capital Charge" or collectively as "Working Capital Charges."

(c) **Net Costs.** Purchaser will pay monthly to the District during each Contract Year, an amount equal to the Purchaser's Percentage of Net Costs determined in accordance with Appendix A to the New Power Sales Contract.

(d) **Coverage Fund Charge.** The District will continue, or establish, and maintain, one or more coverage funds or their equivalents into which will be deposited the Coverage Amount with respect to the Debt Obligations (collectively, the "Coverage Fund"). The Purchaser will pay the Purchaser's Percentage of the Coverage Amount as follows:

(i) On the Project Availability Date for Rocky Reach, Purchaser will pay the District, by wire transfer in immediately available funds, the Purchaser's Percentage of the Coverage Amount (calculated as of such Project Availability Date) attributable to Debt Obligations for Rocky Reach. On the Project Availability Date for Rock Island, Purchaser will pay the District, by wire transfer in immediately available funds, the Purchaser's Percentage of the Coverage Amount (calculated as of such Project Availability Date) attributable to Debt Obligations for Rock Island. The District will notify the Purchaser of such required amounts at least 30 days prior to each such Project Availability Date.

(ii) In addition, upon the issuance or incurrence during any Contract Year of any additional Debt Obligations attributable to Rocky Reach by the District after the Project Availability Date for Rocky Reach and of any additional Debt Obligations attributable to Rock Island by the District after the Project Availability Date for Rock Island, Purchaser will pay to the District, by wire transfer in immediately available funds, within 30 days of demand by the District, an amount equal to the positive difference, if any, between (1) the product of (a) the Purchaser's Percentage, times (b) the Coverage Amount (calculated as of the issuance or incurrence of such additional Debt Obligations), minus (2) the amounts previously paid by the Purchaser pursuant to this subsection.

All amounts paid by the Purchaser to the District pursuant to the provision described in this subsection will be used for any lawful purpose as determined by the District in its sole discretion.

(e) **Prepayment Requirements.** On the first Project Availability Date, the Purchaser will pay to the District as a prepayment an amount equal to the product of (i) \$740,000 multiplied by (ii) Purchaser's Percentage (expressed as a decimal) multiplied by 100. If the Purchaser's Percentage increases at any time during the Term, pursuant to contractual agreement, mandatory step-up pursuant to the New Power Sales Contract, or otherwise, Purchaser will pay to the District within 30 days of the occurrence of such event an additional amount equal to the product of (i) \$740,000, multiplied by (ii) such increase in Purchaser's Percentage (expressed as a decimal) multiplied by 100. The District will maintain separate accounting records of such prepayments but will not be obligated to segregate or separately account for such funds, nor will the Purchaser have any right to or claim in any such funds, but will only have claim against the District to the extent and in the manner described below.

If the Purchaser fails to make any payment due under the New Power Sales Contract as described in this subsection (e) or under the Transmission Agreement, the District will apply the Prepayment Amounts to the satisfaction of such payment obligations (which application will not constitute a cure of the payment default described therein unless and until the Prepayment Amount is replenished as described in the New Power Sales Contract). If the District applies the Prepayment Amount or any portion thereof to any payment then due, the Purchaser will replenish the amounts so credited immediately upon demand so that, after such replenishment, the unused portion of the Prepayment Amount again is thereafter equal to (i) \$740,000 multiplied by (ii) Purchaser's Percentage (expressed as a decimal) multiplied by 100. The District will apply any unused portion of the Prepayment Amount to the last payment(s) due from the Purchaser under the New Power Sales Contract.

(f) **Debt Reduction Charge.** The Purchaser will pay to the District each month of each Contract Year as part of its Periodic Payments one twelfth (1/12th) of the Purchaser's Percentage of an annual debt reduction charge (the "Debt Reduction Charge"), which Debt Reduction Charge will be computed by multiplying the Debt Reduction Charge Percentage for the Contract Year in which such month occurs by the Debt Reduction Charge Obligations for such Contract Year. The Debt Reduction Charge collected by the District pursuant to this section will be held by the District in a separate fund or account to be known as the "Debt Reduction Charge Account" and used only to purchase, redeem or defease debt of the Chelan Power System, to fund (after the Project Availability Date for Rocky Reach) required deposits to Reserve and Contingency Funds for Rocky Reach bonds, to fund (after the Project Availability Date for Rock Island) required deposits to Reserve and Contingency Funds for Rock Island bonds, or to fund Capital Improvements related to the Chelan Power System, in each case as determined by the District.

For purposes of this section:

(i) **"Debt Reduction Charge Percentage"** means that percentage, designated by the District for a Contract Year not less than twelve (12) months prior to the commencement of such Contract Year, which



percentage will be set between a minimum of 0% and a maximum of 3%. Each such designation will be effective for the Contract Year for which such designation is made. If the District fails to make a designation for any Contract Year by the date required above, the Debt Reduction Charge Percentage for such Contract Year will be the greater of 2-1/2% or the last effective Debt Reduction Charge Percentage designated by the District;

(ii) **“Debt Reduction Charge Obligations”** means, for any Contract Year, the aggregate principal amount of all Debt Obligations assumed to be outstanding as of the first day of such Contract Year, determined in accordance with Appendix A to the New Power Sales Contract, as such principal amount may have theretofore been reduced in accordance with the New Power Sales Contract, as described in “— Determination of Chelan Power System Net Costs” below. Prior to the Project Availability Date for Rock Island, the Debt Reduction Charge Obligations for purposes of the New Power Sales Contract will be computed only with reference to those Debt Obligations attributable to Rocky Reach.

(g) **“Capital Recovery Charge.”** The Purchaser will pay to the District each month of each Contract Year as part of its Periodic Payments one twelfth (1/12th) of the Purchaser’s Percentage of an annual capital recovery charge (the “Capital Recovery Charge”), which Capital Recovery Charge will be computed by multiplying the Capital Recovery Charge Percentage for the Contract Year in which such month occurs by the Capital Recovery Charge Base for such Contract Year. The Capital Recovery Charge will be held by the District in a separate fund or account to be known as the “Capital Recovery Charge Account” and used only to purchase, redeem or defease debt of the Chelan Power System, to fund (after the Project Availability Date for Rocky Reach) required deposits to Reserve and Contingency Funds for Rocky Reach bonds, to fund (after the Project Availability Date for Rock Island) required deposits to Reserve and Contingency Funds for Rock Island bonds, or to fund Capital Improvements related to the Chelan Power System, in each case as determined by the District.

For purposes of this section:

(i) **“Capital Recovery Charge Percentage”** means that percentage, designated by the District for a Contract Year not less than twelve (12) months prior to the commencement of such Contract Year, which percentage will be set between a minimum of 0% and a maximum of 50%. Each such designation will be effective for the Contract Year for which such designation is made. If the District fails to make a designation for any Contract Year by the date required above, the Capital Recovery Charge Percentage for such Contract Year will be the greater of 25% or the last effective Capital Recovery Charge Percentage designated by the District.

(ii) **“Capital Recovery Charge Base”** means a base amount equal to \$25,000,000 in 2004 dollars. The Capital Recovery Charge Base, as the same may be adjusted from time to time pursuant to the methodology specified in the following paragraph, will be adjusted annually as of the first day of each Contract Year by the Escalation Factor.

In addition to adjustments resulting from the Escalation Factor, the District may adjust the Capital Recovery Charge Base for a Contract Year by giving written notice to the Purchaser at least 180 days prior to the commencement of such Contract Year. Any such adjustment will not increase the Capital Recovery Charge Base to an amount greater than the District’s estimate, made in good faith, of its average annual Capital Improvement requirements over the next ensuing thirty (30) Fiscal Years. Such estimate will be as computed in real dollars adjusted to be effective as of the first day of such Contract Year. The Capital Recovery Charge Base, as so adjusted, will remain in effect thereafter unless and until subsequently adjusted pursuant to this paragraph or the immediately preceding paragraph. Adjustments for future annual Capital Improvements will not result in the duplication of payments for such future Capital Improvements.

(iii) **“Escalation Factor”** means the percentage change in relative value of the Consumer Price Index using the non-seasonally adjusted US City Average Index for All Urban Consumers (All Items, Base Period 1982-84 = 100), as published by the U.S. Department of Labor, Bureau of Labor Statistics, computed annually in accordance with the following formula:

$$EF = CPI \div CPI-b$$

Where: EF = the Escalation Factor,

CPI = the most recently published consumer price index identified above, in effect as of the date of annual computation

CPI-b = 190.3, the consumer price index identified above for the base month of December, 2004 (<http://data.bls.gov/cgi-bin/surveymost?bls>) as shown in Attachment 1 to the New Power Sales Contract.

Should the index referred to above be discontinued or be substantially modified, then an alternate index will be chosen by the District in its discretion that reasonably tracks the methodology used to track the consumer price index identified above prior to such modification or discontinuance to maintain the purchasing power of one dollar at a constant level, considering the nature of expenses incurred in the acquisition, construction and installation of Capital Improvements of the Chelan Power System.

If the Capital Recovery Charge Base is recalculated pursuant to the second paragraph of clause (ii) above, CPI-b for the calculation of the Escalation Factor for the then current and each succeeding Contract Year (until further changed in accordance with this provision) for purposes of determining the Capital Recovery Charge Base will be changed to the CPI Index number for the December immediately preceding the commencement of the Contract Year in which such recalculation occurs.

(h) Notwithstanding the provisions of the New Power Sales Contract to the contrary, the Purchaser will not be obligated to pay the Purchaser's Percentage of the Debt Reduction Charge and the Capital Recovery Charge in any month if, and only to the extent that, the aggregate value of unspent cash and investments on deposit in the Debt Reduction Charge Fund and the Capital Recovery Charge Fund as of the 15th day of the immediately preceding month exceeds:

(i) five (5) times the Capital Recovery Charge Base for the monthly periods during the Term ending prior to November 1, 2027;

(ii) four (4) times the Capital Recovery Charge Base for the monthly periods beginning November 1, 2027 and ending prior to November 1, 2028;

(iii) three (3) times the Capital Recovery Charge Base for the monthly periods beginning November 1, 2028 and ending prior to November 1, 2029;

(iv) two (2) times the Capital Recovery Charge Base for the monthly periods beginning November 1, 2029 and ending prior to November 1, 2030; and

(v) one (1) times the Capital Recovery Charge Base for the monthly periods beginning November 1, 2030 and ending prior to November 1, 2031.

For purposes of the foregoing, funds will be deemed "spent" when (i) costs are paid or incurred for Capital Improvements, or (ii) costs are committed to be expended for qualified costs pursuant to contracts for design, engineering, acquisition and/or construction of such Capital Improvements, but only to the extent that such costs are expected by the District to be paid or incurred prior to the expiration of the Term, or (iii) funds are applied to the purchase, redemption or defeasance of Debt Obligations.

(i) **Debt Administrative Charge.** The Purchaser will pay the District monthly during each Contract Year, in addition to the Net Costs and other amounts described in the New Power Sales Contract, an administrative charge equal to one-twelfth of Purchaser's Percentage multiplied by one percent (1.0%) per annum of the principal balance of the Debt Obligations outstanding at the beginning of such Contract Year, as determined by the District.

**Unconditional Obligations.** All Periodic Payments due under the New Power Sales Contract will be payable by Purchaser, whether or not the Purchaser can receive, accept, take delivery of or use all or any portion of such Output, regardless of curtailments, shutdowns, force majeure events or other operational, regulatory or financial circumstances that may affect the Purchaser, and whether or not any of the Projects are operable or operating or the operation thereof is interrupted, suspended, interfered with, reduced or curtailed, in whole or in part, at any time for any reason during the term of the New Power Sales Contract (including, without limitation, events of force majeure); provided, however, that the foregoing will not affect the rights of Purchaser to pursue a claim against the District for damages upon the occurrence of an Event of Default by the District with respect to any of its obligations under the New Power Sales Contract. The Periodic Payments payable by Purchaser pursuant to the New Power Sales Contract for any month, will be independent of and not related to the amount of Output, if any, delivered to Purchaser under the New Power Sales Contract during such month.

**Final Payment.** Within ninety (90) days following the expiration or earlier termination of the New Power Sales Contract, Purchaser will pay to the District any and all Periodic Payments accrued but unpaid, net of any credits due to Purchaser as of the date of such expiration or termination. The District will provide Purchaser with a special invoice identifying any such costs and credits within sixty (60) days following the expiration or termination date.

**Use of Funds by District.** Except as otherwise provided in the New Power Sales Contract and in Appendix A to the New Power Sales Contract, the District may use the Periodic Payments paid to the District under the New Power Sales Contract in any manner that the District, in its sole discretion, will determine.

**Disposition of Fund Balances Upon Expiration or Termination of Agreement.** Upon the expiration or prior termination of the New Power Sales Contract at any time for any reason, all amounts collected pursuant to the New Power Sales Contract, including, but not limited to, amounts deposited and on hand in any debt service, reserve, capital, coverage or other fund or account maintained by or on behalf of the District, will be retained by the District (or in the case of the Prepayment Amount, will be applied pursuant to the New Power Sales Contract). Purchaser will have no right, interest or claim in or to any such amounts or any interest or earnings thereon, except as set forth in the New Power Sales Contract.

**Investment of Certain Funds.** The District agrees in the New Power Sales Contract, to the extent consistent with applicable Law, to invest and keep invested in a manner consistent with the District's investment policies in effect from time to time, any unexpended amounts of the Debt Reduction Charges and Capital Recovery Charges during any Contract Year.

## **Billing and Payment**

**Billing of Periodic Payments.** Periodic Payments will be billed as follows:

(a) **Monthly Invoices; Periodic Payments.** On or prior to the tenth (10th) day of each Month, the District will submit to the Purchaser, by electronic or facsimile transmission, a monthly invoice setting forth the Periodic Payments incurred by the District in the current Contract Year, and stating the sum of the Periodic Payments actually received to date from the Purchaser with respect to such Contract Year. Costs incurred but not actually known by the date of the invoice may be estimated, subject to reconciliation the following month or months, as actual costs become known by the District.

The Purchaser will pay each month the Periodic Payments then due as shown on the District's invoice, by electronic funds transfer to the District's account as the District's Treasurer may instruct. Periodic Payments will be due and payable to the District by 5:00 p.m. (Pacific prevailing time (PPT)) on the twentieth (20th) day of each Month in which the District's monthly invoice is received, or if such day is not a Business Day, on the next succeeding Business Day (the "Due Date"). Failure of the District to submit an invoice as scheduled will not release the Purchaser from liability for payment upon future delivery of the invoice.

(b) **Late Charges and Interest.** If payment in full is not made on or before the District's close of business on a Due Date, a delayed payment charge of two percent (2%) of the unpaid amount of the invoice will be

assessed to the Purchaser. Interest will accrue on all past due statements at a rate equal to the lesser of 1.5% per month or the maximum rate allowed by law. Should Purchaser fail to pay any invoice within two (2) Business Days after its Due Date as provided in the New Power Sales Contract, the District will send a notice of such failure to pay to the Purchaser. A monthly payment remaining unpaid three (3) Business Days after the receipt by the Purchaser of such notice of failure to pay will constitute a breach of the New Power Sales Contract for purposes of the New Power Sales Contract, and the District may, in addition to its other remedies, suspend delivery of the Purchaser's Percentage of Output until all amounts due under the New Power Sales Contract (including late charges and interest) are received by the District.

(c) **Payments Unconditional.** The Periodic Payments will accrue, and the Purchaser will be obligated to make such payments through the date of termination of the New Power Sales Contract, irrespective of the condition of the Projects and whether or not they are capable of producing any Output for any reason. This provision will not constitute a waiver of the Purchaser's right to seek damages for a breach by the District of its obligations under the New Power Sales Contract.

(d) **True-Up.** Within thirty (30) days after the finalization of financial, statutory or other required audits for each Fiscal Year, the District will compute any amounts that should have been included as charges or credits in the monthly invoices to Purchaser during such Fiscal Year and prepare and submit to Purchaser a final true-up invoice containing any such expenses and credits (the "Annual True-Up"). If such Annual True-Up invoice shows a payment due to the District from the Purchaser, the final Annual True-Up invoice will be due and payable in the same manner as the monthly payments for Periodic Payments; provided that if the New Power Sales Contract has then expired, the Purchaser will make a payment by electronic funds transfer of such amount to the District within thirty (30) days of the date of such calculation and Purchaser's receipt of such final Annual True-Up invoice. If such Annual True-Up invoice shows a credit due to the Purchaser from the District, such credit will be reflected as a deduction to the Periodic Payment due the month(s) after the final Annual True-Up invoice is issued until such credit is exhausted; provided that if the New Power Sales Contract has then expired or expires prior to such credit being exhausted, the District will make a refund by electronic funds transfer of such amount to the Purchaser within thirty (30) days of the date of such calculation.

(e) **Corrections.** The District may make corrections for expenses and credits discovered by either Party in invoices or Annual True-Up reports in each of the prior three (3) Fiscal Years. No adjustments for or with respect to expenses, credits or energy exchanges will be made with respect to any Fiscal Year ending earlier than the third Fiscal Year preceding the Fiscal Year to which the current audit pertains.

**Accounting.** The District will cause proper books and records of account to be kept for each of the Projects by the District. Such books and records of account will be kept in accordance with the rules and regulations established by any Government Authority authorized to prescribe such rules including, but not limited to, the Division of Municipal Corporations of the State Auditor's Office of the State of Washington or such other Washington State department or agency succeeding to such duties of the State Auditor's Office. The District will also maintain books and records in conformity with GAAP and in accordance with the Uniform System of Accounts prescribed by FERC or such other federal agency having jurisdiction over electric utilities owning and operating properties similar to the District's electric properties. The District will cause such books and records of account to be audited by independent certified public accountants, experienced in electric utility accounting, to be retained by the District. The audits to be made by such certified public accountants, as above mentioned, will be made annually and will cover each Fiscal Year during the term of the New Power Sales Contract. At the Purchaser's written request, the District will deliver a copy of each such annual audit, including any recommendations of the auditors with respect to the Project to Purchaser promptly after it is received by the District.

**Audits by Purchaser.** District will provide or cause to be provided all information that Purchaser may reasonably request to substantiate all invoices, adjustments and claims under the New Power Sales Contract related to the Projects. Purchaser will, upon notice, have the right to audit, at its sole cost and expense, upon reasonable notice and during normal business hours following the receipt of an Annual True-Up, and District will make or cause to be made available any and all books and records related to the Projects which directly relate to the determination of Net Costs as set forth in Appendix A to the New Power Sales Contract and are reasonably necessary for verification of charges and costs included in invoices or amended invoices rendered under the New Power Sales Contract or verification of Purchaser's or the District's compliance with the New Power Sales Contract;

provided, however, that Purchaser will coordinate its rights under this section with the other Share Participants in order to conduct joint, rather than individual, audits pursuant to this provision. The District will also cooperate with Purchaser in its efforts to verify the charges imposed pursuant to the New Power Sales Contract. Any Annual True-Up not challenged within three (3) years following its date will be considered final. Any audit will, at the option of Purchaser and at Purchaser's expense, be performed by designated employees, consultants or agents of Purchaser that Purchaser determines in its discretion are experienced in utility practices. Upon request, District will be entitled to review the complete audit report and any supporting materials.

***No Interest In System.*** The New Power Sales Contract is for a sale of Output as described in the New Power Sales Contract. Nothing in the New Power Sales Contract is intended to grant to Purchaser any rights to or interest in any specific District project, facility or resource.

Nothing in the New Power Sales Contract will be construed to create a partnership, association or joint venture with Purchaser, or any ownership interest or other legal right in Purchaser with respect to any existing District facility, project or resource, including but not limited to, the Chelan Power System or the Projects.

### **Control, Operation and Maintenance of the System**

Subject to the provisions of the New Power Sales Contract, the District will operate and maintain the Chelan Power System in accordance with Prudent Utility Practices and will use Commercially Reasonable Efforts consistent with Prudent Utility Practice to keep the Chelan Power System in good operating condition at all times. The District will use Commercially Reasonable Efforts consistent with Prudent Utility Practice to perform such operations and maintenance in an efficient, economical and workmanlike manner; and the District will make such repairs, renewals, additions, improvements and replacements of Project components as the District determines in its sole discretion.

Nothing in the New Power Sales Contract will be construed to grant Purchaser any right of control over the operation or maintenance of or repairs, renewals, additions, improvements or replacements to any of the District's generation, transmission or distribution facilities or the financing for such activities. All deliveries will be subject to the District's curtailment rights set forth in the New Power Sales Contract.

Following the first Project Availability Date, at the request of Purchaser, the District will meet with representatives of Purchaser on a semi-annual basis. All such meetings will be held at the District's headquarters office, or such other location, and at a date and time as the Parties may mutually agree. The District may elect to schedule such meetings with other Share Participants, but it will not be obligated to do so. The District's representatives will attend and provide information concerning past and future expenditures, budgets, operations, maintenance, capital projects and other matters related to the Chelan Power System, as reasonably requested by Purchaser. Meetings initiated pursuant to this paragraph will not exceed eight (8) hours duration without the District's consent. At such meetings, Purchaser may make recommendations to the District concerning the operation and maintenance of, and repairs, renewals, additions, improvements and replacements to, the Chelan Power System. Nothing in the New Power Sales Contract will be construed to create any implied obligations by the District with respect to the Purchaser's recommendations.

### **Relicensing Support**

The District will follow Prudent Utility Practice in obtaining and maintaining licenses and permits for operation during the Term of each Project after its Project Availability Date in accordance with the New Power Sales Contract. The District's current FERC license for Rocky Reach expires on June 30, 2006; and its current FERC license for Rock Island expires on December 31, 2028. The District currently intends to seek a new license for each of the Projects. In light of the fact that the Output with respect to each of the Projects is material to the New Power Sales Contract, Purchaser covenants and agrees in the New Power Sales Contract to use Commercially Reasonable Efforts, at its cost and expense, to support the District's efforts to obtain a new license for each of the Projects, at such times during the Term and in such manner as the District will reasonably request in writing. Such support may include, but will not be limited to, providing letters or other written statements of support and written or oral testimony before FERC or in other administrative or legal proceedings, and participation in and statements of support at public meetings.

Each Party covenants and agrees in the New Power Sales Contract to act reasonably in support of any request by the other Party for review or approval by any Regulatory Authority of the New Power Sales Contract (or costs incurred under the New Power Sales Contract). Such support may include, but will not be limited to, providing letters or other written statements of support and written or oral testimony before FERC or in other administrative or legal proceedings, and participation in and statements of support at public meetings, in each case as such supporting party reasonably deems prudent.

### **Risk of Loss and Disclaimer of Warranties**

***Risk of Loss.*** The District represents and warrants in the New Power Sales Contract that it will deliver the Output sold under the New Power Sales Contract to Purchaser free and clear of all liens, claims and encumbrances arising prior to the delivery of such Output at the Transmission Point(s) of Receipt. Risk of loss associated with the Output will transfer from the District to Purchaser at the point Output reaches the Transmission Point(s) of Receipt. Purchaser will bear all risk of all occurrences of any nature (including force majeure or any other event beyond the reasonable control of either Party) affecting any interconnection facilities, substations, transmission lines and other facilities on Purchaser's side of the applicable Transmission Point(s) of Receipt. For the avoidance of doubt, the risk of loss pursuant to the foregoing will not reduce or otherwise affect the Purchaser's Periodic Payments as described in the New Power Sales Contract.

The District will not be liable to Purchaser for any damages or losses sustained by Purchaser or its customers or third parties as a result of the curtailment, reduction or interruption of Output.

***Disclaimer of Warranties.*** Except as otherwise expressly set forth in the New Power Sales Contract, the District disclaims any and all warranties beyond the express terms of the New Power Sales Contract, including any implied warranties of merchantability or fitness for a particular purpose, and all other warranties with regard to all Energy and Capacity and other Output made available to Purchaser pursuant to the New Power Sales Contract are expressly disclaimed.

The Parties confirm in the New Power Sales Contract that the express remedies and measures of damages provided in the New Power Sales Contract against the Purchaser, and the express limitations as to remedies and damages provided in the New Power Sales Contract with respect to the District, in each case satisfy the essential purposes of the New Power Sales Contract. For breach of any provision of the New Power Sales Contract for which an express remedy or measure of damages is provided, such express remedy or measure of damages will be the sole and exclusive remedy, the obligor's liability will be limited as set forth in such provision and all remedies or damages at law or in equity are waived. Except as otherwise expressly provided in the New Power Sales Contract, the obligor's liability will be limited to direct actual damages only, such direct actual damages will be the sole and exclusive remedy and all other remedies or damages at law or in equity are waived.

**THE FOREGOING IS IN LIEU OF ALL OTHER WARRANTIES, EXPRESSED OR IMPLIED, INCLUDING THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, IN FACT OR BY LAW WITH RESPECT TO THE OUTPUT PROVIDED UNDER THE NEW POWER SALES CONTRACT. DISTRICT DISCLAIMS ANY AND ALL OTHER WARRANTIES WHATSOEVER.**

The limitations under "Risk of Loss" above will be in addition to, and not in lieu of, the other provisions of the New Power Sales Contract, however, the provisions in the New Power Sales Contract will not apply to liabilities arising under the Transmission Agreement or the Interconnection Agreement.

### **Assignment**

Neither Party will assign the New Power Sales Contract or its rights under the New Power Sales Contract without the prior written consent of the other Party, which consent may be withheld in the exercise of its sole discretion; provided, however, that:

(a) The District may, without the consent of the Purchaser (and without relieving itself from liability under the New Power Sales Contract), pledge or encumber the New Power Sales Contract or the accounts, revenues or proceeds of the New Power Sales Contract in connection with any financing or other financial arrangements; and

(b) So long as no default or event which, following notice or the lapse of time or both, would constitute a default by such assigning Party has occurred and is continuing, and no Downgrade Event with respect to such Party has occurred and is continuing, such Party may, with the consent of the other Party, which consent will not be unreasonably withheld, conditioned or delayed (i) transfer or assign the New Power Sales Contract to an Affiliate of such assigning Party, provided such Affiliate's creditworthiness is equal to or higher than the then existing credit quality of such Party, or (ii) transfer or assign the New Power Sales Contract to any person or entity that, by merger, consolidation or otherwise, succeeds to all or substantially all of the assets of such assigning Party; provided, however, that in each such case, in the reasonable judgment of the non-assigning Party:

(i) the proposed successor has assumed and has agreed to service, and has the requisite skill and experience to service, the retail and commercial distribution system of such Party;

(ii) the proposed successor is capable of performing the obligations of the assigning Party under the New Power Sales Contract in the same manner and with the same capacity as the assignor immediately prior to such transfer;

(iii) the proposed successor's short term and long-term creditworthiness is equal to or higher than the then existing credit quality of such assigning Party;

(iv) after giving effect to such assignment, the prospective assignee would not be in default under the New Power Sales Contract (determined without regard to any notices and cure periods);

(v) such prospective assignee will sign an assumption agreement in form and substance reasonably satisfactory to the non-assigning Party, agreeing to be bound by the assignor's obligations under the New Power Sales Contract; and

(vi) the non-assigning Party will have received such opinions, certificates and other assurances as the non-assigning Party may reasonably request as to the enforceability of such undertaking and to the effect that such transfer will not have a material adverse effect (tax or otherwise) on the non-assigning Party.

If more than one Party has signed the New Power Sales Contract as Purchaser under the New Power Sales Contract, this provision will apply to each entity collectively as a unit. No assignment made under this clause (b) will release the assigning Party from its obligations under the New Power Sales Contract unless the non-assigning Party expressly consents to such release, which consent may be withheld at the non-assigning Party's sole discretion; and

(c) Nothing contained in the New Power Sales Contract will preclude the District, without notice to or the consent of the Purchaser, from entering into lease/leaseback, sale/leaseback with an option to purchase, or other similar arrangements with respect to the Projects, or either of them, the economic effect of which is to transfer tax ownership of the Project or Projects for a stated period to a third party, provided that the District retains control of the management and operation of the Projects and the Output, equivalent to that of a legal owner, as determined by the District, for the Term.

## **Insurance**

Purchaser will acquire and maintain during the Term in full force and effect, at its sole cost and expense, comprehensive general liability insurance that includes operations, products and contractual liability, explosion, collapse, and underground hazards, broad form property damage, sudden and accidental pollution and personal liability, with a minimum combined single limit of \$10,000,000 per occurrence and not less than \$20,000,000 in the aggregate. Each such policy will be primary to and will not contribute to any insurance that may otherwise be

maintained by, or on behalf of, the District. All insurance required under the New Power Sales Contract will contain provisions waiving the insured's and the insurer's rights of subrogation or recovery of any kind against the District, its Affiliates and their respective directors, trustees, agents, employees, officers, successors and assigns. Self insurance may be substituted for all or any part of the insurance requirements under the New Power Sales Contract consistent with any generally applied self insurance program of Purchaser. Purchaser will provide the District with a summary of insurance coverages in force on an annual basis. The District acknowledges and agrees that the Purchaser's current program of insurance and self-insurance, as of the Signing Date, is consistent with and satisfies the foregoing provisions of the New Power Sales Contract.

The District will maintain an insurance and/or self-insurance program with respect to the Chelan Power System for property damage, general liability, and other risks as, consistent with Prudent Utility Practice, the District may determine and the District's Commissioners may approve. The Purchaser acknowledges and agrees in the New Power Sales Contract that the District's current program of insurance and self-insurance meets requirements of the New Power Sales Contract.

### **Default and Termination**

***Events of Default.*** An "Event of Default" means, with respect to a Party (a "Defaulting Party"), the occurrence of any of the following:

(a) the failure to make, when due, any payment required pursuant to the New Power Sales Contract if such failure is not remedied within three (3) Business Days after receipt of written notice, as required in the New Power Sales Contract;

(b) any representation or warranty made by such Party in the New Power Sales Contract is false or misleading in any material respect when made or when deemed made or repeated;

(c) the failure to perform any material covenant or obligation set forth in the New Power Sales Contract (except to the extent constituting a separate Event of Default) if such failure is not remedied within 30 days after receipt of written notice;

(d) the Bankruptcy of such Party;

(e) the failure of the Purchaser to make the Prepayment Amounts at the times and in the amounts required pursuant to the New Power Sales Contract;

(f) the failure of such Purchaser to provide Adequate Assurances to the District within fifteen (15) days following receipt of written notice that the District in good faith has reasonable grounds for insecurity (determined using commercially reasonable standards embodied in Section 2-609(2) of the Washington State Uniform Commercial Code) in the Purchaser's ability to perform its obligations under the New Power Sales Contract;

(g) such Party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all of its assets to, another entity and, at the time of such consolidation, amalgamation, merger or transfer, the resulting, surviving or transferee entity fails to assume all the obligations of such Party under the New Power Sales Contract to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other Party; or

(h) the occurrence and continuation of (i) a default, event of default or other similar condition or event in respect of such Party under one or more agreements or instruments, individually or collectively, relating to indebtedness for borrowed money ("Funding Agreements") in an aggregate amount of not less than the applicable Cross Default Amount which results in such indebtedness becoming immediately due and payable or (ii) a default by such Party in making on the due date therefor one or more payments, individually or collectively, under any judgment, or under any contract or other obligation not included within the definition of "Funding Agreement" above, in an aggregate amount of not less than the applicable Cross Default Amount; provided, however that such



Party will not be deemed in default under this clause (ii) so long as it diligently contests such payments in good faith by appropriate proceedings and pays any amount ultimately determined to be due within 30 days of such determination.

The District's use of Prepayment Amounts to fund a payment default by the Purchaser will not relieve the Purchaser of its obligation to make such payment as and when due and such non-payment will constitute an Event of Default under the New Power Sales Contract, which will be deemed to continue until the Prepayment Amounts have been fully replenished. The decommissioning of one or both Projects pursuant to the New Power Sales Contract will not constitute a breach of the New Power Sales Contract.

***Remedies upon Default.*** The Party as to which an Event of Default has not occurred (each a "Non-Defaulting Party") will have the right, so long as any Event of Default is continuing and has not been cured within the applicable cure periods, if any, to take any one or more of the following actions:

(a) suspend its performance under the New Power Sales Contract, other than any payment obligations that may be due or become due under the New Power Sales Contract, until such Event of Default is cured or formally waived in writing by the Non-Defaulting Party;

(b) in the case of the District only, terminate the New Power Sales Contract and sue for damages as contemplated in the New Power Sales Contract;

(c) maintain successive proceedings against the Defaulting Party for recovery of damages or for a sum equal to any and all payments required to be made pursuant to the New Power Sales Contract; or

(d) take whatever action at law or in equity as may be necessary or desirable to collect the amounts payable by the Defaulting Party under the New Power Sales Contract, as then due or to become due thereafter, or to enforce performance and observation of any obligation, agreement or covenant of the Defaulting Party under the New Power Sales Contract.

If the District suspends performance pursuant to clause (a) above, the District will act in a Commercially Reasonable manner to mitigate damages, including but not limited to using Commercially Reasonable efforts to sell the Purchaser's share of Output to third parties on a short term basis. In such case, Purchaser will pay for the full amount of the monthly Periodic Payments, and any proceeds the District receives from the sale of such Output, net of administrative fees, costs and expenses, as determined by the District, will first be applied against amounts owed by the Purchaser under the New Power Sales Contract with respect to such Output, with the balance, if any, being retained by the District.

Notwithstanding any other provision contained in the New Power Sales Contract, the Purchaser waives any right it may have to terminate the New Power Sales Contract as a result of a default by the District and agrees to limit its remedies related to any such default to claims for damages, specific performance or injunctive or equitable relief.

Except as otherwise expressly provided in the New Power Sales Contract, no right or remedy conferred upon or reserved to a Party is intended to be exclusive of any other right or remedy, and each and every right and remedy will be cumulative and in addition to any other right or remedy given under the New Power Sales Contract, or legally existing at the time of signing the New Power Sales Contract or thereafter, upon the occurrence of any Event of Default. Failure of either Party to insist at any time on the strict observance or performance by the other Party of any of the provisions of the New Power Sales Contract, or to exercise any right or remedy provided for in the New Power Sales Contract will not impair any such right or remedy nor be construed as a waiver or relinquishment thereof for the future. Receipt by the District of any payment required to be made under the New Power Sales Contract with knowledge of the breach of any provisions of the New Power Sales Contract, will not be deemed a waiver of such breach. In addition to all other remedies provided in the New Power Sales Contract, each Party will be entitled, to the extent permitted by applicable Law, to injunctive relief in case of the violation, or attempted or threatened violation, of any of the provisions of the New Power Sales Contract, or to a decree requiring

performance of any of the provisions of the New Power Sales Contract or to any other remedy legally allowed to such Party.

*Calculation of District's Loss upon Termination.*

(a) If the District terminates the New Power Sales Contract pursuant to the New Power Sales Contract, the District will be entitled to recover from the Purchaser the full amount of its loss resulting from the early termination of the New Power Sales Contract. The Parties recognize that it will be difficult to calculate those losses with absolute precision and agree in the New Power Sales Contract that the District's good faith determination of such losses, based on the methodology set forth in the New Power Sales Contract, will be conclusive and binding on the Parties, absent manifest error.

(b) The District's losses and costs upon such termination will be determined based on its assessment of the cost of replacing the defaulting Purchaser with a new creditworthy participant who is willing to assume the obligations of the defaulting Purchaser under the New Power Sales Contract. Such costs will include, among other items, upfront incentive payments the District reasonably believes it will be required to pay to entice a substitute Purchaser to assume the defaulting Purchaser's obligations under the New Power Sales Contract, the present value (calculated at the District's tax exempt borrowing rate, or if the District no longer has tax exempt debt outstanding, at its applicable taxable borrowing rate) of pricing discounts and other concessions that the District reasonably believes will be required to entice a substitute Purchaser to assume such obligations, the legal fees and expenses anticipated to be incurred by the District in effectuating such substitution, and all other losses, costs and expenses that have been, and that the District reasonably believes will be, incurred in connection with such default, termination and substitution.

(c) All such losses and costs will be determined by the District in good faith, using Commercially Reasonable procedures, in order to arrive at a Commercially Reasonable result.

(d) Amounts due and owing by the defaulting Purchaser as of the date of termination, together with all legal fees, costs and expenses incurred by the District, arising out of or as a result of such default in connection with the enforcement of the New Power Sales Contract and the protection of its rights under the New Power Sales Contract (including all costs of collection) will be in addition to the losses calculated in accordance with clause (b) above.

(e) In determining its losses, the District may consider any relevant information, including, without limitation, one or more of the following types of information:

(i) quotations (either firm or indicative) for assumption of the Purchaser's obligations under the New Power Sales Contract, supplied by one or more third parties that take into account the status of the Chelan Power System, the District's existing and anticipated Net Costs, the creditworthiness of the District at the time the quotation is provided and any other factors then existing or anticipated that are relevant to the third party providing such quotation;

(ii) information consisting of relevant market data in the relevant market supplied by one or more third parties, including, without limitation, relevant existing and projected rates, prices, yields, yield curves, volatilities, spreads, correlations and other relevant market data, and the current and anticipated future regulatory environment; or

(iii) information of the types described in the subclauses (i) or (ii) above from internal sources if that information is of the same type used by the District in the regular course of its business for evaluating power sales contracts.

(f) The District will consider, taking into account the standards and procedures described above, quotations pursuant to clause (e)(i) above or relevant market data pursuant to clause (e)(ii) above, unless the District reasonably believes in good faith that such quotations or relevant market data are not readily available or would produce a result that would not satisfy those standards. When considering information described in clause (e)(i), (ii)

or (iii) above, the District may include costs of funding, to the extent it would not be a component of the other information utilized. Third parties supplying quotations pursuant to clause (e)(i) above or market data pursuant to clause (e)(ii) above may include, without limitation, wholesale purchasers in relevant markets, end-users of electric energy, information vendors, brokers, and other sources of market information.

(g) In making the calculations under the New Power Sales Contract, the mandatory step-up provisions of the New Power Sales Contract will be ignored.

(h) If the District determines that its losses, as determined using the foregoing methodology, are negative (meaning that the District will benefit economically from such termination), no amounts will be due by either Party with respect to such losses, and the Purchaser's liability will be limited to (i) amounts due and owing and accrued as of the date of termination, plus (ii) attorneys fees and expenses and other collection costs, plus (iii) the District's reasonable costs of calculating such losses.

(i) The District will notify the Purchaser of its calculation of losses as soon as possible after termination and will supply the Purchaser with a summary analysis of the methodology used in such calculations. The Parties recognize that it will be extremely difficult to precisely determine the amount of actual damages and loss that would be suffered by the District if the Purchaser's default gives rise to a termination of the New Power Sales Contract as contemplated in the New Power Sales Contract, and agree that the District's reasonable determination of such losses, using the methodology pursuant to this section, is a fair and reasonable method of determining of the amount of actual damages that would be suffered by the District in such event. The loss methodology is intended to measure the anticipated damages actually suffered from a termination and is not intended to constitute a penalty or forfeiture.

## **Dispute Resolution**

**General.** Any dispute arising out of, or relating to, the New Power Sales Contract, with the exception of those specifically excluded under the New Power Sales Contract, will be subject to the dispute resolution procedures specified in the New Power Sales Contract. Each Party retains the right, after making a good faith effort at resolving the dispute pursuant to the terms of the New Power Sales Contract, to pursue such other actions and remedies otherwise permitted or authorized by law or equity.

**Good-Faith Negotiations.** The Parties will first negotiate in good faith to attempt to resolve any dispute, controversy or claim arising out of, under, or relating to the New Power Sales Contract (a "Dispute"), unless otherwise mutually agreed to by the Parties. In the event that the Parties are unsuccessful in resolving a Dispute through such negotiations, either Party may proceed immediately to litigation concerning the Dispute.

The process of "good-faith negotiations" requires that each Party set out in writing to the other its reason(s) for adopting a specific conclusion or for selecting a particular course of action, together with the sequence of subordinate facts leading to the conclusion or course of action. The Parties will attempt to agree on a mutually agreeable resolution of the Dispute. A Party will not be required as part of these negotiations to provide any information which is confidential or proprietary in nature unless it is satisfied in its discretion that the other Party will maintain the confidentiality of and will not misuse such information or any information subject to attorney-client or other privilege under applicable Law regarding discovery and production of documents.

The negotiation process will include at least two (2) meetings to discuss any Dispute. Unless otherwise mutually agreed, the first meeting will take place within ten days after either Party has received written notice from the other of the desire to commence formal negotiations concerning the Dispute. Unless otherwise mutually agreed, the second meeting will take place no more than ten days later. In the event a Party refuses to attend a negotiation meeting, either Party may proceed immediately to litigation concerning the Dispute.

**Confidentiality and Non-Admissibility of Statements Made in, and Evidence Specifically Prepared for, Good Faith Negotiations.** Each Party agrees that, to the full extent permitted by law, all statements made in the course of good faith negotiations, as contemplated in the New Power Sales Contract, will be Confidential Information and will not be disclosed, except as provided in the New Power Sales Contract and except that such

statements may be disclosed to or shared with any third person whose presence is necessary to facilitate the negotiation process). Each Party agrees and acknowledges that no statements made in or evidence specifically prepared for good faith negotiations under the New Power Sales Contract will be admissible for any purpose in any subsequent litigation.

***Other Recourse.*** Notwithstanding any other provision of the New Power Sales Contract, either Party may, without prejudice to any negotiation or mediation, proceed in the courts of the State of Washington to obtain provisional judicial relief if, in such Party's sole discretion, such action is necessary to protect public safety, avoid imminent irreparable harm, or to preserve the status quo pending the conclusion of any dispute resolution procedures employed by the Parties or pendency of any action at law or in equity. Except for temporary injunctive relief under this section, neither Party will bring any action at law or in equity to enforce, interpret, or remedy any breach or default of the New Power Sales Contract without first complying with the dispute resolution provisions of the New Power Sales Contract.

***Commitments.*** Unless otherwise agreed to in writing (including any express provision of the New Power Sales Contract) or prohibited by applicable Law, the Parties will continue to honor all commitments under the New Power Sales Contract during the course of any dispute resolution under the New Power Sales Contract and during the pendency of any action at law or in equity.

### **No Dedication of Facilities**

No undertaking under any provision of the New Power Sales Contract will constitute a dedication of any portion of the electric system of either Party to the public or to the other Party.

### **Licenses and Ownership and Control**

Purchaser acknowledges and agrees in the New Power Sales Contract that the District must comply with the terms and provisions of the (i) FERC licenses for the respective Projects and (ii) the respective Debt Obligations and the resolutions and documents authorizing or providing for the issuance or incurrence and/or the terms thereof. The New Power Sales Contract is made subject to the terms and provisions of such FERC licenses and such licenses will govern to the extent of any conflict with the terms and provisions of the New Power Sales Contract.

### **Financial Information**

The Purchaser will deliver to the District (i) within 120 days following the end of each fiscal year of Purchaser, a copy of the Purchaser's annual report containing audited consolidated financial statements for such fiscal year, (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of the Purchaser's quarterly report containing unaudited consolidated financial statements for such fiscal quarter, (iii) all public announcements made by the Purchaser of a financial nature promptly following their release to the public, and (iv) any notice of any Downgrade Event, promptly upon the occurrence thereof. In all cases the statements will be for the most recent accounting period and prepared in accordance with GAAP; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or in the delivery of audited financial statements or certificates with respect thereto, such delay will not be an Event of Default so long as the Purchaser provides notice to the District and diligently pursues the preparation and delivery of the statements and required certificates.

### **Limitation of Liability**

Except as provided in the New Power Sales Contract, and then only to the extent provided therein, neither Party (including each Party's officers, trustees, directors, agents, employees, direct and indirect parents, subsidiaries or Affiliates, and such parents', subsidiaries' or Affiliates' officers, trustees, directors, agents or employees) will be liable or responsible to the other Party (or its direct and indirect parents, subsidiaries, Affiliates, officers, trustees, directors, agents, employees, successors or assigns) or their respective insurers, for special, incidental, indirect, exemplary, punitive or consequential damages connected with or resulting from the performance or non-performance of the New Power Sales Contract, or anything done in connection therewith including, without

limitation, Claims in the nature of business interruption, lost revenues, income or profits (other than payments expressly required and properly due under the New Power Sales Contract), or loss of business, reputation or opportunity, or cost of capital, and irrespective of whether such Claims are based upon downtime costs or Claims of customers, and irrespective of whether such Claims are based upon breach of warranty, tort (including negligence, whether of either District, Purchaser or others), strict liability, contract, operation of law or otherwise, but excluding acts or omissions of gross negligence or willful misconduct.

Each Party agrees that it has a duty to mitigate damages and covenants that it will use Commercially Reasonable Efforts to minimize any damages it may incur as a result of the other Party's non-performance of the New Power Sales Contract.

## **Miscellaneous**

***Entire Agreement; Modifications.*** Except as may be expressly provided in the New Power Sales Contract, all previous communications between the Parties hereto, either verbal or written, with reference to the subject matter of the New Power Sales Contract are abrogated. The Purchaser's entitlement to Output from Rocky Reach under the New Power Sales Contract will only become effective on the expiration of the existing Power Sales Contract between Public Utility District No. 1 of Chelan County, Washington and Purchasers, dated as of November 14, 1957, as heretofore or hereafter amended from time to time (as so amended, "Existing Rocky Reach Power Sales Contract"), and the Purchaser's entitlement to Output from Rock Island under the New Power Sales Contract will only become effective on the expiration of the existing Power Contract – Rock Island Joint System between the Parties dated June 19, 1974, as heretofore or hereafter amended from time to time (as so amended, "Existing Rock Island Power Sales Contract"), and nothing in the New Power Sales Contract will be deemed to supersede or supplement those agreements. Upon the Project Availability Date for a Project, the New Power Sales Contract will constitute the entire agreement between the Parties hereto with respect to such Project. No modifications of or amendments to the New Power Sales Contract will be binding upon the Parties or either of them unless such a modification will be in writing, hereafter duly executed by an authorized officer or employee of each Party.

Neither Party nor any Affiliate thereof may make application to FERC, or any other Government Authority having jurisdiction over the New Power Sales Contract, seeking any change in the New Power Sales Contract pursuant to the provisions of Sections 205 or 206 of the Federal Power Act or under any other statute, regulation or other provision promulgated by a Government Authority, nor support any such application by a third party. Absent the agreement of the Parties to any proposed change, the standard of review for changes to any Section of the New Power Sales Contract specifying the rate(s) or other material economic terms and conditions agreed to by the Parties in the New Power Sales Contract whether proposed by a Party, a non-Party or FERC actions sua sponte, will be the "public interest" standard of review set forth in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (the "Mobile-Sierra" doctrine). The Parties, for themselves and their successors and assigns, (i) agree that this "public interest" standard will apply to any proposed changes in any other documents, instruments or other agreements executed or entered into by the Parties in connection with the New Power Sales Contract and (ii) expressly and irrevocably waive any rights they can or may have to the application of any other standard of review, including the "just and reasonable" standard.

***No Guaranty; Obligations Regarding Bonds or Indebtedness.*** Nothing contained in the New Power Sales Contract will obligate the Purchaser, directly or indirectly, to be or become a guarantor or surety of any bonds or indebtedness of the District and the Purchaser will not directly or contingently be obligated to pay such bonds or indebtedness, nor will it be liable or responsible for the District's use, deposit, investment or application of any funds payable by the Purchaser under the New Power Sales Contract. The District may pledge payments to be made by the Purchaser under the New Power Sales Contract as security for any such bonds or indebtedness; however, such pledge will not imply any obligation of the Purchaser beyond the express terms of the New Power Sales Contract.

***Environmental Attributes.*** If Puget notifies the District that Environmental Attributes have become available that result from or are directly attributable to Output generated from the Chelan Power System, the Parties agree to negotiate in good faith a fair and equitable allocation of such Environmental Attributes, pro rated over the remaining Term; provided, however, that nothing in the New Power Sales Contract is intended to address the Purchaser's right, if any, to any energy certificates or other credits that may otherwise be available to Purchaser

under state or Federal law without the consent, approval or agreement of the District; and provided further, however, that notwithstanding any other provision of his Agreement to the contrary, the Purchaser will not be entitled to Environmental Attributes to the extent the District reasonably determines that such allocations might cause interest on any of its outstanding obligations to be includable in gross income of the holders thereof for federal income tax purposes.

### **Determination of Chelan Power System Net Costs**

***Determination of Net Costs.*** For purposes of the New Power Sales Contract, the District's Chelan Power System net costs ("Net Costs") for any given month will include all costs and expenses of every kind and description, both direct and indirect, paid or accrued by the District in such Month with respect to its ownership, operation, maintenance, repair and improvement of, and the production, sale and delivery of Output from, the Chelan Power System, as determined by the District, including without duplication (whether under the New Power Sales Contract, the Transmission Agreement or the Interconnection Agreement), the items of cost and expense described below, plus any cost or expenses incurred by the District in such month in administrating the New Power Sales Contract that are unique to Purchaser or Purchaser's performance (or failure to perform) under the New Power Sales Contract. Net Costs will not include any depreciation expense. Such Net Costs will include, without intending to limit the generality of the foregoing:

***Operating and Maintenance Costs.*** All operating and maintenance costs of every kind and description, both direct and indirect ("Operating Costs"), paid or accrued by the District with respect to the operation, maintenance and repair of, or the production, sale or delivery of Output from, the Chelan Power System or any part thereof, including allocable District overhead and administrative costs, and costs of generation integration for the Chelan Power System provided by the District's distribution system, all as the District may reasonably determine consistent with GAAP, FERC regulations (including FERC's Uniform System of Accounts) and the District's accounting policies, practices and procedures. Without limiting the generality of the foregoing, Operating Costs will include those items of cost described in subsections (i) through (iv) below.

(i) ***Taxes and Assessments.*** All governmental taxes, assessments or other similar charges with respect to its ownership, operation, maintenance or repair of, or the production, sale or delivery of Output from, the Chelan Power System or any part thereof, including payments by the District in lieu of such governmental taxes, assessments or other similar charges.

(ii) ***Certification, Relicensing and Decommissioning Costs.*** All costs determined by the District to be reasonably allocable to the certification, re-licensing or decommissioning of any of the Projects or any part thereof. The District agrees that it will not accelerate payment of costs associated with measures required or agreed upon, in the District's sole discretion, for the relicensing of either Project in advance of the date(s) necessary to comply with existing and anticipated FERC and other regulatory requirements or settlement agreements related to relicensing.

(iii) ***Litigation.*** All judgments, claims, settlements, arbitration awards and other similar costs and liabilities with respect to its ownership, operation, maintenance, repair or improvement of, or the production, sale or delivery of Output from, the Chelan Power System, including attorneys' fees and costs, in each case to the extent not paid from proceeds of insurance.

(iv) ***Loss Prevention.*** All costs for the prevention of any loss or damage to the Chelan Power System, and all costs of the correction of any loss or damage to the Chelan Power System to the extent not paid from proceeds of insurance covering such loss or damage.

Anything in the Agreement to the contrary notwithstanding, Operating Costs will not include costs paid or deemed paid from the proceeds of Debt Obligations or to the extent the costs of Capital Improvements were paid from Capital Recovery Charges or Debt Reduction Charges as contemplated in the Agreement.

The Purchaser agrees in the New Power Sales Contract that the District may, in its sole discretion, determine what Operating Costs will be incurred in connection with the ownership, operation, maintenance and improvement of, and the production, sale and delivery of Output from, the Chelan Power System.

**Financing Costs.** Financing Costs (“Financing Costs”) for each Month will consist of the monthly accrual, as determined by the District, of the following costs payable or deemed payable by the District or the Chelan Power System, as the case may be, in connection with the issuance, incurring and carrying of Debt Obligations:

(i) **Outstanding Debt Obligations.** With respect to Debt Obligations that are outstanding as of the Signing Date (“Outstanding Debt Obligations”), the Purchaser will pay Financing Costs based on the payment and amortization schedule attached to the New Power Sales Contract, and regardless of actual payments owed by the District and regardless of any subsequent changes in such Debt Obligations, whether as a result of prepayments, refundings, restructuring or otherwise.

(ii) **Future Debt Obligations.** With respect to Debt Obligations that are incurred after the Signing Date (“Future Debt Obligations”), the Purchaser will (a) pay, commencing November 1, 2011, the monthly amortization of the Assumed Debt Service on such Debt Obligations attributable to Rocky Reach, and (b) pay, commencing July 1, 2012, the monthly amortization of the Assumed Debt Service on such Debt Obligations attributable to Rock Island. Following the issuance or incurrence of any Debt Obligation, the District will make available to the Purchaser, at its request, a written schedule showing the Capital Improvements expected to be financed by the District from the proceeds thereof, the estimated Average Service Life of such Capital Improvements as determined by the District and the scheduled monthly Financing Costs associated with such Debt Obligations.

(iii) **Refunding Obligations.** The Purchaser’s Financing Costs with respect to Debt Obligations will be determined as of the Signing Date or the date of original issuance or incurrence thereof, as the case may be, and will not be affected by any subsequent direct or synthetic refinancing of such obligations.

Except as provided below, no adjustment will be made to the Purchaser’s scheduled Debt Obligations payments as calculated in accordance with this Section as a result of the payment, purchase, defeasance, tender, acceleration, redemption or other restructure or modification of Debt Obligations after the initial issuance or incurrence thereof.

**Capital Recovery Charge and Debt Reduction Charge Adjustments.** If the District purchases, redeems or defeases outstanding debt of the Chelan Power System from moneys on deposit in the Capital Recovery Charge Fund or Debt Reduction Charge Fund, or from proceeds of insurance received with respect to components of the Capital Improvements that the District elects not to repair, rebuild or replace, all as determined by the District, the District will provide the Purchaser with a credit against its monthly Financing Costs otherwise due from time to time under the New Power Sales Contract, spread over a 25-year period from the month following the month of calculation (which the District agrees to complete as soon as reasonably practical following such purchase, redemption or defeasance), computed on a level monthly credit basis, using the following criteria, all as determined by the District: (i) the interest component of the credit will be the actual weighted average interest rate applicable to Debt Obligations included in the Purchaser’s Financing Costs (as set forth in the New Power Sales Contract and as determined in accordance with the New Power Sales Contract), and (ii) the principal component of the credit will equal the principal amount of debt of the Chelan Power System that was purchased, redeemed or defeased with such funds.

Anything in the New Power Sales Contract to the contrary notwithstanding, the District’s determination of Net Costs, Operating Costs and Financing Costs will be binding and conclusive on the Purchaser absent manifest error.

Notwithstanding the foregoing, the District, in its discretion, may adjust the Financing Costs contemplated in the New Power Sales Contract as it deems necessary, from time to time, to correct any error in the computation thereof, or to reflect a material change in the District’s reasonable estimate of the In Service Date or the Average

Service Life with respect thereto, and will either add to or credit the amounts otherwise due in such month under the New Power Sales Contract, to reflect the cumulative effect of any such adjustment.

Anything in the New Power Sales Contract to the contrary notwithstanding, except as provided in the Agreement, no credits will be given for any income or revenues from the sale or other disposition of Output to any person.

*Use of Funds; Separate Accounts.*

Except as otherwise expressly set forth in the New Power Sales Contract, the District, in its sole discretion, may use payments received from the Purchaser under the New Power Sales Contract in any manner that the District will determine.

*Issuance and Incurrence of Debt Obligations and Refunding Obligations.*

The District in its discretion may issue and incur Debt Obligations for the purpose of financing Capital Improvements to the Chelan Power System and may issue or incur Refunding Obligations to Refinance Debt Obligations and Refunding Obligations.

Anything in the New Power Sales Contract to the contrary notwithstanding, the covenants, agreements, terms and provisions of all Debt Obligations and Refunding Obligations, including all bond resolutions, loan resolutions, trust agreements and indentures, loan agreements, reimbursement agreements, leases, bonds, notes and other similar instruments, adopted or executed by the District with respect to such Debt Obligations and Refunding Obligations will be determined by the District in its sole discretion.

**Output and Scheduling**

This section describes provisions governing the determination of the Output to be made available to Purchaser under the New Power Sales Contract. Such provisions, in conjunction with the Transmission Agreement and the Interconnection Agreement, will also govern the management, scheduling, delivery and transmission of the Output.

*Output*

***Chelan Power System Output.***

(a) ***Capacity and Energy Component.*** Output includes the deliverable electric Capacity and Energy from the Chelan Power System net of the following adjustments with respect thereto:

- (i) adjustments for receipt and delivery of all upstream and downstream encroachments, adjustment for station service and losses to the Transmission Point(s) of Receipt;
- (ii) adjustment for energy delivery or consumption obligations that are a Project responsibility under applicable Laws or agreements (including, but not limited to, fish hatcheries);
- (iii) adjustment for capacity and energy receipt obligations with the Federal System associated with Immediate Spill Replacement;
- (iv) capacity and energy delivery obligations under the Canadian Entitlement Allocation Extension Agreement signed by the District and the Bonneville Power Administration, acting as the U.S. Entity under the U.S. Canada Treaty of 1964;
- (v) Purchaser adjustments for energy delivery rights that are a Project right under applicable laws or agreements (including, but not limited to, PNCA); and



(vi) adjustments due to limitations imposed by and rights under the FERC licenses, MCHC, HCP, Biological Opinion, Hanford Reach Fall Chinook Protection Program and Immediate Spill Replacement.

(b) **Pond/Storage.** Output includes access to and the ability to use 90% of the Purchaser's Percentage of Pond/Storage of the Projects of the Chelan Power System.

(c) **Load Following and Regulation.** Output includes Load Following/Regulation services by the Chelan Power System.

(d) **Chelan Power System Rights and Obligations.** Output includes the rights and obligations from Canadian Entitlement, MCHC, PNCA, HCP, Biological Opinion, Hanford Reach Fall Chinook Protection Program and Immediate Spill Replacement.

(e) **Output Limitations.** Output is subject to limitation or adjustments due to:

(i) planned or unplanned outages for maintenance or repair;

(ii) any reductions due to fishery programs, including but not limited to, spill for fish bypass and capability reductions for a bypass system;

(iii) any reductions or limitations due to the Hanford Reach Fall Chinook Protection Program and the Biological Opinion or any other limitations imposed by Government Authorities;

(iv) any reductions or limitations due to the HCP;

(v) reductions or interruptions reasonably necessary to promote and support national, regional and local electric system stability and reliability (including, but not limited to, MVAR support of the transmission system);

(vi) minimum generation limitations due to minimum flow requirements;

(vii) other operational limitations lawfully imposed;

(viii) force majeure events; and

(ix) Any other Operational Constraints.

(f) **Excluded Products and Services.** Output does not include the following:

(i) Black Start Capability;

(ii) RAS;

(iii) Voltage Support/MegaVars (MVARs); and

(iv) All other items not specifically included in clauses (a) through (e) of this section, except as otherwise described in clause (g) below. It is Purchaser's responsibility to provide any additional ancillary services required to comply with safety and reliability standards in connection with Purchaser's receipt and use of Output.

(g) **Spinning Operating Reserves and Non-Spinning Operating Reserves.** The Purchaser's ability to utilize Output for purposes of Spinning Operating Reserves and Non-Spinning Operating Reserves will be limited to and as provided in MCHC and its related operating protocols. The Parties agree in the New Power Sales Contract that they will negotiate in good faith with each other and with other MCHC parties to modify MCHC's operating

protocols in order to provide for the availability of Spinning Operating Reserves and Non-Spinning Operating Reserves; provided, however, that under any circumstances, the District reserves the right to refuse to place unloaded Units on-line for the sole purpose of meeting Purchaser's Spinning Operating Reserve obligations.

(h) **Implementation.** The reduction of Chelan Power System Capacity deliveries to Purchaser will be imposed pro-rata such that reductions of Capacity for Purchaser at any time will equal Purchaser's Percentage of the total reductions of Capacity at such time. Energy reductions of the Chelan Power System will be allocated according to procedures in the MCHC. The Purchaser will have the ability to utilize its full Purchaser's Percentage of Output at any point in time, subject to the availability of Units, the amount of water available, FERC limitations, maximum Ramp Rates, and any other Operational Constraints.

**Management of Rocky Reach and Rock Island Storage (MCHC).** Purchaser will have access to and the ability to use its Purchaser's Percentage of Output, inflow, and 90% of the Purchaser's Percentage of Pond/Storage components of Output as it sees fit, subject to all limitations set forth in the New Power Sales Contract. The Chelan Power System has a limited amount of Pond/Storage available each day for daily shaping use. All Pond/Storage at Rocky Reach and Rock Island will be accounted for and controlled pursuant to the terms of the MCHC.

Prior to the first Project Availability Date, the Purchaser must become a signatory of the MCHC. The Purchaser will be responsible for monitoring storage levels and adjusting Energy requests as required to stay within MCHC limits. All expenses associated with acquisition, operation and maintenance of hardware and software on the Purchaser's system necessary to meet Purchaser's obligations under the New Power Sales Contract and the MCHC will be Purchaser's responsibility. In the event the District must intervene to correct an MCHC problem or contractual deficiency on behalf of Purchaser, Purchaser will reimburse the District for all resulting costs and penalties incurred by the District as a result thereof on a monthly basis as a line item on billings.

The Purchaser will manage its Energy requests, subject to the terms of the MCHC, so as not to exceed its total Capacity entitlement at each Project. All rights and duties under the MCHC as applicable to Purchaser's Percentage of Output will be discharged solely by Purchaser, except as otherwise provided in the New Power Sales Contract. Purchaser will not make any request for Energy that would cause its MCHC Pond/Storage account for either Project to go below zero MWH. An account will be kept pursuant to the MCHC for the Purchaser, based on the information provided to the District pursuant to the MCHC. Purchaser's account will reflect Purchaser's Percentage of allocated inflow being added each hour and Purchaser's previous hour's energy subtracted. Purchaser will not violate any MCHC limitation. In the event Purchaser's Pond/Storage account for either Rocky Reach or Rock Island goes below the minimum MCHC requirements, expressed in MWH, the District, as its sole remedy for such condition, may immediately reduce Capacity associated with Purchaser's Percentage of Output available from either Rocky Reach or Rock Island to an amount approximating Purchaser's Percentage of allocated inflow until the Purchaser's Pond/Storage account balance has returned to zero MWH.

**Chelan Transmission Service.** Prior to the initial delivery of Purchaser's Percentage of Output, Purchaser and the District intend to enter into a Transmission Agreement (and, at the discretion of the District, a separate Interconnection Agreement).

The Transmission Agreement will contain all terms and conditions required to effectuate the delivery of Purchaser's Percentage of Output from the Purchaser's "Transmission Point(s) of Receipt", across the Chelan Transmission System to the Purchaser's "Transmission Point(s) of Delivery." The Parties will structure the Transmission Agreement as required to support the efficient exchanges of electric capacity and energy contemplated by Canadian Entitlement, MCHC, and PNCA, and to allow Purchaser flexibility in designation of Transmission Points of Delivery and Transmission Points of Receipt, so long as such flexibility does not adversely affect the safety and reliability of the Chelan Transmission System, the District's retail electric service obligations, or other firm District transmission service obligations.

**APPENDIX J—SUMMARY OF POWER SALES CONTRACT WITH ALCOA, INC.**

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## APPENDIX J - SUMMARY OF POWER SALES CONTRACT WITH ALCOA, INC.

The following is a summary of certain provisions of the Power Sales Contract with Alcoa Power Generating Inc. and Alcoa Inc. (the “Power Sales Contract”). This summary does not purport to be complete and is qualified in its entirety by reference to the foregoing document for a complete statement of the provisions of such document.

### DEFINITIONS

“**Adequate Assurance**” means Performance Assurance or other assurances of continued performance by the Purchaser of its obligations under the Power Sales Contract, in each case reasonably acceptable to the District. Performance Assurance may not necessarily constitute Adequate Assurance in all circumstances.

“**Approval Date**” means the date FERC approves the Power Sales Contract.

“**Assumed Debt Service**” means:

(i) with respect to any Debt Obligation issued after January 31, 2006 and before the first Project Availability Date, the amount for each applicable Contract Year calculated as of the date of issuance or incurrence thereof, that would be sufficient to fully amortize the original stated principal amount thereof, together with interest thereon at the Index Rate (using semi-annual compounding and a year of 360 days), for such Debt Obligation, on an annual level debt service basis over an amortization period commencing on the In Service Date of the Capital Improvements expected to be financed from the proceeds of such Debt Obligation and ending on the last day of such Capital Improvements’ Average Service Life.

(ii) with respect to any Debt Obligation issued on or after the first Project Availability Date, the amount for each applicable Contract Year calculated as of the issuance or incurrence thereof, that would be sufficient to fully amortize the original stated principal amount thereof, together with interest thereon at the Index Rate (using semi-annual compounding and a year of 360 days) for such Debt Obligation on an annual level debt service basis over an amortization period commencing on the date of issuance or incurrence of such Debt Obligation and ending on the Deemed Maturity thereof.

“**Average Service Life**” means, with respect to any Debt Obligation issued after January 31, 2006, the estimated weighted average economic service life of the Capital Improvements that the District expects to finance from proceeds of such Debt Obligations issued or incurred after January 31, 2006, as determined by the District on or as of the date of the issuance or incurrence thereof. For purposes of the foregoing, land will be deemed to have a weighted average economic service life of 25 years.

“**Biological Opinion**” means any opinion issued by a Government Authority authorized to do so under the Endangered Species Act (ESA) that reviews and assesses whether the operating plan submitted by BPA, the U.S. Army Corps of Engineers and the Bureau of Reclamation will jeopardize the survival of any creature or creatures that have been determined to be threatened or endangered pursuant to the ESA.

“**Black Start Capability**” means the ability of generators to self-start without any source of off-site electric power and maintain adequate voltage and frequency while energizing isolated transmission facilities and auxiliary loads of other generators.

“**Bonneville Power Administration (BPA)**” means the Federal power marketing agency responsible for the selling of the output of all Columbia River Federal project generation, and ownership, operation and maintenance of a major share of the northwest high-voltage transmission system.

“**Canadian Entitlement**” means the amount of energy and capacity that Rocky Reach and Rock Island are obligated to return to BPA in its capacity as the US Entity for the account of the Canadian government to fulfill obligations under the US-Canadian Columbia River Treaty of 1964.

“**Capacity**” means the instantaneous generation potential of the Chelan Power System as adjusted for limitations and obligations in accordance with the provisions described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission.”

“**Capacity Reservation Charge Escalation Factor**” means the percentage change in relative value of the Consumer Price Index using the non-seasonally adjusted US City Average Index for All Urban Consumers (All

Items, Base Period 1982-84 = 100), as published by the U.S. Department of Labor, Bureau of Labor Statistics, computed in accordance with the following formula:

$$EF = CPI \div CPI-b$$

Where: EF = the Escalation Factor,

CPI = the most recently published consumer price index identified above, in effect as of the date of signing of the Power Sales Contract

CPI-b = 198.3, the consumer price index identified above for the base month of January 2006

**“Capital Improvements”** means such capital repairs, renewals, additions, improvements and replacements of the Projects, together with preliminary surveys, investigations, architectural, engineering, design, consulting, legal, financial and other services and items properly chargeable thereto, as the District may reasonably determine consistent with GAAP, FERC regulations (including FERC’s Uniform System of Accounts) and District accounting policies, practices and procedures.

**“Capital Recovery Charge Percentage”** means that percentage, designated by the District for a Contract Year not less than twelve (12) months prior to the commencement of such Contract Year, which percentage will be set between a minimum of 0% and a maximum of 50%. Each such designation will be effective for the Contract Year for which such designation is made. If the District fails to make a designation for any Contract Year by the date required above, the Capital Recovery Charge Percentage for such Contract Year will be the greater of 25% or the last effective Capital Recovery Charge Percentage designated by the District.

**“Capital Recovery Charge Base”** means a base amount equal to \$25,000,000 in 2004 dollars. The Capital Recovery Charge Base, as the same may be adjusted from time to time pursuant to the methodology specified in the following paragraph, will be adjusted annually as of the first day of each Contract Year by the Escalation Factor.

**“Change in Control”** means an event or series of events that occurred as a result of which any “person” or “group” (within the meaning of Sections 13(d) and 14(d)(2) of the Exchange Act) will have acquired beneficial ownership (within the meaning of Rule 13d-3 promulgated by the Securities and Exchange Commission under said Act), directly or indirectly, of more than fifty percent (50%) of the combined voting power of or economic interests in the outstanding Equity Interests in Alcoa.

**“Change of Law”** means any change in federal or state statutes or regulations or any judicial or regulatory interpretations.

**“Chelan Power System”** means, collectively, Rocky Reach and Rock Island, in each case as each such Project exists as of its respective Project Availability Date. The Chelan Power System will also include an amount of Output equal to any expansion of the Output determined in relation to the existing Projects after their respective Project Availability Dates, but will not include any other power generation, transmission or distribution assets or rights, now owned or hereafter acquired by the District.

**“Chelan Power System Output”** includes adjustments for the following:

1. Canadian Entitlement
2. MCHC
3. PNCA
4. HCP
5. Biological Opinion
6. Hanford Reach Fall Chinook Protection Program
7. Immediate Spill Replacement
8. Operational Constraints

**“Claims”** means all claims (including counterclaims), demands, actions or proceedings, threatened or filed and whether groundless, false or fraudulent, that directly or indirectly relate to the subject matter of an indemnity or limitation of liability, and the resulting costs, judgments, liabilities, losses, damages, penalties, interest, expenses, attorneys fees, court costs and costs of investigation, whether incurred by settlement or otherwise, and whether such claims or actions are threatened or filed prior to or after the termination of the Power Sales Contract.

**“Contract Year”** means the period commencing on the first Project Availability Date and ending on the next succeeding December 31, and each 12-month period thereafter, except for the 12-month period during which

the expiration or termination date of the Power Sales Contract occurs, in which case the Contract Year means the period commencing on January 1 of such year and ending on such expiration or termination date.

**“Coverage Amount”** means the sum, as of the date of calculation, of (i) with respect to Debt Obligations outstanding as of January 31, 2006 and identified in Schedule A-1, an amount equal to fifteen percent (15%) of the maximum estimated aggregate amount of the Financing Costs described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Determination of Chelan Power System Net Costs” that will be payable in any Contract Year during the Term, as determined by the District as of January 31, 2006 for all Debt Obligations outstanding as of January 31, 2006, and (ii) with respect to all Debt Obligations issued after January 31, 2006, an amount equal to fifteen percent (15%) of the maximum estimated aggregate amount (each amount included in such aggregate amount to be as determined by the District as of the date of issuance or incurrence of the applicable Debt Obligation) of Financing Costs with respect to such Debt Obligations as described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Determination of Chelan Power System Net Costs,” that will be payable in any Contract Year during the Term.

**“Cross Default Amount”** means, with respect to the Purchaser, two and one-half percent (2 1/2%) of the Purchaser’s then current market capitalization (based on its share prices as quoted in the Wall Street Journal the Business Day prior to the date of calculation) and, with respect to the District, \$50,000,000, as adjusted in accordance with the Escalation Factor.

**“Debt Obligation”** means a bond, note (including a commercial paper note or bond anticipation note), installment purchase agreement, financing lease, inter-fund loan or any other obligation for borrowed money, or portion thereof, issued or incurred by or on behalf of the District for either or both Projects, the proceeds of which were or will be applied to finance Capital Improvements with respect to such Project or Projects and which has been or is designated by the District in its discretion as a Debt Obligation with respect to such Project or Projects. For the avoidance of doubt, these obligations will constitute Debt Obligations for purposes of the Power Sales Contract. Debt Obligations will not include any Refunding Obligations, or the principal portion of any obligations issued after January 31, 2006 that otherwise would fall within the definition of Debt Obligations, to the extent such principal portion is or was used to pay costs of issuance or to fund debt service reserves with respect to Debt Obligations, all as determined by the District in its discretion. To avoid double counting, if the District designates inter-fund loans from the District Enterprise Units of the District to the Chelan Power System as Debt Obligations, the corresponding third party obligations of the District will not be included as Debt Obligations for purposes of the Power Sales Contract. “Debt Obligations” will include inter-fund loans from the District Enterprise Units that otherwise qualify as Debt Obligations; however, transfers from the District to the Chelan Power System derived from payments made by the Purchaser in respect of Capital Recovery Charges or Debt Reduction Charges, as determined by the District, will not be treated as Debt Obligations for purposes of the Power Sales Contract. For purposes of the Power Sales Contract, the principal amount of Debt Obligations issued after January 31, 2006 will be deemed to amortize in accordance with the Assumed Debt Service with respect thereto, and not on the actual principal amount of the District’s Debt Obligations that may be outstanding on the date of calculation.

**“Debt Reduction Charge Percentage”** means that percentage, designated by the District for a Contract Year not less than twelve (12) months prior to the commencement of such Contract Year, which percentage will be set between a minimum of 0% and a maximum of 3%. Each such designation will be effective for the Contract Year for which such designation is made. If the District fails to make a designation for any Contract Year by the date required above, the Debt Reduction Charge Percentage for such Contract Year will be the greater of 2-1/2% or the last effective Debt Reduction Charge Percentage designated by the District;

**“Debt Reduction Charge Obligations”** means, for any Contract Year, the aggregate principal amount of all Debt Obligations assumed to be outstanding as of the first day of such Contract Year, determined in accordance with the Power Sales Contract and described in “THE POWER SALES CONTRACT—Determination of Chelan Power System Net Costs,” as such principal amount may have theretofore been reduced in accordance with the Power Sales Contract and described in “THE POWER SALES CONTRACT—Determination of Chelan Power System Net Costs.” Prior to the Project Availability Date for Rock Island, the Debt Reduction Charge Obligations for purposes of “THE POWER SALES CONTRACT—Payment” will be computed only with reference to those Debt Obligations attributable to Rocky Reach.

**“Deemed Maturity”** means that date determined by the District as of the issuance or incurrence of a Debt Obligation, by adding to the date of issuance or incurrence of such Debt Obligation, *the lesser of* (a) twenty-five (25)

years, or (b) the Average Service Life of the Capital Improvements expected to be financed by the District from the proceeds thereof, as determined by the District.

**“District Enterprise Units”** means and includes each utility, enterprise or operating system or unit of the District, exclusive of Rocky Reach and Rock Island, as the District may designate from time to time, that may make advances or inter-fund loans to the Chelan Power System as contemplated within the definition of Debt Obligations.

**“District System Emergency”** means a condition or situation that, in the judgment of the District and in conformance with guidelines of FERC, NERC, the WECC or other entities with regulatory jurisdiction (whether by contract or operation of Law) over the District concerning system emergencies, adversely affects or is likely to adversely affect: (i) public health, life or property; (ii) District’s employees, agents or property; or (iii) District’s ability to maintain safe, adequate and reliable electric service to its respective customers.

**“Downgrade Event”** means the Purchaser’s long-term senior unsecured debt rating (a) from S&P is withdrawn (other than at the request of Purchaser), suspended or reduced below “BBB-” (or corresponding successor rating); or (b) from Moody’s is withdrawn (other than at the request of Purchaser), suspended or reduced below “Baa3” (or corresponding successor rating); or (c) from Fitch is withdrawn (other than at the request of Purchaser), suspended or reduced below “BBB-” (or corresponding successor rating). If any Rating Agency has not assigned a rating to Purchaser as of the Signing Date, a Downgrade Event will not occur as to that Rating Agency until such a rating has been assigned and such rating is either at or below the respective level set forth above, or the initial higher rating is thereafter withdrawn (other than at the request of Purchaser), suspended or reduced below the respective level set forth above. Commencing on the Signing Date, Purchaser is required to maintain ratings from at least two of the three named credit rating agencies.

**“Dryden Facilities”** means the District’s dam, spillway, irrigation flume and related facilities located on the Wenatchee River near Dryden in Chelan County, Washington.

**“Effective Date”** of the Power Sales Contract means the Signing Date.

**“Energy”** means the energy production, expressed in megawatt hours, as determined in relation to the Output of the Chelan Power System as measured in megawatts integrated over an hour and adjusted for limitations and obligations in accordance with the Power Sales Contract and described in “THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission.” Energy may be supplied by the District from any source and the District is not obligated to supply Energy from any particular source.

**“Entiat Facilities”** means the District’s diversion and irrigation facilities located in and adjacent to the Entiat River in Chelan County.

**“Equity Interests”** means, with respect to Alcoa, any and all shares, interests, rights to purchase, warrants, options, participations or other equivalents of or interest in (however designated) Alcoa’s corporate stock.

**“Escalation Factor”** means the percentage change in relative value of the Consumer Price Index using the non-seasonally adjusted US City Average Index for All Urban Consumers (All Items, Base Period 1982-84 = 100), as published by the U.S. Department of Labor, Bureau of Labor Statistics, computed annually in accordance with the following formula:

$$EF = \text{CPI} \div \text{CPI-b}$$

Where: EF = the Escalation Factor,

CPI = the most recently published consumer price index identified above, in effect as of the date of annual computation

CPI-b = 190.3, the consumer price index identified above for the base month of December, 2004.

Should the index referred to above be discontinued or be substantially modified, then an alternate index will be chosen by the District in its discretion that reasonably tracks the methodology used to track the consumer price index identified above prior to such modification or discontinuance to maintain the purchasing power of one dollar at a constant level, considering the nature of expenses



incurred in the acquisition, construction and installation of Capital Improvements of the Chelan Power System.

**“FERC”** means the Federal Energy Regulatory Commission or its successor.

**“Fiscal Year”** means the twelve-month period selected by the District from time to time as its fiscal year for accounting and other purposes, which currently is the twelve-month period commencing on January 1 and ending on the next succeeding December 31.

**“Fish Spill”** means the required spill of water for the passage of fish past the Projects as required by FERC order, the District’s HCP, spill for studies, or other Regulatory Authorities.

**“Fitch”** means Fitch Ratings, or any successor thereto and, if such corporation is dissolved or liquidated or no longer performs the functions of a securities rating agency, “Fitch” is deemed to refer to any other nationally recognized securities rating agency designated in writing by the District.

**“Government Authority”** means any federal, state, local, territorial or municipal government and any department, commission, board, bureau, agency, instrumentality, judicial or administrative body thereof.

**“Habitat Conservation Plans (HCP)”** means the plans approved as part of the Rocky Reach and Rock Island licenses to protect anadromous fish passing upstream and downstream at the projects.

**“Hanford Reach Fall Chinook Protection Program (Vernita Bar)”** means the agreement which defines the Mid-Columbia projects’ (Grand Coulee, Chief Joseph, Wells, Rocky Reach, Rock Island, Wanapum, and Priest Rapids) operational obligations for the fresh water life cycle protection of the Hanford Reach Fall Chinook which has been signed by the District, National Oceanic and Atmospheric Administration’s Department of Fisheries (NOAA Fisheries), Washington Department of Fish and Wildlife, PUD No. 2 of Grant County, and PUD No. 1 of Douglas County.

**“Immediate Spill Replacement”** means the energy received from the Federal government for the purpose of moving spill from the Federal system to reduce total dissolved gas levels downstream from Federal reservoirs.

**“Independent Investment Banker”** means an investment banking firm selected by the District in its discretion that is nationally recognized for its knowledge and experience in the pricing and sale of debt securities and that has, or whose parent company has, a rating from at least two of the Rating Agencies of not less than “A-” in the case of S&P and Fitch, and “A3” in the case of Moody’s.

**“Index Rate”** means, with respect to each Debt Obligation, as of the applicable date of calculation, the fixed interest rate, as determined by the District in consultation with an Independent Investment Banker as of the date of issuance or incurrence thereof, equal to 110% of the weighted average annual interest rate that such Debt Obligation would bear (i) based on the then current underlying long term credit rating of the District; (ii) assuming that interest on such Debt Obligation would be includable in the income of the holders thereof for federal income tax purposes; and (iii) assuming that such Debt Obligation were amortized on a level debt service basis over the applicable amortization period described in the definition of “Assumed Debt Service.” In determining the Index Rate of any Debt Obligation, the District may consider interest indices and other market data generally available as of the date of calculation.

**“In Service Date”** means the estimated weighted average date the Capital Improvements expected to be financed from proceeds of a Debt Obligation are or are expected to be placed in service, as determined by the District.

**“Intentional Breach”** means, with respect to the District, the sale by the District of Purchaser’s Share of Output to third parties, with full knowledge and intent that such action is in breach of the Power Sales Contract and in blatant disregard for its express obligations under the Power Sales Contract. Such term only relates to the failure to deliver Purchaser’s Share of Output to the extent required under the Power Sales Contract, and does not apply to any other obligations of the District including, without limitation, any operational aspect of the System (including curtailments and shutdowns) or transmission facilities, or any other covenant, duty or obligation that may arise under the Power Sales Contract.

**“Interconnection Agreement”** means the agreement between Purchaser and the District providing for the interconnection of the Purchaser’s electric transmission facilities with the Chelan Transmission System, as well as

terms and conditions for the parallel operation of the Chelan Transmission System and Purchaser's transmission system.

**"Law"** means any statute, law, order, rule or regulation imposed by a Regulatory Authority.

**"Letter(s) of Credit"** means one or more clean, irrevocable, transferable direct pay or standby letters of credit issued by a U.S. commercial bank or a foreign bank with a U.S. branch with such bank having a credit rating at all times of at least A- from S&P or A3 from Moody's, in a form acceptable to the District. Costs of a Letter of Credit are to be borne by the Purchaser.

**"Load Following/Regulation"** means the ability to adjust generation within an hour (or pursuant to dynamic scheduling) to follow variations in load. Load Following/Regulation is limited and constrained by the number of Units available, any limitations on the Units, Ramp Rate, and any other power or non-power restrictions.

**"Mid-Columbia Hourly Coordination (MCHC)"** means the 1997 Agreement For The Hourly Coordination Of Projects On The Mid-Columbia River (or its successor agreement), an agreement among the principal parties that own or have rights to generation relating to the seven mid-Columbia hydro projects (Grand Coulee, Chief Joseph, Wells, Rocky Reach, Rock Island, Wanapum, and Priest Rapids). The Power Sales Contract coordinates the hydraulic operation (generation, flows, and storage) among these projects.

**"Moody's"** means Moody's Investors Service, Inc., or any successor thereto and, if such corporation is dissolved or liquidated or no longer performs the functions of a securities rating agency, "Moody's" is deemed to refer to any other nationally recognized securities rating agency designated in writing by the District.

**"NERC"** means the North American Electric Reliability Council or its successor responsible for insuring a reliable, adequate and secure bulk electric system.

**"Non-Spinning Operating Reserves"** means those reserves that may be available at any time from all Units of the Chelan Power System not then connected to the system but capable of being connected and serving demand within a specified time.

**"Operational Constraints"** means any constraints on the Units, or a Project's operation that are deemed necessary by the District in its sole discretion meet any requirement due to the HCP, regulations, Laws, court orders, authority, safety, or to maintain reliability of the Chelan Power System, or to minimize equipment wear, maintain equipment, or repair/replace equipment, or that are due to any other event or circumstance described in "THE POWER SALES CONTRACT—Curtailed and Decommissioning" or any other event beyond the control of the District.

**"Output"** means an amount of Energy determined in relation to the energy production of the Chelan Power System and other products and services, to the extent described in and determined pursuant to the provisions described in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission," subject to the limitations set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission."

**"Pacific Northwest Coordination Agreement (PNCA)"** means the agreement among Northwest parties for the coordinated operation of the Columbia River system on a seasonal and monthly basis. The PNCA defines the firm energy output of the Chelan Power System, as well as other rights and obligations, including provisional energy, interchange energy, in-lieu energy, and others defined in the contract. The PNCA does not allow resources above the head works of Bonneville Dam to be removed from coordination, and currently all Capacity and Energy of the Chelan Power System is included in PNCA planning. PNCA serves as a settlement of the Federal Power Act Section 10(f) obligation to reimburse upstream Federal projects for energy gains as a result of the storage provided, as well as a FERC approved settlement among all Non-Federal parties for upstream benefit payments. The Purchaser may need to become a signatory to PNCA or contract with another PNCA party to fulfill any and all of the obligations required by PNCA with respect to the Purchaser's Percentage of Output.

**"Performance Assurance"** means collateral in the form of either cash, Letters(s) of Credit or Qualified Investments, deposited with the District, or an escrow agent selected by the District and reasonably satisfactory to the Purchaser, and held pursuant to a collateral deposit agreement in form and substance reasonably satisfactory to the District, in an amount equal to the sum of (a) *the greater of* (i) the highest three (3) months of Periodic Payments due under the Power Sales Contract in the twelve (12) months preceding the date of calculation, *or* (ii) the amount that the District estimates will be the sum of the highest three (3) months of Periodic Payments that will become due

under the Power Sales Contract in the twelve (12) month period immediately following the month in which such calculation is made and (b) an amount equal to the Shutdown Settlement Amount for the applicable fiscal year in which the calculation is made (to be adjusted each fiscal year thereafter during which collateralization is required). The initial payments required to be made by the Purchaser on or before the initial Effective Date under “THE POWER SALES CONTRACT—Payment” and not permitted to be included as part of the Periodic Payments for purposes of the calculations made pursuant to this definition.

“**Periodic Payments**” means the sum of the payments, costs and charges described or referred to in the Power Sales Contract.

“**Permanently Retired**” means with respect to a Project, that such Project or specified Units of such Project, have been shut down and notice of permanent cessation of operations with respect thereto has been given by the District to the Purchaser and as such submittal to FERC may be required by the license for such Project.

“**Pond/Storage**” means the volume of water, expressed in MWH, that can be stored behind a Project between its minimum and maximum headwater elevations.

“**Potential Event of Default**” means an event which, with notice or passage of time or both, would constitute an Event of Default.

“**Prior Agreement**” means the Recitals and Amended Power Sales Agreement dates as of October 1, 2004, as amended, by and amount the District, Alcoa and APGI.

“**Project**” means each of Rock Island and Rocky Reach.

“**Project Availability Date**” means for Rocky Reach, 00:00 hours on November 1, 2011, and for Rock Island, 00:00 hours on July 1, 2012.

“**Project Transmission Facilities**” means those Project-owned transmission facilities included in the Chelan Power System that are utilized to transmit Output to the Chelan Transmission System.

“**Prudent Utility Practice**” means any of the practices, methods and acts engaged in, or approved by, a significant portion of the electric utility industry in the Western Interconnection for operating facilities of a size and technology similar to the Project during the relevant time period or any of the practices, methods and acts, which, in the exercise of reasonable judgment in light of the facts known, at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with applicable Laws, longevity, reliability, safety and expedition. Prudent Utility Practice is not intended to be limited to the optimum practice, method or act to the exclusion of all others, but rather to be a spectrum of commonly used practices, methods and acts.

“**Purchaser’s Percentage**” means the percentage set forth in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits” as such amount may be adjusted from time to time pursuant to the terms of the Power Sales Contract.

“**Purchaser’s Percentage of Output**” means an amount for any period equal to the product of (i) the Purchaser’s Percentage, and (ii) the Output.

“**Qualified Investments**” means all securities and other instruments in which the District is authorized to invest under applicable law.

“**Ramp Rate**” means the rate of change in the level of generation for a specified period within all applicable Operational Constraints. The maximum Ramp Rate is a variable quantity based upon these limitations.

“**Rating Agencies**” means, collectively, Fitch, Moody’s and S&P.

“**Regional Transmission Organization**” (RTO) means any regional transmission organization which governs loads, generation, ancillary services and transmission of both Parties. As of the Signing Date, there is no such RTO.

“**Remedial Action Schemes**” (RAS) means any action implemented by the District utilizing the Chelan Power System to maintain the transfer capabilities and stability of the western electrical system.

“**RCW**” means the Revised Codes of Washington.

**“Refunding Obligations”** means a bond, note (including a commercial paper note or bond anticipation note), installment purchase agreement, financing lease, inter-fund loan or any other obligation for borrowed money, or any portion thereof, issued or incurred by or on behalf of the District, for purposes of Refinancing a Debt Obligation or a Refunding Obligation. The term “Refunding Obligations” is not permitted to be included in the calculation of Debt Obligations.

**“Regulatory Authority”** means any Government Authority other than the District itself.

**“Related Power Sales Agreement”** means a power sales agreement between a Share Participant and the District for the purchase and sale of a percentage of Energy production of the Chelan Power System or Output as determined in relation to the Chelan Power System as so designated by the District and containing terms and conditions similar to the terms and conditions set forth in the Power Sales Contract. This term will specifically include that certain Power Sales Contract between the District and Puget Sound Energy, Inc. dated as of February 1, 2006.

**“Reserve and Contingency Fund”** means the fund or funds created under the Project bond resolutions including the Rocky Reach Resolutions 1860 and 4198, and the Rock Island Resolutions 1137, 3443, 4950 and 97-10671, 97-10672 and any successor resolutions adopted. As long as bonds remain outstanding under such resolutions, deposit requirements into the appropriate Reserve and Contingency Fund may be made from the Capital Recovery Fund and/or the Debt Reduction Fund and from Purchaser’s payments made in respect of Financing Costs allocated to that purpose in the Power Sales Contract. Required and authorized uses of the Reserve and Contingency Funds are to be made in accordance with the appropriate Project bond resolution or, after the retirement of such bonds, for any other lawful Project purpose not inconsistent with the provisions of the Power Sales Contract.

**“Rock Island”** means (i) the District’s Rock Island Hydroelectric Project as currently licensed by FERC under license number 943, and any successor license, including any efficiency improvements and upgrades that increase generating capacity and any decommissioning of Units as contemplated in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Curtailed and Decommissioning,” in each case made by the District from time to time during the Term, together with (ii) the Dryden Facilities, the Entiat Facilities and the Tumwater Facilities.

**“Rocky Reach”** means the District’s Rocky Reach Hydroelectric Project as currently licensed by FERC under license number 2145, and any successor license, including any efficiency improvements and upgrades that increase generating capacity and any decommissioning of Units as contemplated in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Curtailed and Decommissioning,” in each case, made by the District from time to time during the Term.

**“Sales and Administrative Charges”** means the sum of (i) the amount of the District’s 1.5% administrative fee with respect to such Excess Energy sales and (ii) an amount equal to \$0.50 times the sum of the Excess Energy sales in MWhs during each Qualifying Day, where a “Qualifying Day” means any day during which Purchaser has placed daily sales of greater than 50 aMW of the Excess Energy Allocation for such day.

**“Schedule” or “Scheduling”** means the actions or product of the District, Purchaser and/or their designated representatives, including each Party’s Transmission Providers, if applicable, of notifying, requesting and confirming to each other the quantity and type of Output to be delivered on any given day or days at a specified Transmission Point of Receipt and/or Transmission Point of Delivery.

**“S&P”** means Standard and Poor’s Ratings Services, a Division of The McGraw-Hill Companies, Inc., or any successor thereto and, if such corporation is dissolved or liquidated or no longer performs the functions of a securities rating agency, “S&P” is deemed to refer to any other nationally recognized securities rating agency designated in writing by the District.

**“Share Participant”** means a third party purchaser, unrelated to the District, who signs a Related Power Sales Agreement with the District for a share of Output of, or determined in relation to, the Chelan Power System.

**“Signing Date”** means the date the Parties sign the Power Sales Contract, which will be deemed to be the date recited in the first paragraph of the Power Sales Contract.

**“Spinning Operating Reserves”** means the difference at any time between total available Capacity of all Units of the Chelan Power System then on-line and the sum of the then current generation level of those on-line Units.

**“Spill”** means water that passes over a spillway without going through turbines to produce energy.

**“Spill Past Unloaded Units”** means a spill that occurs while Units are not all fully loaded.

**“Term”** means the period during which Output will be made available to Purchaser pursuant to the terms of the Power Sales Contract.

**“Transmission Agreement”** means an agreement between the Purchaser and the District that provides terms and conditions for the transmission of the Purchaser’s Percentage of Project Output over the Chelan Transmission System from specified Transmission Point(s) of Receipt to Transmission Point(s) of Delivery.

**“Transmission Point(s) of Delivery”** means the point(s) where the Chelan Transmission System interconnects with the Purchaser’s electric transmission facilities or a third party’s electric transmission facilities.

**“Transmission Point(s) of Receipt”** means the point(s) as defined in the Transmission Agreement of interconnection with the Chelan Transmission System.

**“Transmission Provider”** means any entity or entities transmitting or transporting the Output on behalf of Purchaser to or from the Transmission Point(s) of Delivery; or, with respect to the District when acting as a Transmission Provider, from the Transmission Point(s) of Receipt to the Transmission Point(s) of Delivery.

**“Transmission Rights”** means the Purchaser has transmission rights up to the Purchaser’s Percentage of available Project Transmission Facilities subject to the Transmission Agreement.

**“Tumwater Facilities”** means the dam, spillway and related facilities owned and operated by the District, located on the Wenatchee River in Tumwater Canyon.

**“Uncontrollable Circumstance”** means the occurrence of one or more of the following causes beyond the reasonable control of Purchaser, provided that, as the result thereof, at least one-half pot line is rendered inoperable: (a) Earthquake, storm, lightning, fire, explosion, or act of God; (b) war (regardless of whether declared), act of public enemy, act of civil or military authority, civil disturbance, riot, sabotage or terrorism; (c) expropriation, requisition confiscation, export or import restrictions, closing of ports, roadways, waterways, or rail lines imposed by Government Authorities; (d) catastrophic or major equipment failure at Wenatchee Works due to causes beyond Purchaser’s control and not due to the negligence or lack of diligence by Purchaser or its employees; (e) sudden unforeseen interruptions in power flows affecting Output in relation to the Chelan Power System for which third party power purchases and/or transmission are not immediately available. Uncontrollable Circumstance will not include changes in law, Taxes, costs, regulatory requirements or market conditions, including, but not limited to, changes that affect the cost, transportation or availability or quality of raw materials or supplies, economic hardship, strikes, lockouts and other labor difficulties, economic factors, including prices of alumina, aluminum, labor, regulatory compliance, energy or other utilities, or any other event or circumstance not expressly listed above.

**“Uniform System of Accounts”** means the system of accounts for Public Utilities and Licensees as prescribed by FERC, constituting Part 101 of Title 18 of the Code of Federal Regulations, as supplemented and amended (the “Uniform System of Accounts”), used to account for the costs of generating projects, and any successor thereto and to the account designations thereunder.

**“Unit”** means each generating unit or collectively, the generating units at the Projects. The Units currently consist of the eleven generating Units C1 through C11 at Rocky Reach, the eleven generating Units BH (house Unit) and B1 through B10 at Rock Island Powerhouse One, and the eight generating Units U1 through U8 at Rock Island powerhouse Two. Unit may also include any other generating Units installed in the Chelan Power System.

**“Voltage Support / MegaVars”** (MVARs) means reactive power supplied or absorbed by the Chelan Power System as required to maintain voltage at adjacent switchyards. Under certain operating conditions, the MVARs output from the Units may cause a reduction in the Capacity of the Chelan Power System.

**“WECC”** means the Western Electricity Coordinating Council or its successor, or such other entity or entities responsible for regional reliability as determined by the District.

**“Wenatchee Works”** means the Purchaser’s aluminum plant in Chelas County.

## THE POWER SALES CONTRACT

### Term and Termination

**Term.** The Power Sales Contract will become effective as of the Signing Date. The Term, however, will commence as of the first Project Availability Date and will terminate as of the expiration or termination of the Power Sales Contract pursuant to its terms. Unless terminated or extended, the Power Sales Contract will remain in effect until midnight on October 31, 2028. All obligations accruing or arising prior to the termination or expiration of the Power Sales Contract will survive the termination or expiration thereof until satisfied in full.

**Conditions Precedent to Effectiveness.** The Parties agree and acknowledge that the respective rights and obligations of the Parties under the Power Sales Contract with respect to the Output (including the District's obligation to deliver Output determined in relation to such Projects and the Purchaser's obligation to pay any Periodic Payments (other than the Capacity Reservation Charge referred to in "THE POWER SALES CONTRACT—Payment" attributable to or arising out of such Projects) are contingent, in the District's sole discretion, upon the satisfaction as of each respective Project Availability Date for each such Project (00:00 Hours on November 1, 2011 for Rocky Reach and 00:00 Hours on July 1, 2012 for Rock Island) of the following conditions precedent: (1) no material default will have occurred and be continuing, as of each respective Project Availability Date, under the Prior Agreement or other current contract(s) between the Parties; (2) no Event of Default or Potential Event of Default exists under the Power Sales Contract; (3) the representations contained in the Power Sales Contract continue to be true; (4) no Downgrade Event with respect to the Purchaser has occurred and Purchaser's credit quality has not been placed on negative watch indicating a view to lowering the Purchaser's credit rating to below investment grade by any of the Rating Agencies; (5) any required Performance Assurance, in form acceptable to the District, has been posted by the Purchaser; (6) the Prior Agreement will not have terminated prior to the Rocky Reach Project Availability Date; (7) no termination described in the Power Sales Contract has occurred; (8) the Parties have entered into a Transmission Agreement and an Interconnection Agreement, in form and substance reasonably satisfactory to the District and the Purchaser; and (9) Wenatchee Works has been operating at or above Level 3 (as defined in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sale; Credits—Post-Operative Review") for the twelve (12) calendar months prior to each Project Availability Date, taking into consideration adjustments to operating criteria arising from an Uncontrollable Circumstances (as contemplated in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits—Adjustments to Optimize Performance").

If the conditions precedent set forth above are not satisfied or waived by the District on or within 90 days following each respective Project Availability Date, the District may terminate the Power Sales Contract in accordance with the provisions of the Power Sales Contract and described in "THE POWER SALES CONTRACT—Term and Termination—Termination." Any such termination will apply to the Power Sales Contract as a whole, and not severally as to the Output determined in relation to Rocky Reach or Rock Island.

**Termination.** The Power Sales Contract may only be terminated (i) by mutual agreement of the Parties; (ii) by either Party if the Approval Date has not occurred by the first Project Availability Date, provided that the Party wishing to terminate the Power Sales Contract pursuant to this clause (ii) is required to give the other Party written notice of such termination on or within ninety (90) days prior to the first Project Availability Date; (iii) by the District pursuant to the provisions of the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination—Remedies Upon Default," so long as any Event of Default is continuing and has not been cured within the applicable cure period (which termination event, at the District's discretion, may supersede a termination under "THE POWER SALES CONTRACT—Terms and Termination—Condition Precedent to Effectiveness;"; (iv) by the District pursuant to "THE POWER SALES CONTRACT—Output; Surplus Energy Sales, Credits;"; (v) by the District pursuant to "THE POWER SALES CONTRACT—Terms and Termination—Condition Precedent to Effectiveness." In the event the Power Sales Contract is terminated pursuant to the provisions described in subsections (i), (ii) or (v), neither Party will be liable to the other Party for damages due to such termination. Any termination of the Power Sales Contract by a Party pursuant to the terms thereof will be effected by and effective only upon receipt of written notice of such termination by the other Party.

## **Output; Surplus Energy Sales; Credits**

### *Output To Be Made Available.*

Beginning on the respective Project Availability Date for each Project and continuing until midnight on the date on which the Power Sales Contract is terminated or expires, the District, during each hour, will sell and make available for scheduling by and delivery (or cause to be delivered) to Purchaser, at the Transmission Point(s) of Receipt, Purchaser's Percentage of Output determined in relation to such Project, and Purchaser, during each hour, will purchase and receive (or cause to be received), at the Transmission Point(s) of Receipt, the amount of Purchaser's Percentage of Output scheduled by Purchaser for every such hour. Subject to the applicable provisions of the Power Sales Contract, including the provisions described in the following paragraphs, (i) for the period from the Project Availability Date for Rocky Reach through and including June 30, 2012 (the "Rocky Reach Initial Period"), Purchaser's Percentage will be the equivalent of 27.5% of the Output, determined in relation to Rocky Reach only; and (ii) from and after the Project Availability Date for Rock Island, Purchaser's Percentage, during the Term of the Power Sales Contract, will be the equivalent of 26% of the Output, determined in relation to Chelan Power System, in each case as the same may be modified from time to time pursuant to the provisions described in the following paragraphs and in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits—Mandatory Step-up."

PURCHASER ACKNOWLEDGES THAT, NOTWITHSTANDING ANY OTHER PROVISION OF THE POWER SALES CONTRACT TO THE CONTRARY, THE DISTRICT'S OBLIGATION TO SELL AND DELIVER OUTPUT IS EXPRESSLY LIMITED TO PURCHASER'S PERCENTAGE OF ANY OUTPUT MEASURED IN RELATION TO THE ENERGY ACTUALLY PRODUCED BY THE CHELAN POWER SYSTEM AND AVAILABLE FOR DELIVERY. THE DISTRICT WILL NOT BE LIABLE TO THE PURCHASER FOR THE FAILURE TO DELIVER ANY ENERGY GREATER THAN PURCHASER'S PERCENTAGE OF THE OUTPUT, IF ANY, AS MEASURED IN RELATION TO THE ENERGY ACTUALLY PRODUCED BY THE CHELAN POWER SYSTEM, REGARDLESS OF THE REASON FOR LACK OF PRODUCTION OR DIMINISHED AVAILABILITY OF SUCH OUTPUT.

The District will not be liable to Purchaser for any damage, loss or liability associated with any remarketing of Excess Energy or Supplemental Power Purchases under the Power Sales Contract, whether or not the Excess Energy could be sold at higher prices, on better terms or to more creditworthy purchasers or the Supplemental Power could be purchased at lower prices, on better terms or to more reliable, creditworthy sellers.

### *Share Limitation, Operating Criteria and Resell Rights.*

**General Principles.** The Parties recognize that the following principles support the concepts described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits:"

Purchaser should make its own economic operating decisions knowing the consequences of those decisions in terms of the credit and operational issues.

The District is most interested in Purchaser operating at a full three (3) pot line operation (due to the jobs and other economic value provided by such operation to the community) which has been the basis for negotiation of the provisions of the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits." Thus the District is interested in providing contractual incentives for Purchaser to run at that level. Purchaser has its own reasons for running at the highest level possible to reduce the "per unit" costs of energy for its production.

**Limitation on Availability and Use of Output.** The Output provided pursuant to the Power Sales Contract will be used by Purchaser solely at Wenatchee Works. Except as specifically provided in the Power Sales Contract, Purchaser will not be entitled to receive or resell any portion of Purchaser's Percentage of Output that is not needed in connection with the Wenatchee Works for primary aluminum reduction operations. Any Output in excess of those needs will be retained by the District and sold in a manner that the District in good faith determines to be commercially reasonable. Proceeds received from the sale of such Excess Energy will be applied as set forth in the

Power Sales Contract. The operational criteria for accumulating and using credits that may become available from the sale of such Excess Energy are set forth below. The operational criteria and credit allocations described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits” will not in any way affect Purchaser’s unconditional obligations to pay Net Costs or other amounts due under the Power Sales Contract.

**No Guaranteed Output.** The District does not guarantee any amount of Output to Purchaser. It is the intent of the parties that Purchaser fully utilize power available under the Power Sales Contract to produce aluminum to the extent reasonably possible given smelter operational issues. The parties recognize that there will be variability in the amount of Output that may be available at any given time and that, consequently (i) there will be times that the Output will be insufficient to run Wenatchee Works at any given operating level, during which Supplemental Power Purchases will be necessary to meet operational criteria and (ii) there will also be times that there is Excess Energy available based on Purchaser’s selected operating levels which will be sold by the District on the market pursuant to the terms of the Power Sales Contract.

*Excess Energy Sales and Supplemental Power Purchases.*

Purchaser will not have the right to remarket any Excess Energy or use Output other than as set forth in the Power Sales Contract to meet the energy needs of the Wenatchee Works primary aluminum reduction operations.

Excess Energy not needed in the operation of Wenatchee Works will be sold by the District on a daily basis, or on a forward basis at the written request of Purchaser. The District will remarket such Excess Energy in accordance with certain criteria and limitations described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Excess Energy Sales and Supplemental Power Purchases” and with the District’s policies and procedures for marketing power, as in effect from time to time.

It may be necessary to make Excess Energy sales on a preschedule and/or real time basis. The sales will be subject to certain of the terms described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Excess Energy Sales and Supplemental Power Purchases.” Pursuant to the Power Sales Contract, the sales prices for these sales will be determined as follows:

- (i) The price for daily sales will be the Mid-Columbia Firm Peak and Off-Peak prices, for the respective hours covered by the indices for Monday through Saturday, and for the “Sunday and NERC Holiday” index for all hours on Sunday.
- (ii) In the event that the Mid-Columbia Firm Peak index differs by more than 10% from the Mid-Columbia Non-Firm Peak index or the Mid-Columbia Firm Off-Peak index differs from the Non-Firm Off-Peak index by more than 10% evidencing highly volatile markets, the daily price for sales will be the actual weighted average of all sales, completed during the preschedule and the real-time trading at Mid-Columbia marketing hub, by the District for that day in the respective Peak and Off-Peak periods. Other mutually agreeable triggers may be used if the Non-Firm index does not have sufficient volume to make it relative of the actual real-time market.

At Purchaser’s written request, the District will enter into third party contracts under which the District will make on Purchaser’s behalf, Supplemental Power Purchases for the operation of the Wenatchee Works. Purchaser is required to notify the District in writing of the identity of all persons authorized to request such contracts on behalf of Purchaser. Purchaser will be strictly liable for all payments, costs and expenses arising under any such contracts and will hold the District free and harmless therefrom. Other terms and conditions and applicable Supplemental Power Purchases are described in “THE POWER SALES CONTRACT—Excess Energy Sales and Supplemental Power Purchases.”

It may be necessary to make Supplemental Power Purchases on a preschedule and/or real time basis. The purchases will be subject to certain of the terms described in “THE POWER SALES CONTRACT—Excess Energy Sales and Supplemental Power Purchases.” Pursuant to the Power Sales Contract, the purchase prices for these purchases will be determined as follows:



(i) The price for daily purchases will be the Mid-Columbia firm On-Peak and Off-Peak prices, for the respective hours covered by the indices for Monday through Saturday, and for the “Sunday and NERC Holiday” index for all hours on Sunday.

(ii) In the event that the Mid-Columbia Firm Peak index differs by more than 10% from the Mid-Columbia Non-Firm Peak index or the Mid-Columbia Firm Off-Peak index differs from the Non-Firm Off-Peak index by more than 10% evidencing highly volatile markets, the daily price for purchases will be the actual weighted average of all purchases, completed during the preschedule and the real-time trading at Mid-Columbia marketing hub, by the District for that day in the respective Peak and Off-Peak periods. Other mutually agreeable triggers may be used if the Non-Firm index does not have sufficient volume to make it relative of the actual real-time market.

The District will not be liable to Purchaser for any damage, loss or liability associated with any remarketing of Excess Energy or Supplemental Power Purchases under the Power Sales Contract, whether or not the Excess Energy could be sold at higher prices, on better terms or to more creditworthy purchasers or the supplemental power could be purchased at lower prices, on better terms or to more reliable, creditworthy sellers.

**Post-Operation Review.** On or about November 15<sup>th</sup> of each year, beginning November 15, 2012, the District will generate a report setting forth the average monthly MW energy consumption of Wenatchee Works for the 12 month period ending the preceding October 31<sup>st</sup> (each such period being referred to as a “Operating Year”) or, in the case of the period ending October 31, 2012, the four month period commencing July 1, 2012 (such four month period being referred to as the “Initial Operating Year”). The parties will then determine the operating level of Wenatchee Works for such Operating Year or Initial Operating Year, as the case may be (the respective “Operating Level”), based on the lowest three consecutive months of average MW usage at Wenatchee Works, using the table below.

Operating Level of Wenatchee Works

250 aMW plus	Level 1
215 to less than 250 aMW	Level 2
175 to less than 215 aMW	Level 3
less than 175 aMW but not Shutdown	Level 4

Special Rules for Initial Operating Year Operating Level of Wenatchee Works

215 aMW plus	Level 1
less than 215 aMW but not Shutdown	Level 4

**Use of Revenues From Power Sales Within a Month to Offset the Cost of Supplemental Power Purchases Within the Same Month.** If, within any one calendar month and at certain times, the District sells energy from Purchaser’s Percentage of Output that is not needed in the operation of Wenatchee Works (“Excess Energy”), and, at other times, Purchaser makes arms length on-market third party power purchases (from the District or from third parties) to maintain the operating level at Wenatchee Works within such month (“Supplemental Power Purchases”), the District is required under the Power Sales Contract to reimburse Purchaser for its documented costs (documentation will include original confirmations and other documentation satisfactory to the District) of such Supplemental Power Purchases related to such month not otherwise netted out from Excess Energy within such month, such reimbursement to be made solely from, and only to the extent of, the proceeds actually received by the District from the sale of such Excess Energy related to that month, less the District’s Sales and Administrative Charges with respect thereto.

*Accumulation of Surplus Proceeds.*

Within each month during an Operating Year, the District will sell Excess Energy not needed for the operation of Wenatchee Works. On or about the 25<sup>th</sup> of the following Month, the District is required under the Power Sales Contract to determine the proceeds actually received from the sale of such Excess Energy properly allocable to such month, and will deduct therefrom: (i) all costs, obligations and expenses to third parties associated with such sales including, without limitation, all broker fees, transmission costs, line loss charges, scheduling fees,

rebates, losses (including losses arising from payment defaults), damages, liabilities and related expenses (including collection costs) and all other costs related thereto, (ii) the amounts distributed or otherwise made available to Purchaser pursuant to the provisions of the Power Sales Contract described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits” is required under the Power Sales Contract, and (iii) the amount of the District’s Sales and Administrative Charges with respect to such Excess Energy sales not paid to the District pursuant to the provisions of the Power Sales Contract described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits—Use of Revenues From Power Sales Within a Month to Offset the Cost of Supplemental Power Purchases Within the Same Month” (such net amounts being referred to as “Surplus Proceeds”).

The District will maintain records of such Surplus Proceeds received within an Operating Year and disbursements made by the District to Purchaser within such Operating Year to reimburse it for Supplemental Power Purchases to determine the net amounts available within an Operating Year from which Purchaser can be reimbursed for further Supplemental Power Purchases. (“Purchaser’s Current Year’s Credit Pool”). Within each such Operating Year upon proper documentation, the District will reimburse Purchaser for its substantiated arms-length costs of Supplemental Power Purchases occurring within such Operating Year (documentation will include original confirmations or other documentation satisfactory to the District), to the extent not reimbursed pursuant to “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits—Accumulation of Surplus Proceeds,” without regard to the Operating Level of Wenatchee Works, from and only to the extent of the net accumulated amounts then remaining available in Purchaser’s Current Year’s Credit Pool.

On or about November 15<sup>th</sup> of each year, the District will determine the applicable Operating Level of Wenatchee Works for the preceding Operating Year pursuant to the criteria described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits—Post-Operation Review.” The District will also compute the cumulative amount, if any, of Surplus Proceeds in Purchaser’s Current Year’s Credit Pool, if any, which were not distributed to Purchaser during such Operating Year. The cumulative Surplus Proceeds, if any, for such Operating Year remaining in Purchaser’s Current Year’s Credit Pool (the “Annual Cumulative Surplus Proceeds”), will be allocated for future credit to Purchaser (“Purchaser’s Long Term Credit Pool”), or will be retained by the District, or both, in accordance with the following criteria:

- (i) If Wenatchee Works operated at Operating Level 1 for such Operating Year, all Annual Cumulative Surplus Proceeds for such Operating Year will be allocated to Purchaser’s Long Term Credit Pool.
- (ii) If Wenatchee Works operated at Operating Level 2 for such Operating Year, fifty percent (50%) of the Annual Cumulative Surplus Proceeds for such Operating Year will be allocated to Purchaser’s Long Term Credit Pool and the remaining 50% will be retained by the District.
- (iii) If Wenatchee Works operated at Operating Level 3 for such Operating Year, thirty percent (30%) of the Annual Cumulative Surplus Proceeds for such Operating Year will be allocated to Purchaser’s Long Term Credit Pool and the remaining seventy (70%) will be retained by the District.
- (iv) If Wenatchee Works operated at Operating Level 4 but is not Shutdown for such Operating Year, all of the Annual Cumulative Surplus Proceeds for such Operating Year will be retained by the District.

*Use of Surplus Proceeds by the Parties; No Segregation; No Interest; and Forfeiture.*

If during any calendar month the Purchaser makes Supplemental Power Purchases for which Purchaser has not been reimbursed pursuant to “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits—Use of Revenues From Power Sales Within a Month to Offset the Cost of Supplemental Power Purchases Within the Same Month” and “—Accumulation of Surplus Proceeds,” it will be entitled to reimbursement from the District of its substantiated costs thereof, from and to the extent of amounts available in Purchaser’s Long Term Credit Pool. Purchaser will also be entitled to reimbursement from Purchaser’s Long Term Credit Pool for substantiated costs incurred in connection with Supplemental Power Purchases that occurred within a period of two (2) years preceding the date reimbursement is requested. All such reimbursements will be subject to the submission by Purchaser, no more frequently than monthly, of such reasonable and appropriate documentation as the District may request to substantiate the required payment criteria, including confirmations, invoices and evidence of payment.

Reimbursements will be made by the District within thirty (30) days of receipt of all required documentation in form reasonably satisfactory to the District, and the District will be liable to the Purchaser for interest thereon (calculated pursuant to the provisions described in “THE POWER SALES CONTRACT—Billing and Payment—Billing of Periodic Payment”) if payment has not been made by the due date.

The District will not be obligated to segregate or separately manage or account for any Surplus Proceeds as and when received or at any time thereafter, no interest will accrue or be deemed to accrue thereon, and any amounts allocated to the District pursuant to the provisions described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sale; Credits” may be used for any purpose, without restriction.

Any Surplus Proceeds to which Purchaser would otherwise be entitled under the Power Sales Contract will be subject to set off and counterclaims for any payments due from Purchaser under the Power Sales Contract, and for any damages arising upon a default by Purchaser or other liabilities arising in the performance of any of Purchaser’s obligations to the District.

Surplus Proceeds and all Purchaser credits remaining at the expiration or termination of the Power Sales Contract will be forfeited by the Purchaser pursuant to the provisions described in “THE POWER SALES CONTRACT—Payment—Disposition of Fund Balances Upon Expiration or Termination of Agreement” below.

***Adjustments to Operating Performance.*** Notwithstanding the foregoing, if the operation of Wenatchee Works is adversely affected by an Uncontrollable Circumstance, Purchaser will notify the District of the occurrence thereof as set forth in the Power Sales Contract and the Parties will agree on the extent to which such event adversely affected plant operating performance and energy usage. To the extent the Uncontrollable Circumstance occurs within any of the months used to calculate Wenatchee Works Operating Level for a Contract Year, the District, upon consultation with Purchaser, will determine the operating level Wenatchee Works would have achieved had such event not occurred for purposes of the calculations described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits.”

If Purchaser claims the existence of an Uncontrollable Circumstance, it will promptly and diligently make such Commercially Reasonable efforts as may be necessary and practical under the then-existing circumstances to remove the cause of failure and resume full operations at Wenatchee Works as soon as possible. Purchaser will not be entitled to assert an Uncontrollable Circumstance to the extent it has failed to remedy the condition and to resume the performance of such covenants or obligations with reasonable dispatch, or failed to prevent or mitigate the effects of an Uncontrollable Circumstance by following Commercially Reasonable procedures.

Purchaser may not assert the existence of an Uncontrollable Circumstance under the Power Sales Contract unless it notifies the District orally or in writing or by facsimile of the existence of such condition as soon as reasonably possible; however, any oral notification is required to be followed by a written notice or facsimile within a reasonable time. The notice is required to specify the nature of the Uncontrollable Circumstance, the date of its commencement, the measures to be taken to alleviate such Uncontrollable Circumstance and the estimated time such corrective action is expected to take. The notice is required to include a full explanation of the events or circumstances giving rise to the Uncontrollable Circumstance.

Notwithstanding anything to the contrary contained in the Power Sales Contract, any Uncontrollable Circumstance described in (d) of the definition of that term affecting the operation of Wenatchee Works will be deemed to terminate within one hundred eighty (180) days after the initiation of the Uncontrollable Circumstance unless the District, in its sole discretion, agrees in writing to a specific extension.

The District will have the right to inspect Wenatchee Works and related properties, along with books, records and other data in the possession of Purchaser, to make inquiries of its officers, consultants, agents and employees, and to conduct tests and analysis on or off the premises in a reasonable and not materially disruptive manner, all as necessary in the District’s reasonable judgment to verify the existence of the Uncontrollable Circumstance, the remedial steps Purchaser intends to take and is taking with respect thereto, and the potential duration thereof.

***Net Costs.*** Purchaser will remain responsible for the payment of all Net Costs associated with the Purchaser’s Percentage of Output, regardless of power availability or usage of the surplus funds generated by surplus power sales.

Any Surplus Proceeds to which Purchaser would otherwise be entitled under the Power Sales Contract will be subject to set off and counterclaims arising from a default by Purchaser in the performance of its obligations under the Power Sales Contract.

Surplus Proceeds and all Purchaser credits at the expiration or termination of the Power Sales Contract will be subject to forfeiture pursuant to the Power Sales Contract and described in “THE POWER SALES CONTRACT—Payment” below.

***Special Rules During Shutdown Period.*** The parties recognize that the Capacity Reservation Charge contemplated in the Power Sales Contract is substantially below that paid by other slice power purchasers of the System and the District has agreed to this reduced amount in consideration of the jobs the full operation of Wenatchee Works would mean to the community, along with other factors. If Wenatchee Works becomes idle, particularly in connection with an extended plant shutdown, the benefits anticipated by the District will be lost. Consequently, the parties have agreed to certain procedures, accumulation and use of surplus proceeds, payments and other results in the event of a Shutdown of Wenatchee Works pursuant to the Power Sales Contract and described in “THE POWER SALES CONTRACT—Capacity, Reservation Charge Escalation Factor.”

***District’s Right to Terminate.*** The District may, in its sole discretion, terminate the Power Sales Contract, if (i) Purchaser’s operations at Wenatchee Works consumes less than 175 aMW for 18 consecutive months regardless of the cause or circumstance and without any adjustment of any type including any adjustment for Uncontrollable Circumstances; or (ii) Purchaser formally announces that it has elected to abandon Wenatchee Works or to permanently shutdown its Wenatchee Works operations, or (iii) Purchaser announces that Wenatchee Works operations have been sold to a third party operator (unless the District has agreed in writing and in its sole discretion to the assignment in conformance with the provisions of the Power Sales Contract described in “THE POWER SALES CONTRACT—Assignment”). The District’s termination of the Power Sales Contract pursuant to the provisions described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits” will not be deemed to be a default by either Party.

***Mandatory Step-up.*** If a Share Participant (a “Defaulting Participant”) defaults under a Related Power Sales Agreement and the District elects to terminate that Defaulting Participant’s entitlement to Output, the Purchaser will purchase from the District, commencing on a date fifteen (15) days following written notice from the District (such date, the “Step-Up Effective Date”), Purchaser’s pro rata share of the Output to which the Defaulting Participant was entitled from and after the Step-Up Effective Date, on the terms and conditions set forth in the Power Sales Contract (other than the provisions described in “THE POWER SALES CONTRACT—Payment”), for a term equal to the lesser of the Defaulting Participant’s remaining contract term or the remaining term of the Power Sales Contract.

The Purchaser’s pro rata share of a Defaulted Participant’s Output entitlement (the “*Purchaser’s Step-up Percentage*”) will be determined based on the Purchaser’s Percentage divided by the sum of Purchaser’s Percentage, the percentage of Output shares held by other Share Participants excluding the Defaulting Participant, and the Output share retained by the District. For example, if the Purchaser’s Percentage is 26%, the Defaulting Participant’s share is 10%, the District’s share is 39% and the other Share Participants’ shares are 25%, the Purchaser’s Step-Up Percentage under this section would be:

$$10\% \times [(26\% \div (26\% + 39\% + 25\%))] = 2.89\%, \text{ to be added to Purchaser’s Percentage}$$

For the avoidance of doubt, Purchaser will not be liable for any amounts owed by the Defaulting Participant to the District prior to the Step-Up Effective Date (and Purchaser will have no obligation or liability to perform any of the obligations under the Related Power Sales Agreement and no liability for any default or breach thereunder), and any amounts for which the Purchaser will become liable under the Power Sales Contract and described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits,” will be determined under the Power Sales Contract and not under the Related Power Sales Agreement.

If as a result of a Share Participant’s default under a Related Power Sales Agreement, the District imposes the mandatory step-up requirement pursuant to the terms described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits,” a portion of the damages recovered by the District that were awarded to compensate the District for prospective losses, if any, directly attributable to the early termination of such Related Power Sales Agreement (net of costs and expenses), adjusted for the number of years remaining under the Power Sales Contract (if less than the period for which such damages were measured), will be allocated to the Purchaser based on the Purchaser’s Step-up Percentage and will be credited against all future payments due from Purchaser

under the Power Sales Contract that are attributable to Purchaser's Step-Up Percentage of such Output until such allocated recoveries have been exhausted. If the Purchaser contests its obligation to purchase the Purchaser's Step-up Percentage of the Defaulting Purchaser's share of Output, Purchaser's share of such recoveries will be held by the District until Purchaser assumes (by instrument in form and substance satisfactory to the District) its Step-Up Percentage, and will then be applied to future payment obligations in accordance with the preceding sentence.

If Purchaser is required to purchase increased Output pursuant to the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits," Purchaser may direct the District to sell such increased Output to third parties pursuant to the sales methodology set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits" and "—Excess Energy Sales and Supplemental Power Purchases" and the District's policies and procedures for marketing power, as in effect from time to time. Net proceeds from the sale of such increased Output will not be included in the calculations under, nor subject to limitations or restrictions or allocation of Surplus Proceeds as set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits" and will be made available to Purchaser monthly following receipt, as soon as the applicable calculations are reasonably made and the proceeds are collected. With regard to this subsection, the District agrees not to initiate any material changes to its policies and procedures, other than those required by any accounting, regulatory or legal requirements, unless (i) such changes are not projected by the District, in its reasonable judgment, to material adversely affect the net sales proceeds that otherwise could be realized by Purchaser without such changes, or (ii) Purchaser consents to such changes, which consent will not be unreasonably withheld, conditioned or delayed, or (iii) the District compensates Purchaser for any loss resulting from and directly attributable to such change, as determined by the District in its reasonable judgment.

***Environmental Attributes Not Included.*** Although the amount of Output to which Purchaser is entitled under the Power Sales Contract, and the cost thereof, will be determined in reference to the Chelan Power System, the District may source the Output from any source. The District retains for its own use and benefit any environmental attributes (as those terms may be defined from time to time under any applicable federal or state law, rule or regulation or by any market or otherwise) generated as part of the Output of the Chelan Power System or any other source used by the District to supply Energy to the Purchaser. It is the Parties' intent that the definition of environmental attributes as used in this section, and the District's retention of those rights, will be liberally applied and construed to be most inclusive in favor of the District.

***Renewable Resources and Purchaser's Obligations.*** The Energy Independence Act, RCW 19.285, referenced as Initiative 937, was recently enacted into law by the voters in Washington State. Initiative 937 requires utilities to meet a certain percentage of its load to retail customers through acquisition of renewable resources or renewable energy credits. The parties agree that under RCW 19.285, or any other federal or state law, the Power Sales Contract and the sale of Output to Purchaser will be considered a wholesale arrangement and that Purchaser is not a "retail customer" nor a "retail load" of the District. The Parties agree to cooperate to ensure that this interpretation is upheld in the context of any applicable legislation, rules or regulations and that it is clearly communicated in political and legal forums as the District may direct. However, if that interpretation fails for any reason or a Change in Law occurs requiring the acquisition of renewable resources or renewable energy credits associated with Purchaser's energy usage, Purchaser will take all steps necessary to put the District in the same economic and operational condition as it would have been in had the Change of Law or interpretation not occurred. Without limiting the foregoing, Purchaser will fund the District's acquisition of appropriate resources or credits and pay any costs of integrating such resources into the District's system necessary for the District to comply with RCW 19.285 or any other law with respect to the sales of Output to Purchaser. Prior to taking any such action, the District and Purchaser will discuss the potentials options and solutions for compliance. Purchaser will have the right to acquire a resource or credits as defined in the law to ensure the District's compliance in lieu of the District acquiring the same. If Purchaser acquires the resource, the parties will agree upon the terms for integration of the resources, including the costs to be paid to the District for such integration and on-going maintenance/operation, and Purchaser will assign its rights to the resource to the District to the extent necessary for the District to comply with the applicable law during the term of the Power Sales Contract.

### **Curtailement and Decommissioning**

***Curtailement.*** The District will have the right, in its sole discretion, to temporarily interrupt, reduce or suspend delivery (through manual operation, automatic operation or otherwise) of Output from the Projects during any one or more of the following circumstances: (i) to prevent damage to the District's system or to maintain the

reliable and safe operation of the District's system; (ii) a District System Emergency; (iii) if suspension is required for relocation, repair or maintenance of facilities or to facilitate restoration of line outages; (iv) a force majeure event; (v) any Operational Constraints in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission;" (vi) negligent acts or intentional misconduct of Purchaser which are reasonably expected to present imminent threat of damage to property or personal injury; (vii) an event of Default by the Purchaser, as provided in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination"; (viii) to comply with any directive or requirement of a Governmental Authority, including but not limited to FERC, NERC or WECC, or (ix) any other reason consistent with Prudent Utility Practice. Any energy production (or in the case of Purchaser, Output) during each such interruption, reduction or suspension will be allocated pro rata among the District, the Purchaser and the other Share Participants, except and to the extent the District determines (or had determined at any time prior to such interruption, reduction or suspension) in its sole discretion that due to a District System Emergency such pro-rata allocation of remaining energy production (or in the case of Purchaser, Output) due to such interruption, reduction or suspension is impracticable or infeasible. The District will give advance notice, as circumstances permit, as determined by the District, of the need for such suspension, reduction or interruption to employees of the Purchaser designated from time to time by the Purchaser to receive such notice. The District will not be responsible for payment of any penalty or cost incurred by the Purchaser during or as a result of such interruption, reduction or suspension. The provisions contained in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Curtailed and Decommissioning" will not limit or modify the scope of and limitations on the District's obligations under the Power Sales Contract as otherwise set forth in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits" and the Power Sales Contract and described in "THE POWER SALES CONTRACT—Limitations of Liability."

**Restoration of Service.** Purchaser and District will endeavor to restore deliveries of Output as promptly as is reasonably possible in the event of an interruption, reduction or suspension under the Power Sales Contract and described in "THE POWER SALES CONTRACT—Curtailed and Decommissioning."

**Decommissioning.** Over the term of this Power Sales Contract, the District may, in its sole discretion, cause components of the Project responsible for not more than 20% of the Output in the aggregate to be Permanently Retired. The District may also cause the Projects, or any components thereof, to be Permanently Retired if, as a result of the adoption or implementation of, or a change in, any Law, rule or regulation, or any policy, guideline or directive of, or any change in the interpretation or administration thereof by, any Regulatory Authority (in each case, having the force of Law) (collectively a "Change in Law"), the District would be required to make material modifications to such Projects or components in order to continue their operation, and the District determines in good faith that, absent such components being Permanently Retired, it would not be Commercially Reasonable to comply with such statutory or regulatory requirements. In each case, the District will give Purchaser as much advance written notice of its determination to Permanently Retire Projects or components as reasonably practicable, as determined by the District. Decommissioning will not reduce Purchaser's payment obligations under the Power Sales Contract; provided however, that to the extent that components are Permanently Retired and such action results in a material reduction of the amount of the Output available to the Purchaser, the Parties will negotiate in good faith a proportionate and commensurate reduction in the aMW Operating Levels as set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits."

**Load Shedding.** In addition to the foregoing and other rights of curtailment set forth in the Power Sales Contract, the District may curtail deliveries of Output to Purchaser when needed to meet the System's power load requirements, as determined by the District, provided that such curtailment under this section will be limited to durations of not more than 1 hour in any 24 hour period, not more than twice in any rolling twelve (12) month period and for not more than 40 MW per hour. The Parties may also negotiate and agree upon other opportunities for curtailment during the term of the Power Sales Contract.

## **Payment**

**Payments and Charges.** In consideration of the District's agreement to provide Purchaser with Purchaser's Percentage of Output, the Purchaser agrees to pay the District the following charges at the times and in the amounts specified below:

**Capacity Reservation Charges.** Within 30 days following the Signing Date, Purchaser is required to pay the District by wire transfer in immediately available funds, a non-refundable capacity reservation charge of

\$21,000,000 (stated in January, 2006 Dollars) (the “Capacity Reservation Charge”) as adjusted in accordance with the Capacity Reservation Charge Escalation Factor. These amounts will not reduce amounts that may become due in the event of a Shutdown.

The parties recognize that the District has agreed to defer a significant portion of the Capacity Reservation Charge based on the expectation of continuous operation of Wenatchee Works after the Effective Date. If Shutdowns occur during the Term, additional Capacity Reservation Charges would become due, as follows:

(i) Upon the occurrence of an initial Shutdown during the Term, Purchaser would pay the District, as part of the Deferred Capacity Reservation Charge, the Initial Shutdown Amount. Such payment would be due in immediately available funds on the first anniversary of the Shutdown Date (the “Shutdown Payment Date”).

(ii) Once the occurrence of a Shutdown has been determined, and during the remaining Shutdown Period, in lieu of the application of Surplus Proceeds described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits,” the District will reduce Purchaser’s monthly Net Costs by the amount of Surplus Proceeds actually received from the sale of Surplus Power for that month during the Shutdown Period. The District would be entitled to retain all Surplus Proceeds above such monthly Net Costs, and Purchaser will remain liable for all Net Costs that exceed such collected Surplus Proceeds.

(iii) If the initial Shutdown Period extends for more than eighteen (18) months or if a Shutdown occurs after the first Shutdown Period, the Shutdown Settlement Amount would become due and payable by Purchaser. Such payment would be made in immediately available funds on and as of (i) the first day of the nineteenth (19<sup>th</sup>) month of the initial Shutdown Period, or (ii) on the day following the determination that a second Shutdown has occurred, whichever occurs first, in each case without any annual deferral and regardless of any subsequent startup of Wenatchee Works. The payment of the Initial Shutdown Amount will not reduce any Shutdown Settlement Amount that may become due.

(iv) Once the Shutdown Settlement Amount has been paid in full, no further Deferred Capacity Reservation Charges will be due under this Capacity Reservation Charge Escalation Factor and during the remainder of the then existing Shutdown Period and for each subsequent Shutdown Period during the Term, the District will reduce Purchaser’s Net Costs by the Surplus Proceeds actually received from the sale of Surplus Power during each respective Shutdown Period, and the rules described in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits,” during each respective Shutdown Period will not apply. District will retain the remainder of such Surplus Proceeds during such Shutdown Period. Purchaser will remain liable for all Net Costs that exceed such collected Surplus Proceeds.

(v) For purposes of this Capacity Reservation Charge Escalation Factor, the rules of the Power Sales Contract will apply, meaning that a Shutdown caused by an Uncontrollable Circumstance will not, in and of itself, trigger a Shutdown for purposes of these provisions. In addition, solely for the purposes of the application of this Capacity Reservation Charge Escalation Factor, a labor dispute arising in connection with the good faith negotiation of Purchaser’s collective bargaining agreement at Wenatchee Works (and arising from factors or circumstances unrelated to, and made without regard to, the effect of this provision) which results in a strike or lockout determined by the National Labor Relations Board and/or court of competent jurisdiction to have been reasonable, in good faith and in compliance with applicable laws, that causes Shutdown of the Wenatchee Works, will also be considered an “Uncontrollable Circumstance.”

If a Shutdown has not occurred during the Term, no Deferred Capacity Reservation Charges will become due.

“**Shutdown**” means the consumption of Output by Wenatchee Works of not more than 60 aMW for 90 consecutive days, as determined by the District that is not directly attributable to either a material reduction in the amount of Output available to Purchaser pursuant to the Power Sales Contract or an Intentional Breach of the Power Sales Contract by the District.

“**Initial Shutdown Amount**” means the amount specified in the Power Sales Contract for the respective Fiscal Year in which a Shutdown has occurred, multiplied by a fraction, the numerator of which is the number of

whole and partial months from the beginning of the Shutdown Period to the date that startup has occurred (but not to exceed eighteen (18) months) and the denominator of which is twelve (12).

**“Shutdown Date”** means the first day of the ninety (90) day period giving rise to a determination that a Shutdown has occurred.

**“Shutdown Period”** means the period commencing on the Shutdown Date and ending on the date the Startup Conditions have been satisfied.

**“Shutdown Settlement Amount”** means (i) if the initial Shutdown Period extends at least eighteen (18) months, the amount specified in the Power Sales Contract for such Fiscal Year in which the first day following the end of such eighteenth (18<sup>th</sup>) month falls, and (ii) for any subsequent Shutdown, the amount specified in the Power Sales Contract for the respective Fiscal Year in which the first day of such Shutdown Period falls.

**“Startup Conditions”** means the use of more than 60 aMW for more than 30 consecutive days and a plan for ramping up potline operation that can be verified by the District.

**Working Capital Charges.** The Purchaser will pay Working Capital Charges as follows:

(i) On the Project Availability Date of Rocky Reach, Purchaser will pay the District, by wire transfer in immediately available funds, an initial Working Capital Charge of \$2,600,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in “THE POWER SALES CONTRACT—Payment” to such Project Availability Date. Within fifteen (15) days following the commencement of each Contract Year thereafter, Purchaser will pay the District, by wire transfer in immediately available funds, an additional Working Capital Charge equal to the amount, if any, by which \$2,600,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in “THE POWER SALES CONTRACT—Payment” to the beginning of such Contract Year, exceeds the sum of the Working Capital Charges previously paid pursuant to this subsection (i).

(ii) On the Project Availability Date of Rock Island, Purchaser will pay the District, by wire transfer in immediately available funds, a second Working Capital Charge of \$2,600,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in “THE POWER SALES CONTRACT—Payment” to such Project Availability Date. Within fifteen (15) days following the commencement of each Contract Year thereafter, Purchaser will pay the District, by wire transfer in immediately available funds, an additional Working Capital Charge equal to the amount, if any, by which \$2,600,000 (stated in December, 2004 Dollars), as adjusted in accordance with the Escalation Factor set forth in “THE POWER SALES CONTRACT—Payment” to the beginning of such Contract Year, exceeds the sum of the Working Capital Charges previously paid pursuant to this subsection (ii).

(iii) Each initial Working Capital Charge payment pursuant to subsections (i) and (ii) above constitutes the Purchaser’s Percentage of the amount the District deems necessary as of the Signing Date to provide an adequate working capital balance for each respective Project.

(iv) From time to time during any Contract Year, Purchaser will pay to the District, by wire transfer in immediately available funds, upon demand by the District, an amount equal to the Purchaser’s Percentage of any additional Working Capital Charge that is necessary to provide an adequate level of working capital for the Chelan Power System as determined by the District in accordance with Prudent Utility Practice.

(v) The payments described in this section are sometimes referred to in the Power Sales Contract as a “Working Capital Charge” or collectively as “Working Capital Charges.”

**Net Costs.** Purchaser will pay monthly to the District during each Contract Year, an amount equal to the Purchaser’s Percentage of Net Costs.

**Coverage Fund Charge.** The District will continue, or establish, and maintain, one or more coverage funds or their equivalents into which will be deposited the Coverage Amount with respect to the Debt Obligations (collectively, the “Coverage Fund”). The Purchaser will pay the Purchaser’s Percentage of the Coverage Amount as follows:



(i) On the Project Availability Date for Rocky Reach, Purchaser will pay the District, by wire transfer in immediately available funds, the Purchaser's Percentage of the Coverage Amount (calculated as of such Project Availability Date) attributable to Debt Obligations for Rocky Reach. On the Project Availability Date for Rock Island, Purchaser will pay the District, by wire transfer in immediately available funds, the Purchaser's Percentage of the Coverage Amount (calculated as of such Project Availability Date) attributable to Debt Obligations for Rock Island. The District will notify the Purchaser of such required amounts at least 30 days prior to each such Project Availability Date.

(ii) In addition, upon the issuance or incurrence during any Contract Year of any additional Debt Obligations attributable to Rocky Reach by the District after the Project Availability Date for Rocky Reach and of any additional Debt Obligations attributable to Rock Island by the District after the Project Availability Date for Rock Island, Purchaser will pay to the District, by wire transfer in immediately available funds, within 30 days of demand by the District, an amount equal to the positive difference, if any, between (1) the product of (a) the Purchaser's Percentage, times (b) the Coverage Amount (calculated as of the issuance or incurrence of such additional Debt Obligations), minus (2) the amounts previously paid by the Purchaser pursuant to "THE POWER SALES CONTRACT—Payments."

(iii) All amounts paid by the Purchaser to the District pursuant to "THE POWER SALES CONTRACT—Payment" will be used for any lawful purpose as determined by the District in its sole discretion.

**Credit Rating Premium.** The Purchaser will supply the District, on the first Effective Date, and during the first week of January of each year, with its current long term senior unsecured credit rating(s) by each of the Rating Agencies (each, the "Purchaser's Credit Rating") and will notify the District as soon as practicable during such year of any changes to such credit ratings or credit outlook. The District will compare Purchaser's Credit Rating by each such Rating Agency to the District's corresponding long-term senior underlying rating of the District from each respective Rating Agency then assigning a rating as of such date (the "District's Credit Rating"). If the lowest District's Credit Rating from any Rating Agency is greater than one rating category (including for this purpose, all sub-rating categories of each such Rating Agency) above the Purchaser's Credit Rating (or equivalent rating) from any Rating Agency (a "Credit Spread Condition"), the Purchaser will pay the District a Credit Rating Premium calculated using the methodology set forth below.

If the Purchaser's Credit Rating is suspended or has been withdrawn as of the date of calculation, its Credit Rating for purposes of the calculations under the Power Sales Contract will be assumed to be "junk bond" status until a rating is restored. If the Purchaser has been rated by fewer than all three Rating Agencies, only the Rating Agencies actually providing a rating on the Purchaser will be used in the calculations contemplated under this section. If the Purchaser has never been rated by any of the Rating Agencies, the District, in consultation with the Independent Investment Banker, will utilize its best efforts to establish the Purchaser's Credit Rating using, to the extent possible, an industry standard methodology, and the District's determination of the Purchaser's Credit Rating will be binding on both Parties until an official Credit Rating from at least one of the Rating Agencies has been obtained.

If a Credit Spread Condition exists on January 1, of any year, or arises as a result of a Downgrade Event during the year, the District, in consultation with the Independent Investment Banker, will determine a current market interest rate for long term 30 year fixed rate obligations of the Purchaser and the District, as the case may be, using the District's and the Purchaser's respective Credit Ratings as determined pursuant to the foregoing criteria. The Purchaser's applicable interest rate will be calculated based on a hypothetical 30 year fixed rate obligation using comparable taxable rates, based on its then applicable Credit Rating. The District's applicable interest rate will be calculated based on a hypothetical 30 year fixed rate, taxable municipal bond obligation, based on its then applicable Credit Rating. The two interest rates will be netted, and the resulting difference in rates will be multiplied by the Purchaser's Percentage of the outstanding principal amount of the District's Debt Obligations as of December 31<sup>st</sup> of the year preceding the date of calculation. The resulting product is referred to as the "*Credit Rating Premium*." The Purchaser will pay, as part of its monthly Periodic Payments, one twelfth (1/12<sup>th</sup>) of the Credit Rating Premium as calculated pursuant to the Power Sales Contract, until a different calculation is made pursuant to the Power Sales Contract.

**Debt Reduction Charge.** The Purchaser will pay to the District each month of each Contract Year as part of its Periodic Payments one twelfth (1/12<sup>th</sup>) of the Purchaser's Percentage of an annual debt reduction charge (the

“Debt Reduction Charge”), which Debt Reduction Charge will be computed by multiplying the Debt Reduction Charge Percentage for the Contract Year in which such month occurs by the Debt Reduction Charge Obligations for such Contract Year. The Debt Reduction Charge collected by the District pursuant to this section will be held by the District in a separate fund or account to be known as the “Debt Reduction Charge Account” and used only to purchase, redeem or defease debt of the Chelan Power System, to fund (after the Project Availability Date for Rocky Reach) required deposits to Reserve and Contingency Funds for Rocky Reach bonds, to fund (after the Project Availability Date for Rock Island) required deposits to Reserve and Contingency Funds for Rock Island bonds, or to fund Capital Improvements related to the Chelan Power System, in each case as determined by the District.

**Capital Recovery Charge.** The Purchaser will pay to the District each month of each Contract Year as part of its Periodic Payments one twelfth (1/12<sup>th</sup>) of the Purchaser’s Percentage of an annual capital recovery charge (the “Capital Recovery Charge”), which Capital Recovery Charge will be computed by multiplying the Capital Recovery Charge Percentage for the Contract Year in which such month occurs by the Capital Recovery Charge Base for such Contract Year. The Capital Recovery Charge will be held by the District in a separate fund or account to be known as the “Capital Recovery Charge Account” and used only to purchase, redeem or defease debt of the Chelan Power System, to fund (after the Project Availability Date for Rocky Reach) required deposits to Reserve and Contingency Funds for Rocky Reach bonds, to fund (after the Project Availability Date for Rock Island) required deposits to Reserve and Contingency Funds for Rock Island bonds, or to fund Capital Improvements related to the Chelan Power System, in each case as determined by the District.

In addition to adjustments resulting from the Escalation Factor, the District may adjust the Capital Recovery Charge Base for a Contract Year by giving written notice to the Purchaser at least 180 days prior to the commencement of such Contract Year. Any such adjustment will not increase the Capital Recovery Charge Base to an amount greater than the District’s estimate, made in good faith, of its average annual Capital Improvement requirements over the next ensuing thirty (30) Fiscal Years. Such estimate will be as computed in real dollars adjusted to be effective as of the first day of such Contract Year. The Capital Recovery Charge Base, as so adjusted, will remain in effect thereafter unless and until subsequently adjusted pursuant to this paragraph or the immediately preceding paragraph. Adjustments for future annual Capital Improvements will not result in the duplication of payments for such future Capital Improvements.

If the Capital Recovery Charge Base is recalculated pursuant to the Power Sales Contract, CPI-b for the calculation of the Escalation Factor for the then current and each succeeding Contract Year (until further changed in accordance with this provision) for purposes of determining the Capital Recovery Charge Base will be changed to the CPI Index number for the December immediately preceding the commencement of the Contract Year in which such recalculation occurs.

**Limit on Capital Recovery Charge and Debt Reduction Charge.** Notwithstanding the provisions of the Power Sales Contract and described in “THE POWER SALES CONTRACT—Payment” to the contrary, the Purchaser will not be obligated to pay the Purchaser’s Percentage of the Debt Reduction Charge and the Capital Recovery Charge in any month if, and only to the extent that, the aggregate value of unspent cash and investments on deposit in the Debt Reduction Charge Fund and the Capital Recovery Charge Fund as of the 15<sup>th</sup> day of the immediately preceding month exceeds:

- (i) five (5) times the Capital Recovery Charge Base for the monthly periods during the Term ending prior to November 1, 2027; and
- (ii) four (4) times the Capital Recovery Charge Base for the monthly periods beginning November 1, 2027 and ending prior to November 1, 2028.

For purposes of the foregoing, funds will be deemed “spent” when (i) costs are paid or incurred for Capital Improvements, or (ii) costs are committed to be expended for qualified costs pursuant to contracts for design, engineering, acquisition and/or construction of such Capital Improvements, but only to the extent that such costs are expected by the District to be paid or incurred prior to the expiration of the Term, or (iii) funds are applied to the purchase, redemption or defeasance of Debt Obligations.

**Unconditional Obligations.** All Periodic Payments due under the Power Sales Contract will be payable by Purchaser, on an “assured payment basis,” and are payable whether or not the Purchaser can receive, accept, take

delivery of or use all or any portion of such Output, regardless of curtailments, shutdowns, force majeure events or other operational, regulatory or financial circumstances that may affect the Purchaser, and whether or not any of the Projects are operable or operating or the operation thereof is interrupted, suspended, interfered with, reduced or curtailed, in whole or in part, at any time for any reason during the term of the Power Sales Contract (including, without limitation, events of force majeure); provided, however, that the foregoing will not affect the rights of Purchaser to pursue its remedies as and to the extent provided in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Default and Termination.” The Periodic Payments payable by Purchaser pursuant to the Power Sales Contract for any month, will be independent of and not related to the amount of Output, if any, delivered to Purchaser under the Power Sales Contract during such month.

**Final Payment.** Within ninety (90) days following the expiration or earlier termination of the Power Sales Contract, Purchaser will pay to the District any and all Periodic Payments accrued but unpaid, net of any credits due to Purchaser as of the date of such expiration or termination. The District will provide Purchaser with a special invoice identifying any such costs and credits within sixty (60) days following the expiration or termination date.

**Use of Funds by District.** Except as otherwise provided in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Payment” “—Determination of Chelan Power System Net Costs,” the District may use the Periodic Payments paid to the District under the Power Sales Contract in any manner that the District, in its sole discretion, will determine.

**Disposition of Fund Balances Upon Expiration or Termination of Power Sales Contract.** Upon the expiration or prior termination of the Power Sales Contract at any time for any reason, all amounts collected pursuant to the Power Sales Contract, including but not limited to, amounts deposited and on hand in or credited to any debt service, reserve, capital, coverage, working capital, credit pool or other fund or account maintained by or on behalf of the District, will be retained by the District. Purchaser will have no right, interest or claim in or to any such amounts or any interest or earnings thereon, except as set forth in the Power Sales Contract.

**Investment of Certain Funds.** The District agrees, to the extent consistent with applicable Law, to invest and keep invested in a manner consistent with the District’s investment policies in effect from time to time, any unexpended amounts of the Debt Reduction Charges and Capital Recovery Charges during any Contract Year.

## **Billing and Payment**

**Billing of Periodic Payments.** Periodic Payments will be billed as follows:

**Monthly Invoices; Periodic Payments.** On or prior to the tenth (10th) day of each Month, the District will submit to the Purchaser, by electronic or facsimile transmission, a monthly invoice setting forth the Periodic Payments incurred by the District in the current Contract Year, and stating the sum of the Periodic Payments actually received to date from the Purchaser with respect to such Contract Year. Costs incurred but not actually known by the date of the invoice may be estimated, subject to reconciliation the following month or months, as actual costs become known by the District.

The Purchaser is required to pay each month the Periodic Payments then due as shown on the District’s invoice, by electronic funds transfer to the District’s account as the District’s Treasurer may instruct. Periodic Payments will be due and payable to the District by 5:00 p.m. (Pacific prevailing time (PPT)) on the twentieth (20th) day of each Month in which the District’s monthly invoice is received, or if such day is not a Business Day, on the next succeeding Business Day (the “Due Date”). Failure of the District to submit an invoice as scheduled will not release the Purchaser from liability for payment upon future delivery of the invoice.

**Late Charges and Interest.** If payment in full is not made on or before the District’s close of business on a Due Date, a delayed payment charge of two percent (2%) of the unpaid amount of the invoice will be assessed to the Purchaser. Interest will accrue on all past due statements at a rate equal to the lesser of 1.5% per month or the maximum rate allowed by law. Should Purchaser fail to pay any invoice within two (2) Business Days after its Due Date as provided in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Billing and Payment,” the District is required to send a notice of such failure to pay to the Purchaser. A monthly payment remaining unpaid three (3) Business Days after the receipt by the Purchaser of such notice of failure to pay will constitute a breach of the Power Sales Contract as described in “THE POWER SALES CONTRACT—Default and Termination,” and the District may, in addition to its other remedies, suspend delivery of the Purchaser’s Percentage

of Output until all amounts due under the Power Sales Contract (including late charges and interest) are received by the District.

***Payments Unconditional.*** The Periodic Payments will accrue, and the Purchaser will be obligated to make such payments through the date of termination of the Power Sales Contract, irrespective of the condition of the Projects and whether or not they are capable of producing any Output for any reason. This provision will not constitute a waiver of the Purchaser's right to seek damages for a breach by the District of its obligations under the Power Sales Contract.

***Accounting.*** The District will cause proper books and records of account to be kept for each of the Projects by the District. Such books and records of account will be kept in accordance with the rules and regulations established by any Government Authority authorized to prescribe such rules including, but not limited to, the Division of Municipal Corporations of the State Auditor's Office of the State of Washington or such other Washington State department or agency succeeding to such duties of the State Auditor's Office. The District will also maintain books and records in conformity with GAAP and in accordance with the Uniform System of Accounts prescribed by FERC or such other federal agency having jurisdiction over electric utilities owning and operating properties similar to the District's electric properties. The District will cause such books and records of account to be audited by independent certified public accountants, experienced in electric utility accounting, to be retained by the District. The audits to be made by such certified public accountants, as above mentioned, will be made annually and will cover each Fiscal Year during the term of the Power Sales Contract. At the Purchaser's written request, the District will deliver a copy of each such annual audit, including any recommendations of the auditors with respect to the Project to Purchaser promptly after it is received by the District.

***Audits by Purchaser.*** District will provide or cause to be provided all information that Purchaser may reasonably request to substantiate all invoices, adjustments and claims under the Power Sales Contract related to the Projects. Purchaser will, upon notice, have the right to audit, at its sole cost and expense, upon reasonable notice and during normal business hours following the receipt of an Annual True-Up, and District will make or cause to be made available any and all books and records related to the Projects which directly relate to the determination of Net Costs as set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Determination of Chelan Power System—Net Costs" and are reasonably necessary for verification of charges and costs included in invoices or amended invoices rendered under the Power Sales Contract or verification of Purchaser's or the District's compliance with the Power Sales Contract; provided, however, that Purchaser will coordinate its rights under this section with the other Share Participants in order to conduct joint, rather than individual, audits pursuant to this provision. The District will also cooperate with Purchaser in its efforts to verify the charges imposed pursuant to the Power Sales Contract and described in "THE POWER SALES CONTRACT—Payments." Any Annual True-Up not challenged within three (3) years following its date will be considered final. Any audit will, at the option of Purchaser and at Purchaser's expense, be performed by designated employees, consultants or agents of Purchaser that Purchaser determines in its discretion are experienced in utility practices. Upon request, District will be entitled to review the complete audit report and any supporting materials.

***No Interest In System.*** The Power Sales Contract is for a sale of Output as described in "THE POWER SALES CONTRACT—Output, Surplus Energy Sales, Credits." Nothing in the Power Sales Contract is intended to grant to Purchaser any rights to or interest in any specific District project, facility or resource.

## **Interconnection and Transmission**

***Interconnection and Transmission Agreements.*** Output will be made available to Purchaser at Transmission Points of Receipt as specified in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission." The Parties will concurrently herewith or prior to the Effective Date, enter into the Transmission Agreement. The Parties will also enter into an Interconnection Agreement, to be negotiated and executed by the parties following the Signing Date and prior to January 1, 2010 (or such later date as may be agreed to by the Parties), that provides for transmission of Output from such Points of Integration, across the Chelan Power System, to specified Transmission Points of Delivery and that addresses interconnection facilities necessary to interconnect the Chelan transmission system with Purchaser's system or with a third party transmission provider, and clarifies related issues with respect to such interconnection, points of delivery, types of service, scheduling of energy deliveries and fees associated with such services. Purchaser would

be responsible for Output transmission from the Transmission Points of Delivery to its own electric system or other designated electric system. Transmission charges will be based upon the District's entire transmission system and reflect the same charges as contained in the Transmission Agreement with Puget Sound Energy.

**Type of Service; Scheduling.** Types of service and Scheduling of Energy deliveries will be made in accordance with the provisions of the Power Sales Contract and described in "THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission" thereof.

### **Exclusive Control of the System**

The District, and not the Purchaser, will have exclusive control over the operation and maintenance of the Chelan Power System and all repairs, renewals, additions, improvements, retirements, decommissions of and replacements to either of the Projects, and all of the District's generation, transmission or distribution facilities, all units and components thereof, and the financing related to such activities. All deliveries will be subject to the District's curtailment rights set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Curtailment and Decommissioning."

Following the first Project Availability Date, at the request of Purchaser, the District will meet with representatives of Purchaser on a semi-annual basis. All such meetings will be held at the District's headquarters office, or such other location, and at a date and time as the Parties may mutually agree. The District may elect to schedule such meetings with other Share Participants, but it will not be obligated to do so. The District's representatives will attend and provide information concerning past and future expenditures, budgets, operations, maintenance, capital projects and other matters related to the Chelan Power System, as reasonably requested by Purchaser. Meetings initiated pursuant to this paragraph will not exceed eight (8) hours duration without the District's consent. At such meetings, Purchaser may make recommendations to the District concerning the operation and maintenance of, and repairs, renewals, additions, improvements and replacements to, the Chelan Power System. Nothing in the Power Sales Contract will be construed to create any implied obligations by the District with respect to the Purchaser's recommendations.

Nothing contained in the Power Sales Contract will entitle the Purchaser to make any claim for damages arising from the failure to deliver power or from the disruption of service from or in relation to the Chelan Power System. Except as provided in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination," for an Intentional Breach by the District, the Purchaser's sole remedy for the District's breach of its undertaking under the Power Sales Contract will be to bring an action for mandamus to specifically enforce the District's covenants under the Power Sales Contract.

### **Relicensing Support**

The District's current FERC license for Rocky Reach expired on June 30, 2006 (annual licenses will be renewed until a new license is issued); and its current FERC license for Rock Island expires on December 31, 2028. The District is currently pursuing a new license for Rocky Reach and intends to seek a new license for Rock Island. In light of the fact that the Output determined in relation to each of the Projects is material to the Power Sales Contract, Purchaser covenants and agrees to use Commercially Reasonable Efforts, at its cost and expense, to support the District's efforts to obtain a new license for each of the Projects, at such times during the Term and in such manner as the District reasonably requests in writing. Such support may include, but will not be limited to, providing letters or other written statements of support and written or oral testimony before FERC or in other administrative or legal proceedings, and participation in and statements of support at public meetings.

### **Risk of Loss and Disclaimer of Warranties**

**Risk of Loss.** The District represents and warrants that it will deliver the Output sold under the Power Sales Contract to Purchaser free and clear of all liens, claims and encumbrances arising prior to the delivery of such Output at the Transmission Point(s) of Receipt. Purchaser will bear all risk of all occurrences of any nature affecting any interconnection facilities, substations, transmission lines and other facilities serving Purchaser. For the avoidance of doubt, the risk of loss pursuant to the foregoing will not reduce or otherwise affect the Purchaser's Periodic Payments as described in the Power Sales Contract.

The District will not be liable to Purchaser for any damages or losses sustained by Purchaser (except as provided in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and

Termination,” for an Intentional Breach by the District) or its customers or third parties as a result of the curtailment, reduction or interruption of Output or the transmission of Output to Purchaser’s Transmission Point(s) of Receipt.

***Disclaimer of Warranties.*** Except as otherwise expressly set forth in the Power Sales Contract, the District disclaims any and all warranties beyond the express terms thereof, including any implied warranties of merchantability or fitness for a particular purpose, and all other warranties with regard to Output made available to Purchaser pursuant to the Power Sales Contract are expressly disclaimed.

The Parties confirm that the express remedies and measures of damages provided in the Power Sales Contract against the Purchaser, and the express limitations as to remedies and damages provided in the Power Sales Contract with respect to the District, in each case satisfy the essential purposes thereof. For breach of any provision thereof for which an express remedy or measure of damages is provided, such express remedy or measure of damages will be the sole and exclusive remedy, the obligor’s liability will be limited as set forth in such provision and all remedies or damages at law or in equity are waived. Except as otherwise expressly provided in the Power Sales Contract, the obligor’s liability will be limited to direct actual damages only, such direct actual damages will be the sole and exclusive remedy and all other remedies or damages at law or in equity are waived.

THE FOREGOING IS IN LIEU OF ALL OTHER WARRANTIES, EXPRESSED OR IMPLIED, INCLUDING THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, IN FACT OR BY LAW WITH RESPECT TO THE OUTPUT PROVIDED UNDER THE POWER SALES CONTRACT. DISTRICT DISCLAIMS ANY AND ALL OTHER WARRANTIES WHATSOEVER.

These limitations will be in addition to, and not in lieu of, the provisions of the Power Sales Contract and described in “THE POWER SALES CONTRACT—Output, Surplus Energy Sales, Credits,” “—Curtailment and Decommissioning” and “—Limitation of Liability.”

### **Assignment**

Neither Party will assign the Power Sales Contract or its rights under the Power Sales Contract without the prior written consent of the other Party, which consent may be withheld in the exercise of its sole discretion; provided, however, that:

The District may, without the consent of the Purchaser (and without relieving itself from liability under the Power Sales Contract), pledge or encumber the Power Sales Contract or the accounts, revenues or proceeds thereof in connection with any financing or other financial arrangements; and

If more than one Party has signed the Power Sales Contract as Purchaser under the Power Sales Contract, this provision will apply to each entity collectively as a unit. No assignment made under this Clause (B) will release the assigning Party from its obligations under the Power Sales Contract unless the non-assigning Party expressly consents to such release, which consent may be withheld at the non-assigning Party’s sole discretion.

Nothing contained in the Power Sales Contract will preclude the District, without notice to or the consent of the Purchaser, from entering into lease/leaseback, sale/leaseback with an option to purchase, or other similar arrangements with respect to the Projects, or either of them, the economic effect of which is to transfer tax ownership of the Project or Projects for a stated period to a third party, provided that the District retains control of the management and operation of the Projects and related Energy and Capacity, equivalent to that of a legal owner, as determined by the District, for the Term, and provided, that any such assignment or transfer by the District would not impair the Power Sales Contract or the sale of Output to Purchaser.

### **Insurance**

Purchaser will acquire and maintain during the Term in full force and effect, at its sole cost and expense, comprehensive general liability insurance that includes operations, products and contractual liability, explosion, collapse, and underground hazards, broad form property damage, sudden and accidental pollution and personal liability, with a minimum combined single limit of \$10,000,000 per occurrence and not less than \$20,000,000 in the aggregate. Each such policy will be primary to and will not contribute to any insurance that may otherwise be maintained by, or on behalf of, the District. All insurance required under the Power Sales Contract will contain provisions waiving the insured’s and the insurer’s rights of subrogation or recovery of any kind against the District,

its Affiliates and their respective directors, trustees, agents, employees, officers, successors and assigns. Self insurance may be substituted for all or any part of the insurance requirements under the Power Sales Contract consistent with any generally applied self insurance program of Purchaser. Purchaser will provide the District with a summary of insurance coverages in force on an annual basis. The District acknowledges and agrees that the Purchaser's current program of insurance and self-insurance, as of the Signing Date, is consistent with and satisfies the foregoing provisions of the Power Sales Contract.

The District will maintain an insurance and/or self-insurance program with respect to the Chelan Power System for property damage, general liability, and other risks as, consistent with Prudent Utility Practice, the District may determine and the District's Commissioners may approve. The Purchaser acknowledges and agrees that the District's current program of insurance and self-insurance meets requirements of the Power Sales Contract.

### **Default and Termination**

**Events of Default.** An "Event of Default" means, with respect to a Party (a "Defaulting Party"), the occurrence of any of the following:

(A) the failure to make, when due, any payment required pursuant to the Power Sales Contract if such failure is not remedied within three (3) Business Days after receipt of written notice, as required in the Power Sales Contract;

(B) any representation or warranty made by such Party in the Power Sales Contract is false or misleading in any material respect when made or when deemed made or repeated;

(C) the failure to perform any material covenant or obligation set forth in the Power Sales Contract (except to the extent constituting a separate Event of Default) if such failure is not remedied within 30 days after receipt of written notice;

(D) the Bankruptcy of such Party;

(E) the failure of such Party to provide Performance Assurance within the time requirements set forth in the Power Sales Contract;

(F) the failure of such Purchaser to provide Adequate Assurances to the District within fifteen (15) days following receipt of written notice that the District in good faith has reasonable grounds for insecurity (determined using commercially reasonable standards embodied in Section 2-609(2) of the Washington State Uniform Commercial Code) in the Purchaser's ability to perform its obligations under the Power Sales Contract;

(G) such Party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all of its assets to another entity and/or assigns to another entity without the express written consent of the other party pursuant to the Power Sales Contract or, in the case of Purchaser, Purchaser suffers a Change in Control with respect to which the District has not expressly consented within 30 days following the occurrence thereof;

(H) the occurrence and continuation of (i) a default, event of default or other similar condition or event in respect of such Party under one or more agreements or instruments, individually or collectively, relating to indebtedness for borrowed money ("Funding Agreements") in an aggregate amount of not less than the applicable Cross Default Amount which results in such indebtedness becoming immediately due and payable or (ii) a default by such Party in making on the due date therefor one or more payments, individually or collectively, under any judgment, or under any contract or other obligation not included within the definition of "Funding Agreement" above, in an aggregate amount of not less than the applicable Cross Default Amount; provided, however that such Party will not be deemed in default under this clause (ii) so long as it diligently contests such payments in good faith by appropriate proceedings and pays any amount ultimately determined to be due within 30 days of such determination.

The decommissioning of one or both Projects will not constitute a breach of the Power Sales Contract. Termination of the Power Sales Contract by the District will not constitute a breach of the Power Sales Contract.

**Remedies Upon Default.** The Party as to which an Event of Default has not occurred (each a "Non-Defaulting Party") will have the right, so long as any Event of Default is continuing and has not been cured within the applicable cure periods, if any, to take any one or more of the following actions:

(A) suspend its performance under the Power Sales Contract, other than any payment obligations that may be due or become due under the Power Sales Contract, until such Event of Default is cured or formally waived in writing by the Non-Defaulting Party;

(B) in the case of the District only, terminate the Power Sales Contract and sue for damages as contemplated in “THE POWER SALES CONTRACT—Default and Termination;”

(C) maintain successive proceedings against the Defaulting Party for recovery of damages (to the extent permitted under the Power Sales Contract) or for a sum equal to any and all payments required to be made pursuant to the Power Sales Contract; or

(D) take whatever action at law or in equity as may be necessary or desirable to collect the amounts payable by the Defaulting Party under the Power Sales Contract, as then due or to become due thereafter, or to enforce performance and observation of any obligation, agreement or covenant of the Defaulting Party under the Power Sales Contract.

If, during the continuation of a default by Purchaser, Wenatchee Works is operating at or above Level 3, payments or distributions from Purchaser’s Current Year’s Credit Pool and Purchaser’s Long Term Credit Pool to which Purchaser would otherwise be entitled under the *Power Sales Contract* and described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits” will be suspended until the default has been cured. If, during such default, Wenatchee Works is operating at Level 4, or is Shutdown, all Annual Cumulative Surplus Proceeds are required to be retained by the District. In either case, Purchaser will remain liable for and will pay Net Costs and any Initial Shutdown Amount and Shutdown Settlement Amounts that may become due.

If the District suspends performance pursuant to clause (A) above, the District will act in a Commercially Reasonable manner to mitigate damages, including but not limited to using Commercially Reasonable efforts to sell the Purchaser’s Percentage of Output to third parties on a short term basis. In such case, Purchaser is required to pay for the full amount of the monthly Periodic Payments, and any proceeds the District receives from the sale of such Output, net of Sales and Administrative Charges, fees, costs and expenses, as determined by the District to be due, will first be applied against amounts owed by the Purchaser under the Power Sales Contract with respect to such Output, with the balance, if any, being retained by the District.

The Purchaser waives any right it may have to terminate the Power Sales Contract as a result of a default by the District. Except as set forth in the following sentence, Purchaser specifically agrees to limit its remedies related to any default by the District to claims for specific performance or injunctive or equitable relief. In the event of an Intentional Breach by the District, the Purchaser’s sole remedy will be the recovery from the District of an amount equal to the gross proceeds received by the District from the sale of Purchaser’s Share of Output that was the subject of the breach.

Except as otherwise expressly provided in the Power Sales Contract, no right or remedy conferred upon or reserved to a Party is intended to be exclusive of any other right or remedy, and each and every right and remedy will be cumulative and in addition to any other right or remedy given under the Power Sales Contract, or now or hereafter legally existing, upon the occurrence of any Event of Default. Failure of either Party to insist at any time on the strict observance or performance by the other Party of any of the provisions of the Power Sales Contract, or to exercise any right or remedy provided for in the Power Sales Contract will not impair any such right or remedy nor be construed as a waiver or relinquishment thereof for the future. Receipt by the District of any payment required to be made under the Power Sales Contract with knowledge of the breach of any provisions of the Power Sales Contract, will not be deemed a waiver of such breach. In addition to all other remedies provided in the Power Sales Contract, each Party will be entitled, to the extent permitted by applicable Law, to injunctive relief in case of the violation, or attempted or threatened violation, of any of the provisions of the Power Sales Contract, or to a decree requiring performance of any of the provisions of the Power Sales Contract or to any other remedy legally allowed to such Party.

*Calculation of District’s Loss upon Termination.*

If the District terminates the Power Sales Contract pursuant to the provisions of the Power Sales Contract and described in “THE POWER SALES CONTRACT—Default and Termination,” the District will be entitled to recover from the Purchaser the full amount of its loss resulting from the early termination of the Power Sales Contract. The Parties recognize that it will be difficult to calculate those losses with absolute precision and agree that the District’s good faith determination of such losses, based on the methodology set forth in the Power Sales



Contract and described in “THE POWER SALES CONTRACT—Default and Termination,” will be conclusive and binding on the Parties, absent manifest error.

The District’s losses and costs upon such termination will be determined based on its assessment of the cost of replacing the defaulting Purchaser with a new creditworthy participant who is willing to assume the obligations of the defaulting Purchaser under the Power Sales Contract. Such costs will include, among other items, upfront incentive payments the District reasonably believes it will be required to pay to entice a substitute Purchaser to assume the defaulting Purchaser’s obligations under the Power Sales Contract, the present value (calculated at the District’s tax exempt borrowing rate, or if the District no longer has tax exempt debt outstanding, at its applicable taxable borrowing rate) of pricing discounts and other concessions that the District reasonably believes will be required to entice a substitute Purchaser to assume such obligations, the legal fees and expenses anticipated to be incurred by the District in effectuating such substitution, and all other losses, costs and expenses that have been, and that the District reasonably believes will be, incurred in connection with such default, termination and substitution.

All such losses and costs will be determined by the District in good faith, using Commercially Reasonable procedures, in order to arrive at a Commercially Reasonable result.

Amounts due and owing by the defaulting Purchaser as of the date of termination, together with all legal fees, costs and expenses incurred by the District, arising out of or as a result of such default in connection with the enforcement of the Power Sales Contract and the protection of its rights under the Power Sales Contract (including all costs of collection) will be in addition to the losses calculated in accordance with Clause (B) above.

In determining its losses, the District may consider any relevant information, including, without limitation, one or more of the following types of information:

(i) quotations (either firm or indicative) for assumption of the Purchaser’s obligations under the Power Sales Contract, supplied by one or more third parties that take into account the status of the Chelan Power System, the District’s existing and anticipated Net Costs, the creditworthiness of the District at the time the quotation is provided and any other factors then existing or anticipated that are relevant to the third party providing such quotation;

(ii) information consisting of relevant market data in the relevant market supplied by one or more third parties, including, without limitation, relevant existing and projected rates, prices, yields, yield curves, volatilities, spreads, correlations and other relevant market data, and the current and anticipated future regulatory environment; or

(iii) information of the types described in the clauses (i) or (ii) above from internal sources if that information is of the same type used by the District in the regular course of its business for evaluating power sales contracts.

The District will consider, taking into account the standards and procedures described above, quotations pursuant to Clause (E)(i) above or relevant market data pursuant to Clause (E)(ii) above, unless the District reasonably believes in good faith that such quotations or relevant market data are not readily available or would produce a result that would not satisfy those standards. When considering information described in Clause (E)(i), (ii) or (iii) above, the District may include costs of funding, to the extent it would not be a component of the other information utilized. Third parties supplying quotations pursuant to Clause (E)(i) above or market data pursuant to Clause (E)(ii) above may include, without limitation, wholesale purchasers in relevant markets, end-users of electric energy, information vendors, brokers, and other sources of market information.

In making these calculations, the mandatory step-up provisions described in “THE POWER SALES CONTRACT—Output; Surplus Energy Sales; Credits” will be ignored.

If the District determines that its losses, as determined using the foregoing methodology, are negative (meaning that the District will benefit economically from such termination), no amounts will be due by either Party with respect to such losses, and the Purchaser’s liability will be limited to (i) amounts due and owing and accrued as of the date of termination, plus (ii) attorneys fees and expenses and other collection costs, plus (iii) the District’s reasonable costs of calculating such losses.

The District will notify the Purchaser of its calculation of losses as soon as possible after termination and will supply the Purchaser with a summary analysis of the methodology used in such calculations. The Parties recognize that it will be extremely difficult to precisely determine the amount of actual damages and loss that would be suffered by the District if the Purchaser's default gives rise to a termination of the Power Sales Contract as described in "THE POWER SALES CONTRACT—Default and Termination," and agree that the District's reasonable determination of such losses, using the methodology pursuant to this section, is a fair and reasonable method of determining of the amount of actual damages that would be suffered by the District in such event. The loss methodology is intended to measure the anticipated damages actually suffered from a termination and is not intended to constitute a penalty or forfeiture.

The calculation of losses for a default by Purchaser does not apply to a termination of the Power Sales Contract as a result of the District's failure to consent to a Change in Control pursuant to the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination."

### **Dispute Resolution**

**General.** Any dispute arising out of, or relating to, the Power Sales Contract, with the exception of those specifically excluded under the Power Sales Contract, will be subject to the dispute resolution procedures specified in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Dispute Resolution." Each Party retains the right, after making a good faith effort at resolving the dispute pursuant to the terms of the Power Sales Contract and described in "THE POWER SALES CONTRACT—Dispute Resolution," to pursue such other actions and remedies otherwise permitted or authorized by law or equity.

**Good-Faith Negotiation.** The Parties will first negotiate in good faith to attempt to resolve any dispute, controversy or claim arising out of, under, or relating to the Power Sales Contract (a "Dispute"), unless otherwise mutually agreed to by the Parties. In the event that the Parties are unsuccessful in resolving a Dispute through such negotiations, either Party may proceed immediately to litigation concerning the Dispute.

The process of "good-faith negotiations" requires that each Party set out in writing to the other its reason(s) for adopting a specific conclusion or for selecting a particular course of action, together with the sequence of subordinate facts leading to the conclusion or course of action. The Parties will attempt to agree on a mutually agreeable resolution of the Dispute. A Party will not be required as part of these negotiations to provide any information which is confidential or proprietary in nature unless it is satisfied in its discretion that the other Party will maintain the confidentiality of and will not misuse such information or any information subject to attorney-client or other privilege under applicable Law regarding discovery and production of documents.

**Other Recourse.** Notwithstanding any other provision of the Power Sales Contract, either Party may, without prejudice to any negotiation or mediation, proceed in the courts of the State of Washington to obtain provisional judicial relief if, in such Party's sole discretion, such action is necessary to protect public safety, avoid imminent irreparable harm, to provide uninterrupted electrical and other services, or to preserve the status quo pending the conclusion of any dispute resolution procedures employed by the Parties or pendency of any action at law or in equity. Except for temporary injunctive relief under this section, neither Party will bring any action at law or in equity to enforce, interpret, or remedy any breach or default of the Power Sales Contract without first complying with the provisions of the Power Sale Agreement.

### **No Dedication of Facilities**

No undertaking under any provision of the Power Sales Contract will constitute a dedication of any portion of the District's electric system or the Chelan Power System to the public or to Purchaser.

### **Licenses and Ownership and Control**

Purchaser acknowledges and agrees that the District must comply with the terms and provisions of the (i) FERC licenses for the respective Projects and (ii) the respective Debt Obligations and the resolutions and documents authorizing or providing for the issuance or incurrence and/or the terms thereof. The Power Sales Contract is made subject to the terms and provisions of such FERC licenses and such licenses will govern to the extent of any conflict with the terms and provisions of the Power Sales Contract.

## **Credit and Collateral Requirements**

**Financial Information.** The Purchaser will deliver to the District (i) within 120 days following the end of each fiscal year of Purchaser, a copy of the Purchaser's annual report containing audited consolidated financial statements for such fiscal year, (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of the Purchaser's quarterly report containing unaudited consolidated financial statements for such fiscal quarter, (iii) all public announcements made by the Purchaser of a financial nature promptly following their release to the public, (iv) any notice of any Downgrade Event, including a change in rating outlook, promptly upon the occurrence thereof and (v) a written report concerning any material changes in Purchaser's ability to perform its obligations under the Power Sales Contract, immediately upon the occurrence thereof. In all cases the statements will be for the most recent accounting period and prepared in accordance with GAAP; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or in the delivery of audited financial statements or certificates with respect thereto, such delay will not be an Event of Default so long as the Purchaser provides notice to the District and diligently pursues the preparation and delivery of the statements and required certificates. Notwithstanding the foregoing, the reports, announcements, notices and statements to be delivered under the Power Sales Contract will be deemed to be delivered on the date the same will be posted on the Securities and Exchange Commission website ([www.sec.gov](http://www.sec.gov)). Upon the District's written request, Purchaser will deliver to the District hard copies of the documents contemplated under the Power Sales Contract.

**Credit Assurances.** Upon the occurrence of a Downgrade Event, or if the District otherwise has reasonable grounds to believe that the Purchaser's creditworthiness or performance under the Power Sales Contract has become unsatisfactory, the District may provide the Purchaser with written notice requesting Performance Assurance. Upon receipt of such notice, the Purchaser will have five (5) Business Days to remedy the situation by providing such Performance Assurance to the District. In the event that the Purchaser fails to provide such Performance Assurance, or a guaranty or other credit assurance acceptable to the District within five (5) Business Days of receipt of notice, then an Event of Default under the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination" will be deemed to have occurred and the District will be entitled to the remedies set forth in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination" of the Power Sales Contract.

## **Limitation of Liability**

**Limitation of Liability.** Except as provided in the Power Sales Contract and described in "THE POWER SALES CONTRACT—Default and Termination," neither Party (including each Party's officers, trustees, directors, agents, employees, direct and indirect parents, subsidiaries or Affiliates, and such parents', subsidiaries' or Affiliates' officers, trustees, directors, agents or employees) will be liable or responsible to the other Party (or its direct and indirect parents, subsidiaries, Affiliates, officers, trustees, directors, agents, employees, successors or assigns) or their respective insurers, for any direct, special, incidental, indirect, exemplary, punitive or consequential damages connected with or resulting from the performance or non-performance of the Power Sales Contract, or anything done in connection therewith including, without limitation, Claims in the nature of business interruption, lost revenues, income or profits (other than payments expressly required and properly due under the Power Sales Contract), or loss of business, reputation or opportunity, or cost of capital, and irrespective of whether such Claims are based upon downtime costs or Claims of customers, and irrespective of the basis of such Claims.

**No Personal Liability.** Neither any partner, shareholder, member, parent company or other Affiliate of either Party (or any officer or director or any employee thereof), nor any partner, shareholder, member, parent company or other Affiliate or successor-in-interest of such partner, shareholder, member, parent company or other Affiliate (or any officer or director of any employee thereof), will have any personal liability or responsibility for, relating to or in connection with said Party's failure to properly perform any term, covenant, condition or provision of the Power Sales Contract.

## **Entire Agreement; Modifications**

Except as may be expressly provided in the Power Sales Contract, all previous communications between the Parties hereto, either verbal or written, with reference to the subject matter of the Power Sales Contract are abrogated. The Purchaser's entitlement to Output under the Power Sales Contract will only become effective on the expiration of the Prior Agreement, and nothing in the Power Sales Contract will be deemed to supersede or supplement that agreement. Upon each respective Effective Date, the Power Sales Contract will constitute the entire

agreement between the Parties hereto with respect to the applicable Project. No modifications of or amendments to the Power Sales Contract will be binding upon the Parties or either of them unless such a modification is in writing, duly executed by an authorized officer or employee of each Party.

#### **Determination of Chelan Power System Net Costs**

**Determination of Net Costs.** For purposes of the Power Sales Contract, the District's Chelan Power System net costs ("Net Costs") for any given month will include all costs and expenses of every kind and description, both direct and indirect, paid or accrued by the District in such Month with respect to its ownership, operation, maintenance, repair and improvement of, and the production and delivery of Output from, the Chelan Power System, as determined by the District, including without duplication (whether under the Power Sales Contract, the Transmission Agreement or the Interconnection Agreement), the items of cost and expense described below, plus any cost or expenses incurred by the District in such month in administering the Power Sales Contract that are unique to Purchaser or Purchaser's performance (or failure to perform) under the Power Sales Contract. Net Costs will not include any depreciation expense or any expense incurred in the District's purchasing Energy or its use of Energy from another source other than the Chelan Power System. It is specifically understood that Purchaser's costs of Output will be determined in relation to the Net Costs and other provisions of the Power Sales Contract. Such Net Costs will include, without intending to limit the generality of the foregoing:

**Operating and Maintenance Costs.** All Operating Costs paid or accrued by the District with respect to the operation, maintenance and repair of, or the production, sale or delivery of Output from, the Chelan Power System or any part thereof, including allocable District overhead and administrative costs, and costs of generation integration for the Chelan Power System provided by the District's distribution system, all as the District may reasonably determine consistent with GAAP, FERC regulations (including FERC's Uniform System of Accounts) and the District's accounting policies, practices and procedures. Without limiting the generality of the foregoing, Operating Costs will include those items of cost described in subsections (i) through (iv) below.

- (i) **Taxes and Assessments.** All governmental taxes, assessments or other similar charges with respect to its ownership, operation, maintenance or repair of, or the production, sale or delivery of Output from, the Chelan Power System or any part thereof, including payments by the District in lieu of such governmental taxes, assessments or other similar charges.
- (ii) **Certification, Relicensing and Decommissioning Costs.** All costs determined by the District to be reasonably allocable to the certification, re-licensing or decommissioning of any of the Projects or any part thereof. The District agrees that it will not accelerate payment of costs associated with measures required or agreed upon, in the District's sole discretion, for the relicensing of either Project in advance of the date(s) necessary to comply with existing and anticipated FERC and other regulatory requirements or settlement agreements related to relicensing.
- (iii) **Litigation.** All judgments, claims, settlements, arbitration awards and other similar costs and liabilities with respect to its ownership, operation, maintenance, repair or improvement of, or the production, sale or delivery of Output from, the Chelan Power System, including attorneys' fees and costs, in each case to the extent not paid from proceeds of insurance or otherwise recovered from third parties.
- (iv) **Loss Prevention.** All costs for the prevention of any loss or damage to the Chelan Power System, and all costs of the correction of any loss or damage to the Chelan Power System to the extent not paid from proceeds of insurance covering such loss or damage.

Notwithstanding anything to the contrary, Operating Costs will not include costs paid or deemed paid from the proceeds of Debt Obligations or to the extent the costs of Capital Improvements were paid from Capital Recovery Charges or Debt Reduction Charges as contemplated in the Power Sales Contract.

The Purchaser agrees that the District may, in its sole discretion, determine what Operating Costs will be incurred in connection with the ownership, operation, maintenance and improvement of, and the production, sale and delivery of Output from, the Chelan Power System.

Notwithstanding anything to the contrary, if an item of cost or expense referred to above or any part thereof will relate to less than all of the Share Participants, or will clearly not be applicable to

a Share Participant, such item will only be included as an item of Net Costs with respect to those Share Participants to which such cost or expense relates.

**Financing Costs.** Financing Costs (“Financing Costs”) for each Month will consist of the monthly accrual, as determined by the District, of the following costs payable or deemed payable by the District or the Chelan Power System, as the case may be, in connection with the issuance, incurring and carrying of Debt Obligations:

- (i) **Outstanding Debt Obligations.** With respect to Debt Obligations that are outstanding as of January 31, 2006 (“Outstanding Debt Obligations”), the Purchaser will pay Financing Costs based on the payment and amortization schedule attached hereto as Schedule A-1, and regardless of actual payments owed by the District and regardless of any subsequent changes in such Debt Obligations, whether as a result of prepayments, refundings, restructuring or otherwise.
- (ii) **Future Debt Obligations.** With respect to Debt Obligations that are incurred after January 31, 2006 (“Future Debt Obligations”), the Purchaser will (a) pay, commencing November 1, 2011, the monthly amortization of the Assumed Debt Service on such Debt Obligations attributable to Rocky Reach, and (b) pay, commencing July 1, 2012, the monthly amortization of the Assumed Debt Service on such Debt Obligations attributable to Rock Island. Following the issuance or incurrence of any Debt Obligation, the District will make available to the Purchaser, at its request, a written schedule showing the Capital Improvements expected to be financed by the District from the proceeds thereof, the estimated Average Service Life of such Capital Improvements as determined by the District and the scheduled monthly Financing Costs associated with such Debt Obligations.
- (iii) **Refunding Obligations.** The Purchaser’s Financing Costs with respect to Debt Obligations will be determined as of January 31, 2006 or the date of original issuance or incurrence thereof, as the case may be, and will not be affected by any subsequent direct or synthetic refinancing of such obligations.

Except as provided below, no adjustment will be made to the Purchaser’s scheduled Debt Obligations payments as calculated in accordance with this section as a result of the payment, purchase, defeasance, tender, acceleration, redemption or other restructure or modification of Debt Obligations after the initial issuance or incurrence thereof.

**Capital Recovery Charge and Debt Reduction Charge Adjustments.** If the District purchases, redeems or defeases outstanding debt of the Chelan Power System from moneys on deposit in the Capital Recovery Charge Fund or Debt Reduction Charge Fund, or from proceeds of insurance received with respect to components of the Capital Improvements that the District elects not to repair, rebuild or replace, all as determined by the District, the District will provide the Purchaser with a credit against its monthly Financing Costs otherwise due from time to time under the Power Sales Contract, spread over a 25 year period from the month following the month of calculation (which the District agrees to complete as soon as reasonably practical following such purchase, redemption or defeasance), computed on a level monthly credit basis, using the following criteria, all as determined by the District: (i) the interest component of the credit will be the actual weighted average interest rate applicable to Debt Obligations included in the Purchaser’s Financing Costs, and (ii) the principal component of the credit will equal the principal amount of debt of the Chelan Power System that was purchased, redeemed or defeased with such funds.

Notwithstanding anything to the contrary, the District’s determination of Net Costs, Operating Costs and Financing Costs will be binding and conclusive on the Purchaser absent manifest error.

Notwithstanding the foregoing, the District, in its discretion, may adjust the Financing Costs as it deems necessary, from time to time, to correct any error in the computation thereof, or to reflect a material change in the District’s reasonable estimate of the In Service Date or the Average Service Life with respect thereto, and will either add to or credit the amounts otherwise due in such month, to reflect the cumulative effect of any such adjustment.

Notwithstanding anything to the contrary, except as provided in the Power Sales Contract and described in “THE POWER SALES CONTRACT—Default and Termination,” no credits will be given for any income or revenues from the sale or other disposition of Output to any person.

*Use of Funds; Separate Accounts.*

- A. Except as otherwise expressly set forth in the Power Sales Contract, the District, in its sole discretion, may use payments received from the Purchaser under the Power Sales Contract in any manner that the District will determine.
- B. The moneys in any fund or account established pursuant to the Power Sales Contract may be deposited and invested on a commingled basis by the District; provided, that the District will maintain adequate accounting records to reflect any restricted applications of the moneys on deposit therein.
- C. The designation of any fund or account in the Power Sales Contract will not be construed to require the establishment of any independent, self-balancing fund as such term is commonly defined and used in governmental accounting, but rather is intended solely to constitute an earmarking of certain funds for certain purposes and to establish certain priorities or requirements for application thereof.

***Issuance and Incurrence of Debt Obligations and Refunding Obligations.***

The District in its discretion may issue and incur Debt Obligations for the purpose of financing Capital Improvements to the Chelan Power System and may issue or incur Refunding Obligations to Refinance Debt Obligations and Refunding Obligations.

Anything in the Power Sales Contract to the contrary notwithstanding, the covenants, agreements, terms and provisions of all Debt Obligations and Refunding Obligations, including all bond resolutions, loan resolutions, trust agreements and indentures, loan agreements, reimbursement agreements, leases, bonds, notes and other similar instruments, adopted or executed by the District with respect to such Debt Obligations and Refunding Obligations will be determined by the District in its sole discretion.

**Output, Scheduling, Planning and Transmission**

***Chelan Power System Output.***

***Energy Component.*** Purchaser's Percentage of Output will be determined in reference to actual deliverable electric energy from the Chelan Power System from time to time in amounts expressed in megawatt hours ("Equivalent Energy") as determined by the following methodology, it being understood that Output may be for purposes of the Power Sales Contract supplied by the District from any source and not necessarily from the Chelan Power System.

"Equivalent Energy" will be determined in accordance with the following methodology:

1. Determine the average total stream flow for the day for both the Rocky Reach and the Rock Island Projects in thousand cubic feet per second (kcfs).
2. Determine the average turbine flow for the day at the Rocky Reach Project in thousand cubic feet per second (kcfs). Turbine flow equals the total stream flow less spill.
3. Determine the number of generating units which were available for operation hour by hour for both the Rocky Reach and the Rock Island Projects.

The District, in consultation with the Purchaser, will develop Tables for each Rocky Reach and Rock Island Projects to correlate the amount of Equivalent Energy to be made available to the Purchaser for variable turbine flows and unit availabilities. All upstream and downstream encroachments, adjustment for station service and losses to the Transmission Point(s) of Receipt will be reflected in the Tables. Energy deliveries or consumption obligations that are a Project responsibility under applicable Laws or agreements (including, but not limited to, fish hatcheries) will be reflected in the Tables. These Tables will be revised and updated by the District to reflect the current energy correlations.

***Load Following and Regulation.*** Output includes Load Following/Regulation services by the Chelan Power System.

***Chelan Power System Rights and Obligations.*** Output includes the rights and obligations from Canadian Entitlement, MCHC, PNCA, HCP, Biological Opinion, Hanford Reach Fall Chinook Protection Program and Immediate Spill Replacement.

***Spinning Operating Reserves and Non-Spinning Operating Reserves.*** The Purchaser's ability to utilize Output for purposes of Spinning Operating Reserves and Non-Spinning Operating Reserves will be limited to and as provided in MCHC and its related operating protocols. The Parties agree that they will negotiate in good faith with each other and with other MCHC parties to modify MCHC's operating protocols in order to provide for the availability of Spinning Operating Reserves and Non-Spinning Operating Reserves; provided, however, that under any circumstances, the District reserves the right to refuse to place unloaded Units on-line for the sole purpose of meeting Purchaser's Spinning Operating Reserve obligations. Purchaser will not be entitled to sell or transfer Spinning or Non-Spinning Operating Reserves. Purchaser's use of Spinning Reserves is limited to such use as necessary to meet regulatory or reliability requirements as described in "THE POWER SALES CONTRACT—Output, Scheduling, Planning and Transmission."

***Excluded Products and Services.*** Output does not include the following:

- (i) Capacity (Output does include Capacity required for load following and reserve requirements);
- (ii) Pond/Storage;
- (iii) Black Start Capability;
- (iv) RAS;
- (v) Voltage Support/MegaVars (MVARs); and
- (vi) All other items not specifically included in the Power Sales Contract. It is Purchaser's responsibility to provide any additional ancillary services required to comply with safety and reliability standards in connection with Purchaser's receipt and use of Output.

### **Control Area Services and Fees**

The Purchaser's load is within the District's Balancing Authority. There are certain fees (such as WECC fees) that are assessed based on load in the District's Balancing Authority. The Purchaser will be responsible for their percentage share of the total assessment. Their percentage share of the total assessment will be calculated by multiplying the total assessment by the fraction of the Wenatchee Works annual energy usage, in MWHs, divided by the sum of the Wenatchee Works annual energy usage and the District's annual energy usage, in MWHs for the applicable period. These costs will be charged as costs in addition to Net Costs.

### **Operating Reserves and the Northwest Power Pool Reserve Sharing Group**

The Purchaser is responsible for providing an adequate amount of operating reserves per the Regulatory Authority for an amount of generation equal to the "Equivalent Energy" and for an amount of load equal to the Wenatchee Works energy usage. The Purchaser may use their percentage share of the Output to provide these operating reserves; provided, however if the amount of operating reserves from the Output is less than the minimum required amount per the Regulatory Authority, the Purchaser will procure operating reserves to meet the Regulatory Authority's minimum requirement. The Purchaser will be responsible for all costs to purchase, schedule and deliver any necessary operating reserves. The District is a member of the Northwest Power Pool Reserve Sharing Group (NWPPRSG) which allows the District to provide fewer operating reserves than if the District was not a member. Since the Wenatchee Works Load is in the District's Balancing Authority, the Purchaser also shares in the benefits and obligations of the NWPPRSG.

### **Scheduling of Output**

Purchaser will notify the District of the Wenatchee Works energy requirements and instruct the District on managing the Purchaser's Energy usage/resource balance. The District will execute Supplemental Power Purchases and Excess Energy Sales to balance the Purchaser's resources with the Purchaser's energy usage. The Parties will

each be responsible for their respective adherence to all scheduling protocols in WECC, NERC, RTO, or another Regulatory Authority's imposed protocols. The scheduling protocols established in the Power Sales Contract are not intended to confer or grant to Purchaser any additional rights or entitlements to Output beyond that otherwise described in the body of the Power Sales Contract.

### **Operating Data**

Purchaser may from time to time request that the District provide Purchaser with available operating data related to the Chelan Power System, including planned outages, Fish Spill estimates and other anticipated events or circumstances that might affect Output over the ensuing 12 months. The District will use commercially reasonable efforts to comply with such requests, to the extent such information is in the District's possession; provided, however, that the District will not be liable to the Purchaser for any inaccuracies in such information or the failure of the District to deliver it in a timely manner. The Parties anticipate that the technology for the transfer of such information and the information required to operate Purchaser's Percentage of Output will change over time. The Parties agree to transfer operating information reasonably needed by Purchaser to manage its Percentage of Output by means of a technology that is both cost-effective and timely, as mutually agreed by the Parties.

### **Coordination Agreement**

***Pacific Northwest Coordination Agreement ("PNCA")***. The District is currently a signatory of the PNCA and expects that the PNCA will remain in effect throughout the term of the Power Sales Contract. The District's current FERC licenses also require that the Projects be coordinated with other generating facilities in the Pacific Northwest. It is the intention of both Parties that Purchaser's Percentage of Output remain coordinated under the PNCA. All rights and duties under the PNCA as applicable to Purchaser's Percentage of Output will be discharged solely by Purchaser, except as otherwise provided in the Power Sales Contract. None of the means to implement this coordination, whether through the Purchaser becoming signatory to the PNCA, or by means of the District's current PNCA contract, or other mutually agreeable methods are precluded or specified by the Power Sales Contract, and are left for later determination. If Purchaser is not a signatory to the PNCA, it is expected that another mutually acceptable agreement will be reached by the Parties prior to the delivery of any Purchaser's Percentage of Output to Purchaser. In the event that no such agreement is reached, Purchaser commits to becoming a signatory to PNCA and will assume all rights and obligations associated with coordinating its Purchaser's Percentage of Output under PNCA. The headwater benefit obligations defined by the PNCA are also a settlement of FERC Section 10(f) obligations to the upstream Federal projects, as well as non-Federal parties. As such, any costs of such headwater benefits with respect to Rock Island and Rocky Reach are considered a Project cost and will be included in Net Costs.

### **Transmission**

(A) ***Third Party Transmission Service***. Purchaser is responsible for obtaining all necessary transmission capacity, arranging scheduling and paying associated costs to transmit all "Equivalent Energy" obtained from its Purchaser's Percentage of Output from the Transmission Point(s) of Delivery to Purchaser's system or any alternate point of receipt. The Purchaser is also responsible for obtaining all necessary transmission capacity, arranging scheduling and paying associated costs to transmit Supplemental Power Purchases.

(B) ***Project Facilities***. Project Transmission Facilities may be required to transmit Purchaser's Percentage of Output from the relevant interconnection points to the Transmission Points(s) of Receipt. Purchaser will pay a pro-rata share, equal to its Purchaser's Percentage of Output, of the costs of construction, maintenance and upkeep of Project Transmission Facilities as part of Net Costs and will be entitled to use the same share of the electric capacity. Any unused capacity on Project Transmission Facilities will be available for use by the District.

(C) It will be Purchaser's responsibility to handle its own transmission availability posting and scheduling in accordance with FERC regulations for its pro-rata share of the capacity of Project Transmission Facilities.

(D) ***Chelan Transmission Service***. Prior to the initial delivery of Purchaser's Percentage of Output, Purchaser and the District intend to enter into a Transmission Agreement (and, at the discretion of the District, a separate Interconnection Agreement).



(E) The Transmission Agreement will contain all terms and conditions required to effectuate the delivery of Purchaser's Percentage of Output from the Purchaser's "Transmission Point(s) of Receipt," across the Chelan Transmission System to the Purchaser's "Transmission Point(s) of Delivery." The Parties will structure the Transmission Agreement as required to support the efficient exchanges of electric capacity and energy contemplated by Canadian Entitlement, MCHC, and PNCA, and to allow Purchaser flexibility in designation of Transmission Points of Delivery and Transmission Points of Receipt, so long as such flexibility does not adversely affect the safety and reliability of the Chelan Transmission System, the District's retail electric service obligations, or other firm District transmission service obligations.

### **Excess Energy Sales and Supplemental Power Purchases**

The District will use Commercially Reasonable Efforts to assist Purchaser, at its request, with the management of its power resource portfolio for Wenatchee Works.

- a) At Purchaser's request, the District will make market purchases/sales (Supplemental Power Purchases and sales of Excess Energy) to balance all of the resources with Wenatchee Works plant load. The District and Purchaser will mutually agree upon the amounts and timing for forward and balance of the month sales and purchases. The District will make decisions as to preschedule and real time sales and purchases. Purchaser acknowledges that market prices for purchases/sales fluctuate rapidly and that prompt response times and sales confirmations are necessary to achieving the desired pricing structure.
- Purchaser will specify in its Forward Sales Request the proposed effective date of each such sale (the "Start Date"), the termination date thereof (which will not be earlier than the balance of the month, nor later than three (3) months (or other mutually agreeable period) from the date of the Forward Sales Request) (the "End Date"), and the amount of Excess Energy that it wishes to sell (in increments of not less than 25 MW). The period between the Start Date and the End date is the "Forward Sales Period." The date so specified will not be later than the scheduled expiration date of the Power Sales Contract.
  - Purchaser will specify in its Forward Purchase Request the proposed effective date of each such purchase (the "Start Date"), the termination date thereof (which will not be earlier than the balance of the month, nor later than three (3) months from the date of the Forward Purchase Request) (the "End Date"), and the amount of power that it wishes to purchase (in increments of not less than 25 MW). The period between the Start Date and the End date is referred to as the "Forward Purchase Period."
  - Purchaser will provide the District a list of approved counterparties for these forward purchases/sales. The District makes no representation to Purchaser about the creditworthiness of any counterparties or the capacity, reliability or appropriateness of said counterparty for the transactions. Purchaser specifically agrees that it is not relying upon the District for any determination of the creditworthiness or capacity, reliability or appropriateness of the counterparties to the transactions.
  - If, following a Forward Sales Request or Forward Purchase Request, the District, Purchaser reach agreement as to the advisability of such transactions, the District will use commercially reasonable efforts to effectuate such sales or purchases to one or more parties on a list of counterparties approved in advance by Purchaser, in accordance with normal energy sales procedures then in place by the District. Purchaser will bear the full risk of all such sales and purchases.
  - The District will be listed as the source or sink control area on electronic tags.
  - The District will maintain appropriate internal records of the forward purchases/sales of energy so that such forward and balance of the month purchases/sales may be tracked separately from other sales/purchases made by the District.
  - The purchase/sales price of the forward transactions will be the price as evidenced by the confirmation documentation. Broker fees, when applicable, will be billed to Purchaser. All transmission fees/charges associated with the energy transactions will also be charged

to Purchaser. Any purchase of energy will require use of the District's transmission system and appropriate charges will be paid by the Purchaser to the District for the use of the transmission system.

- Purchaser will pay scheduling fees per the District's Electric Rate Schedule 4, except to the extent a Sales and Administrative Charge has been charged with respect to such Forward Sales pursuant to the Power Sales Agreement.
  - The District will not be obligated to post any collateral, margin, or other security interest to facilitate the transactions described in the Power Sales Contract. If the District completes a purchase or sales transaction and subsequently the counterparty requires that such collateral, margin, or other security interest to secure performance under that purchase or sale transaction, it will be the responsibility of Purchaser to post any required collateral in a timely fashion and in such form that is acceptable to the counterparty. If Purchaser failure to promptly post the required collateral the District may reverse the transaction with the counterparty and charge Purchaser for any losses associated with the transaction reversal or termination, together with all unwind costs and expenses.
  - In the event forward sales made by the District are greater either on the high load hours or light load hours than the energy available to Purchaser, the shortfall will be considered a Supplemental Power Purchase.
- b) Purchaser may not submit Forward Sales Requests or Forward Purchase Requests when they are in default under the Power Sales Contract.
- c) Purchaser will bear all risks associated with purchases/sales including, without limitation, the non-payment risk, the risk of after the fact refunds, price caps or any other downward adjustment to the sales price. The District will, upon request of Purchaser, assign to Purchaser the contractual rights associated with such purchases/sales. Purchaser will bear the full costs associated with all sales and purchases, including, without limitation, all Losses, non-delivery risk, the non-payment risk, the risk of refunds, price caps or any other downward adjustment to the sales price and all collection and enforcement costs.
- d) Purchaser, as a condition to the initiation of any sale or purchase agree to indemnify and hold the District harmless from any and all adverse consequences resulting from any sale or purchase, including, without limitation (A) non-payment, late payments, contract disputes, collection fees, costs and expenses or other difficulties with the counterparties, brokerage fees and penalties and (B) all other losses, costs and expenses associated with such sales and purchases (all such adverse consequences being collectively referred to as "Losses"). Losses will not include any actual or perceived impact on the District caused by changes in market prices as a result of any sale or purchase. Any losses may be deducted from any Surplus Proceeds as determined by the District.
- e) The parties agree that the District will not be liable to Purchaser, and Purchaser waives any and all claims, for Losses or damages arising from any miscalculation of the amount of resources available to Purchaser, the failure of any counterparty to take or pay for the energy, the failure of any counterparty to deliver energy, whether or not the Power could be sold at higher prices, whether or not the Power could have been purchased at lower prices, or any other losses or damages due to sales or purchases or lack of sales or purchases of said energy by the District, in each case except to the extent such Losses arose from the District's gross negligence or willful misconduct.

In the event of a default by any purchaser of energy from the District's system for preschedule and real time sales, Purchaser's share of any revenue derived from such sales, will be reduced in proportion to their sales in relation to all sales from the District's system in the period of the default. In the event of any recovery of funds after default, Purchaser will receive a credit in proportion to their share of the original losses, net of Purchaser's share of all costs of collection. In the event of retroactive price caps, rebates, refunds, or any retroactive price reduction or increase imposed on the District, Purchaser's respective daily high load and light load sales prices will be reduced or increased to reflect the District's adjusted sales price and a billing adjustment issued.

## APPENDIX K—FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this “Disclosure Certificate”) is entered into as of March 6, 2013, by Public Utility District No. 1 of Chelan County, Washington (the “District”) for the benefit of the Owners and Beneficial Owners of the Bonds (each as defined below) in connection with the issuance of \$65,250,000 aggregate principal amount of Consolidated System Revenue Bonds, Refunding Series 2008B (the “Bonds”).

WITNESSETH:

WHEREAS, pursuant to Resolution No. 07-13067 adopted by the Commission of the District (the “Commission”) on March 12, 2007 (the “Master Resolution”), as amended and supplemented, including as amended by Resolution No. 07-13099, adopted by the Commission on April 30, 2007 (the “First Supplemental Resolution”), and by Resolution No. 08-13258, adopted by the Commission on February 11, 2008 (the “Fourth Supplemental Resolution”), as amended and supplemented by Resolution No. 09-13452, adopted by the Commission on April 27, 2009 (the “Fifth Supplemental Resolution”), and as supplemented by Resolution No. 13-13775, adopted by the Commission on January 7, 2013 (the “Tenth Supplemental Resolution” and together with the First Supplemental Resolution, the Fourth Supplemental Resolution, the Fifth Supplemental Resolution and the Master Resolution, the “Resolution”), the District has provided for the issuance and remarketing of the Bonds; and

WHEREAS, the underwriter with respect to the Bonds (the “Underwriter”) is required to comply with the provisions of Rule 15c2-12 promulgated by the Securities and Exchange Commission (the “SEC”) pursuant to the Securities Exchange Act of 1934, as amended (the “1934 Act”);

NOW THEREFORE, the District covenants and agrees for the benefit of the Owners and Beneficial Owners of the Bonds as follows:

SECTION 1. Definitions. The following capitalized terms shall have the following meanings:

“Annual Report” shall mean any Annual Report provided by the District pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“Beneficial Owner” shall mean any person that (a) has or shares the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, or otherwise make investment decisions concerning ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

“Bond Register” shall have the meaning provided in the Resolution.

“Business Day” shall mean a day that is not a Saturday, Sunday or legal holiday on which banking institutions in the State of Washington or the State of New York are closed.

“Dissemination Agent” shall mean the District, or any successor Dissemination Agent designated in writing by the District and that has filed with the District a written acceptance of such designation.

“Listed Events” shall mean any of the events listed in Section 5(a) or (b) of this Disclosure Certificate.

“Official Statement” shall mean the Remarketing Memorandum with respect to the Bonds dated February \_\_, 2013.

“Owner,” whenever used herein with respect to a Bond, shall mean the Person in whose name the ownership of such Bond is registered on the Bond Register.

“Person” shall mean an individual, corporation, firm, association, partnership, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

“Repository” or “MSRB” shall mean the Municipal Securities Rulemaking Board or any other entity designated or authorized by the SEC to receive reports pursuant to the Rule. Until otherwise designated by the MSRB or the SEC, filings with the MSRB are to be made through the Electronic Municipal Market Access (EMMA) website of the MSRB, currently located at <http://emma.msrb.org>.

“Rule” shall mean Rule 15c2-12 promulgated by the SEC under the 1934 Act, as the same may be amended from time to time.

“State” shall mean the State of Washington.

“Trustee” shall have the meaning provided in the Resolution.

SECTION 2. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the District for the benefit of the Owners and the Beneficial Owners, and in order to assist the Underwriters in complying with the Rule.

SECTION 3. Provision of Annual Reports.

(a) The District shall, or shall cause the Dissemination Agent to, not later than six months after the end of each fiscal year of the District, commencing with the fiscal year of the District ended December 31, 2013, provide to the Repository copies of an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Certificate. The Annual Report may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided, that the audited financial statements of the District may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the District’s fiscal year changes, the District shall give notice of such change in a filing with the MSRB. The Annual Report shall be submitted on a standard form in use by industry participants or other appropriate form and shall identify the Bonds by name and CUSIP number.

(b) Not later than 15 Business Days prior to the date specified in Section 3(a) for providing the Annual Report to Repository, the District shall provide the Annual Report to the Dissemination Agent (if the Dissemination Agent is other than the District). If by 15 Business Days prior to such date, the Dissemination Agent has not received a copy of the Annual Report, the Dissemination Agent (if other than the District) shall contact the District to determine if the District is in compliance with Section 3(a).

(c) If the Dissemination Agent is unable to verify that an Annual Report has been provided to the Repository by the date required in Section 3(a), the Dissemination Agent shall, in a timely manner, send or cause to be sent to the MSRB a notice in substantially the form attached hereto as Exhibit A.

(d) The Dissemination Agent (if the Dissemination Agent is other than the District) shall file a report with the District certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided to the Repository.

SECTION 4. Content of Annual Reports. The District’s Annual Report shall contain or include by reference the following:

- (a) (i) the District’s annual audited financial statements for the previous fiscal year prepared in accordance with generally accepted accounting principles;
- (ii) updated information for Tables 6 through 19 (but excluding Tables 8, 17 and 18) of the Official Statement for the previous fiscal year;
- (iii) updated information of the type presented in Table 20 of the Official Statement, to the extent not already included in the audited financial statements; and
- (iv) updated information for APPENDIX H of the Official Statement.

(b) Any or all of the items listed in Section 4(a) may be set forth in one or a set of documents or may be incorporated by specific reference from other documents, including official statements of debt issues of the District or related public entities, that have been submitted to the Repository or the SEC and made available to the public on the Repository's website. The District shall clearly identify each such other document so incorporated by reference.

The contents, presentation and format of the Annual Report may be modified from time to time as determined in the judgment of the District to conform to changes in accounting or disclosure principles or practices and legal requirements followed by or applicable to the District or to reflect changes in the business, structure, operations, legal form of the District or any mergers, consolidations, acquisitions or dispositions made by or affecting the District; provided, that any such modifications shall comply with the requirements of the Rule; provided further, that if the respective Annual Report is modified to conform to changes in accounting or disclosure principles, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting or disclosure principles and those prepared on the basis of the former accounting or disclosure principles.

(c) The District further agrees to use its best efforts to provide or cause to be provided to the Repository information substantially in the form set forth under "Available Information" and "Incorporation of Certain Documents by Reference" in APPENDIX H with respect to each Obligated Person (as defined below); provided, that such information is at the time on file with the SEC pursuant to the 1934 Act. To the extent that an Obligated Person is not required to file information with the SEC pursuant to the 1934 Act, the District agrees to use its best efforts to provide or cause to be provided to the Repository information with respect to such Obligated Person as set forth below, in each case only if and to the extent applicable to such Obligated Person:

- (i) such Obligated Person's audited financial statements prepared in accordance with generally accepted accounting principles; provided, that if such Obligated Person's financial statements are not yet available, the District shall provide unaudited financial statements in substantially the same format, and audited financial statements when they become available;
- (ii) such Obligated Person's outstanding long-term indebtedness;
- (iii) such Obligated Person's retail customers, energy sales, peak loads and revenues;
- (iv) such Obligated Person's operating results and debt service coverage on its outstanding indebtedness; and
- (v) such Obligated Person's energy requirements, resources and power costs.

Items (ii) through (v), inclusive, shall be required only to the extent that such information is not included in the information provided pursuant to item (i). "Obligated Person" means any Person that at the time is obligated directly or indirectly, by contract, generally or through an enterprise, fund or account, to make payments in the current or any succeeding fiscal year to be applied to pay at least 10% of the aggregate amount of principal of and interest scheduled to become due in such year on the Bonds.

#### SECTION 5. Reporting of Significant Events.

(a) The District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds in a timely manner not later than ten business days after the occurrence of the event:

1. Principal and interest payment delinquencies;
2. Unscheduled draws on debt service reserves reflecting financial difficulties;
3. Unscheduled draws on credit enhancements reflecting financial difficulties;

4. Substitution of credit or liquidity providers, or their failure to perform;
5. Adverse tax opinions or the issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB);
6. Tender offers;
7. Defeasances;
8. Rating changes; or
9. Bankruptcy, insolvency, receivership or similar event of the obligated person.

Note: for the purposes of the event identified in subparagraph (9), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governmental body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

(b) The District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material, in a timely manner not later than ten business days after the occurrence of the event:

1. Unless described in paragraph 5(a)(5), adverse tax opinions or other material notices or determinations by the Internal Revenue Service with respect to the tax status of the Bonds or other material events affecting the tax status of the Bonds;
2. Modifications to rights of Bond holders;
3. Optional, unscheduled or contingent Bond calls;
4. Release, substitution, or sale of property securing repayment of the Bonds;
5. Non-payment related defaults;
6. The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or
7. Appointment of a successor or additional trustee or the change of name of a trustee.

(c) The Dissemination Agent (if other than the District) shall, promptly upon obtaining actual knowledge at the address listed in Section 13 of this Disclosure Certificate of the occurrence of any of the Listed Events, contact the District, inform the District of the event and request that the District promptly notify the Dissemination Agent in writing whether or not to report the event (if such event is described in Section 5(b)) pursuant to subsection (f).

(d) If the District obtains knowledge of the occurrence of a Listed Event described in Section 5(a), or if the District determines that knowledge of the occurrence of a Listed Event described in Section 5(b) would be material under applicable federal securities laws, the District shall promptly notify the Dissemination

Agent (if other than the District) in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (f).

(e) If in response to a request under subsection (c), the District determines that the Listed Event described in Section 5(b) would not be material under applicable federal securities laws, the District shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to Section 5(f).

(f) If the Dissemination Agent has been instructed by the District to report the occurrence of a Listed Event, the Dissemination Agent shall file a notice of such occurrence with the Repository. Notwithstanding the foregoing, notice of the occurrence of a Listed Event described in Section 5(a)(7) and (b)(3) need not be given under this Section 5(f) any earlier than the notice, if any, of the underlying event is given to Owners of affected Bonds pursuant to the Resolution, and notice of any other Listed Event is required only following the actual occurrence of the Listed Event.

(g) The Dissemination Agent may conclusively rely on an opinion of counsel that the District's instructions to the Dissemination Agent under this Section 5 comply with the requirements of the Rule.

SECTION 6. Format for Filings with the Repository. Any report or filing with the Repository pursuant to this Disclosure Certificate must be submitted in electronic format, accompanied by such identifying information as is prescribed by the Repository.

SECTION 7. Termination of Reporting Obligation. The District's and the Dissemination Agent's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the District shall give notice of such termination in the same manner as for a Listed Event under Section 5(f).

SECTION 8. Dissemination Agent. The District may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent. Upon such discharge, however, a new Dissemination Agent must be appointed within 60 days. The Dissemination Agent may resign by providing 60 days' written notice to the District. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the District pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the District shall be the Dissemination Agent. The initial Dissemination Agent shall be the District.

SECTION 9. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the District may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a) or (b), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an Obligated Person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Owners in the same manner as provided in the Resolution for amendments to the Resolution with the consent of Owners (other than amendments requiring the consent of every Owner affected), or (ii) does not, in the opinion of the Dissemination Agent or nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the District shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the District. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in a filing with the MSRB, and (ii) the Annual Report for the year in which the change is made shall present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 10. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the District from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice required to be filed pursuant to this Disclosure Certificate, in addition to that which is required by this Disclosure Certificate. If the District chooses to include any information in any Annual Report or notice in addition to that which is expressly required by this Disclosure Certificate, the District shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event or any other event required to be reported.

SECTION 11. Default. In the event of a failure of the District to comply with any provision of this Disclosure Certificate, the Dissemination Agent may (and, at the request of any Underwriters or the Owners of at least 25% of aggregate principal amount of the Bonds then Outstanding, shall), or any Owner or Beneficial Owner may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the District to comply with its obligations under this Disclosure Certificate; provided, that any such action may be instituted only in a Washington State Court sitting in Chelan County or in U.S. District Court for the Eastern District of Washington. A default under this Disclosure Certificate shall not be deemed an Event of Default under the Resolution, and the sole remedy under this Disclosure Certificate in the event of any failure of the District to comply with this Disclosure Certificate shall be an action to compel performance, and no Person shall be entitled to recover monetary damages under this Disclosure Certificate.

SECTION 12. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are expressly set forth in this Disclosure Certificate, and the District agrees, to the extent permitted by law, to indemnify and save the Dissemination Agent, or the employees and agents of the Dissemination Agent, harmless against any loss, expense and liabilities which the Dissemination Agent or such employees or agents may incur arising out of or in the exercise or performance of the Dissemination Agent's powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the District under this Section 12 shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

SECTION 13. Notices. Any notices or communications to or among any of the parties to this Disclosure Certificate may be given as follows:

To the District:

Public Utility District No. 1 of Chelan County, Washington  
327 North Wenatchee Avenue  
Wenatchee, Washington 98801  
Attn.: Treasurer

To the initial Dissemination Agent:

Public Utility District No. 1 of Chelan County, Washington  
327 North Wenatchee Avenue  
Wenatchee, Washington 98801  
Attn: Treasurer



Any person may, by written notice to the other persons listed above, designate a different address or telephone number(s) to which subsequent notices or communications should be sent.

SECTION 14. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the District, the Dissemination Agent, the Underwriters and the Owners and Beneficial Owners from time to time, and shall create no rights in any other person or entity.

SECTION 15. Governing Law. This Disclosure Certificate shall be governed by the laws of the State of Washington determined without regard to the principles of conflict of law.

IN WITNESS WHEREOF, the party hereto has caused this Disclosure Certificate to be executed by its proper officer thereunto duly authorized, as of the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN  
COUNTY, WASHINGTON

By \_\_\_\_\_  
Authorized Representative

ACCEPTED:  
TREASURER OF PUBLIC UTILITY  
DISTRICT NO. 1 OF CHELAN  
COUNTY, WASHINGTON,  
as Dissemination Agent

By \_\_\_\_\_  
Treasurer

EXHIBIT A

NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Issuer: Public Utility District No. 1 of Chelan County, Washington

Name of Bond Issue: Consolidated System Revenue Bonds  
Series 2008B

Date of Delivery: November 9, 2011

Notice is hereby given that Public Utility District No. 1 of Chelan County, Washington (the "District") has not provided an Annual Report with respect to the above-referenced bonds (the "Bonds") as required by Section 3 of the Continuing Disclosure Certificate, dated as of November 1, 2011, entered into by the District for the benefit of the Owners and Beneficial Owners of the Bonds. [The District anticipates that the Annual Report will be filed by \_\_\_\_\_.]

Dated: \_\_\_\_\_

TREASURER OF PUBLIC UTILITY DISTRICT NO. 1  
OF CHELAN COUNTY, WASHINGTON,  
as Dissemination Agent

By \_\_\_\_\_

cc: Public Utility District No. 1 of Chelan County, Washington



