



**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON**  
**CONSOLIDATED SYSTEM REVENUE BONDS**  
**\$164,425,000 REFUNDING SERIES 2011C (TAXABLE)**

**Dated:** Date of Delivery

**Due:** As shown the inside front cover.

The Consolidated System Revenue Bonds, Refunding Series 2011C (Taxable) (the “2011C Bonds”) of Public Utility District No. 1 of Chelan County, Washington (the “District”) are to be issued as fixed rate bonds maturing in the amounts and bearing interest at the rates set forth on the inside front cover of this Official Statement, payable January 1 and July 1 of each year, commencing January 1, 2012.

When issued, the 2011C Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company (“DTC”). DTC will act as securities depository for the 2011C Bonds. Individual purchases will be made in book-entry form in authorized denominations, and purchasers of the 2011C Bonds will not receive certificates representing their interests in the 2011C Bonds. Payments of principal of and premium, if any, and interest on the 2011C Bonds are to be paid to purchasers by DTC through DTC Participants (defined herein). U.S. Bank National Association (the “Trustee”) will serve as Trustee for the 2011C Bonds.

The principal of and, premium, if any, and interest on the 2011C Bonds are payable solely from and secured by the applicable accounts within the 2011C Bond Fund, the 2011C Reserve Account and Revenues of the Consolidated System pledged to such funds and from amounts on deposit in any sinking funds established for the 2011C Bonds, all as provided in the Master Resolution and in the Ninth Supplemental Resolution authorizing the 2011C Bonds. The 2011C Bonds are being 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 heretofore or hereafter entered into with respect to a Series of Bonds on a parity basis. See “SECURITY FOR THE 2011C BONDS.”

The 2011C Bonds are subject to optional redemption prior to maturity as described herein.

**The 2011C 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 of or premium, if any, or interest on the 2011C Bonds.**

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**MATURITY SCHEDULE — See Inside Front Cover**

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In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, interest on the 2011C Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”). 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 2011C Bonds. Investors are advised to read the Official Statement in its entirety to obtain information essential to the making of an informed investment decision.***

*The 2011C Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of validity by Orrick, Herrington & Sutcliffe LLP, Seattle, Washington, Bond Counsel and Disclosure Counsel to the District, and to certain other conditions. Certain legal matters will be passed upon for the Underwriters by their counsel, Hawkins Delafield & Wood LLP, New York, New York. It is expected that the 2011C Bonds in book-entry form will be delivered through the facilities of DTC in New York, New York on or about November 9, 2011.*

**Barclays Capital**

**JP Morgan**

**Morgan Stanley**

**BofA Merrill Lynch**

October 26, 2011

## MATURITY SCHEDULE

### PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON CONSOLIDATED SYSTEM REVENUE BONDS

**\$164,425,000**  
**REFUNDING SERIES 2011C (TAXABLE)**

**\$164,425,000 Serial Bonds**

<b>Maturity Date</b>	<b>Principal</b>	<b>Interest</b>		<b>CUSIP No.</b>
<b><u>July 1</u></b>	<b><u>Amount</u></b>	<b><u>Rate</u></b>	<b><u>Price</u></b>	<b><u>163103<sup>†</sup></u></b>
2012	\$ 6,000,000	0.520%	100%	TY0
2013	2,920,000	0.982	100	TZ7
2014	4,025,000	1.398	100	UA0
2015	9,110,000	1.867	100	UB8
2016	4,030,000	2.267	100	UC6
2017	12,425,000	2.655	100	UN2
2018	13,700,000	3.005	100	UD4
2019	17,150,000	3.303	100	UE2
2020	15,670,000	3.453	100	UF9
2021	11,370,000	3.603	100	UG7
2022	11,765,000	3.703	100	UH5
2023	12,155,000	3.903	100	UJ1
2024	12,600,000	4.053	100	UK8
2025	15,080,000	4.153	100	UL6
2026	16,425,000	4.253	100	UM4

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<sup>†</sup> Copyright 2011, American Bankers Association. The CUSIP numbers are provided by Standard and Poor's, CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. These numbers are not intended to create a database and do not serve in any way as a substitute for the CUSIP Service. CUSIP numbers are provided for convenience of reference only. CUSIP numbers are subject to change. Neither the District nor the Underwriters take any responsibility for the accuracy of such CUSIP Numbers.

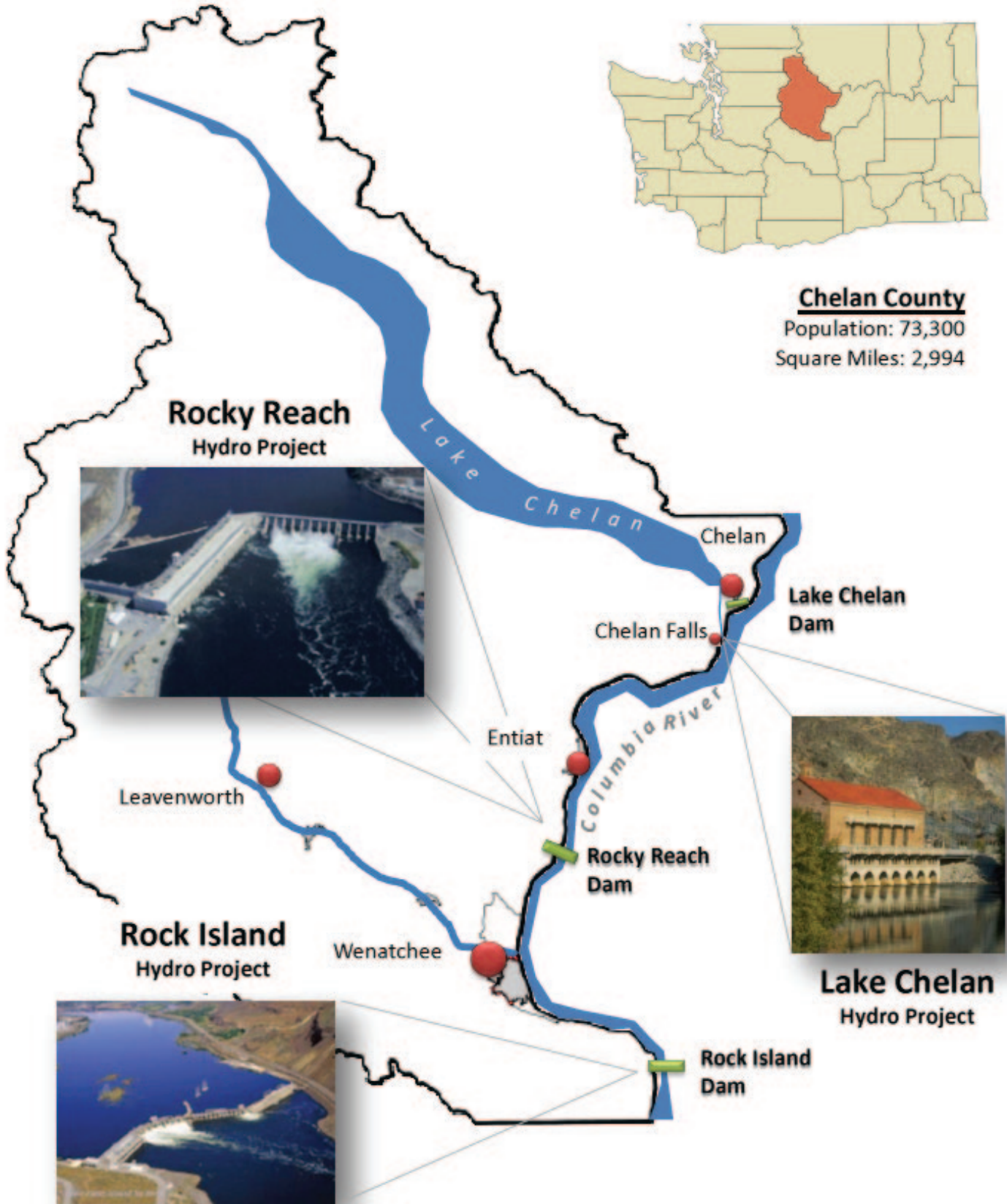
# Washington State



## Chelan County

Population: 73,300

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](http://www.chelanpud.org)\*

**COMMISSION**

Term Expires

Randy Smith, President .....	December 31, 2012
Norman Gutzwiler, Vice President .....	December 31, 2014
Carnan Bergren, Secretary .....	December 31, 2012
Ann Congdon, Commissioner .....	December 31, 2016
Dennis Bolz, Immediate Past President .....	December 31, 2014

**MANAGEMENT**

John Janney .....	General Manager
Kelly Boyd.....	Chief Finance/Risk Officer/ CFO-CRO
Gregg Carrington.....	Energy Resources Managing Director
Chris Church.....	Fiber & Telecommunications Interim Managing Director
Kirk Hudson .....	Generation & Transmission Managing Director
LaDawn Ostmann .....	HR/Labor Relations Managing Director
John Stoll.....	Customer Utilities Managing Director
Carol A. Wardell .....	General Counsel / CCO
Wayne W. Wright.....	District Services Managing Director
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 2011C Bonds. The 2011C Bonds are offered only by means of this Official Statement.

No dealer, broker, salesperson or any other person has been authorized by the District or the Underwriters to give any information or to make any representations, other than the information and representations contained herein, in connection with the offering of the 2011C 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 Official Statement does not constitute an offer to sell or the solicitation of an offer to buy any of the 2011C Bonds, nor shall there be any sale of the 2011C 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 Underwriters, and certain other sources that are believed by the District to be reliable but is not guaranteed as to accuracy or completeness by the Underwriters, and this Official Statement is not to be construed as a representation by the Underwriters. The information and expressions of opinion contained herein are subject to change without notice, and neither the delivery of this Official Statement 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 Official Statement is not to be construed as a contract with the purchasers of the 2011C Bonds.

CERTAIN STATEMENTS CONTAINED IN THIS OFFICIAL STATEMENT 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 OFFICIAL STATEMENT.

In connection with this offering, the Underwriters may over-allot or effect transactions that stabilize or maintain the market price of the 2011C Bonds at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time. The 2011C Bonds may be reoffered and sold to certain dealers (including dealers depositing the 2011C Bonds into investment accounts) and to others at prices lower than the public offering prices set forth on the inside cover page of this Official Statement.

The District has undertaken to provide continuing disclosure on certain matters, including annual financial information and certain events, if material, as more fully described herein. See "CONTINUING DISCLOSURE UNDERTAKING."

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

THE 2011C 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.

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**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON**  
**CONSOLIDATED SYSTEM REVENUE BONDS**  
**\$164,425,000 REFUNDING SERIES 2011C (TAXABLE)**

**SUMMARY STATEMENT**

This Summary Statement is subject in all respects to the more complete information contained in this Official Statement. Investors are advised to read the entire Official Statement 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 Official Statement.

**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-Optics System, which serve portions of the County. See “INTRODUCTION,” “THE DISTRICT—General” and “THE CONSOLIDATED SYSTEM—General,” “—Properties and Facilities of the District” and “—Other Properties and Facilities of the District.”

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 Hydro-Electric Project, (iii) the Fiber-Optics System, (iv) the Water System, and (v) the Wastewater System. All of these systems have been consolidated into a single system for financing purposes. For accounting purposes, however, only the four utility business operations have been consolidated into a single system, and the Lake Chelan Hydro-Electric Project is accounted for separately. 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 retail power supply from its three 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 2010 the cost of energy from the Hydro-Electric Projects was substantially below the market value of such energy. For the year ended December 31, 2010, the Rock Island Project delivered 2,496,000 megawatt hours (“MWh”) of power at an average cost of generation of \$32 per MWh, the Rocky Reach Project delivered 4,862,000 MWh of power at an average cost of generation of \$15 per MWh and the Lake Chelan Project delivered 417,000 MWh of power at an average cost of generation of \$24 per MWh. The Hydro-Electric Projects collectively thus produced 7,775,000 MWh of power at an average cost of generation of \$21 per MWh. By comparison, for the same period, both the “average adjusted wholesale” preference rate for Bonneville Power Administration (“Bonneville”) customers and the Mid-Columbia Electricity Price Index average were \$33 per MWh.



Under almost all power production and hydrologic conditions, the District's reserved shares of the three 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 some periods of extremely low water conditions or during periods of peak energy demand, the reserved share of the Hydro-Electric Projects may be insufficient to meet retail load requirements. The extent and duration of these shortfalls are estimated in advance by the District's power planners, and on these occasions the District buys power from other suppliers to cover the shortfalls in generation.

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 2010 was 99.98%, in 2009 was 99.99% and in 2008 was 99.98%.

See "THE DISTRICT—General."

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

### ***General***

The Consolidated System purchases power from the Rock Island and Rocky Reach Systems (as an operating expense of the Consolidated System) for sale to its retail customers through the Distribution Division. The power from the Rock Island and the Rocky Reach Systems not needed for the District's own retail load is sold:

(a) on a cost-of-service basis pursuant to existing long-term contracts with a number of investor-owned utilities, another public utility district and a large industrial purchaser, which contracts expire on October 31, 2011 with respect to the Rocky Reach Project and in June 7, 2012 with respect to the Rock Island Project;

(b) beginning in November 1, 2011 with respect to the Rocky Reach Project and in July 1, 2012 with respect to the Rock Island Project, on a cost-of-service "plus" basis under new long-term contracts with an investor-owned utility, another public utility district and a large industrial purchaser;

(c) under relatively recent fixed-price contracts, each for a fixed percentage of output with purchasers selected through an auction process and which have staggered terms of up to five years;

(d) under relatively recent fixed-price contracts, each for a fixed amount of output with purchasers selected through an auction process and which have staggered terms of up to five years; and

(e) as short-term surplus power at market prices in the wholesale market.

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."

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

In 2010, 54% of the power output from the District's Hydro-Electric Projects was sold to several power purchasers pursuant to long-term take-or-pay power sales contracts (each, a "Current Power Sales Contract" and, collectively, the "Current Power Sales Contracts"), including Puget Sound Energy, Inc. ("Puget Sound Energy"), Portland General Electric Company, PacifiCorp and Avista Corporation (formerly the Washington Water Power Company) ("Avista"), which serve a wide area of the Pacific Northwest (Washington, Oregon, Idaho and western Montana). In 2010, the Distribution Division delivered 44% of the power output of the Hydro-Electric Projects (including power purchased through Alcoa Power Generating, Inc. ("Alcoa Power"), a subsidiary of Alcoa Inc. ("Alcoa")) throughout an area coextensive with the County and as surplus sales on the wholesale market. The Distribution Division delivered an additional 2% of the power output of the Hydro-Electric Projects in 2010 to Public Utility District No. 1 of Douglas County, Washington. See "THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts—General."



In February 2006, the District executed a new long-term power sales contract (the “New PSE Contract”) with Puget Sound Energy, and in July 2008, the District executed a new long-term power sales contract (the “New Alcoa Contract” and together with the New PSE Contract, the “New Power Sales Contracts”) with Alcoa, Inc. (“Alcoa”). Deliveries under the New Power Sales Contracts are scheduled to commence on November 1, 2011 and July 1, 2012 upon the expiration of the Current Power Sales Contracts for the Rocky Reach and Rock Island Projects on October 31, 2011 and June 7, 2012, respectively.

Under the New PSE Contract, Puget Sound Energy will purchase an amount equal to 25% of the combined energy and capacity from both the Rocky Reach and Rock Island Projects in exchange for payment by Puget Sound Energy of its proportionate share of operation and maintenance, debt service and other costs and charges, which payments are allocated among costs of the Rock Island and Rocky Reach Projects and of the Consolidated System. In addition, Puget Sound Energy 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 will recognize the \$89 million payment as revenue of the Consolidated System for accounting purposes in equal annual amounts over the term of the New PSE Contract, commencing on November 1, 2011. As part of its strategic planning in 2007, the District allocated the entire payment for use by the various systems of the District, including \$18 million allocated to the Fiber-Optics System. The New PSE Contract was approved by the Federal Energy Regulatory Commission (“FERC”) in March 2006. The New PSE Contract is scheduled to terminate on October 31, 2031. See “THE CONSOLIDATED SYSTEM—New Puget Sound Energy Sales Contract” and APPENDIX I—“Summary of New Power Sales Contract with Puget Sound Energy, Inc.”

Under the New Alcoa Contract, Alcoa will purchase an amount equal to 27.5% of the output from the Rocky Reach Project from November 1, 2011 to June 30, 2012, and thereafter will purchase an amount equal to 26% of the combined output from both the Rocky Reach and Rock Island Projects in exchange for payment by Alcoa of its proportionate share of operation and maintenance, debt service and other costs and charges, which payments are allocated among costs of the Rock Island and Rocky Reach Projects and of the Consolidated System. The District retained all capacity rights and environmental attributes and has the right to source energy from other sources. Payment provisions of the New Alcoa Contract are similar to those of the New PSE Contract. In addition, Alcoa 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 will recognize the \$22.9 million payment as revenue of the Consolidated System for accounting purposes in equal annual amounts over the term of the New Alcoa Contract, commencing on 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. The New Alcoa Contract is scheduled to terminate on October 31, 2028. See “THE CONSOLIDATED SYSTEM—New Alcoa Power Sales Contract” and APPENDIX J—“Summary of New 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 exceed expected demand, and enters into short-term forward physical power purchase agreements when expected demand exceeds the resources estimated to be available.

As part of its plan to improve financial stability, to mitigate potential wholesale sales and price volatility and to keep future rates stable and affordable, the District has implemented a comprehensive forward hedging strategy. In addition to the New Power Sales Contracts, a key component of the strategy includes executing mid-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 with parties and at prices determined pursuant to an auction process and for staggered terms of up to 60 months. This strategy is intended to mitigate the District’s risks related to power marketing, pricing and water levels, while securing revenue for the future. As of October 17, 2011, the District has locked in predictable revenue of \$371.5 million from January 2012 through the end of 2015. The District expects that having a base level of predictable power sales revenue during such period will help avoid large swings in power rates charged to local customers and help stabilize overall revenues.

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 35% of annual Distribution Division revenues in fiscal year 2010 and 32% of annual Distribution Division revenues in fiscal year 2009. The District anticipates that the amount of surplus power sold in future years will increase due to implementation of the New 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, the cost and the availability of alternative sources of power, including in particular energy generated by facilities fueled by natural gas, and numerous other factors. The District seeks to moderate the variability in its revenues arising from these factors through a variety of means, including implementation of an energy hedging policy, 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," "THE CONSOLIDATED SYSTEM—Energy Sales; Load/Resource Balancing; Hedging Strategy" and "SECURITY FOR THE 2011C BONDS—Rate Stabilization Fund."

#### **Purposes of the 2011C Bonds**

Proceeds of the 2011C Bonds, together with other available moneys of the District and funds released from reserves securing the Refunded Bonds mentioned below, are to be applied (i) to refund certain of the District's outstanding Senior Consolidated System Bonds (as further defined herein, the "Refunded Bonds"), (ii) to fund a reserve account deposit for the 2011C Bonds and (iii) to pay costs of issuing the 2011C Bonds.

#### **Security for the 2011C Bonds**

The 2011C Bonds are being issued pursuant to Resolution No. 07-13067, adopted by the Commission of the District (the "Commission") on March 12, 2007 (the "Master Resolution"), as it may from time to time be amended and supplemented, including as amended and supplemented by Resolution No. 07-13099, adopted by the Commission on April 30, 2007 (the "First Supplemental Resolution"), and as supplemented by Resolution No. 11-13684, adopted by the Commission on October 24, 2011 (the "Ninth Supplemental Resolution"), and by the Certificate of the District to be delivered at the time of issuance of the 2011C Bonds setting forth certain terms with respect to the 2011C Bonds (the "2011C Delivery Certificate"). The Master Resolution, as so amended and supplemented, including as amended by the First Supplemental Resolution and as supplemented by the Ninth Supplemental Resolution and by the 2011C Delivery Certificate, is referred to herein collectively as the "Resolution."

The 2011C Bonds are special limited obligations of the District, and the principal of and premium, if any, and interest on the 2011C Bonds are payable from and secured by (1) amounts on deposit in the applicable accounts in the bond fund established under the Ninth Supplemental Resolution for the 2011C Bonds (the "2011C Bond Fund"), the applicable account in the Reserve Fund established under the Ninth Supplemental Resolution for the 2011C Bonds (the "2011C Reserve Account") and any sinking fund that may be established for such 2011C Bonds and (2) 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 2011C Bonds, on Revenues. See "SECURITY FOR THE 2011C BONDS—Pledge of Revenues."

The outstanding 2011C 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 September 30, 2011, the Bonds were outstanding in the aggregate principal amount of \$378,365,000 (excluding the 2009A/B Bonds (defined herein) held in trust, which are not considered outstanding for

financial reporting purposes). Upon the issuance of the 2011C Bonds, and after giving effect to mandatory sinking fund redemptions of Bonds and retirement of Bonds maturing prior to the issuance of the 2011C Bonds, the Bonds will be outstanding in the aggregate principal amount of approximately \$542,790,000 (excluding the 2009A/B 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 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 2011C Bonds. As of September 30, 2011, the Senior Consolidated System Bonds were outstanding in the aggregate principal amount of \$239,050,000.

Proceeds of the 2011C Bonds, together with other available funds of the District, are to be applied to refund the Refunded Bonds as hereinafter described. See “PURPOSES OF THE 2011C BONDS.” Upon the issuance of the 2011C Bonds and the defeasance of the Refunded Bonds, and after giving effect to mandatory sinking fund redemptions of Senior Consolidated System Bonds, optional redemptions of Senior Consolidated System Bonds called for redemption on November 1, 2011, and retirement of Senior Consolidated System Bonds maturing prior to the issuance of the 2011C Bonds, the Senior Consolidated System Bonds are expected to be outstanding in the aggregate principal amount of \$61,800,000.

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. In connection with the issuance of the 2009A/B Bonds, the District entered into the 2009 Payment Agreement and the 2009 Reversal Payment Agreement (each as defined herein). The District entered into a forward starting Payment Agreement (the “2013 Payment Agreement”) in connection with its refunding Bonds expected to be issued in 2013. Payment Agreement Payments to be made by the District to the respective counterparties pursuant to the Payment Agreements also are payable on a parity with the Bonds. Upon compliance with certain terms and conditions contained in the Master Resolution, the District may in the future enter into additional 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.”

In the past, the District has financed and refinanced capital improvements to the Rock Island and Rocky Reach Systems by lending proceeds of Senior Consolidated System Bonds and Bonds (each as defined herein) to such Systems pursuant to the Loan Resolutions (as defined herein) establishing the terms of payment for such loans. The obligations of the Rock Island and Rocky Reach Systems to make loan payments to the Consolidated System are subordinate to the obligations of such Systems to pay operation and maintenance expenses and debt service on revenue bonds issued by such Systems. See “FINANCIAL INFORMATION—Interfund and Intersystem Loans” and APPENDIX E—“Summary of Certain Provisions of the Loan Resolutions and Financing Agreements.”

### **Limited Obligation**

The 2011C 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 of or premium, if any, or interest on the 2011C Bonds.

## **Reserve Accounts**

The Ninth Supplemental Resolution establishes reserve accounts in the Reserve Fund to secure the 2011C Bonds (the “2011C Reserve Account”).

Upon the issuance of the 2011C Bonds, \$5,350,740.40 will be deposited into the 2011C Reserve Account, which amount is equal to the maximum amount of interest payable in any fiscal year on the 2011C Bonds, determined as of the date of issuance of the 2011C Bonds (the “2011C Reserve Requirement”). The District may initially fund the 2011C Reserve Requirement with amounts released from reserve funds securing the Refunded Bonds or with other available funds of the District.

The 2011C Reserve Account may also secure additional Series of Bonds that are designated by the District as a “2011C Reserve Account Series.” To the extent any future Series of Bonds is secured by the 2011C Reserve Account, the aggregate 2011C Reserve Requirement shall be the maximum amount of interest payable in any fiscal year on such future Series and on the 2011C Bonds, determined as of the date of issuance of such future Series.

See “SECURITY FOR THE 2011C BONDS—Reserve Funds—*Consolidated System.*”

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**Consolidated System  
Distribution Division  
Energy Requirements, Resources and Power Costs  
As of December 31, 2010  
(000)**

	<u>2006<sup>(1)</sup></u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b><u>Requirements (MWh)</u></b>					
Total Sales <sup>(2)</sup>	4,874	4,845	4,416	4,257	4,227
Timing Differences & Losses <sup>(3)</sup>	(255)	(64)	(10)	(8)	(67)
	<u>4,619</u>	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>
<b><u>Resources (MWh)</u></b>					
Rocky Reach System	2,241	2,341	2,091	1,982	1,839
Rock Island System <sup>(4)</sup>	1,473	1,516	1,393	1,345	1,283
Lake Chelan Project	452	459	405	338	417
Non-firm Purchases <sup>(5)</sup>	378	368	460	525	577
Contractual Repurchases <sup>(6)</sup>	75	97	57	59	44
	<u>4,619</u>	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>
<b><u>Purchased Power Costs</u></b>					
Rocky Reach System	\$ 29,370	\$ 29,782	\$ 31,449	\$ 28,274	\$ 30,668
Rock Island System <sup>(4)</sup>	32,289	33,540	37,309	38,398	40,206
Lake Chelan Project	4,972	5,171	6,152	9,003	10,198
Non-firm Purchases <sup>(5)</sup>	15,733	18,543	27,901	18,130	22,392
Contractual Repurchases <sup>(6)</sup>	1,591	2,584	1,584	542	488
	<u>\$ 83,955</u>	<u>\$ 89,620</u>	<u>104,395</u>	<u>94,857</u>	<u>103,952</u>
Average Cost (\$/MWh) <sup>(7)</sup>	\$ 18	\$ 19	\$ 24	\$ 22	\$ 25

(1) Year 2006 has been restated to reflect a minor misstatement of contractual repurchases.

(2) See Table 7, "Customer, Energy Sales and Revenues."

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

(4) The District's share of power produced by the first powerhouse of the Rock Island System is delivered to the Distribution Division as a contractually specified percentage of total cost, which is equal to the cost of service. The District received 45% of the power produced by the second powerhouse of the Rock Island System during the first 10 months of 2006 and 50% (the maximum permitted) commencing November 1, 2006 and expects to continue to receive 50% until June 7, 2012.

(5) Non-firm purchases include power purchased to: meet local requirements, hedge price movements and minimize the District's overall risk exposure to changes in power prices.

(6) Contractual obligation to purchase power for resale, during limited time periods, or as required under contractual arrangements with Alcoa and Alcoa Power. Includes capacity-to-energy exchange agreements. See "THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts—Alcoa."

(7) 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 Power. See "THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts—Alcoa."

### **Electric Rates; 2010 Strategic Plan**

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 and, in the opinion of the District, free from the jurisdiction and control of 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 optics, 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 June 2007, the District concluded a series of strategic planning sessions with the Commission, customer-owners and employees, and after 10 months of deliberations and analysis, the Commission adopted a set of governing policies and guiding principles intended to allow management to execute the agreed upon operating plan. The strategic package included an electric rate increase of 5% for 2008, as well as a renewed focus on cost control and efficiency. The rate increase was intended to move the District away from reliance on wholesale power sales over time. Prior to the 2008 rate increase, the District had not increased electric rates since January 2000. See “THE CONSOLIDATED SYSTEM—Electric Rates; Other Rates.”

The District recognized in the 2007 strategic planning discussions that a surcharge may be needed occasionally in years when water supplies are low or the price of power sold on the wholesale market drops. 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 implemented contingency plans, including reductions in operating and maintenance expenditures and deferrals of some capital projects. See “FINANCIAL INFORMATION—District Near-Term Financial Outlook; 2010 Strategic Plan.”

On April 27, 2009, the District also implemented a temporary 9% electric rate surcharge, the mechanisms for which were established more than a year prior. The surcharge went into effect on May 1, 2009, and was initially to remain in place for up to 12 months. With the continued low river flows and low market prices experienced the first three months of 2010, on April 5, 2010, the District continued the temporary 9% electric rate surcharge. On November 15, 2010 with continuing budget shortfalls the surcharge was extended through the end of 2011. The District had anticipated implementing an electric rate design change on April 1, 2009; however, the effective date of such change has been postponed, with the intent that it would not take effect until the extended surcharge expired. On October 17, 2011, the Commission held a public meeting at which it adopted the revised electric rate design proposal. The revised rate design includes an overall retail rate increase of 2.5% and takes effect January 1, 2012 after the expiration of the 9% surcharge. If the conditions adversely affecting the District’s revenues (including below-average river flows, depressed wholesale energy prices and/or reduced interest income on investments) return in the future, the District may re-impose an electric rate surcharge or take other rate action to maintain the health of the District’s finances. See “FINANCIAL INFORMATION—District Near-Term Financial Outlook; 2010 Strategic Plan” and “THE CONSOLIDATED SYSTEM—Electric Rates; Other Rates.”

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 intended to put the District’s finances on a more reliable, sustainable path over the next several years (2010 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 through cash reserves and other sources while paying down outstanding debt, building “rainy day” reserves and avoiding large, sudden rate adjustments. See “THE CONSOLIDATED SYSTEM—Electric Rates; Other Rates” and FINANCIAL INFORMATION—District Near-Term Financial Outlook; 2010 Strategic Plan.”

## **Climate Change**

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.

## **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 2011C 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 2011C 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. Pursuant to the Subordinate Consolidated System Resolution (as defined herein), the District has issued its Subordinate Consolidated System Obligations, which 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, 2010, the Subordinate Consolidated System Obligations were outstanding in the aggregate principal amount of \$82,665,000. See “SECURITY FOR THE 2011C BONDS—Subordinate Obligations.”

In addition, 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 purposes of (i) satisfying any collateral requirements of the District in connection with any electricity hedges, (ii) making termination payments with respect to any Payment Agreements, or (iii) upon receipt of the prior written consent of Bank of America (which consent may not be unreasonably withheld), other general purposes of the District. 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 October 1, 2011, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit. See “FINANCIAL INFORMATION—Consolidated System Liquidity.”

Upon compliance with certain terms and conditions contained in the Subordinate Consolidated System Resolution, the District may in the future enter into one or more interest rate swap agreements with respect to all or a portion of a series of Subordinate Consolidated System Obligations. See “FINANCIAL INFORMATION—Consolidated System Payment Agreements.”

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**

**OFFICIAL STATEMENT**

**RELATING TO**

**PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON  
CONSOLIDATED SYSTEM REVENUE BONDS  
\$164,425,000 REFUNDING SERIES 2011C (TAXABLE)**

**INTRODUCTION**

The purpose of this Official Statement, including the cover, inside front cover, summary statement and appendices hereto, is to provide information regarding Public Utility District No. 1 of Chelan County, Washington (the “District”) and its Consolidated System mentioned below and the issuance of the District’s Consolidated System Revenue Bonds, Refunding Series 2011C (Taxable) in the aggregate principal amount of \$164,425,000 (the “2011C Bonds”).

The 2011C Bonds are being 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 Resolution No. 07-13067, adopted by 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 as supplemented by Resolution No. 11-13684, adopted by the Commission on October 24, 2011 (the “Ninth Supplemental Resolution”), and by the Certificate of the District to be delivered at the time of issuance of the 2011C Bonds setting forth certain terms with respect to the 2011C Bonds (the “2011C Delivery Certificate”). The Master Resolution, as amended and supplemented, including as amended by the First Supplemental Resolution, and as supplemented by the Ninth Supplemental Resolution and by the 2011C Delivery Certificate, is referred to herein collectively as the “Resolution.” The outstanding 2011C 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.”

The District has consolidated its Lake Chelan System, Water System, Fiber-Optics System, Wastewater System and Distribution Division into a single system known as the “Consolidated System.” All of these systems have been consolidated into a single system for financing purposes. For accounting purposes, however, only the four utility business operations have been consolidated into a single system, and the Lake Chelan Hydro-Electric Project is accounted for separately. The Rocky Reach System and the Rock Island System are not part of the Consolidated System. The revenues of the Rock Island System and the Rocky Reach System are not pledged or otherwise available to pay or secure the Bonds of the Consolidated System, including the 2011C Bonds. Rather, the revenues of Rock Island System and the Rocky Reach System are pledged to the payment of bonds issued pursuant to separate master resolutions of the District to finance costs of those respective Systems. The currently outstanding bonds of the Rock Island System (the “Rock Island Bonds”) have a final stated maturity in 2034, and the currently outstanding bonds of the Rocky Reach System (the “Rocky Reach Bonds”) have a final stated maturity in 2034. See “FINANCIAL INFORMATION—Outstanding Debt” for information about the outstanding indebtedness of the Rock Island System and Rocky Reach System. Upon compliance with certain terms and conditions, the District may issue additional Rock Island Bonds and Rocky Reach Bonds. See “SECURITY FOR THE 2011C BONDS—Additional Indebtedness.”

In addition, the District has preserved substantial flexibility concerning the use of revenues derived from the Water System and Wastewater System, which revenues are part of the Revenues of the Consolidated System, and may pledge such revenues to secure debt of the Water and Wastewater Systems, respectively. The Water System and the Wastewater System are both very small utilities serving a very limited number of customers.

For approximately the past 35 years, the District has financed and refinanced capital improvements to the Rocky Reach, Rock Island and Lake Chelan Systems in part through bonds issued by the Consolidated System, the proceeds of which were loaned to such Hydro-Electric Systems. The Hydro-Electric Systems make payments to the Consolidated System on such loans. These payments constitute Revenues of the Consolidated System and, subject to the senior lien of the Senior Consolidated System Resolution, are available to pay and secure the Bonds. The principal components of the loan payments are available to make additional loans to the Hydro-Electric Systems. The obligations of the Rock Island and Rocky Reach Systems to make loan payments to the Consolidated System are subordinate to the obligations of such Systems to pay operation and maintenance expenses and debt service on the revenue bonds issued by such Systems. See “FINANCIAL INFORMATION—Interfund and Intersystem Loans.”

This Official Statement 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.

This Official Statement includes summaries of the terms of the Senior Consolidated System Bonds, the Outstanding Bonds, the 2011C Bonds, the Master Resolution, the Ninth Supplemental Resolution, the Senior Consolidated System Resolution, the New Power Sales Contracts, the Loan Resolutions (as defined herein), financing agreements 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, E, I and J or in the respective documents.

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## PURPOSES OF THE 2011C BONDS

Proceeds of the 2011C Bonds, together with other available moneys of the District and funds released from reserves securing the Refunded Bonds mentioned below, are to be applied (i) to refund certain of the District's outstanding Senior Consolidated System Bonds, as set forth below (the "Refunded Bonds"), (ii) to fund a reserve account deposit for the 2011C Bonds and (iii) to pay costs of issuing the 2011C Bonds.

### Refunded Bonds

Refunded Bonds (Series and Division)	Refunded Maturity	Principal Amount Refunded	Redemption Date	Redemption Price (% of Principal)	CUSIP Number <sup>†</sup>
2002A	July 1, 2037	\$44,905,000	July 1, 2012	100%	163103NR1
2002B	July 1, 2037	35,000,000	July 1, 2012	100	163103NS9
2002C	July 1, 2012	655,000	At Maturity	100	163103PC2
2002C	July 1, 2013	685,000	July 1, 2012	100	163103PD0
2002C	July 1, 2014	710,000	July 1, 2012	100	163103PE8
2002C	July 1, 2017	2,355,000	July 1, 2012	100	163103PF5
2002C	July 1, 2022	4,840,000	July 1, 2012	100	163103PG3
2002C	July 1, 2033	15,995,000	July 1, 2012	100	163103PH1
2003A	July 1, 2032	29,440,000	July 1, 2013	101	163103MS0
2004A	January 1, 2039	5,510,000	July 1, 2012	102	163103PJ7
2004B	July 1, 2012	775,000	At Maturity	100	163103PT5
2004B	July 1, 2014	1,485,000	July 1, 2012	102	163103PU2
2004B	July 1, 2018	18,420,000	July 1, 2012	102	163103PV0
2004B	July 1, 2027	3,650,000	July 1, 2012	102	163103PW8

The District expects to provide for the defeasance and redemption of the Refunded Bonds by irrevocably depositing cash and Government Obligations into one or more escrow funds held by U.S. Bank National Association, as Escrow Agent, which Government Obligations will bear interest at such rates and will be scheduled to mature at such times so that, when paid in accordance with their terms, sufficient moneys will be available, together with initial cash deposits, to make full and timely payment of the redemption price of the Refunded Bonds on the dates fixed for redemption and the interest due on the Refunded Bonds on and prior to such dates. The Arbitrage Group, Inc., independent verification agent, will verify from the information provided to them the accuracy as of the date of the delivery of the 2011C Bonds of the mathematical computations relating to the adequacy of maturing principal amounts of and interest earned on the escrowed Government Obligations (and necessary cash balance, if any) to redeem the Refunded Bonds. See "VERIFICATION AGENT."

<sup>†</sup> CUSIP numbers have been assigned by an organization unaffiliated with the District. The District is not responsible for the selection of the CUSIP numbers and makes no representation as to the accuracy thereof as set forth above.

**ESTIMATED APPLICATION OF THE PROCEEDS OF THE 2011C BONDS AND DISTRICT FUNDS**

The proceeds of the 2011C Bonds and other funds of the District are estimated to be applied as follows:

<b>SOURCES:</b>	
Par Amount of 2011C Bonds	\$164,425,000
2002A Bond Reserve Account	2,447,323
2002B Bond Reserve Account	1,837,500
2002C Bond Reserve Account	1,436,114
2003A Bond Reserve Account	620,427
Other District Funds	11,580,895
Total Sources	\$182,347,259
 <b>USES:</b>	
Deposits to 2011C Escrow Funds	\$175,761,633
Costs of Issuance**	1,234,886
2011C Reserve Account	\$ 5,350,740
Total Uses	\$182,347,259

\*\* Includes printing costs, Underwriters’ fees, Trustee, verification, rating agency, financial advisor and legal fees and other costs.

**DESCRIPTION OF THE 2011C BONDS**

**General**

The 2011C Bonds will be issued pursuant to the Ninth Supplemental Resolution in the form of fully registered bonds without coupons in authorized denominations and dated their date of delivery. The 2011C Bonds will be issued in the aggregate principal amount of \$164,425,000 as fixed rate bonds maturing in the amounts and bearing interest at the rates set forth on the inside front cover of this Official Statement. Interest on the 2011C Bonds, calculated based upon a 360-day year consisting of twelve 30-day months, is payable on each January 1 and July 1, commencing January 1, 2012, until maturity or prior redemption. The authorized denominations of the 2011C Bonds will be \$5,000 and any integral multiple of \$5,000.

Upon initial issuance, the 2011C Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company (“DTC”). Purchases of beneficial interests in the 2011C 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 2011C Bonds is discontinued, (i) the principal of and premium, if any, on each 2011C 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 2011C Bond to the Trustee; (ii) interest on the 2011C 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 2011C 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 2011C Bonds will be exchangeable for other fully registered certificated 2011C Bonds of the same maturity and interest rate 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. 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 2011C 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 Ninth Supplemental Resolution.”

## Redemption

***Make-Whole Optional Redemption of the 2011C Bonds.*** All of the 2011C Bonds are subject to redemption prior to their respective stated maturity dates, at the option of the District, from any source of available funds, as a whole or in part, and if in part, on a *pro rata* basis and not by lot (as further described below), in Authorized Denominations, on any Business Day, at a redemption price equal to 100% of the principal amount of 2011C Bonds called for redemption, plus the Make-Whole Premium (as defined below), if any, together with accrued interest to the date fixed for redemption.

For purposes of the foregoing paragraph, the following terms are defined as follows:

“Make-Whole Premium” means, with respect to any 2011C Bond to be redeemed, an amount calculated by an Independent Banking Institution (as defined below) equal to the positive difference, if any, between:

- (1) The sum of the present values, calculated as of the date fixed for redemption of:
  - (a) Each interest payment that, but for the redemption, would have been payable on the 2011C Bond or portion thereof being redeemed on each regularly scheduled Interest Payment Date occurring after the date fixed for redemption through the maturity date of such 2011C Bond (excluding any accrued interest for the period prior to the date fixed for redemption); plus
  - (b) The principal amount that, but for such redemption, would have been payable on the maturity date of the 2011C Bond or portion thereof being redeemed; minus
- (2) The principal amount of the 2011C Bond or portion thereof being redeemed.

The present values of the interest and principal payments referred to in (1) above will be determined by discounting the amount of each such interest and principal payment from the date that each such payment would have been payable but for the redemption to the date fixed for redemption on a semiannual basis (assuming a 360-day year consisting of twelve (12) 30-day months) at a discount rate equal to the Comparable Treasury Yield (as defined below), plus 35 basis points.

“Comparable Treasury Yield” means the yield which represents the weekly average yield to maturity for the preceding week appearing in the most recently published statistical release designated “H.15(519) Selected Interest Rates” under the heading “Treasury Constant Maturities,” or any successor publication selected by the Independent Banking Institution that is published weekly by the Board of Governors of the Federal Reserve System and that establishes yields on actively traded United States Treasury securities adjusted to constant maturity, for the maturity corresponding to the remaining term to maturity of the Bond being redeemed. The Comparable Treasury Yield will be determined as of the 10th Business Day immediately preceding the applicable date fixed for redemption. If the H.15(519) statistical release sets forth a weekly average yield for United States Treasury securities that have a constant maturity that is the same as the remaining term to maturity of the 2011C Bonds being redeemed, then the Comparable Treasury Yield will be equal to such weekly average yield. In all other cases, the Comparable Treasury Yield will be calculated by interpolation on a straight-line basis, between the weekly average yields on the United States Treasury securities that have a constant maturity (a) closest to and greater than the remaining term to maturity of the 2011C Bonds being redeemed; and (b) closest to and less than the remaining term to maturity of the 2011C Bonds being redeemed. Any weekly average yields calculated by interpolation will be rounded to the nearest 1/100th of 1%, with any figure of 1/200th of 1% or above being rounded upward.

If, and only if, weekly average yields for United States Treasury securities for the preceding week are not available in the H.15(519) statistical release or any successor publication, then the Comparable Treasury Yield will be the rate of interest per annum equal to the semiannual equivalent yield to maturity of the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price (each as defined herein) as of the date fixed for redemption.

“Comparable Treasury Issue” means the United States Treasury security selected by the Independent Banking Institution as having a maturity comparable to the remaining term to maturity of the 2011C Bonds being redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term to maturity of the 2011C Bonds being redeemed.

“Independent Banking Institution” means an investment banking institution of national standing which is a primary United States government securities dealer in the City of New York designated by the Commission (which may be one of the Underwriters). If the Commission fails to appoint an Independent Banking Institution at least 30 days prior to the date fixed for redemption, or if the Independent Banking Institution appointed by the Commission is unwilling or unable to determine the Comparable Treasury Yield, the Comparable Treasury Yield will be determined by an Independent Banking Institution designated by the Trustee.

“Comparable Treasury Price” means, with respect to any date on which a 2011C Bond or portion thereof is being redeemed, either (a) the average of five Reference Treasury Dealer quotations for the date fixed for redemption, after excluding the highest and lowest such quotations, and (b) if the Independent Banking Institution is unable to obtain five such quotations, the average of the quotations that are obtained. The quotations will be the average, as determined by the Independent Banking Institution, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of principal amount) quoted in writing to the Independent Banking Institution, at 5:00 p.m. New York City time on the 10th Business Day preceding the date fixed for redemption.

“Reference Treasury Dealer” means a primary United States Government securities dealer in the United States appointed by the Commission and reasonably acceptable to the Independent Banking Institution (which may be one of the Underwriters). If the Commission fails to select the Reference Treasury Dealers within a reasonable period of time, the Trustee will select the Reference Treasury Dealers in consultation with the District.

**Selection.** If less than all of a maturity of the 2011C Bonds is to be redeemed, the Trustee will select the 2011C Bonds to be redeemed, from the outstanding 2011C Bonds of such maturity not previously called for redemption, on a *pro rata* basis, which will be calculated based on the following formula: (principal of the 2011C Bonds of a maturity to be redeemed) x (principal amount of 2011C Bonds of such maturity owned by an owner) / (total principal amount of 2011C Bonds of such maturity Outstanding immediately prior to the date of redemption). The result of such calculation will be rounded down to the next lower integral multiple of \$1,000; provided, that the portion of any 2011C Bonds to be redeemed shall be in Authorized Denominations and all 2011C Bonds of a maturity remaining outstanding following such redemption shall be in Authorized Denominations.

If the 2011C Bonds are registered in book-entry-only form and so long as DTC or a successor securities depository is the sole registered owner of the 2011C Bonds, partial redemptions will be done in accordance with DTC procedures. It is the District’s intent that redemption allocations made by DTC be made in accordance with these same proportional provisions. However, the District can provide no assurance that DTC will allocate redemptions among beneficial owners on such a proportional basis.

**Notice and Effect of Redemption.** Notice of redemption of any 2011C Bonds to be redeemed shall be given by first class mail to the owners of the 2011C Bonds designated for redemption at least 30 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 2011C Bonds designated for redemption shall become due and payable on the date fixed for redemption and interest on such 2011C Bonds so called for redemption shall cease to accrue as of the date fixed for redemption.

## **Defeasance**

Under the Master Resolution, upon the deposit with the Trustee, at or before maturity, of 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 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 Ninth Supplemental Resolution—The Master Resolution—Discharge and Defeasance.”

If the District defeases any 2011C Bond, such 2011C Bond may be deemed to be retired and “reissued” for federal income tax purposes as a result of the defeasance. In that event, the Beneficial Owner of the 2011C Bond will recognize taxable gain or loss equal to the difference between the amount realized from the sale, exchange or retirement (less any accrued qualified stated interest which will be taxable as such) and the Beneficial Owner’s adjusted tax basis in the 2011C Bond.

### **Trustee**

U.S. Bank National Association (the “Trustee”) has been appointed Trustee for the 2011C Bonds. The Trustee may be removed or replaced as Trustee by the District as provided in the Resolution.

### **Book-Entry System**

The 2011C 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 2011C Bonds. Ownership interests in the 2011C 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 2011C Bonds, neither the District nor the Trustee shall have any 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 2011C 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 2011C 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 of, premium, if any, or interest on the 2011C Bonds. The District and the Trustee may treat and consider the person in whose name each 2011C Bond is registered in the Bond Register as the holder and absolute owner of such 2011C Bond for the purpose of payment of principal of and interest on such 2011C Bond, for the purpose of giving notices with respect to such 2011C Bond, and for all other purposes whatsoever. See APPENDIX G—“Book-Entry Only System.”

## **SECURITY FOR THE 2011C BONDS**

### **Pledge of Revenues**

The 2011C Bonds are special limited obligations of the District, and the principal of and premium, if any, and interest on the 2011C Bonds are payable from and secured by (1) amounts on deposit in the applicable accounts in the bond funds established under the Ninth Supplemental Resolution for the 2011C Bonds (the “2011C Bond Fund”), the applicable accounts in the Reserve Fund established under the Ninth Supplemental Resolution for the 2011C Bonds (the “2011C Reserve Account”) and any sinking fund that may be established for such 2011C Bonds and (2) 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 2011C Bonds, on Revenues. The District pledges, obligates and binds itself in the Resolution to pay into the applicable accounts in the 2011C 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 2011C 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 optics 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. See “SECURITY FOR THE 2011C BONDS—Loan Resolutions and Financing Agreements” and APPENDIX E—“Summary of Certain Provisions of the Loan Resolutions and Financing Agreements.”

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 Ninth 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 assets 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 PSE and Alcoa under the New 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 2011C Bonds 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 2011C 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 2011C Bonds. The 2011C 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 2011C 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 September 30, 2011, the Bonds were outstanding in the aggregate principal amount of \$378,365,000 (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). Upon the issuance of the 2011C Bonds, and after giving effect to mandatory sinking fund redemptions of Bonds and retirement of maturing Bonds prior to the date of issuance of the 2011C Bonds, the Bonds will be outstanding in the aggregate principal amount of approximately \$542,790,000 (excluding the 2009A/B Bonds).

### **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 2011C Bonds. As of September 30, 2011, the Senior Consolidated System Bonds are outstanding in the aggregate principal amount of \$239,050,000. Upon the issuance of the 2011C Bonds and the defeasance of the Refunded Bonds as described above, and after giving effect to mandatory sinking fund redemptions of the Senior Consolidated System Bonds, optional redemptions of certain Senior Consolidated System Bonds called for redemption on November 1, 2011 and retirement of maturing Senior Consolidated System Bonds prior to the issuance of the 2011C Bonds, the Senior Consolidated Bonds will be outstanding in the aggregate principal amount of \$61,800,000.

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 2011C Bonds. Therefore, the Senior Consolidated System Bonds also have a prior claim on any intersystem loan payments made by the Hydro-Electric Systems to the Consolidated System.

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.”

Under the Master Resolution, the District has covenanted not to issue any additional Senior Consolidated System Bonds under 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 Hydro-Electric 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 Ninth 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 2011C 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 and the 2011C Bonds, for any lawful purpose, including, without limitation (1) 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 (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. See APPENDIX D—"Summary of Certain Provisions of the Master Resolution and the Ninth 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 2011C 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 its Consolidated System Subordinate Revenue Notes, Series 2008A (the "2008A Subordinate Notes") and its Consolidated System Subordinate Revenue Notes, Series 2009A and Series 2009B (the "2009A/B Subordinate Notes"). The outstanding 2008A Subordinate Notes and 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 September 30, 2011, the Subordinate Consolidated System Obligations were outstanding in the aggregate principal amount of \$82,665,000.

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. As of October 1, 2011, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit. See “FINANCIAL INFORMATION—Consolidated System Liquidity” and “District Near-Term Outlook; 2010 Strategic Plan.”

### **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 Ninth 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.”

### **Loan Resolutions and Financing Agreements**

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”). Pursuant to certain financing agreements under the Current Power Sales Contracts, the current Power Purchasers have agreed (i) that the obligation of the Rocky Reach System and the Rock Island System, as appropriate, to repay such loans to the Consolidated System shall constitute a “cost” of such System, as that term is defined and used in the applicable Current Power Sales Contracts, and (ii) to make payments to the District for credit to the Rocky Reach System and the Rock Island System, as appropriate, sufficient to provide for the repayment of the loan obligations to the Consolidated System as part of the cost of power purchased. See “FINANCIAL INFORMATION—Intersystem Loans” and APPENDIX E—“Summary of Certain Provisions of the Loan Resolutions and Financing Agreements” for a discussion of the interfund loans and the payments by the power purchasers. The financing agreements with the power purchasers will expire simultaneously with the expiration of the Current Power Sales Contracts. Upon such expiration, the power purchasers will have no further obligations with respect to the repayment of such loans; however, under both the New PSE Contract and the New Alcoa Contract, respectively, PSE and Alcoa will be obligated to make payments. See “THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts” and “—The Rock Island Power Sales Contract.” “—New Puget Sound Energy Sales Contract” and “—New 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 such payments.

Under the Current Power Sales Contracts, the purchasers, including the Distribution Division, are required to pay a significant portion of the costs associated with operating the Rock Island and Rocky Reach Projects, regardless of whether the Projects are operating or generating power. Approximately \$12 million of aggregate

principal amount of bonds issued under the Rock Island Resolution and the Rocky Reach Resolution, however, represent costs of those Systems for which the Distribution Division is not obligated to pay if no power is delivered. Once the New Power Sales Contracts go into effect in November 2011 and in July 2012, this amount will increase to approximately \$17 million.

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 2011C 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.

## **Reserve Funds**

### ***Senior Consolidated System Bonds***

The District has established reserve funds to be held in trust by the District pursuant to the supplemental resolutions authorizing the outstanding Senior Consolidated System Bonds issuances (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.

For purposes of the Senior Consolidated System Bonds, the term “Reserve Fund Credit Policy” is defined generally as an insurance policy, surety bond, letter of credit or other credit facility provided by 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. Table 1 on the following page 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.

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

Series of Senior Consolidated System Bonds	Outstanding Principal Amount (as of 12/31/2010)	Reserve Account Credit Policy Expiration Date <sup>(1)</sup>	Amount of Reserve Account Credit Policy <sup>(2)</sup>	Reserve Account Credit Policy Provider <sup>(3)</sup>
2003A <sup>(4)</sup>	\$29,440,000	2032	\$1,160,692.50	NPFPG
2004A <sup>(4)</sup>	5,510,000	2039	342,324.06	NPFPG
2004B <sup>(4)</sup>	26,880,000	2027	2,538,848.71	NPFPG
2004C	15,000,000	2014	903,783.33	NPFPG
2004E	20,120,000	2012	1,179,255.56	NPFPG
2005A	25,430,000	2015	1,303,287.50	NPFPG
2005B	2,440,000	2012	362,125.00	NPFPG

- (1) 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, 2004E and 2005A Senior Consolidated System Bonds, however, expire upon their initial mandatory tender dates. The final maturities for the 2004C, 2004E and 2005A Senior Consolidated System Bonds are 2024, 2020 and 2039, respectively.
- (2) The amount of each Reserve Account Credit Policy is equal to the applicable reserve requirement, except that the Senior Consolidated System Reserve Account securing the 2003A Bonds is funded in part by the policy and in part with \$620,427.50 in cash.
- (3) The Reserve Account Credit Policy for the 2003A Senior Consolidated System Bonds was originally issued by MBIA Insurance Corporation, and the Reserve Account Credit Policies for the 2004A, 2004B, 2004C, 2004E, 2005A and 2005B Senior Consolidated System Bonds were initially issued by Financial Guaranty Insurance Company. All of these Reserve Account Credit Policies are currently reinsured and administered by National Public Finance Guarantee Corporation (“NPFPG”).
- (4) The Reserve Account Credit Policies relating to the 2003A, 2004A and 2004B Senior Consolidated System Bonds will expire upon the defeasance of such series of Senior Consolidated System Bonds.

***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.

**2011C Reserve Account.** The Ninth Supplemental Resolution establishes the 2011C Reserve Account to secure the 2011C Bonds, as well as any future Series of Bonds designated as a “2011C Reserve Account Series.” Upon the delivery of the 2011C Bonds, the 2011C Reserve Account will be funded at the 2011C Reserve Requirement for the 2011C Bonds. The 2011C Reserve Requirement is equal to the maximum annual interest determined as of the date of issuance of the 2011C Bonds. The initial 2011C Reserve Requirement for the 2011C Bonds is equal to \$5,350,740.40. To the extent any future Series of Bonds is secured by the 2011C Reserve Account, the aggregate 2011C Reserve Requirement shall be maximum amount of interest payable in any fiscal year on such future Series and on the 2011C Bonds, determined as of the date of issuance of such future Series.

The District may satisfy its obligations to fund the 2011C Reserve Account with funds released from reserve funds securing the Refunded Bonds, other available funds of the District, authorized investments or Reserve Account Credit Facilities, or a combination thereof, in an aggregate amount equal to the 2011C Reserve Requirement. Moneys in the 2011C Reserve Account may be used solely for the purpose of paying and securing the payment of the principal of and interest on the 2011C Bonds and any other 2011C Reserve Account Series of Bonds and may not be used to pay principal of or interest on any other Series of Bonds.

**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, 2010, approximately 14% 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 86% funded with cash. After giving effect to the issuance of the 2011C Bonds, the defeasance of the Refunded Bonds and the other retirements of the District’s outstanding indebtedness scheduled to occur prior to the issuance of the 2011C Bonds, approximately 7% of the District’s aggregate reserve fund requirements are expected to be secured by reserve account credit policies or facilities, with the remaining 93% funded with cash.

### **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-optics networks 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 E—“Summary of Certain Provisions of the Master Resolution and the Ninth 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 Ninth 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, 2011, the District continues to maintain a balance of \$50 million in the Rate Stabilization Fund.

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 Ninth 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, 2011, there was \$69 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 Ninth 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," footnote 9 to Table 14 in "—Outstanding Debt" and APPENDIX D—"Summary of Certain Provisions of the Master Resolution and the Ninth 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 1 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, and the 2008A Subordinate Notes will mature in the principal amount of \$53,695,000 on July 1, 2013. 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 Ninth 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 Ninth Supplemental Resolution—Definitions” for definitions of other capitalized terms used above.

## 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. The District also owns and operates the Water System, the Wastewater System and the Fiber-Optics System, which serve portions of Chelan County (the “County”). The District has its administrative offices in Wenatchee, Washington.

The District 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, 2010, the Hydro-Electric Projects collectively produced 7,775,000 MWh of power at an average cost of generation of \$21 per MWh. By comparison, for the same period, both the “average adjusted wholesale” preference rate for Bonneville Power Administration (“Bonneville”) customers and the Mid-Columbia Electricity Price Index average were \$33 per MWh.

Under almost all power production or hydrological conditions, the District’s reserved shares 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 some periods of extremely low water conditions or during periods of peak energy demand, the reserved share of the Hydro-Electric Projects can be insufficient to meet retail load requirements. The extent and duration of these shortfalls are estimated in advance by the District’s power planners, and on these occasions the District buys power from other suppliers to cover the shortfalls in generation. 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 2010 was 99.98%, in 2009 was 99.99% and in 2008 was 99.98%.

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 System, 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. Effective June 1, 1993, the revenues of the Lake Chelan System became 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. In 2008, the District completed the purchase of the only city-owned electric utility in the County from the City of Cashmere (“Cashmere”). The Cashmere electric system has become part of the District’s Distribution Division. The District is not aware of any other city or utility that is considering providing electric service. 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.

### **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:

**Randy Smith, President**, is currently serving his first term as Commissioner, which expires on December 31, 2012. Mr. Smith represents the District as a delegate to the Northwest Public Power Association. Mr. Smith is an orchardist and has served on the boards of several community, business and national organizations.

**Norman Gutzwiler, Vice 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 Washington Public Utility Districts 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.

**Carnan Bergren, Secretary**, is currently serving his first term as Commissioner, which expires on December 31, 2012. 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, Commissioner**, 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 operated 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, Immediate Past President**, 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.

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 masters degree in finance from Boston College.

**Kelly Boyd, Chief Finance and 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.

**Chris Church, Fiber & Telecommunications Interim Managing Director**, was appointed to his current position in May 2011. He is also serving as Director – Engineering and Project Management Division. Mr. Church has been employed by the District since January 2001 and previously served as Hydro Engineering Supervisor and Senior Civil Engineer. He began his career with the City of Seattle in 1980 and worked for Seattle City Light, Seattle Solid Waste and Seattle Water departments as an engineer and manager. Mr. Church is a licensed Civil Engineer in the State of Washington.

**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.

**LaDawn Ostmann, HR/Labor Relations Managing Director**, was appointed to her current position in June 2011. She previously served as Director of Human Resources and Manager of Labor Relations. Ms. Ostmann has been employed by the District since February 2008. Ms. Ostmann began her career in the labor relations field working in the utility and healthcare industries. She is a member of the bar in the State of Washington and the State of Missouri and is a Senior Human Resource Professional.

**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.

**Wayne W. Wright, District Services Managing Director**, was appointed to his present position in October 2001. He previously served as Director of Corporate Communications, Community Services Administrator and Public Information Officer. Mr. Wright has been employed by the District since July 1979.

## **Employees**

As of September 30, 2011, the total number of District employees was 698, including some seasonal employees. Of these employees, 286 hold management, administrative and professional positions and 412 are part of a bargaining unit represented by Local 77 of the International Brotherhood of Electrical Workers. On August 3, 2009, the Commission approved a three-year collective bargaining agreement with Local 77, which was ratified by the bargaining unit employees on July 28, 2009. The agreement between the District and Local 77 includes pay increases for bargaining unit employees of 3.00% effective August 1, 2009, 3.00% effective August 1, 2010, 3.00% effective August 1, 2011 and 1.25% effective January 1, 2012. The District has never experienced any work stoppages or slowdowns. The District considers its over-all employee relations to be good.

## **Pension Plan and Other Post-Employment Benefits**

**General.** The State administers 13 defined benefit retirement plans, including 11 plans that cover both State and local government employees. The retirement plans are funded by a combination of investment returns and contributions by employers and employees. Substantially all of the District's full-time and qualifying part-time employees participate in the Washington Public Employees Retirement System ("PERS").

Information regarding PERS was derived from the 2009 Valuation Report and Preliminary 2010 Valuation Report (each 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, 2010 (the "2010 Retirement Fund Audit").

**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, and eligible employees hired after that date are members of PERS 2 or PERS 3 or, if they were hired after August 31, 2002, are members of PERS 3 unless they choose to elect irrevocably to join PERS 2. The District is one of approximately 1,189 governmental employers that participate in PERS. As of June 30, 2010, 76,889 retirees and beneficiaries were receiving benefits under PERS, 28,860 terminated plan members were entitled to, but not yet receiving, benefits and 156,526 were active plan members. Active members in PERS Plan 1 or 2 are vested after five years of service, and active members in PERS Plan 3 vest after 10 years unless they qualify for 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, including investment income, set aside for the retirement fund. 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. 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. 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 October 2010, the OSA released an actuarial valuation for June 30, 2009 (the “2009 Valuation Report”) and in September 2011 released preliminary results from the actuarial valuation for June 30, 2010 (the “Preliminary 2010 Valuation Report”). The primary purposes of the 2009 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, 2009. Washington statutes require that valuation reports that are used in determining contribution rates be audited by independent actuaries selected by the PFC. The audit of the 2009 Valuation Report, performed by Cheiron, was released in May 2011.

The Preliminary 2010 Valuation Report provides information about funding progress and developments during the fiscal year ended June 30, 2010. The Preliminary 2010 Valuation Report (and the final 2010 Valuation Report, when it’s released) is not used to recommend contribution rates to be adopted by the PFC but as described below, provides information about the contribution rates, funding progress and developments since the date of the 2009 Valuation Report and is considered when reviewing assumptions, methods and policies. The OSA notes in both Valuations Reports that they are based on the State’s then-current funding policy and are not prepared or intended to satisfy financial reporting requirements.

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. The next experience study is scheduled to be released in 2014. Economic assumptions are adopted by the PFC and/or prescribed by the Legislature. In 2009, for example, the Legislature suspended the mortality improvement assumption changes, and lowered the general salary increase assumption, recommended by OSA and adopted by the PFC. 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. OSA’s recommended changes to the economic assumptions include reducing the assumed rate of inflation from the current 3.50 to 3.0%; reducing the assumed annual investment return from the current 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 the current 4.0% to 3.75%. The PFC is scheduled to consider these recommendations in the Fall of 2011.

**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. The assumed annual investment rate of return on the value of PERS assets is 8%; however, actual returns vary year by year, and the OSA is recommending that the assumed rate be reduced to 7.5% over the next five biennia. 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 8%) over a period of not to exceed eight years. To help ensure that the AVA maintains a reasonable relationship to the MVA, a 30% "corridor" is in place, which means that any valuation of the AVA may need exceed 130% of, nor drop below 70% of, the MVA.

As of June 30, 2009, the funded status for PERS 1 and PERS 2/PERS 3 on an actuarial basis, based on the PUC method was 70% and 116%, respectively, and as of June 30, 2010, the funded status for PERS 1 was 74% and for PERS 2/3 was 113%. The OSA notes that the 2010 funded ratio for PERS 1 would drop to 63% if both gain sharing and the Uniform COLA are reinstated. See "Contribution Rates" below. As noted in Table 2, this method differs from the method used for accounting purposes.

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

	<u>2009</u>		<u>2010</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>	\$13,945	\$15,701	\$12,531	\$17,272
Valuation Assets <sup>(1)(3)</sup>	<u>9,776</u>	<u>18,260</u>	<u>9,293</u>	<u>19,474</u>
Unfunded Liability <sup>(1)</sup>	\$ 4,169	(\$2,560)	\$ 3,238	(\$2,202)
Funded Ratio	70%	116%	74%	113%

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

<sup>(2)</sup> Liabilities have been valued using the PUC cost method at an interest rate of 8%. Note 2(d) to the 2010 Retirement Fund Audit indicates that PERS 2/3 is funded at 99%, based on using the entry age normal method for determining the UAAL for GASB 50 purposes. 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; 2009 Valuation Report and Preliminary 2010 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. The employee contribution rate for PERS 2, which is determined by the PFC, has increased from 4.59% of covered payroll to 4.64% of covered payroll as of September 1, 2011. 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% of covered salary to a maximum of 15.0% of 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 each of the past 11 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.

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. The court is scheduled to consider the replacement benefits in December 2011.

For the year ended December 31, 2010, the District’s total payroll was \$56,122,189, and the District’s total payroll for employees covered by PERS was \$55,578,250. Both the District and its employees made the required contributions to PERS in 2010, with the District contributing \$2,863,700, consisting of \$69,075 to PERS 1, \$2,345,456 to PERS 2 and \$449,180 to PERS 3, and the District’s employees contributing and \$2,345,503.

As of June 30, 2011, the employer contribution rate for all PERS plans is 7.07% of covered payroll, which includes the employer administrative expense fee (currently 0.16%) and amortization of the PERS 1 UAAL.

The District does not have any control over the determination of the employer contribution rates or the process for setting such rates. The Legislature may adopt changes in benefits, but may not necessarily apply the

resulting savings to reducing the UAAL. As described above, the Legislature may reduce contribution rates, especially during difficult economic times. The OSA and other members of the State government continue to review retirement plan funding policies and methods, especially with respect to closed plans, including PERS 1. 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.

**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, 2010 was \$627.8 million of which 25% was contributed, and the ARC for PERS 2/3 was \$383.1 million, of which 85% was contributed.

GASB has proposed amendments to Statement 25 (for retirement systems) and to Statement 27 (for employers) that, among other things, would requirement reporting on a standardized basis that would be more conservative than the methods used by the OSA for the PERS defined benefit plans to determine funding status and contribution rates.

#### ***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 determined to recognize that liability in 2006 and in 2007 to replace its health insurance program and to fund 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 23. 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, 2010, there were 648 active participants and 50 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, 2010 and 2009, the District contributed 28% of the cost of premiums for eligible retired Plan members and their spouses, or \$126,000 and \$140,000, respectively, and Plan members receiving benefits contributed 72% of premium costs, or an aggregate \$323,000 and \$364,000, 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 on the following page 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 the 2011 OPEB Valuation. The actuarial value of the assets in the OPEB Trust at January 1, 2009, \$1,791,487, was the market value of the OPEB Trust assets as of December 31, 2008, and the actuarial value of the OPEB Trust assets as of January 1, 2008, \$2,080,362, was the market value of the OPEB Trust assets as of December 31, 2007. See Note 9 and the Required Supplementary Information in Appendix A.



**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, 2006	\$0	\$1,922,663	\$1,922,663	0%	\$45,737,000	4%
January 1, 2007	\$0	\$2,177,526	\$2,177,526	0%	\$46,311,000	5%
January 1, 2008	\$2,177,526	\$2,227,526	\$50,000	98%	\$48,046,983	0.1%
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)%

Source: 2011 OPEB Valuation and the District

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

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

(1) 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.

(2) 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.

(3) 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 was \$0 under the current plan and assumptions, and the 2010 Annual OPEB Cost was 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 and to the extent similar insurance is carried by other electric utilities operating like properties.

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 \$350,000 to \$200 million; crime from \$100,000 to \$35 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 December 31, 2010, the self-insurance restricted cash reserve and claim funds had a combined balance of \$4,891,702.

## **Seismic Risks**

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 135 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") 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 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 2010 on a schedule and in a manner approved by FERC. The study has been reviewed by an independent review panel, comprised of experts selected by the District, Grant PUD, Douglas PUD and FERC. Based on the review panel's input, minor modifications are being made to the study report prior to formal submission of the report to 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, Grant PUD and Douglas PUD to complete a work plan 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 CONSOLIDATED SYSTEM**

### **General**

In 1976, the District consolidated all of its electric utility operations into the Chelan Hydro Consolidated System, consisting of the Distribution Division and the Hydro-Electric Projects. Such consolidation, however, was subject to the terms, limitations, restrictions, covenants, liens, charges and pledges contained in the resolutions of the District which established the Rock Island System and the Rocky Reach System and which provided for the issuance of bonds to finance those Systems. Accordingly, the revenues of the Rock Island System and the Rocky Reach System are not a part of the Revenues of the Consolidated System. Effective June 1, 1993, the revenues of the Lake Chelan Project became part of the Revenues of the Chelan Hydro Consolidated System (redesignated the "Consolidated System" in 2007). In 2007, the District elected to rescind the consolidation of the Rocky Reach System and the Rock Island System into the Consolidated System.

The Hydro-Electric 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 2011C Bonds, or the Subordinate Consolidated System Obligations.

For the year ended December 31, 2010, the Distribution Division served an average of 48,124 customers and had energy sales of 4,227,000 MWh and operating revenues of \$122,821,000. 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."

In 1992, the Water System and Wastewater System were consolidated into what is now called the Consolidated System. 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 2011C Bonds. The Revenues of the Consolidated System are not pledged to the debt of the Water System or Wastewater System existing or incurred prior to the consolidation of such systems into the Consolidated System. For the year ended December 31, 2010, the Water System served 5,448 customers and the Wastewater System served 479 customers. As of December 31, 2010, the Water System had outstanding long-term debt in the principal amount of \$9,018,428 and Consolidated System intersystem loans payable in the amount of \$650,453. As of December 31, 2010, the Wastewater System had outstanding long-term debt in the principal amount of \$117,841 and no Consolidated System intersystem loans payable. 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 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 market purchases that represented approximately 5% of the District's portfolio in 2009 (the most recent year for which data is available). 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 of the Consolidated System serves at retail the entire territory within the County. As of December 31, 2010, the Distribution Division included 37 substations with a total capacity of 1,228,100 kVA, 873 miles of overhead and 844 miles of underground distribution lines and other buildings, equipment, stores and related facilities. As of December 31, 2010, the gross utility plant of the Distribution Division, including construction work in progress, was \$286,756,000, with net utility plant of \$165,680,000. The Distribution Division also includes the Cashmere system. See "THE DISTRICT—General."

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

**General.** As of December 31, 2010, the combined gross utility plant of the Hydro-Electric Projects, including construction work in progress, was \$1,272,259,000, with net utility plant of \$787,895,000. The Rock Island System and the Rocky Reach System are not part of the Consolidated System.

**The Lake Chelan System.** The Lake Chelan System consists of (i) the Lake Chelan Hydro-Electric Generating Plant (the “Lake Chelan Project”), 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 (formerly The Washington Water Power Company) (“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 387,000 MWh annually during the three years from 2008 through 2010. For the year ended December 31, 2010, the generating plant delivered 417,000 MWh, at an average cost of \$24 per MWh. As of December 31, 2010, the gross utility plant of the Lake Chelan Project, including construction work in progress, was \$120,574,000, with net utility plant of \$99,211,000.

See “THE CONSOLIDATED SYSTEM—Consolidated System Energy Resources—The Lake Chelan Project” for information regarding the sale of the output of the Lake Chelan System.

### ***Fiber-Optics System***

The Fiber-Optics System has been consolidated into the Consolidated System. See “THE CONSOLIDATED SYSTEM—The Fiber-Optics System” for information regarding the Fiber-Optics 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 5,198,000 MWh annually during the three years from 2008 through 2010. For the year ended December 31, 2010, the generating plant delivered 4,862,000 MWh, at an average cost of \$15 per MWh. As of December 31, 2010, the gross utility plant of the Rocky Reach System, including construction work in progress, was \$604,837,000, with net utility plant of \$372,085,000.

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 September 30, 2011, the Rocky Reach Bonds were outstanding in the aggregate principal amount of \$19,395,000. In addition, as of December 31, 2010, intersystem loans payable from the

revenues of the Rocky Reach System were \$297,420,229. See “FINANCIAL INFORMATION—Outstanding Debt” and “—Interfund and Intersystem Loans.”

Since 1999, the District has issued bonds payable from the Rocky Reach System in the amount of approximately \$10,493,440 as capital appreciation bonds and current interest bonds 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, 2010 were outstanding in the principal amount of \$11,195,000. Payment of principal on these bonds began in 2007.

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 first installation was completed in 1996 and the final unit was completed in 2006. The results of the modernization program have increased the efficiency of the plant by 4.5% to 5.5%. This efficiency gain is expected to pay for a portion of the costs of the program. The turbine design also incorporates 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 Units C1-C7. A temporary repair has been applied to all of the 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 next unit outage began in September 2011. The District 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, future 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 combined outages are anticipated to result in potential lost opportunity costs of approximately \$5.7 million.

See “THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts” for information regarding the sale of the output of the Rocky Reach System.

**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 2,596,000 MWh annually during the three years from 2008 through 2010. For the year ended December 31, 2010, the generating plant delivered 2,496,000 MWh, at an average cost of \$32 per MWh. As of December 31, 2010, the gross utility plant of the Rock Island System, including construction work in progress, was \$546,848,000, with net utility plant of \$316,599,000.

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 September 30, 2011, the Prior Rock Island Bonds were outstanding in the aggregate principal amount of \$253,762,131. Pursuant to 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 September 30, 2011, the Rock Island Bonds were outstanding in the aggregate principal amount of \$14,830,000. In addition, as of December 31, 2010, intersystem loans payable from revenues of the Rock Island System were \$213,748,315. 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 is scheduled to be completed in spring of 2012. The new units are expected to have improved efficiencies of about 10% and the turbines are safer for fish passage. Four additional units will receive new stators, and rotors and turbine components will be repaired or refurbished on site as necessary. Work on the four units is expected to be completed by the middle of 2013. Efficiency improvement of the new stators is expected to be about 1.0%. The turbines are expected to last another 20 years with minor repairs and routine maintenance. The District estimates that the total modernization program at Powerhouse No. 1 will cost approximately \$110 million through 2013.

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%.

See “THE CONSOLIDATED SYSTEM—The Rock Island Power Sales Contract” for information regarding the sale of output from the Rock Island System.

**Federal Energy Regulatory Commission License Status**

*General*

The District operates the Lake Chelan Project, the Rock Island Project and the Rocky Reach Project under long-term licenses issued by FERC pursuant to the Federal Power Act of 1920, as amended. The Rock Island Project license was issued on January 18, 1989, and will expire in December 2028. 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.

**Table 5  
FERC Licenses**

<u>Hydro-Electric Project</u>	<u>Expiration Date</u>
Lake Chelan Project	October 31, 2056
Rocky Reach Project	January 31, 2052
Rock Island Project	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 by the District to FERC in October 2003, with several changes. The license requires detailed management plans for operations, fish, wildlife and recreation resources. These plans were approved by FERC in November 2007 and in

April 2008. In accordance with the comprehensive settlement agreement, the FERC-approved fish management plans and the 401 Water Quality Certification, 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 Lake Chelan Project tailrace. These projects were completed in October 2009. Spawning and rearing monitoring conducted since completion has shown positive results, with a marked increase in the number of Chinook salmon and steelhead trout spawning in the newly-created habitat in Reach 4 of the Chelan River and powerhouse tailrace areas over the years prior to the District's habitat improvements. As the result of the first two years of observation, the District is confident that the habitat restoration will enable compliance with the Lake Chelan 401 Water Quality Certification.

In 2010, the District completed construction of a trail link between the newly constructed Reach 1 Trail and Riverwalk Loop Trail located in Chelan, as required by the approved recreation management plan, and conducted the required second-year study on whitewater boating. In 2011, the Legislature passed and the Governor signed SB5388, which provides that an owner of a hydro-electric project would not be liable for unintentional injuries to recreational users and observers resulting from releasing water or flows and making waterways or channels available for kayaking, canoeing or rafting purposes pursuant to and in substantial compliance with a hydro-electric license issued by FERC, and making available adjacent lands to view such activities.

The comprehensive settlement agreement and license include some 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 December 31, 2010, the District has internally reserved \$7.9 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, 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 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 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 reasonable and prudent 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, improvements to the Entiat, Daroga and Lincoln Rock parks and construction of two new trails. The license also requires that the District develop detailed management plans for operations, recreation and wildlife resources. The District submitted the plans to FERC in February 2010, and FERC approved the plans on December 3, 2010, October 12, 2010 and September 22, 2010, respectively. The District is now implementing those plans.

The Rocky Reach 401 Water Quality Certification identifies the District's requirements to comply with narrative and numeric criteria. Narrative criteria include consideration of fish spawning, rearing, migration, and harvest (flow is related to these), recreation, wildlife, and aesthetics. Water quality parameters identified under the numeric criteria include total dissolved gas ("TDG"), temperature, turbidity, toxics, and oil spills.

As they relate to fish, compliance with water quality narrative standards can be complex. The aforementioned HCP is being implemented to cover any considerations for anadromous salmonids, including those

listed as threatened and endangered salmonids in the mainstem Columbia River. During the Rocky Reach relicensing process, considerable time was spent working collaboratively with fish agencies and other stakeholders to build agreement on an adaptive management process to protect other species of concern, including white sturgeon, pacific lamprey and bull trout. The adaptive management process for these four fish species was written into fish management plans approved by the FERC and included in the 401 Water Quality Certification for the Rocky Reach Project. 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. Although uncertainty associated with these efforts remains, it is substantially less than in prior years due to the work completed upfront with stakeholders to identify goals and measures of success that were included in the fish management plans and 401 Water Quality Certification.

The two areas of interest associated with compliance with numeric criteria at the Rocky Reach Project are temperature and TDG. The District has demonstrated that the Rocky Reach Project generally meets the numeric criteria for water temperature. However, the license requires the District to monitor 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 water quality numeric criteria. A long-term effort is underway 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”). Release of the TMDL has been delayed to allow for necessary discussions and information exchange. A TMDL is a calculation of the maximum amount of a “pollutant” 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 mainstream, the incremental temperature increase allowed to the Rocky Reach Project may change from existing standards. The schedule for implementation of the TMDL is yet to be determined by the federal Environmental Protection Agency and therefore any new treatments that may be imposed on the District are unknown at this time.

The District’s other area of concern with regard to meeting 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 without using it to generate power to facilitate downstream passage of juvenile fish. While fish spill is recognized as a passage method and often required by federal fish managers, spilling water can increase 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 and 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 Water Quality Certification requires compliance with TDG standards at year 5 of the license (2014). If compliance is demonstrated, then the WDOE may require the District to continue existing project operations that have resulted in compliance. If compliance is not demonstrated, the WDOE may require evaluation of operational and 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 HYDRO-ELECTRIC PROJECTS—Endangered Species Act.” The Rock Island license expires on December 31, 2028.

### ***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 major sources of power supply are its Hydro-Electric Projects. See “The Rocky Reach Power Sales Contracts” and “The Rock Island Power Sales Contract” under this heading and “The Lake Chelan Project” below. For the year ended December 31, 2010, 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 2006 through 2010.

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**Table 6**  
**Consolidated System**  
**Distribution Division**  
**Energy Requirements, Resources and Power Costs**  
**As of December 31, 2010**

	<u>2006<sup>(1)</sup></u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b><u>Requirements (000 MWh)</u></b>					
Total Sales <sup>(2)</sup>	4,874	4,845	4,416	4,257	4,227
Timing Differences & Losses <sup>(3)</sup>	(255)	(64)	(10)	(8)	(67)
Total Requirements	<u>4,619</u>	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>
<b><u>Resources (000 MWh)</u></b>					
Rocky Reach System	2,241	2,341	2,091	1,982	1,839
Rock Island System <sup>(4)</sup>	1,473	1,516	1,393	1,345	1,283
Lake Chelan Project	452	459	405	338	417
Non-firm Purchases <sup>(5)</sup>	378	368	460	525	577
Contractual Repurchases <sup>(6)</sup>	75	97	57	59	44
Total Resources	<u>4,619</u>	<u>4,781</u>	<u>4,406</u>	<u>4,249</u>	<u>4,160</u>
<b><u>Purchased Power Costs (\$000)</u></b>					
Rocky Reach System	\$ 29,370	\$ 29,782	\$ 31,449	\$ 28,784	\$ 30,668
Rock Island System <sup>(4)</sup>	32,289	33,540	37,309	38,938	40,206
Lake Chelan Project	4,972	5,171	6,152	9,003	10,198
Non-firm Purchases <sup>(5)</sup>	15,733	18,543	27,901	18,130	22,392
Contractual Repurchases <sup>(6)</sup>	1,591	2,584	1,584	542	488
Total Purchased Power Costs	<u>\$ 83,955</u>	<u>\$ 89,620</u>	<u>\$ 104,395</u>	<u>\$ 94,857</u>	<u>\$ 103,952</u>
Average Cost (\$/MWh) <sup>(7)</sup>	\$ 18	\$ 19	\$ 24	\$ 22	\$ 25

(1) Year 2006 has been restated to reflect a minor misstatement of contractual repurchases.

(2) See Table 7, "Customer, Energy Sales and Revenues."

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

(4) The District's share of power produced by the first powerhouse of the Rock Island System is delivered to the Distribution Division as a contractually specified percentage of total cost, which is equal to the cost of service. The District received 45% of the power produced by the second powerhouse of the Rock Island System during the first 10 months of 2006 and 50% (the maximum permitted) commencing November 1, 2006 and expects to continue to receive 50% until June 7, 2012.

(5) Non-firm purchases include power purchased to: meet local requirements, hedge price movements and minimize the District's overall risk exposure to changes in power prices.

(6) Contractual obligation to purchase power for resale, during limited time periods, or as required under contractual arrangements with Alcoa and Alcoa Power. Includes capacity-to-energy exchange agreements. See "THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts—Alcoa."

(7) 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 Power. See "THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts—Alcoa."

### ***The Rocky Reach and Rock Island 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 Rocky Reach Power Sales Contracts" and "The Rock Island Power Sales Contract" under this heading.

### *The Lake Chelan Project*

The Lake Chelan Project became fully consolidated into what is now called the Consolidated System on June 1, 1993. The entire output of the Lake Chelan Project is taken by the Distribution Division. The Lake Chelan Project output constituted approximately 10% of the Distribution Division's total energy requirements for the year ended December 31, 2010.

### *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.

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, 2010, \$57,720,000 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, 2010, \$17,600,000 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 2010, the average capacity factor of Phases 1 and 2 combined energy delivered to the District was 27.8%.

Phase 3 of the project (the final phase) is a 14 turbine, 32 MW expansion that was placed into commercial operation on May 8, 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 29.6% from 2008 through 2010. 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.

In April 2007, Energy Northwest reached a warranty settlement agreement with Siemens Wind Power A/S ("Siemens") regarding gearboxes and main shaft bearings. The project has experienced numerous gearbox failures in both Phases 1 and 2. The gearbox warranties were originally established for five-year periods. Phase 1 ended August 2007, and Phase 2 ended December 2008. The failure of main bearings has all been post warranty with the first being in September 2005. The standard three-year warranty for Phase 1 ended in August 2005, and Phase 2 ended in December 2006.

The settlement includes a five-year extension for gearbox coverage, including augmented spares for covered components. In regards to main bearings, Siemens is also to provide augmented spares for covered components. In addition, Siemens, at its sole cost and expense, is obligated to perform a root cause analysis of the main bearing problems for the purpose of developing a corrective action plan. Energy Northwest also contracted an independent contractor to perform a main bearing failure analysis. This report differed from Siemens's conclusions.

In April 2010, Energy Northwest and Siemens reached a financial settlement regarding the main shaft bearings. With this settlement, Energy Northwest and Siemens release and forever discharge each other of any and all claims related in any way to the issues and disputes over the main shaft bearings at Phases 1 and 2 of the Nine Canyon Wind Project. All obligations with respect to the 2007 warranty settlement agreement remain in full force and effect.

Although the District is not a participant in Phase 3, the District does receive power from Phase 3 turbines and pays a portion of the combined maintenance and operation costs as described earlier. For these reasons, the District has an interest in the equipment warranties associated with Phase 3. The Phase 3 wind turbines have a five-year warranty on all components, effective through April 2013. In addition, this warranty includes an extensive component failure clause, which will require remedial action as determined necessary from a root cause analysis if three or more wind turbines experience a major component defect.

## **The Rocky Reach Power Sales Contracts**

### ***General***

The energy available to the District from its ownership and operation of the Rocky Reach System is governed by the Current Power Sales Contracts between the District and various power purchasers, which expire October 31, 2011. A major portion (59.1%) of the power output of the Rocky Reach System is currently sold to four investor-owned utility companies (collectively, the “Rocky Reach Power Purchasers”) on a take-or-pay and cost-of-service basis, with the balance (40.9%) taken by the District. Each party pays its percentage share of the total annual cost of the Rocky Reach System. The Rocky Reach Power Purchasers and their current respective shares of the output of the Rocky Reach System are Puget Sound Energy (38.9%), Portland General Electric Company (12%), PacifiCorp (5.3%) and Avista (2.9%). The Current Power Sales Contracts with the Rocky Reach Power Purchasers extend through October 31, 2011. The Rocky Reach System output purchased by the District constituted approximately 44% of the Consolidated Systems’ Distribution Division’s total energy requirements for the year ended December 31, 2010. The District has executed the New PSE Contract and the New Alcoa Contract (each as defined herein) for both the Rocky Reach and Rock Island Projects, beginning November 1, 2011 with respect to the Rocky Reach Project.

Pursuant to a long-term Power Sales Contract between the District and Douglas PUD, the District agreed to make available to Douglas PUD, from the District’s share of Rocky Reach System energy, an amount of energy equal to 2.77% of the output of the Rocky Reach System, upon payment by Douglas PUD of an amount equal to the District’s cost of making such energy available from the Rocky Reach System. 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 ends 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.

### ***Alcoa***

In October 2004, the District and Alcoa Power entered into a Restated and Amended Industrial Power Sales Contract (the “Current Alcoa Power Contract”). Energy sales to Alcoa Power under the Current Alcoa Power Contract, consisting of approximately 23% of the equivalent output of the Rocky Reach System, are 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 can 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 Current Alcoa Power Contract are classified by the District as “Resale.” The Current Alcoa Power Contract terminates on October 31, 2011.

## **The Rock Island Power Sales Contract**

The energy available to the District from its ownership and operation of the Rock Island System is governed by the Current Power Sales Contract between the District and Puget Sound Energy. The contract with

Puget Sound Energy extends through June 7, 2012. The District has executed the New PSE Contract for both the Rocky Reach and Rock Island Projects, which is effective beginning July 1, 2012 with respect to the Rock Island Project.

The Rock Island System Current Power Sales Contract provides that the output of the Rock Island System is 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. For 2010, 50% of the power output of the Rock Island System was sold to Puget Sound Energy, and the remaining 50% was taken by the District.

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

In February 2006, the District executed a new long-term power sales contract (the “New PSE Contract”) with Puget Sound Energy. Deliveries under the New PSE Contract will commence on November 1, 2011 and July 1, 2012 for the Rocky Reach and Rock Island Projects, respectively, following the expiration of the Current Power Sales Contracts on October 31, 2011 and June 7, 2012, respectively. The New PSE Contract is scheduled to terminate on October 31, 2031 with respect to power from both the Rocky Reach and Rock Island Projects. Under the New PSE Contract, Puget Sound Energy will purchase an amount equal to 25% of the combined energy and capacity from both the Rocky Reach and Rock Island Projects. In exchange, Puget Sound Energy will be obligated to pay, among other things, 25% 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 New PSE 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 New PSE Contract); and (v) an annual Debt Reduction Charge (as defined in the New PSE 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 will recognize the \$89 million payment as revenue in equal annual amounts over the term of the New PSE Contract, commencing on November 1, 2011. FERC approved the New PSE Contract in March 2006.

The Coverage Amount is an amount approximately equal to 15% of the 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 based upon an assumed amortization, on a level debt service basis at an assumed taxable interest rate approximately equal to then-current market rates, of the outstanding debt of the Rocky Reach and Rock Island Projects over periods equal to the estimated average economic useful life of the respective facilities and improvements to be financed from the proceeds of such debt.

In December 2010, the Commission has set the annual Debt Reduction Charge and the Capital Recovery Charge at the maximum rates authorized under the New PSE Contract, effective January 1, 2012. 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 Puget’s 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, however, 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 New PSE 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 New PSE 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 New Power Sales Contract with Puget Sound Energy, Inc.”

### **New Alcoa Power Sales Contract**

In July 2008, the District executed a new long-term power sales contract with Alcoa (the “New Alcoa Contract” and together with the New PSE Contract, the “New Power Sales Contracts”). Deliveries under the New Alcoa Contract will commence on November 1, 2011 and July 1, 2012 for the Rocky Reach and Rock Island Projects, respectively, following the expiration of the Current Power Sales Contracts on October 31, 2011 and June 7, 2012, respectively. The New Alcoa Contract is scheduled to terminate on October 31, 2028 with respect to power from both the Rock Island and Rocky Reach Projects. Under the New Alcoa Contract, Alcoa will purchase an amount equal to 27.5% of the output of the Rocky Reach Project from November 1, 2011 to June 30, 2012, and thereafter Alcoa will purchase an amount equal to 26% of the combined Output of both the Rock Island and Rocky Reach Projects. “Output” is defined in the New 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 will be 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 New Alcoa Contract) with respect to the Rocky Reach and Rock Island Projects; (iii) a Coverage Amount (as defined in the New Alcoa Contract); (iv) an annual Capital Recovery Charge (as defined in the New Alcoa Contract); and (v) an annual Debt Reduction Charge (as defined in the New 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 will recognize the \$22.9 million payment as revenue in equal annual amounts over the term of the New Alcoa Contract, commencing on November 1, 2011. FERC approved the New Alcoa Contract in September 2008.

The payment provisions of the New Alcoa Contract are similar to those of the New PSE Contract, including the Coverage Amount, the Debt Reduction Charge and the Capital Recovery Charge provisions summarized above. In December 2010, the Commission has set the annual Debt Reduction Charge and the Capital Recovery Charge at the maximum rates authorized under the New Alcoa Contract, effective January 1, 2012. 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 \$9.1 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 New 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, however, 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 New 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 New 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 New Alcoa Contract also provides that:

(i) The Output provided pursuant to the New 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 New Alcoa Contract.

(ii) A deferred capacity reservation charge of up to \$87 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 (prorated for the period shut down to the annual initial shutdown amount of \$8.6 million). 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 New Alcoa Contract).

(iii) The District will have the option to terminate the New 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 New Alcoa Contract, Alcoa will remain liable for all remaining payments under the New Alcoa Contract.

(iv) Alcoa may not assign the New 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 New Alcoa Contract. The District's consent to either situation is within the District's sole discretion. See APPENDIX J—“Summary of New 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 fired up the third pot line in March 2011.

*[Remainder of page intentionally blank.]*

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

Table 7 on the following page presents the District's customers and energy sales of its Distribution Division for the years 2006 through 2010. Because approximately 73% 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.

In addition, a significant portion of the District's sales are wholesale sales. 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 exceed expected demand and enters into short-term forward physical power purchase agreements when expected demand exceeds the resources estimated to be available.

As part of its plan to improve financial stability, to mitigate potential wholesale sales and price volatility and to keep future rates stable and affordable, the District has implemented a comprehensive forward hedging strategy. In addition to the New Power Sales Contracts, a key component of the strategy includes executing mid-term power sales contracts (i) fixed percentages of future output from the Rock Island and Rocky Reach Projects and (ii) fixed amounts of such output, in each case with parties and at prices determined pursuant to an auction process and for staggered terms of up to 60 months. This strategy is intended to mitigate the District's risks related to power marketing, pricing and water levels, while securing revenue for the future. As of October 17, 2011, the District has locked in predictable revenue of \$371.5 million from January 2012 through the end of 2015. The District expects that having a base level of predictable power sales revenue during such period will help avoid large swings in power rates charged to local customers and help stabilize overall revenues. The District expects to still have adequate energy supplies to meet local load during this period, and, for most forecasted weather conditions and water supply, the District expects to have additional power to sell on the surplus market beyond the power that was auctioned.

*[Remainder of page intentionally blank.]*



**Table 7**  
**Distribution Division – Customers, Energy Sales and Revenues**  
**As of December 31, 2010**

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b><u>Customers</u></b>					
Retail:					
Residential	33,442	34,129	35,357	35,516	35,687
General Service	5,563	5,666	5,968	6,027	6,074
Industrial	30	30	32	31	31
Interdepartmental	491	501	523	544	549
Other <sup>(1)</sup>	4,905	4,985	5,745	5,749	5,710
<b>Total Retail Customers</b>	<b>44,431</b>	<b>45,311</b>	<b>47,625</b>	<b>47,867</b>	<b>48,051</b>
Resale	55	60	68	70	73
<b>Total Customers</b>	<b>44,486</b>	<b>45,371</b>	<b>47,693</b>	<b>47,937</b>	<b>48,124</b>
<b><u>Energy Sales (000 MWh)</u></b>					
Retail:					
Residential	707	723	744	803	738
General Service	418	434	447	469	447
Industrial	300	297	297	315	296
Interdepartmental	20	18	19	20	19
Other <sup>(1)</sup>	43	45	47	48	40
<b>Total Retail Sales</b>	<b>1,488</b>	<b>1,517</b>	<b>1,554</b>	<b>1,655</b>	<b>1,540</b>
Resale:					
Alcoa Power	1,630	1,464	1,380	1,313	1,341
Douglas PUD	176	176	159	146	140
City of Cashmere <sup>(2)</sup>	60	61	49	-	-
Other – Firm	-	-	-	-	19
Other – Non-firm	1,520	1,627	1,274	1,143	1,187
<b>Total Sales for Resale</b>	<b>3,386</b>	<b>3,328</b>	<b>2,862</b>	<b>2,602</b>	<b>2,687</b>
<b>Total Energy Sales</b>	<b>4,874</b>	<b>4,845</b>	<b>4,416</b>	<b>4,257</b>	<b>4,227</b>
<b><u>Revenue (\$000)</u></b>					
Retail:					
Residential	\$ 20,988	\$ 21,515	\$ 23,197	\$ 26,203	\$ 25,132
General Service	13,480	13,970	15,154	16,842	16,687
Industrial	5,601	5,542	5,757	6,378	6,246
Interdepartmental	554	506	559	607	583
Other <sup>(1)</sup>	1,490	1,536	1,650	1,775	1,719
<b>Total Retail Revenue</b>	<b>\$ 42,113</b>	<b>\$ 43,069</b>	<b>\$ 46,317</b>	<b>\$ 51,805</b>	<b>\$ 50,367</b>
Resale:					
Alcoa Power	\$ 20,451	\$ 21,427	\$ 25,025	\$ 22,448	\$ 24,740
Douglas PUD	1,939	2,073	2,004	1,930	2,074
City of Cashmere <sup>(2)</sup>	814	830	721	-	-
Other – Firm	-	-	-	-	771
Other – Non-firm	70,629	79,377	66,250	36,484	43,358
<b>Total Resale Revenue</b>	<b>\$ 93,833</b>	<b>\$ 103,707</b>	<b>\$ 94,000</b>	<b>\$ 60,862</b>	<b>\$ 70,943</b>
Other Revenues	2,108	1,256	2,619	1,615	1,511
<b>Total Revenue</b>	<b>\$ 138,054</b>	<b>\$ 148,032</b>	<b>\$ 142,936</b>	<b>\$ 114,282</b>	<b>\$ 122,821</b>

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

(2) In 2008, the District acquired Cashmere's distribution system, which is now part of the District's Distribution Division.

## **Electric Rates; Other Rates**

The District is empowered and required under the Enabling Act 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 State Utilities and Transportation Commission. 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 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 June 2007, the District concluded a series of strategic planning sessions with the Commission, customer-owners and employees. This series of public meetings was designed to discuss important challenges the District was facing at the time and that it would continue to face. The objectives of these meetings were to review the then-current business model, project how the business model was expected to function in the future and provide the Commission with a series of tactical operating plans to address future challenges. After 10 months of deliberations and analysis, the Commission adopted a set of governing policies and guiding principles intended to allow management to execute the agreed upon operating plan. The strategic package set a new financial direction that included an electric rate increase of 5.0% for 2008, as well as a renewed focus on cost control and efficiency. The rate increase was intended to move the District away from reliance on wholesale power sales over time. Prior to the 2008 rate increase, the District had not increased electric rates since January 2000.

The District recognized in the 2007 strategic planning discussions that a surcharge may be needed occasionally in years when water supplies are low or the price of power sold on the wholesale market drops. 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 implemented contingency plans, including reductions in planned operating and maintenance expenditures and deferrals of some capital projects. See "FINANCIAL INFORMATION—District Near-Term Financial Outlook; 2010 Strategic Plan." On April 27, 2009, the District also implemented a temporary 9% electric rate surcharge, the mechanisms for which were established more than a year prior. The surcharge went into effect on May 1, 2009, and was initially to remain in place for up to 12 months. With the continued low river flows and low market prices experienced the first three months of 2010, on April 5, 2010, the District continued the temporary 9% electric rate surcharge. On November 15, 2010, with continuing budget shortfalls, the surcharge was extended through the end of 2011. If the conditions adversely affecting the District's revenues (including below-average river flows, depressed wholesale energy prices and/or reduced interest income on investments) return in the future, the District may re-impose an electric rate surcharge or take other rate action to maintain the health of the District's finances. See "FINANCIAL INFORMATION—District Near-Term Financial Outlook; 2010 Strategic Plan." 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 had anticipated implementing an electric rate design change on April 1, 2009; however, the effective date of such change has been postponed, with the intent that it would not take effect until the extended surcharge expired. During 2011, the District staff re-evaluated the 2009 electric rate design plan, and on August 22, 2011 recommended to the Commission a revised rate proposal. The revised rate proposal would have a blended over-all effect of a 2.5% increase; however, under the revised rate proposal, a flat hourly rate would be charged for all residential electric use and all minimum usage charges would be eliminated. The Commission held multiple special meetings in the fall of 2011 to consider the new rate design proposal, and at a public hearing held on October 17, 2011, the Commission adopted the new rate design proposal, which is scheduled to go into effect on January 1, 2012.

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 and 5.0% for both systems on April 1, 2011. The District also increased wholesale rates charged to serviced providers for its Fiber-Optics System by 2.0% on January 1, 2008 and by an approximate blended rate of 5% on January 1, 2011.

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 March 1, 2011.

**Table 8**  
**Comparative Monthly Electric Bills<sup>(1)</sup>**  
**As of March 1, 2011**

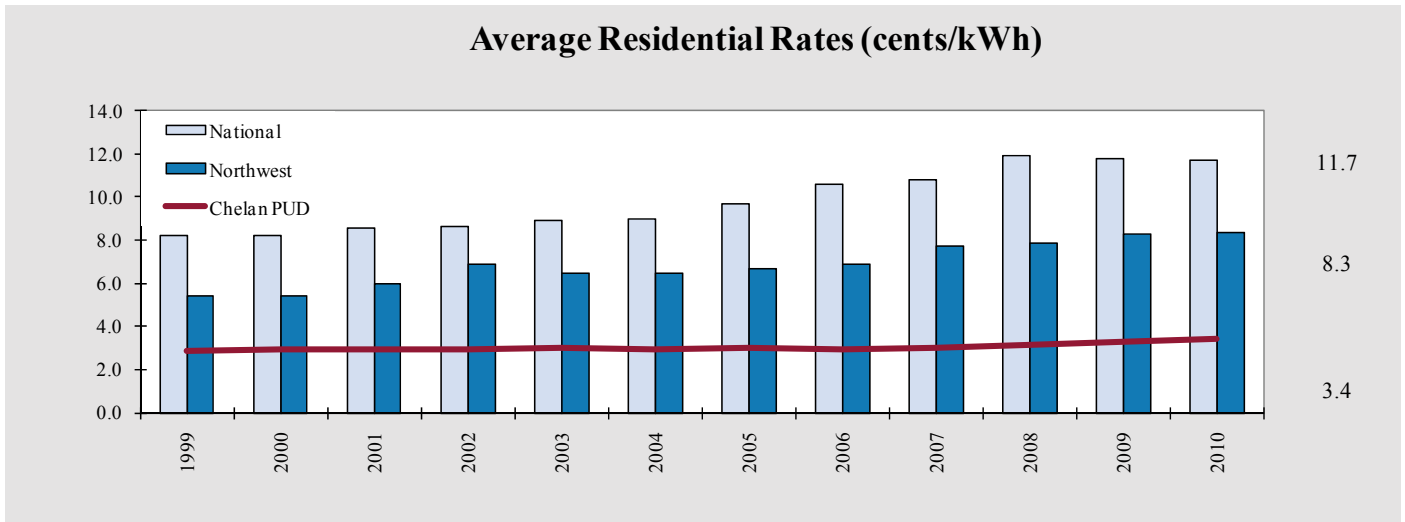
	<b>Residential</b>		<b>Commercial<sup>(2)</sup></b>		<b>Industrial<sup>(2)</sup></b>	
	<b>(1,000 kWh)</b>	<b>(2,000 kWh)</b>	<b>(30 kW, 9,000 kWh)</b>		<b>(400 kW, 150,000 kWh)</b>	
	<b>Summer</b>	<b>Winter</b>	<b>Summer</b>	<b>Winter</b>	<b>Summer</b>	<b>Winter</b>
<b>The District</b>	\$33	\$65	\$267	\$267	\$5,105	\$5,105
Selected Municipalities:						
Tacoma Power	68	130	577	577	7,247	7,247
City of Seattle	99	194	610	610	9,044	9,044
Selected Public Utilities:						
Grant County PUD No. 2	49	86	380	380	4,136	4,136
Snohomish County PUD No. 1	80	167	647	722	9,822	11,175
Investor Owned Utilities:						
Avista	72	152	905	905	11,266	11,266
Puget Sound Energy	99	202	793	820	11,646	12,802

<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.

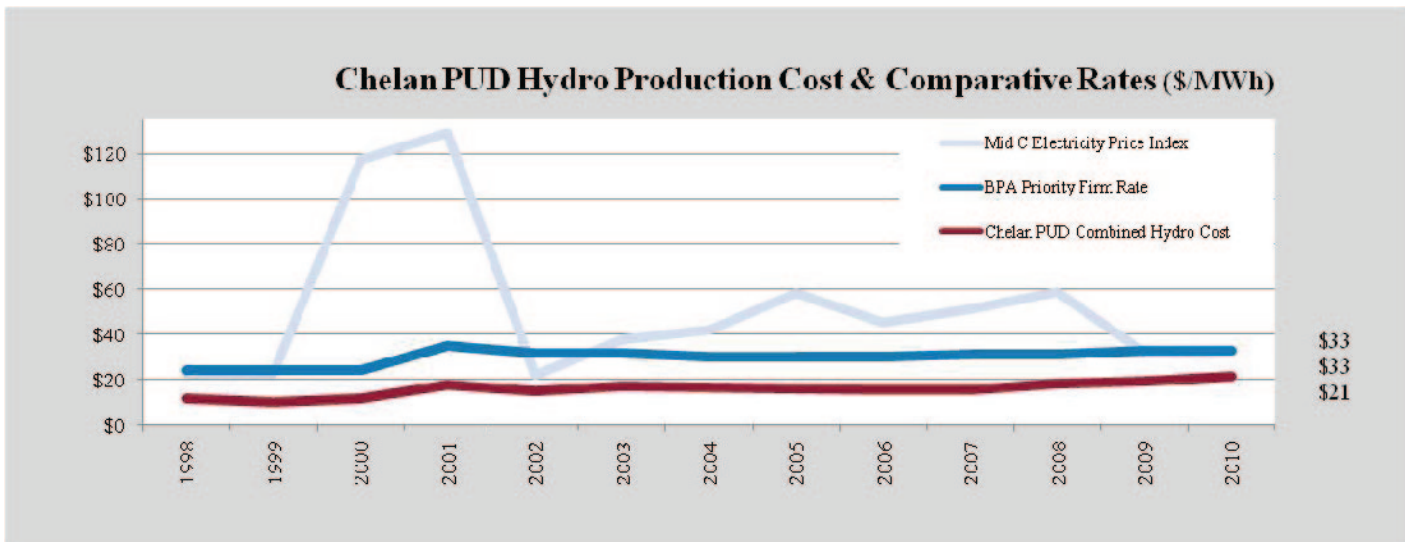
<sup>(2)</sup> Assumes power delivered is three-phase where available. Delivery voltage varies.

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 2010 compared to 8.3 cents per kWh for the Pacific Northwest average and 11.7 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 2010, the District's combined Hydro-Electric System cost was \$21 per MWh (2.13 cents per kWh) compared to Bonneville's firm priority rate of \$33 per MWh (3.31 cents per kWh) and the Mid-Columbia market average of \$33 per MWh (3.28 cents per kWh).

**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 Rocky Reach Power Sales Contracts” and “The Rock Island Power Sales Contract” under this heading. For the year ended December 31, 2010, the Power Purchasers, which excludes Alcoa and Douglas PUD, collectively purchased approximately 56.6% 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, 2010. Alcoa Power, the Distribution Division’s largest local wholesale purchaser, accounted for 20.1% of the revenues of the Distribution Division.

**Table 9**  
**Consolidated System**  
**Distribution Division**  
**Five Largest Local Wholesale Purchasers and Major Retail Customers <sup>(1)</sup>**  
**2010**

<b>Customer</b>	<b>Business</b>	<b>Energy Sales (000 MWh)</b>	<b>Revenue from Energy Sales (\$000)</b>	<b>Percent of Distribution’s Total Revenue</b>
Alcoa Power <sup>(2)</sup>	Aluminum Mfg.	1,341	\$ 24,740	20.1%
Douglas County PUD	Electric Utility	140	2,074	1.7%
Stemilt Growers Inc.	Agriculture	64	1,280	1.0%
Keyes Fibre Inc.	Paper Products	41	741	0.6%
Yahoo!	Internet Services	32	556	0.5%
		1,618	\$ 29,391	23.9%

(1) Excludes non-firm sales for resale.

(2) In 2004, the Distribution Division and Alcoa Power entered into the Restated Alcoa Power Contract, which continued the assignment made in 1992 of Alcoa Power’s 23% share of the output of the Rocky Reach System to the Distribution Division. In return, the Distribution Division provides power equivalent to 23% of the Rocky Reach System output to Alcoa at cost and procures any additional power needed or sells any surplus power to Alcoa Power at contractual rates, which approximate market rates. The New Alcoa Contract will take effect on November 1, 2011 with respect to the Rocky Reach Project and on July 1, 2012 with respect to the Rock Island System.

## Wholesale Power Management Activity

The District in most years has a surplus supply of its own low-cost hydroelectric power available to sell. With the advent of deregulation, the District also has the opportunity to purchase and sell power from and to a number of power marketing firms, 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. The committee also has established 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 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-Optics System**

### ***General***

The District built, maintains and operates the Fiber Optics System that runs throughout the County to provide various communication services necessary for the District to conduct its business. The Fiber Optics 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-Optics System, the District also provides telecommunications infrastructure access to approximately 20 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 firms set their own end user pricing and are directly responsible for billing each end user. The District bills the service provider for the wholesale services provided by the District through the Fiber-Optics System.

As of the end of 2010, the District has made fiber-optic services available to approximately 30,000 premises in the County. The District intends to continue connecting premises in those areas where the fiber infrastructure has been constructed. The estimated number of end users of the fiber network increased to 10,704 by the end of 2010. Of these end users, an estimated 88% use the network to access the Internet, 58% use it for telephone service and 46% for television, with certain users accessing the network for multiple services.

The District is continuing to develop a long-range, strategic plan for the Fiber Optics System.

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

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 the State’s Utilities and Transportation Commission (“UTC”) 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 the UTC.

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-Optics System. The District has reviewed FCC requirements with outside counsel and believes that all registration and filings required by Federal regulations 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.

### ***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. Clearwire began offering WiMax wireless broadband and VoIP service in the Wenatchee area during 2007. The

District's fiber network currently provides the service providers in many areas with faster download speeds than those available from Charter or Frontier. The service providers on the District network currently offer a comparable number of high definition channels in the digital tier than are currently available from Charter. Current broadband internet and television offerings from the service providers are priced competitively with Charter and Frontier.

### ***Historical Results***

Table 10 below sets forth a summary of financial results of operation of the Fiber-Optics System for the past five fiscal years.

**Table 10**  
**Consolidated System**  
**Fiber-Optics System**  
**Summary of Operating Results**  
**(\$000)**

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b><u>Operating revenues</u></b>					
Wholesale fiber services	\$ 1,639	\$ 2,563	\$ 3,088	\$ 3,706	\$ 4,109
Fiber leasing	173	378	422	464	487
Intra-district revenues	1,239	1,509	1,695	1,869	1,984
Total operating revenues	<u>3,051</u>	<u>4,450</u>	<u>5,205</u>	<u>6,039</u>	<u>6,580</u>
<b><u>Operating expenses</u></b> <sup>(1)</sup>					
Administrative and general	1,840	1,647	1,601	1,678	1,522
Repairs and maintenance	195	865	806	743	1,043
Other operating	1,448	1,466	1,582	1,205	1,400
Depreciation expense	3,125	3,385	4,072	4,764	5,170
Total operating expenses	<u>6,608</u>	<u>7,363</u>	<u>8,061</u>	<u>8,390</u>	<u>9,135</u>
Operating loss	(3,557)	(2,913)	(2,856)	(2,351)	(2,555)
Other expense	(3,237)	(3,617)	(4,091)	(4,733)	(4,856)
Net loss before capital contributions	<u>(6,794)</u>	<u>(6,530)</u>	<u>(6,947)</u>	<u>(7,084)</u>	<u>(7,411)</u>
Capital contributions	-	6	309	10	5
Interfund equity transfers <sup>(2)</sup>	-	18,000	-	-	94
Changes in Net Assets	<u>\$ (6,794)</u>	<u>\$ 11,476</u>	<u>\$ (6,638)</u>	<u>\$ (7,074)</u>	<u>\$ (7,312)</u>

(1) Includes NoaNet assessments.

(2) 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-Optics System. In 2010, represents a temporary 2.0% Distribution Division rate increase effective December 1, 2010 through April 15, 2011 intended to defray certain project costs.

### ***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. A PON network can serve up to 32 homes or businesses from a single strand of fiber and up to 4,608 homes or businesses from a single chassis, with up to four chassis per node. It also uses passive components in the field installations. 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 powering 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.

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

### ***System Integrity***

In the District's opinion, its reserve funds and insurance coverage are adequate to cover loss or damage associated with the fiber-optic network. In addition, the network is designed to have some level of resiliency and redundancy where possible, with ongoing efforts to improve reliability. Lastly, the District's core 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 uninterruptable power system to minimize these risks. The District maintains a daily backup copy of all critical network provisioning at an offsite location.

### ***NOANet***

The District is a member of Northwest Open Access Network ("NOANet"), a Washington non-profit mutual corporation. A "member" of a mutual corporation is the effective equivalent of a shareholder. 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. NOANet's original members included 16 public utility districts ("PUDs") and one regional electric utility joint action agency, Energy Northwest. NOANet now has 13 members, consisting of 12 PUDs and Energy Northwest. The members with the four largest percentage interests include Benton County PUD (14.17%), Grant County PUD (14.17%), Kitsap County PUD (12.97%), and the District (11.71%).

Pursuant to NOANet's Articles of Incorporation, all members must be public agencies located in Bonneville's service area. Members can withdraw at any time, although they remain subject to liabilities to NOANet and any third parties incurred prior to withdrawal. The percentage interest of a withdrawing member is redistributed *pro rata* among the remaining members. Members have voting rights equal to their respective percentage interests. Pursuant to NOANet's Bylaws, members are subject to assessment for costs incurred by NOANet that are in excess of NOANet's revenues upon approval by a two-thirds vote of the Board of Directors. The District currently does not have a representative on NOANet's Board. Pursuant to the Bylaws, any guaranties by members or other similar commitments must be unanimously approved by all the members.

NOANet 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 ("ILECs"), Competitive Local Exchange Carriers ("CLECs"), Inter-eXchange Carriers ("IXCs"), Regional Service Providers ("RSPs"), Internet Service Providers ("ISPs"), and Application Service Providers ("ASPs"). NOANet is a registered telecommunications company under the regulatory oversight of the Washington Utilities and Transportation Commission.

NOANet benefits the District by providing (1) high speed data transmission for such utility purposes as coordination of the five major Mid Columbia PUD dams, and communication services required for power marketing, and (2) regional connectivity for the District's commercial wholesale telecommunications network.

Pursuant to a separate agreement with NOANet (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 currently outstanding bonds. The District has guaranteed the payment of 10.12% of debt service on such long-term bonds, of which approximately \$14,000,000 remained outstanding as of the end of 2010. The District and the other 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 failure to pay pursuant to the Third Repayment Agreement. The payment obligation of each 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 utility system, (2) the principal and interest on any existing or future bonds or other



obligations of the member's utility system, and (3) required reserves for such obligations and the bond and note covenants of the member.

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 projects to be funded with the Grants (the "Projects") and the cash and in-kind contributions from the Project Participants include (1) a \$103 million project for network and support infrastructure which will include approximately 80 high-capacity routes to 40 underserved or unserved primarily rural communities and approximately 120 "anchor institutions" in those communities, including hospitals and libraries; and (2) a \$78 million project to provide high-capacity broadband to community colleges around the State, as well as public safety and emergency medical service providers, justice facilities, public schools and other "anchor institutions."

The Grants are expected to allow completion of NOANet's network system. The District itself is not a Project Participant or a participant in either Grant, and is not a party to any of the Grant Agreements or Participant Agreements.

The District believes that NOANet has sufficient legal authority to undertake the Grants and the Projects as currently approved, and to do so under the Interlocal Cooperation Act as a joint exercise of the powers of its member utilities, so long as NOANet's activities, including the Projects, are limited to providing wholesale and not retail communications services. There are, however, no statutes that expressly authorize NOANet or its members to accept the Grants or undertake the Projects, or to execute the Grant Agreements or the Participation Agreements. In addition, the District believes, based in part upon NOANet's Articles of Incorporation and Bylaws, that the District is not liable generally for the obligations or liabilities of NOANet other than those which the District has expressly assumed by contract.

If it were later determined that NOANet lacked such legal authority, or that the District has greater liability generally for the obligations or liabilities of NOANet, including the Grants and/or the Projects, the District is unable to predict what financial or other impacts that would have on the District, but it is possible that such impacts could be substantial.

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, other than (i) its percentage share of NOANet's ongoing operating and other expenses attributable to such projects that are not otherwise paid from NOANet's ongoing revenues, and (ii) any future assessments with respect to the Grants, Grant Agreements, Participation Agreements or Projects that might be imposed pursuant to NOANet's Bylaws by a two-thirds majority of the Board.

### **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 project switchyard;
- (2) one 230-kV Bonneville line connected to the Rocky Reach project 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 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, 2010, Energy Northwest had outstanding approximately \$5.97 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, 2010, revenue bonds outstanding for Projects Nos. 1 and 3 totaled approximately \$1.82 billion and \$1.68 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 (Rock Island, Rocky Reach and Lake Chelan) on the wholesale market have generated substantial revenues for the Consolidated System, providing 35% of annual Distribution Division revenues in 2010 and 32% of annual Distribution Division revenues in 2009. These surplus revenues have allowed the District to keep rates to Distribution Division customers among the lowest in the nation.

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—Electric Rates; Other Rates.”

Table 11 below presents the actual statement of revenues and expenses of the Distribution Division for the years 2006 through 2010. The Distribution Division is part of the Consolidated System, but is accounted for separately. Appendix A of this Official Statement contains the audited financial statements and accompanying notes of the District for the year ended December 31, 2010. Appendix B of this Official Statement contains the unaudited financial data of the District for the six months ended June 30, 2011. The District’s financial statements have been prepared in conformity with generally accepted accounting principles applicable to governmental entities applied on a consistent basis.

**Table 11**  
**Consolidated System**  
**Distribution Division <sup>(1)</sup>**  
**Statement of Revenues and Expenses**  
**(\$000)**

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Operating Revenues</b>					
Retail	\$ 42,113	\$ 43,069	\$ 46,317	\$ 51,805	\$ 50,367
Resale <sup>(2)</sup>	93,833	103,708	94,000	60,862	70,943
Other	2,108	1,255	2,619	1,615	1,511
Total	<u>138,054</u>	<u>148,032</u>	<u>142,936</u>	<u>114,282</u>	<u>122,821</u>
<b>Operating Expenses <sup>(2)</sup></b>	<u>121,407</u>	<u>126,582</u>	<u>143,040</u>	<u>130,977</u>	<u>141,310</u>
Net Operating Revenue (loss)	16,647	21,450	(104)	(16,695)	(18,489)
<b>Other Income</b>	<u>6,095</u>	<u>10,746</u>	<u>11,000</u>	<u>8,139</u>	<u>4,584</u>
<b>Net Revenue (loss) <sup>(3)</sup></b>	<u>\$ 22,742</u>	<u>\$ 32,196</u>	<u>\$ 10,896</u>	<u>\$ (8,556)</u>	<u>\$ (13,905)</u>

(1) Excludes Fiber-Optics System. Year 2006 has been restated to exclude the Fiber-Optics System, which was formerly included. See Table 10, “Fiber-Optics System, Summary of Operating Results.”

(2) Includes contractual purchases and non-firm purchases for resale.

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

## Management’s Discussion of Distribution Division Financial Results

### *General*

**New Power Sales Contracts.** In February 2006 and July 2008, the District executed the New PSE Contract and the New Alcoa Contract, respectively. Deliveries under the New Power Sales Contract are scheduled to commence on November 1, 2011 and July 1, 2012, respectively, upon the expiration of the Current Power Sales Contracts for the Rocky Reach and Rock Island Projects on October 31, 2011 and June 7, 2012, respectively. For a description of the New PSE Contract, see “THE CONSOLIDATED SYSTEM—New Puget Sound Energy Sales Contract” and APPENDIX I—“Summary of New Power Sales Contract with Puget Sound Energy, Inc.” For a description of the New Alcoa Contract, see “THE CONSOLIDATED SYSTEM—New Alcoa Power Sales Contract” and APPENDIX J—“Summary of New 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 new power sales contracts with respect to the output from the Rock Island and Rocky Reach Projects, including the New Contract with Puget Sound Energy. 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 2011C BONDS—and APPENDIX D—“Summary of Certain Provisions of the Master Resolution and the Ninth Supplemental Resolution.”

**2010 Strategic Plan.** 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, which incorporated new financial targets intended to put the District’s finances on a more reliable, sustainable path over the next several years (2010 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. See “FINANCIAL INFORMATION—District Near-Term Financial Outlook; 2010 Strategic Plan” and “—Consolidated System Liquidity.”

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

**General.** For the year ended December 31, 2010, the Distribution Division incurred a net loss of \$13.9 million compared to a net loss of \$8.6 million for the same period in 2009. The 2010 loss was \$5.3 million greater than the 2009 loss 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, 2010, Distribution Division operating revenues increased 7.5% compared to the same period in 2009. 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 2009, operating revenues decreased 20% from 2008. Generation at the District’s Hydro-Electric Projects was down as a result of lower-than-average river flows. Additionally, the 2009 decrease resulted from a decrease in non-firm sales for resale. Operating revenues in 2008 decreased slightly (3.4%) from 2007. During 2007 operating revenues increased by 7% from 2006.

**Operating Expenses.** For the year ended December 31, 2010, Distribution Division operating expenses 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 discussed above. 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. Operating expenses in 2007 increased by 4% from 2006.

**Balance Available for Distribution Division Debt Service.** 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. Funds available in 2007 increased by \$9.2 million from 2006 as result of as the result of increased non-firm sales for resale.

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Table 12 below presents the actual power cost and power delivered for the Hydro-Electric Systems for the years 2006 through 2010.

**Table 12**  
**Hydro-Electric Projects**  
**Power Cost and Net Power Delivered**  
**(\$000)**

	2006	2007	2008	2009	2010
<b><u>Rocky Reach System</u></b>					
Operating Expenses <sup>(1)</sup>	\$ 40,359	\$ 41,938	\$ 44,201	\$ 40,023	\$ 40,777
Debt Service: <sup>(2)</sup>					
Hydro Issues	1,570	1,564	1,553	1,948	2,633
Consolidated System Loans	33,277	33,814	34,680	29,942	33,021
Other Revenues <sup>(3)</sup>	(3,399)	(4,498)	(4,795)	(1,410)	(1,448)
Total Power Cost <sup>(4)</sup>	<u>\$ 71,807</u>	<u>\$ 72,818</u>	<u>\$ 75,639</u>	<u>\$ 70,053</u>	<u>\$ 74,983</u>
Net Power Delivered (000 MWh)	5,947	6,247	5,564	5,169	4,862
Cost in \$/MWh	\$ 12	\$ 12	\$ 14	\$ 14	\$ 15
Plant Factor <sup>(5)</sup>	52%	55%	49%	45%	43%
Availability Factor	96%	98%	98%	99%	91%
Average River Flow (000 CFS) <sup>(6)</sup>	111	111	103	91	89
<b><u>Rock Island System</u></b>					
Operating Expenses <sup>(1)</sup>	\$ 36,074	\$ 35,430	\$ 38,715	\$ 39,050	\$ 40,321
Debt Service: <sup>(2)</sup>					
Hydro Issues	22,581	22,577	22,594	22,971	23,560
Consolidated System Loans	12,965	12,435	16,335	17,446	19,134
Other Revenue <sup>(3)</sup>	(4,055)	(3,198)	(3,026)	(2,736)	(2,602)
Total Power Cost <sup>(4)</sup>	<u>\$ 67,565</u>	<u>\$ 67,244</u>	<u>\$ 74,618</u>	<u>\$ 76,731</u>	<u>\$ 80,413</u>
Net Power Delivered (000 MWh) <sup>(7)</sup>	2,854	2,796	2,721	2,572	2,496
Cost in \$/MWh	\$ 24	\$ 24	\$ 27	\$ 30	\$ 32
Plant Factor <sup>(5)</sup>	52%	51%	50%	47%	45%
Availability Factor	98%	93%	94%	94%	90%
<b><u>Lake Chelan Project</u></b>					
Operating Expenses <sup>(1)</sup>	\$ 3,378	\$ 3,498	\$ 3,426	\$ 3,220	\$ 3,523
Debt Service: <sup>(2)</sup>					
Hydro Issues	-	-	-	-	-
Consolidated System Loans	1,892	2,336	3,816	6,552	7,402
Other Revenue <sup>(3)</sup>	(298)	(663)	(1,090)	(769)	(727)
Total Power Cost <sup>(4)</sup>	<u>\$ 4,972</u>	<u>\$ 5,171</u>	<u>\$ 6,152</u>	<u>\$ 9,003</u>	<u>\$ 10,198</u>
Net Power Delivered (000 MWh)	454	459	405	338	417
Cost in \$/MWh	\$ 11	\$ 11	\$ 15	\$ 27	\$ 24
Plant Factor <sup>(5)</sup>	108%	109%	96%	80%	81%
Availability Factor	100%	99%	100%	68%	99%
<b>Combined Hydro Cost in \$/MWh</b>	<b>\$ 16</b>	<b>\$ 15</b>	<b>\$ 18</b>	<b>\$ 19</b>	<b>\$ 21</b>

(1) Does not include depreciation expense.

(2) Based on accrual debt schedules.

(3) Primarily interest income that reduces power costs.

(4) Non-GAAP, may not be comparable with other similarly titled District metrics.

(5) Net power delivered as a percentage of rated capacity for the year.

(6) Annual average Columbia River flow measured at Rocky Reach System in thousands of cubic feet per second (000 CFS).

(7) 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 as if the Bond Coverage Ratio requirement under the Master Resolution had been in effect for the fiscal years 2006 through 2010.

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

	2006 <sup>(1)</sup>	2007 <sup>(1)</sup>	2008	2009	2010
<b>Operating Revenues</b> <sup>(2)</sup>					
Retail <sup>(3)</sup>	\$ 46,025	\$ 47,145	\$ 50,671	\$ 56,572	\$ 54,989
Resale <sup>(4)</sup>	101,846	113,314	105,347	75,891	87,702
Other	16,909	18,130	20,172	17,555	18,088
Total	164,780	178,589	176,190	150,018	160,779
<b>Less: Operating Expenses</b>					
Purchased power and water	(84,279)	(89,941)	(104,720)	(95,200)	(104,265)
Other operation & maintenance	(45,916)	(45,331)	(48,154)	(45,018)	(44,730)
Taxes	(4,099)	(4,260)	(4,497)	(5,021)	(4,653)
Depreciation & amortization	(17,372)	(17,714)	(17,685)	(18,449)	(20,804)
<b>Operating Income (Loss)</b>	13,114	21,343	1,134	(13,670)	(13,673)
<b>Adjustments</b> <sup>(5)</sup>					
Add back depreciation & amortization	17,372	17,714	17,685	18,449	20,804
Add investment income	14,107	17,915	14,659	8,191	5,405
Add principal and interest payments from Rocky Reach & Rock Island	44,526	44,734	48,870	47,247	51,003
Less investment earnings credited to Rocky Reach & Rock Island <sup>(6)</sup>	(3,498)	(4,120)	(3,438)	(1,102)	(1,171)
Total Adjustments	72,507	76,243	77,776	72,785	76,041
<b>Net Revenues</b> <sup>(7)</sup>	85,621	97,586	78,910	59,115	62,368
Plus withdrawals(deposits) to Rate Stabilization Fund	-	-	-	-	-
<b>Adjusted Net Revenues</b>	85,621	97,586	78,910	59,115	62,368
<b>Available Funds</b> <sup>(8)</sup>	190,430	128,467	172,832	159,605	151,781
<b>Annual Debt Service</b>					
Senior Consolidated System Bonds	47,785	45,836	39,451	31,084	28,817
Bonds	-	915	7,893	10,903	13,237
Total Debt Service	\$ 47,785	\$ 46,751	\$ 47,344	\$ 41,951	\$ 42,054
<b>Debt Service Coverage</b>					
With available funds (min. 1.25x)	5.78	4.84	5.32	5.21	5.09
Without available funds (min. 1.00x)	1.79	2.09	1.67	1.41	1.48

- (1) 2006 and 2007 are in some cases restated to reflect clarification to the definitions under the Master Resolution.
- (2) Includes revenues of the District's Distribution Division, Treasury Services and Internal Service Funds, and Lake Chelan, Fiber-Optics, 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 and Fiber-Optic System.
- (5) As determined pursuant to the definition of Revenues in the Master Resolution.
- (6) 2006 and 2007 have been restated to include investment earnings credited 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. The definition has been revised in the Master Resolution to be more restrictive.

## District Near-Term Financial Outlook; 2010 Strategic Plan

### *Power Sales Revenues*

Power from the Rock Island and Rocky Reach Systems not needed for the District's own retail load currently is sold:

(i) on a cost-of-service basis pursuant to existing long-term contracts with a number of investor-owned utilities, another public utility district and a large industrial purchaser, which contracts expire on October 31, 2011 with respect to the Rocky Reach Project and on June 7, 2012 with respect to the Rock Island Project;

(ii) beginning on November 1, 2011 with respect to the Rocky Reach Project and on July 1, 2012 with respect to the Rock Island Project, on a cost-of-service "plus" basis under new long-term contracts with an investor-owned utility, another public utility district and a large industrial purchaser;

(iii) under relatively recent fixed-price contracts, each for a fixed percentage of output with purchasers selected through an auction process and which have staggered terms of up to five years;

(iv) under relatively recent fixed-price contracts, each for a fixed amount of output with purchasers selected through an auction process and which have staggered terms of up to five years; and

(v) as short-term surplus power at market prices in the wholesale market.

The sales of surplus power generate substantial revenues for the District's Consolidated System, providing 35% of annual Distribution Division revenues in 2010 and 32% of annual Distribution Division revenues in 2009.

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 implemented contingency plans, including deferral of some capital projects and the reduction of planned operation and maintenance expenses. In addition, the District implemented a temporary 9% electric rate surcharge, effective May 1, 2009 through the end of 2011. See "THE CONSOLIDATED SYSTEM—Electric Rates."

The District's financial results for the six months ended June 30, 2011 have improved compared to the same period in 2010. Significant increases in power generation at the Hydro-Electric Projects, due primarily to improved snow pack and stream flows, resulted in decreased purchases of energy on the wholesale market and increased revenues from sales on the wholesale energy market of energy in excess of the District's load requirement. The increase in sales volume was partially offset by lower than average sales prices as compared to prices for the same period in 2010. The District's continued cost containment efforts also contributed to improvements in earnings. See APPENDIX B – UNAUDITED FINANCIAL DATA OF THE DISTRICT FOR THE SIX MONTHS ENDED JUNE 30, 2011.

If the conditions adversely affecting the District's revenues (including below-average river flows, depressed wholesale energy prices and/or reduced interest income on investments) return in future fiscal years, the District may re-impose an electric rate surcharge or take other rate action to maintain the health of the District's finances. For a discussion of projected runoff for the Columbia River, see "DEVELOPMENTS AFFECTING THE ELECTRIC UTILITY INDUSTRY—Recent Market Conditions."

The District currently anticipates significantly improved wholesale power sales revenues beginning in 2012 after the Current Power Sales Contracts have expired and the New PSE Contract and the New Alcoa Contract have gone into effect due to 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 Systems for sale as surplus power in the wholesale market (currently expected to increase from approximately 130 aMW under the Current Power Sales Contracts to approximately 330 aMW under the New Power Sales Contracts). See "THE CONSOLIDATED SYSTEM—New Puget Sound Energy Sales Contract" and "—New Alcoa Power Sales Contract" and APPENDIX I—"Summary of New Power Sales Contract with Puget Sound Energy, Inc." and APPENDIX J—"Summary of New Power Sales Contract with Alcoa, Inc." The power from the Rock Island and Rocky Reach Systems delivered under the New PSE Contract and the New Alcoa Contract will be sold on a cost-of-service "plus" basis to Puget Sound



Energy and Alcoa, and the balance of the power from the Rock Island and Rocky Reach Systems not needed for the District's own retail load may be sold as surplus power in the wholesale market. As of March 31, 2011, the District's financial model estimated net revenues from sales of surplus power in 2012 of between \$103.7 million and \$140.3 million, resulting in a range in change of net assets from an increase of \$55.9 million to an increase of \$92.5 million in 2012. These estimates have not changed substantially since March 2011, 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, 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."

### ***2010 Strategic Plan***

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 over the next several years (2010 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.

The District determines its debt ratio based on (i) total debt, divided by (ii) total debt plus net assets (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 2011C Bonds. The District may also retire some of its outstanding Senior Consolidated System Bonds and Subordinate Consolidated System Obligations ahead of their scheduled maturity dates. See Table 14, "Senior Consolidated System, Consolidated System, Subordinate Consolidated System and Hydro-Electric 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 Hydro-Electric Projects through at least 2015. 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 2011C 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 assets divided by the net utility plant (on a combined basis). The District's current annual target range for Rate of Return beginning in 2012 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" for 2011 through 2015 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 June 30, 2011, the District's "total liquidity" targets for 2011 through 2015 based on the liquidity requirements methodology were \$175 million, \$198 million, \$283 million, \$243 million and \$220 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 October 1, 2011, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit. 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, 2010.

Table 14 does not include \$107,500,000 aggregate principal amount of the District's Consolidated System Revenue Bonds, Refunding Series 2011A (AMT) and \$72,220,000 aggregate principal amount of the District's Consolidated System Revenue Bonds, Refunding Series 2011B (AMT) (collectively, the "2011A/B Bonds") that the District issued on June 1, 2011 to refund certain of the District's outstanding Senior Consolidated System Bonds or the defeasance of such Senior Consolidated System Bonds. See Footnote 8 to Table 14.

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**Table 14**  
**Senior Consolidated System, Consolidated System, Subordinate Consolidated System and**  
**Rock Island and Rocky Reach Hydro-Electric Systems**  
**Outstanding Long-Term Debt as of December 31, 2010**  
**(\$000)**

<b>Date of Bonds</b>	<b>Final Maturity Date <sup>(1)</sup></b>	<b>Series of</b>	<b>Original Principal Amount</b>	<b>Scheduled Retirement <sup>(2)</sup></b>	<b>Actual Retirement <sup>(3)</sup></b>	<b>Amount Outstanding</b>	<b>Accumulated for Retirement <sup>(4)</sup></b>
<b>SENIOR CONSOLIDATED SYSTEM</b>							
9/1/1998	7/1/2033	1998A <sup>(8)</sup>	\$ 28,050	\$ -	\$ -	\$ 28,050	\$ 1,470
9/1/1998	7/1/2033	1998B <sup>(10)</sup>	6,500	-	-	6,500	324
9/1/1998	7/1/2018	1998C <sup>(10)</sup>	1,230	955	955	275	53
3/1/2001	1/1/2036	2001A <sup>(8)</sup>	65,620	-	-	65,620	3,675
3/1/2001	1/1/2036	2001B <sup>(8)</sup>	78,375	-	-	78,375	4,298
5/1/2001	7/1/2032	2001C <sup>(8)</sup>	28,655	-	-	28,655	643
5/1/2001	6/1/2015	2001D <sup>(10)</sup>	15,755	8,470	8,470	7,285	693
12/12/2002	7/1/2037	2002A <sup>(9)</sup>	44,905	-	-	44,905	2,443
12/12/2002	7/1/2037	2002B <sup>(9)</sup>	35,000	-	-	35,000	1,834
12/12/2002	7/1/2033	2002C <sup>(9)</sup>	30,000	4,130	4,130	25,870	1,433
4/2/2003	7/1/2032	2003A <sup>(9)</sup>	29,440	-	-	29,440	619
4/29/2004	1/1/2039	2004A <sup>(9)</sup>	5,510	-	-	5,510	-
4/29/2004	7/1/2027	2004B <sup>(9)</sup>	42,510	15,630	15,630	26,880	-
4/29/2004	7/1/2024	2004C	15,000	-	-	15,000	-
4/29/2004	7/1/2020	2004E	20,120	-	-	20,120	-
4/5/2005	1/1/2039	2005A	25,430	-	-	25,430	-
4/5/2005	7/1/2012	2005B	8,590	6,150	6,150	2,440	-
<b>Total Senior Consolidated System</b>			<b>\$ 480,690</b>	<b>\$ 35,335</b>	<b>\$ 35,335</b>	<b>\$ 445,355</b>	<b>\$ 17,485</b>
<b>CONSOLIDATED SYSTEM</b>							
5/31/2007	7/1/2042	2007B <sup>(11)</sup>	\$ 8,370	\$ -	\$ -	\$ 8,370	\$ 429
5/31/2007	7/1/2037	2007C	25,590	1,265	1,265	24,325	1,270
2/28/2008	7/1/2024	2008A	47,075	2,095	2,095	44,980	2,455
3/7/2008	7/1/2032	2008B	92,880	1,910	1,910	90,970	3,537
8/11/2009	7/1/2019	2009C	6,545	490	490	6,055	247
8/11/2009	7/1/2039	2009D	27,015	-	-	27,015	1,840
<b>Total Consolidated System</b>			<b>\$ 207,475</b>	<b>\$ 5,760</b>	<b>\$ 5,760</b>	<b>\$ 201,715</b>	<b>\$ 9,778</b>
<b>SUBORDINATE CONSOLIDATED SYSTEM</b>							
11/13/2008	7/1/2013	2008A <sup>(5)</sup>	\$ 53,695	\$ -	\$ -	\$ 53,695	\$ -
7/22/2009	7/1/2014	2009A <sup>(7)</sup>	20,630	-	-	20,630	1,366
7/22/2009	7/1/2014	2009B <sup>(7)</sup>	8,340	-	-	8,340	531
<b>Total Subordinate Consolidated System</b>			<b>\$ 82,665</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 82,665</b>	<b>\$ 1,897</b>
<b>ROCK ISLAND SYSTEM</b>							
3/17/1997	6/1/2029	1997A <sup>(6)</sup>	\$ 135,944	\$ 37,150	\$ 37,150	\$ 262,082	\$ 30,263
12/4/2008	12/1/2011	2008A	8,290	5,385	5,385	2,905	316
8/11/2009	7/1/2034	2009A	14,000	305	305	13,695	621
<b>Total Rock Island System</b>			<b>\$ 158,234</b>	<b>\$ 42,840</b>	<b>\$ 42,840</b>	<b>\$ 278,682</b>	<b>\$ 31,200</b>
<b>ROCKY REACH SYSTEM</b>							
12/4/2008	7/1/2014	2008A	\$ 7,415	\$ 1,950	\$ 1,950	\$ 5,465	\$ 267
8/11/2009	7/1/2034	2009A	15,895	310	310	15,585	781
<b>Total Rocky Reach System</b>			<b>\$ 23,310</b>	<b>\$ 2,260</b>	<b>\$ 2,260</b>	<b>\$ 21,050</b>	<b>\$ 1,084</b>
<b>Grand Total</b>			<b>\$ 952,374</b>	<b>\$ 86,195</b>	<b>\$ 86,195</b>	<b>\$ 1,029,467</b>	<b>\$ 61,408</b>

- (1) Portions of the Senior Consolidated System Bonds of each series are subject to mandatory tender for purchase at various intervals upon the expiration of the current Fixed-Term Interest Rate Periods, which vary from one year to more than 30 years. The District may or may not choose to remarket such Senior Consolidated System Bonds in new Interest Rate Periods at such times.
- (2) Amount of serial bonds matured as of December 31, 2010 plus scheduled minimum redemption of term bonds to have been retired from mandatory sinking funds.
- (3) Amount of serial bonds matured as of December 31, 2010 plus actual retirement of term bonds retired from mandatory sinking funds, reserve accounts and optional purchases.
- (4) 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.
- (5) Represents Subordinate Consolidated System Obligations that mature in whole on July 1, 2013 with semi-annual interest payments. These Subordinate Consolidated System Obligations are not subject to redemption prior to maturity.
- (6) 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.
- (7) 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.
- (8) These Senior Consolidated System Bonds were refunded on June 1, 2011 with proceeds of the 2011A/B Bonds.
- (9) The District expects to refund these Senior Consolidated System Bonds in whole or in part with proceeds of the 2011C Bonds.
- (10) These Senior Consolidated System Bonds have been called for redemption on November 1, 2011.
- (11) Represents Bonds that mature in whole on July 1, 2042.

The financing agreements with respect to Hydro-Electric System loans must include a 15% cover component with respect to the interest coming due on such loans in any fiscal year. The initial 15% cover component payment is retained by the District and carried forward from year to year on a “rolling” basis, rather than being paid in every year. The cover component is to remain in the Consolidated System as long as the related bonds are Outstanding or the financing agreements are in place. In addition, the loan payments must include a “replacement payment” calculated to equal the amounts that would be required to amortize the total principal amount of such loans over the estimated weighted average useful life of the repairs, replacements, additions and improvements financed from the proceeds of the loan. See “SECURITY FOR THE 2011C BONDS—Loan Resolutions and Financing Agreements” and APPENDIX E —“Summary of Certain Provisions of the Loan Resolutions and Financing Agreements.”

## **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-Optics System are all accounted for separately. Proceeds of the Senior Consolidated System Bonds, the Bonds and the Subordinate Consolidated System Obligations have been advanced to separate systems 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 and the repayment of those interfund loans by such Systems to the Consolidated System. Each loan to the Hydro-Electric Systems is repaid through periodic principal and interest payments made from such Systems to the Consolidated System. The principal component of each loan payment is deposited into a special fund of the District with respect to the respective Hydro-Electric System to which such loan was made. These amounts are available to be re-loaned to such Hydro-Electric System to finance such System’s capital programs. See APPENDIX E—“Summary of Certain Provisions of the Loan Resolutions and Financing Agreements” for a description of the loan resolutions.

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 Systems to pay operation and maintenance expenses and debt service on revenue bonds issued by such Systems. The loan payments made by the Hydro-Electric Systems to the Consolidated System are part of the total costs of those Systems payable by the respective purchasers of power from the Hydro-Electric Systems, including the District’s Distribution Division. The payments made by the Consolidated System’s Distribution Division to the respective Hydro-Electric 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 2011C 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 below presents a summary of the outstanding intersystem loans as of December 31, 2010 to the Rocky Reach and Rock Island Systems and the interfund loans to funds and components of the Consolidated System.

**Table 15**  
**Consolidated System Loans**  
**as of December 31, 2010**  
**(\$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	\$ 297,420	\$ (31,269)	\$ 266,151
Rock Island System	213,748	(29,601)	184,147
Consolidated System <sup>(3)</sup>	<u>218,567</u>	<u>(22,895)</u>	<u>195,672</u>
<b>Total</b>	<u><u>\$ 729,735</u></u>	<u><u>\$ (83,765)</u></u>	<u><u>\$ 645,970</u></u>

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

(2) 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.

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

#### **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, 2010. Table 16 does not reflect adjustments to aggregate annual debt service resulting from the issuance of the 2011A/B Bonds, the refunding of certain Senior Consolidated System Bonds with proceeds of the 2011A/B Bonds, mandatory sinking fund redemptions, optional redemptions and retirements at maturity prior to the issuance of the 2011C Bonds of certain outstanding Senior Consolidated System Bonds, mandatory sinking fund redemptions and retirements at maturity prior to the issuance of the 2011C Bonds of certain outstanding Bonds, or mandatory sinking fund redemptions and retirements at maturity prior to the issuance of the 2011C Bonds of certain outstanding Rocky Reach Bonds, Rock Island Bonds and Prior Rock Island Bonds.

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 Hydro-Electric Systems from the Consolidated System as of December 31, 2010. See “—Intersystem Loans” under this heading. The total amount of such loan payments through 2042 is equal to 78% 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 Hydro-Electric Systems from payments received from the respective purchasers of power from those Systems, including the District’s Distribution Division. The Current Power Sales Contracts pursuant to which such loan payments currently are made by the power purchasers expire in 2011 and 2012, respectively; however, a similar payment obligation continues under both the New PSE Contract and the New Alcoa Contract, and is expected to be included in any future such contracts with other parties. See “THE CONSOLIDATED SYSTEM—New Puget Sound Energy Sales Contract” and “—New Alcoa Power Sales Contract.”

**Table 16**  
**Senior Consolidated System, Consolidated System and Subordinate Consolidated System Debt Service and**  
**Rocky Reach and Rock Island Hydro-Electric System Loan Payments**  
**as of December 31, 2010**

Year	Senior Consolidated System Bonds, Bonds and Subordinate Consolidated System Obligations			Hydro-Electric System Annual Loan Payments <sup>(3)</sup>		
	Aggregate Annual Debt Service			Rocky Reach	Rock Island	Total Loan Payments
	Principal <sup>(2)</sup>	Interest <sup>(1)</sup>	Total			
2011	8,675,000	36,113,071	44,788,071	32,236,453	18,889,936	51,126,389
2012	7,200,000	36,854,758	44,054,758	33,011,104	19,121,957	52,133,061
2013	59,940,000	36,525,714	96,465,714	32,604,883	19,767,585	52,372,468
2014	72,977,154	33,567,700	106,544,854	33,455,242	20,362,154	53,817,396
2015	6,180,518	29,681,648	35,862,166	34,372,348	20,307,141	54,679,489
2016	5,035,000	29,395,786	34,430,786	34,860,080	18,362,433	53,222,513
2017	22,205,000	28,794,753	50,999,753	34,613,453	17,888,425	52,501,878
2018	22,787,298	28,178,838	50,966,136	28,585,983	16,532,602	45,118,585
2019	5,597,400	27,008,826	32,606,226	26,938,432	16,456,447	43,394,879
2020	26,285,000	26,725,429	53,010,429	26,324,820	16,801,784	43,126,604
2021	6,510,000	25,423,749	31,933,749	25,173,215	16,290,381	41,463,596
2022	6,875,000	25,111,437	31,986,437	25,667,078	16,296,210	41,963,288
2023	7,275,000	24,781,732	32,056,732	26,184,333	16,558,105	42,742,438
2024	6,524,019	24,427,995	30,952,014	26,721,312	16,829,379	43,550,691
2025	6,090,000	24,054,717	30,144,717	25,745,283	16,488,989	42,234,272
2026	5,670,000	23,789,502	29,459,502	24,237,294	16,692,213	40,929,507
2027	4,785,000	23,550,895	28,335,895	23,234,801	16,902,650	40,137,451
2028	5,310,000	23,308,321	28,618,321	21,992,799	16,627,279	38,620,078
2029	3,855,000	23,098,806	26,953,806	21,075,323	15,347,210	36,422,533
2030	4,035,000	22,915,571	26,950,571	20,042,712	15,362,307	35,405,019
2031	4,235,000	22,721,555	26,956,555	19,484,963	15,392,467	34,877,430
2032	102,794,632	21,561,206	124,355,838	17,015,339	14,969,443	31,984,782
2033	35,961,261	16,991,071	52,952,332	14,872,368	10,577,724	25,450,092
2034	2,930,000	14,969,974	17,899,974	12,298,271	9,546,005	21,844,276
2035	3,065,000	14,839,725	17,904,725	10,757,500	9,356,849	20,114,349
2036	139,217,030	10,716,989	149,934,019	7,393,951	6,765,489	14,159,440
2037	77,721,204	6,588,475	84,309,679	4,015,498	4,865,374	8,880,872
2038	1,905,000	2,155,176	4,060,176	1,470,988	2,972,898	4,443,886
2039	31,134,940	1,272,116	32,407,056	738,316	1,681,502	2,419,818
2040	-	385,020	385,020	-	476,270	476,270
2041	-	385,020	385,020	-	434,839	434,839
2042	7,951,826	385,020	8,336,846	-	385,020	385,020
Total	700,727,282	666,280,595	1,367,007,877	645,124,142	425,309,067	1,070,433,209

- (1) Interest is shown net of the federal subsidy to be received by the District in connection with its Consolidated System Revenue Bonds, Series 2009D Taxable *Build America Bonds* (Direct Payment).
- (2) Includes serial and balloon payments reduced by funds held in Reserve Accounts at the time of final maturity. The District may elect to utilize the Reserve Accounts other than shown depending on market conditions and limitations contained in the governing resolution. The District anticipates that most balloon payments will be refinanced on or prior to the dates they become due.
- (3) Represents loan payment obligations of the Rocky Reach and Rock Island Hydro-Electric Systems to the Consolidated System with respect to intersystem loans from the Consolidated System and excludes intersystem loans from other District Systems.

### Capital Requirements

The District has prepared projections of the capital requirements for the five-year period 2011 through 2015. These projections are in accordance with the District's best estimates and long-range planning by the District staff.

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 Hydro-Electric Systems**  
**Projected Capital Requirements**  
**(\$000)**

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Distribution Division	\$ 11,207	\$ 23,797	\$ 14,272	\$ 14,127	\$ 18,789
Networks Fiber Optics System	4,460	3,000	2,775	2,554	2,336
Water/Wastewater Systems	1,840	4,208	3,795	6,021	1,727
Internal Service System	3,913	8,064	12,839	9,507	2,709
Rocky Reach System <sup>(1)</sup>	10,952	7,251	14,500	14,059	16,280
Rock Island System <sup>(2)</sup>	22,039	8,273	9,367	13,412	21,195
Lake Chelan Project <sup>(1)</sup>	275	180	547	2,027	2,028
<b>Total Capital Requirements</b>	<b>\$ 54,686</b>	<b>\$ 54,773</b>	<b>\$ 58,095</b>	<b>\$ 61,707</b>	<b>\$ 65,064</b>

(1) Includes capital requirements for license implementation related expenses, which may vary significantly.

(2) Includes estimates for modernization.

A major portion of the projected 2011 capital requirements for the Rock Island System relates to a multi-year modernization project at Powerhouse No. 1, which is expected to be completed in 2012. 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 received new turbines, generators, governors and controls. Work on the second unit is scheduled to be completed in spring of 2012. The new units are expected to have improved efficiencies of about 10% and the turbines are safer for fish passage. Four additional units will receive new stators, and rotors and turbine components will be repaired or refurbished on site as necessary. Work on the four units is expected to be completed by the end of 2012. Efficiency improvement of the new stators is expected to be about 1.0%. The turbines are expected to last another 20 years with minor repairs and routine maintenance.

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 Hydro-Electric Systems**  
**Projected Sources of Funds**  
**(\$000)**

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Proceeds of New Bond Issues	\$ -	\$ -	\$ -	\$ -	\$ -
Other Available Funds <sup>(1)</sup>	54,686	54,773	58,095	61,707	65,064
<b>Total</b>	<b>\$ 54,686</b>	<b>\$ 54,773</b>	<b>\$ 58,095</b>	<b>\$ 61,707</b>	<b>\$ 65,064</b>

(1) Includes other internal funds such as unspent proceeds of prior bond issues, contributions in aid of construction, revenue fund cash and intersystem loan obligations. Also includes loan and power contract obligation payments made by the Power Purchasers and the District's Distribution Division and available for subsequent capital expenses of the Hydroelectric 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 New 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 December 31, 2010. As of June 30, 2011, the total unaudited fund balances for the Consolidated System were \$304 million.

**Table 19**  
**Consolidated System**  
**Unrestricted and Restricted Fund Balances**  
**(\$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>
<b>December 31, 2010 Balances:</b>					
<sup>(1)</sup>					
Unrestricted Funds					
Revenue Fund <sup>(4)</sup>	\$ 10,540	\$ 3,293	\$ -	\$ 8,287	\$ 22,120
Available Funds:					
Rate Stabilization Fund	50,000	-	-	-	50,000
Operating Reserve Fund	57,915	-	-	-	57,915
Contingency Reserve Fund	9,950	-	-	-	9,950
Other Unrestricted Funds: <sup>(5)</sup>	25,903	7,892	-	9,929	43,724
<b>Total Unrestricted Funds</b>	<b>154,308</b>	<b>11,185</b>	<b>-</b>	<b>18,216</b>	<b>183,709</b>
Restricted Funds <sup>(6)</sup>	45,750	2,397	81,841	5,303	135,291
<b>Total Fund Balances</b>	<b>\$ 200,058</b>	<b>\$ 13,582</b>	<b>\$ 81,841</b>	<b>\$ 23,519</b>	<b>\$ 319,000</b>

(1) Amounts reflect both cash and book value of investments.

(2) Includes Distribution Division, Fiber-Optics, Water and Wastewater Systems and Treasury Services Fund.

(3) Financing facilities refers to debt service reserve funds associated with the District's Senior Consolidated System Bonds, Bonds and Subordinate Consolidated System Obligations.

(4) Unencumbered funds of the District held in the Revenue Fund.

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

(6) Includes all Restricted Funds such as Bond Proceeds and Reserves.

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 2011C 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 2011C 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—District Near-Term Financial Outlook; 2010 Strategic Plan.”

On April 1, 2011, the District and Bank of America entered into 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. As of October 1, 2011, the District has not drawn on the Credit Agreement or requested the issuance of any letters of credit. See “FINANCIAL INFORMATION-District Near-Term Financial Outlook; 2010 Strategic Plan.”

As part of its 2010 Strategic Plan, the District has adopted total liquidity targets for 2011 through 2015. As of June 30, 2011, the District’s targets for available total liquidity for the years ended December 31, 2011, 2012, 2013, 2014 and 2015 were \$175 million, \$198 million, \$283 million, \$243 million and \$220 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 November 15, 2010. 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 FASB ASC 980, "Regulated Operations", 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 assets 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 \$23.3 million and \$6.1 million as of December 31, 2010 and 2009, respectively.

**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 2010, the District recorded deferrals of contributed capital in the amount of \$2.3 million. There were no deferrals in 2009.

**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 2010, the District has not recorded any regulatory deferrals of conservation program expenditures.

### **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.

**2008B Payment Agreements.** On August 3, 2005, the District competitively bid and executed two interest rate swap payment agreements with respect to the 2008B Bonds (the “2008B Payment Agreements”), one of which was terminated and replaced on October 17, 2008. On March 11, 2011, the District terminated the remaining 2008B Payment Agreements.

**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 September 30, 2011, Assured was rated Aa3 and AA+ by Moody’s and S&P, respectively. Assured is not rated by Fitch. Due to uncertainty in the financial markets, 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 2009 Swapped 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.

**2011 Payment Agreement.** On April 13, 2006, the District competitively bid and executed an interest rate swap payment agreement (the “2011 Payment Agreement”) pursuant to which the District was to receive payments from the counterparty at a variable rate with respect to a portion of variable rate Bonds expected to be issued by the District in 2011, and the District was to pay to the counterparty a fixed rate. On May 19, 2011, the District terminated the 2011 Payment Agreement. The District funded the termination payment with available funds of the District.

**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 District’s refunding Bonds expected to be issued in 2013. 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 September 30, 2011.

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

<u>Associated Bonds</u>	<u>Effective Date</u>	<u>Initial Notional Amount</u>	<u>Counterparty/Guarantor</u>	<u>Counterparty Credit Ratings (Moody's/S&amp;P)<sup>(1)</sup></u>	<u>District Receives</u>	<u>District Pays</u>	<u>Mark to Market Value<sup>(2)</sup></u>	<u>Expiration Date</u>
<b>2009 Bonds</b>	June 1, 2009	\$30,355,000	JPMorgan Chase Bank, N.A.	Aa1/AA-	70% of BBA LIBOR	4.031%	(\$11,907,902)	July 1, 2034
<b>2009 Bonds</b>	July 22, 2010	\$30,355,000	The Bank of New York Mellon	Aaa/AA	1.760%	70% of BBA LIBOR	\$1,157,676	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.	Aa1/AAA	70% of BBA LIBOR	4.085%	(\$9,049,101)	July 1, 2032
TOTAL		\$167,900,000						

(1) As of September 30, 2011.

(2) As of September 30, 2011.

## **AGREEMENTS, PROCEEDINGS AND LAWS AFFECTING THE HYDRO-ELECTRIC PROJECTS**

### **Coordination Agreements**

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

On January 17, 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 for the duration of the Canadian Treaty as a result of the coordinated use of the improved streamflow in the Columbia River created by storage projects constructed in Canada pursuant to the terms of the Canadian Treaty (the “Canadian Entitlement”). See “THE CONSOLIDATED SYSTEM—Consolidated System Energy Resources.”

A portion of the Canadian Entitlement may be disposed of within the United States, subject to authorization by Canada and the United States. By an exchange of notes dated September 16, 1964, Canada and the United States authorized the sale of the Canadian Entitlement within the United States pursuant to the Canadian Treaty; such sale (the “Entitlement Sale”) was accomplished by the Canadian Entitlement Purchase Agreement, which expired in stages on March 31, 1998, March 31, 1999, and March 31, 2003. Under the Canadian Entitlement Allocation Agreements, which expired March 31, 2003, the District agreed to make available to Bonneville the share of the Entitlement Sale that had been allocated to the Rocky Reach and Rock Island Systems. An Extension Agreement, signed in 1997, established the parameters for determining the District’s obligations to return energy to Canada, via Bonneville, beginning with the expiration dates set forth above and continuing until September 15, 2024. 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 recently 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. Even if the Canadian Treaty is not terminated, there will be changes regarding flood control planning on the Columbia River. The District cannot predict what requirements may be agreed to for the period after 2024. The District’s current obligations are 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.

#### ***1997 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. On September 15, 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 to achieve economies and additional firm power resources for the Pacific Northwest while taking into account non-power uses for water resources so that the water resources are managed for maximum sustained benefit for the public good.

The 1964 PNCA became effective on January 4, 1965, and expired on July 31, 2003. A renewed PNCA (the “1997 PNCA”) became effective August 1, 2003 and continues until July 31, 2024. All regulatory approvals have been received. The 1997 PNCA serves as a settlement agreement for upstream benefit payments due the federal government under the FPA. It also serves as a settlement for payments to and from non-federal parties due to operation of upstream and downstream projects.

### ***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 terminating 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**

The District operates each of its Hydro-Electric Projects under separate long-term licenses from FERC. *See* “THE CONSOLIDATED SYSTEM—Federal Energy Regulatory Commission License Status” 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 new license measures for both Projects. A long-term license for the Rock Island Project was issued by FERC in January 1989 and expires in December 2028.

#### ***General***

The Endangered Species Act (“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”) or the U.S. Fish and Wildlife services (“USFWS”) is not an ESA violation. In 1982, Congress amended the ESA to allow for the incidental take of listed species. 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 takes “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 (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 which 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 is defined in the ESA as "(i) the specific areas within the geographic area occupied by the species . . . on which are found those physical or biological features (I) essential to the conservation of the species and (II) specific areas outside the geographical area occupied by the species . . . upon a determination by the Secretary . . . that such areas are essential for the conservation of the species." 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, based on new listings or information and pursuant to specific provisions set forth in the ESA and its implementing regulations, result in federal agencies taking action that triggers a duty to consult 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 within the vicinity of the Rocky Reach and Rock Island Projects are discussed below, as are other selected species.

**Steelhead—Upper Columbia DPS.** On August 18, 1997, NMFS published notice listing 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 pursuant to a U.S. District Court decision. In June 2009, the Upper Columbia Steelhead DPS was again reclassified as threatened, pursuant to a subsequent U.S. District Court decision. The DPS includes all naturally spawned anadromous *O. mykiss* (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 six artificial propagation programs: the Wenatchee River, Wells Hatchery (in the Methow and Okanogan Rivers), Winthrop National Fish Hatchery, Omak Creek, and the Ringold steelhead hatchery programs.

On July 26, 2011, NMFS issued the 5-year status review findings and concluded that the Upper Columbia River steelhead DPS should remain listed as threatened.

The District's Rocky Reach and Rock Island Projects lie within the Upper Columbia River DPS. On September 2, 2005, NMFS designated critical habitat for the entire Upper Columbia, including the Columbia River mainstem and tributaries, which includes the 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.** On March 25, 1999, NMFS published notice listing the Middle Columbia River Steelhead DPS as threatened under the ESA, which was reaffirmed by NMFS on January 5, 2006. This DPS includes all naturally-spawned anadromous *O. mykiss* (steelhead) populations below natural and manmade 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 *O. mykiss* from the Snake River Basin, as well seven artificial propagation programs: the Touchet River Endemic, Yakima River Kelt Reconditioning Program (in Satus Creek, Toppenish Creek, Naches River, and Upper Yakima River), Umatilla River, and the Deschutes River steelhead hatchery programs.

The District's Rocky Reach and Rock Island Projects lie upstream of the Middle Columbia River Steelhead DPS. On September 2, 2005, NMFS designated critical habitat for the Middle Columbia River Steelhead DPS.

**Spring Chinook—Upper Columbia ESU.** On March 24, 1999, NMFS published notice listing the Upper Columbia River Spring Run Chinook Salmon Evolutionarily Significant Unit ("ESU") as an endangered species under the ESA. The 1999 rule notice listed only naturally spawning populations of this ESU. On June 28, 2005, NMFS published the final rule to reaffirm the ESU's endangered status and include certain artificially

propagated fish (i.e., hatchery origin fish) in the listed ESU. This ESU includes all 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: the Twisp River, Chewuch River, Methow Composite, Winthrop National Fish Hatchery, Chiwawa River, and White River spring-run Chinook hatchery programs. On September 2, 2005, NMFS designated critical habitat for the Upper Columbia Spring Chinook ESU.

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.

**Bull Trout—Columbia Basin DPS.** The USFWS issued a final rule listing the bull trout in all DPSs as threatened on November 1, 1999. The USFWS considers the Columbia River population as one of five DPS (i.e., they meet the joint policy of the USFWS and NOAA Fisheries regarding the recognition of distinct vertebrate populations). The Upper Columbia segment of the Columbia Basin DPS is defined as encompassing the basin upstream of the confluence of the Yakima River to Chief Joseph Dam, including the mainstem Columbia River and all of its associated tributaries. This geographic area is referred to as the Upper Columbia Recovery Unit in the Bull Trout Draft Recovery Plan. Bull trout in the Upper Columbia constitute one portion of the total Columbia River population. On September 26, 2005, the USFWS issued a Critical Habitat designation, but declined to designate critical habitat in the Upper Columbia Basin. The Court on July 1, 2009 ordered USFWS to re-analyze Critical Habitat and produce a final Critical Habitat designation by September 30, 2010. USFWS issued a proposed rule to revise the Critical Habitat designation on January 14, 2010 (75 Fed. Reg. 2269) and a final rule revising Critical Habitat on October 17, 2010 (75 Fed. Reg. 63,898). The revised 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, delistings or critical habitat designations for listed species. For instance, on May 26, 2004, several environmental organizations filed suit in the U.S. District Court of Oregon against the USFWS seeking action on their petition to list four separate species of lamprey, one of which was Pacific lamprey, under the ESA. Pacific lamprey do pass Rock Island and Rocky Reach Projects. On December 22, 2004, the USFWS announced that a petition to list four species of lamprey did not contain sufficient information to warrant further review at that time. The USFWS currently notes the Pacific lamprey as a “species of concern” and, on April 29, 2010, released a document titled “Best Management Practices to Minimize Adverse Effects to Pacific Lamprey.” As another example, in 1999, a proposed rule to list the southwestern Washington/lower Columbia River DPS of coastal cutthroat trout as threatened was jointly published by NMFS and USFWS. USFWS withdrew the listing proposal in 2002. That decision was ultimately overturned in federal court, and the USFWS was required to revisit the decision. On March 24, 2009, the USFWS reopened the public comment period on the proposal to list the coastal cutthroat trout as a threatened species. On February 25, 2010 the USFWS published a decision, once again withdrawing the previous proposal to list. USFWS currently considers the Washington/lower Columbia River DPS of coastal cutthroat trout a “species of concern.” The District cannot predict whether species, such as the Pacific lamprey or the coastal cutthroat trout, will be re-petitioned for listing under the ESA in the future.

#### ***Ramifications of Listings and Critical Habitat Designations to Rocky Reach and Rock Island Projects***

As a result of the listings under the ESA, minimization and mitigation measures may be required by the Services to address potential effects of the Hydro-Electric Projects’ operations on the listed species or their habitat. These measures could alter the operations of the Rock Island and the Rocky Reach Projects and could result in further and possibly substantial reductions in power generation at the Hydro-Electric Projects, and thereby increase 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 in “Rocky Reach and Rock Island Anadromous Fish Agreements and Habitat Conservation Plans” and “Bull Trout.”



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

In late 1994, the Mid-Columbia PUDs initiated discussions with the Services and Washington Department of Fish and Wildlife (“WDFW”) to develop a Mid-Columbia Habitat Conservation Plan (“MCHCP”) 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 MCHCP to the parties in May 1996.

The District, along with Douglas PUD, the Services, WDFW and the Colville and Yakama tribes, 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” will be achieved on a specified schedule and maintained for the duration of the agreements for each Plan Species affected by the projects. No Net Impact 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.

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

On June 21, 2004, FERC issued an Order amending the operating licenses for the Rocky Reach and Rock Island Projects to incorporate the terms of the HCPs. On November 23, 2004, FERC issued a final Order, which addressed the corrections and clarifications requested by the District.

The District is currently engaged in full implementation of the programs outlined in the HCPs. Committees formed pursuant to the terms of the HCPs have been established, including the Coordinating, Hatchery and Tributary Committees. These committees include representatives from the parties who were signatories to the HCPs.

The Coordinating Committees are the primary means of consultation and coordination between the District and the other signatories in connection with the conduct of in-season operations, studies and implementation of the measures set forth in the HCPs to benefit the Plan Species. They have the authority to oversee all aspects of study standards and methodologies, and implementation of measures intended to benefit survival of the Plan Species. They are also responsible for preparing annual progress reports, ensuring timely circulation of studies and reports prepared pursuant to the agreements, and approval and implementation of the survival standards established in the Passage Survival Plans for each project. The Hatchery Committees are responsible for overseeing development of recommendations for implementing the hatchery elements of the HCPs, including improvements, monitoring, and evaluation, as identified in the Hatchery Compensation Plans. The Tributary Committees are charged with implementing the Tributary Conservation Plans of the HCPs by selecting tributary habitat improvement projects and approving project budgets.

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

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 parties including the District, NMFS, and USFWS. 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.

Regarding hatchery-specific (i.e., site-specific) consultations, in 2003, NMFS issued separate biological opinions evaluating the issuance under ESA section 10 of Permit 1196 for the Upper Columbia River spring Chinook hatchery program and Permit 1395 for the Upper Columbia River steelhead hatchery program. In 2004, NMFS re-consulted regarding the Upper Columbia River spring Chinook program to evaluate proposed amendments to Permit 1196. Collectively, these consultations concluded that the specific hatchery activities authorized by Permits 1196 and 1395, which also included programs administered by Douglas PUD and WDFW, were not likely to jeopardize listed salmon and steelhead species. As discussed further below, NMFS is currently considering, in a Section 7 consultation, the issuance of new permits for the District's HCP-related hatchery programs for Upper Columbia River spring Chinook and Upper Columbia River steelhead.

In 2004, USFWS consulted regarding FERC's incorporation of the HCPs as amendments into the Hydro-Electric Project licenses. In its biological opinion, USFWS concluded that implementation of the HCPs was not likely to jeopardize bull trout or destroy or adversely modify proposed bull trout critical habitat. However, USFWS was clear that future HCP-related hatchery actions would require additional ESA consultation at a site specific level. In 2008, USFWS consulted with FERC regarding FERC's relicensing of the Rocky Reach Project, including continued implementation of the Rocky Reach HCP's hatchery programs. 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.

On September 12, 2008, NMFS announced that it intended to conduct new ESA consultations on federal and non-federal Columbia River basin hatchery programs, including the District's Chiwawa spring Chinook and Wenatchee steelhead programs. Although Permits 1196 and 1395 authorizing those programs were not set to expire until January 2014 and October 2013, respectively, NMFS felt that new information and hatchery policy documents might warrant modifications or refinement of those programs. In particular, NMFS cited a final ESA recovery plan, supporting Technical Recovery Team documents, a 2009 Hatchery Scientific Review Group (HSRG) report, the Federal Columbia River Power System's Supplemental Comprehensive Analysis, USFWS Hatchery Review Team findings, fitness studies, and other research results and life-cycle modeling information. NMFS asked hatchery program managers, including the District, to prepare new Hatchery and Genetic Management Plans (HGMPs) reflecting the new information and policies.

In coordination with the HCP Hatchery Committee, the District prepared updated HGMPs, which were approved by the Hatchery Committee on August 15, 2009, as required by the HCPs. The District subsequently provided copies of the approved HGMPs to NOAA Fisheries on August 21, 2009 and formally submitted the final HGMPs for NOAA Fisheries' review on October 15, 2009.

On March 24, 2010, NMFS issued a public notice in the Federal Register pursuant to ESA Section 10(c). That notice indicated that NMFS would evaluate the HGMPs as applications for new ESA Section 10(a)(1)(A) permits, review the associated documents and any comments received, and determine whether the HGMPs meet the requirements of ESA section 10(a)(1)(A). NMFS will engage in formal consultation, resulting in preparation of a biological opinion, to ensure that issuance of permits consistent with the HGMPs is not likely to jeopardize listed Upper Columbia River spring Chinook or Upper Columbia River steelhead or destroy or adversely modify their critical habitat. This consultation will be the most recent of the "site-specific" consultations contemplated in NMFS's 2003 HCP biological opinions and 2007 Rocky Reach relicensing biological opinion. NMFS will also initiate consultation with USFWS regarding the effects, if any, of the issuance of new HGMP Section 10(a)(1)(A) permits on bull trout. These regulatory processes will result in the issuance of new Section 10(a)(1)(A) with new terms and conditions, governing the operations of the District's Chiwawa spring Chinook and Wenatchee steelhead hatchery programs.

### ***HCP Phase I Implementation***

The District began early implementation by performing survival studies as required for one species under the Rock Island HCP in 2002 and 2003. From 2004 to 2007, survival studies on all four species were performed for both Rocky Reach and Rock Island HCPs. In 2006, the District met the 3-year study requirements with survival exceeding HCP levels of 93% juvenile survival for all three spring migrants (sockeye, steelhead and spring Chinook) at Rock Island. Since the three-year average survival exceeded 93% for these spring migrants, they are

now in Phase III Standard Achieved. Under Phase III, the District has satisfied a major component of the No Net Impact aspect of the HCPs.

From 2007 to 2010, the District tested new operations 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 required 93% survival standard. The HCP agreement recognizes the successful achievement of the survival standards by allowing a 10-year period in which no survival studies need occur provided that hydro plant operations remain consistent with operations used to achieve the standard and similar levels of effort are applied to the associated complementary survival management programs (pikeminnow removal and avian predation mitigation). No further studies are required by the HCP until 2020, when check-in survival studies are to be performed.

The District completed survival studies at the Rocky Reach Project for steelhead in 2006, for sockeye in 2009 and for spring Chinook in 2011. Steelhead and sockeye exceeded the 93% survival standard and spring Chinook exceeded the 91% combined adult and juvenile survival standard. All three spring migrant species are now in Phase III – Standards Achieved. The 10-year check-in studies are to be performed at Rocky Reach no later than 2021.

Currently the summer migrants (summer/fall subyearling Chinook) cannot be studied to assess projected survival using existing technologies due to the small size and number of the fish. As such, the HCP Coordinating Committee has designated subyearling Chinook for both the Rocky Reach and Rock Island Projects as Phase III Additional Juvenile Studies and has appropriately committed to continued monitoring of technological advances to address future survival study needs for subyearling Chinook. While the HCP requires the District to meet No Net Impact for all Plan Species by 2013, it also states that the inability to determine a survival standard because of technological limitations should not be seen as a failure to meet No Net Impact. The HCP provides for adaptive management pursuant to which all parties could agree to an alternative scheme that would still meet the goals of the HCP and thus continue to support the grounds on which NOAA Fisheries issued its permits. The HCP states that if the District is unable to achieve survival standards, the parties will work through the Coordinating Committees to jointly seek a solution. As part of the effort to gain more information on the subyearling Chinook as well as other species, the District partnered with Douglas PUD in 2010 to install a Passive Integrated Transponder tag system in the Rocky Reach juvenile fish bypass system. This installation will allow vital life history (migrations timing and traits) to be known and will assist the District with future planning efforts to study survival as technology advances in this field. The joint solution approach is consistent with the intent of the HCP for parties to work together to address issues that may arise so long as the District is working with the Coordinating Committee to address meeting survival standards. The solutions (i.e., structural modifications to bypass system or operations) would be tested and approved by HCP Coordinating Committee action.

### ***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 license 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, which were to be developed in collaboration with various federal and state agencies and relevant tribes. The District worked closely with USFWS to include measures for bull trout that USFWS deemed necessary to protect the continued existence of bull trout from adverse effects of continued operation of the Rock Island Project and the Rocky Reach Project in its Licensing Settlement Agreement. The bull trout management plans were completed in February 2005, and implementation began in May 2005. The management plan has been successfully implemented since approval by FERC in April 2005. Implementation of the bull trout management plans (monitoring & evaluation component) has shown no adverse effects to bull trout from the operation of Rocky Reach and Rock Island Projects. On December 8, 2008, the USFWS issued its Biological Opinion and Incidental Take Statement for the new Rocky Reach Project license, concluding that the Project is not likely to jeopardize the continued existence of bull trout. Critical habitat was not designated at that time. As noted above, however, USFWS issued a revised Critical Habitat designation on October 17, 2010, which includes the mainstem Columbia River, including the Rocky Reach and Rock Island reservoirs. As a result of this revised designation, FERC is required by the ESA consultation regulations to “reinitiate” ESA section 7 consultation for the Rocky Reach and Rock Island Projects to consider the impact of the projects on critical habitat. This reinitiation has

not yet occurred, but the District expects that USFWS and FERC will re-consult in due course. This is not unique to the District's Hydro-Electric Projects; USFWS is facing the same reinitiation requirement for every issued biological opinion where an ongoing activity may affect the newly designated critical habitat and ongoing federal discretion exists. Because there is no biological opinion for the Lake Chelan project, there is no reinitiation requirement. It is possible that USFWS will request that FERC enter into a new consultation for Lake Chelan to consider impacts to Critical Habitat, but it is not clear that FERC will agree to do so. Finally, the new critical habitat designation should be a subject of consultation when NMFS consults with USFWS regarding NMFS's issuance of new hatchery permits, as detailed herein. Each of the consultations and reinitiations described herein could result in the imposition of additional measures to minimize impacts to bull trout and its habitat.

### ***Hanford Reach Fall Chinook Protection Plan***

In 2004, the Hanford Reach Fall Chinook Protection Program was signed by the District, Grant PUD, Douglas PUD, the Bonneville Power Administration, the NMFS, the WDFW and the Confederated Tribes of the Colville Indian Reservation, and was signed at a later date by the USFWS and the Yakama Nation. This agreement established the obligations of the signatories with respect to the protection of fall Chinook in the Hanford Reach of the Columbia River, including the obligations of the Mid-Columbia PUDs under any new licenses issued by FERC. No signatories to the agreement may petition FERC directly or through WDOE, to modify any provisions of this agreement or request operations inconsistent with this agreement until ten years after the effective date of the agreement.

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

The federal hydropower system is comprised of federally owned dams and those federal agencies that operate, or market power from, the Federal Columbia River Hydropower System (the "FCRPS"), namely, Bonneville Power Administration, the U.S. Army Corps of Engineers and the U.S. Bureau of Reclamation (together, the "Action Agencies"). 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.

On March 2, 1995, NMFS issued a biological opinion to the FCRPS under the ESA concerning the effects of the FCRPS on listed Snake River salmon. On May 14, 1998, NMFS issued a supplemental biological opinion to the FCRPS concerning the effects of the FCRPS on listed Snake and Columbia River steelhead, as well as the effects of the juvenile transportation program and smolt monitoring program on listed Snake and Columbia River salmon and steelhead. On December 21, 2000, NMFS issued a biological opinion on the reinitiation of consultation on operations of the FCRPS, including the juvenile fish transportation program and 19 Bureau of Reclamation Projects in the Columbia Basin. Also on December 21, 2000, the USFWS issued a biological opinion on the effects of the FCRPS on bull trout, a threatened species, and Kootenai River white sturgeon. In June 2003, the federal district court for Oregon remanded the 2000 biological opinion to NMFS to resolve certain deficiencies. In a subsequent "minute order," the Judge denied plaintiffs' motion to vacate the biological opinion. On November 30, 2004, NMFS issued a new, 10-year biological opinion for FCRPS operations. Environmental groups challenged the November 30, 2004 biological opinion in the federal district court for Oregon. On April 9, 2007, the Ninth Circuit Court of Appeals affirmed the lower federal court's May 26, 2005 decision invalidating the 2004 biological opinion. The district court did not vacate the 2004 biological opinion but remanded the 2004 biological opinion to NMFS. That decision was again upheld on rehearing by the Ninth Circuit on April 24, 2008. NMFS subsequently issued a new 10-year biological opinion on May 5, 2008. Environmental groups filed a fifth amended complaint challenging the new biological opinion on September 12, 2008. The fifth amended complaint added a claim under Section 9 of the ESA and Section 401 of the Clean Water Act.

Judge Redden urged the newly-elected Obama Administration to review the 2008 biological opinion to ensure that it satisfied the ESA. In the fall of 2009, the new Administration reaffirmed the adequacy of the 2008 biological opinion as augmented by the "Adaptive Management Implementation Plan" ("AMIP"), which set forth additional monitoring, mitigation, and adaptive management requirements. But, because the AMIP was not part of the 2008 administrative record, the Court granted a request by NMFS for a voluntary remand to incorporate the AMIP into the 2008 record, and to ensure that the reissued biological opinion embraced the best available science. Pursuant to the Court's 2009 remand order, the Action Agencies reinitiated consultation pursuant to 50 C.F.R. 402.16 and released what has come to be known as the 2010 supplemental biological opinion. On July 2, 2011,

Judge Redden issued an Opinion and Order that concluded that the 2008 biological opinion, as supplemented by the 2010 biological opinion, did not violate the ESA, but remanded the biological opinion back to NMFS for reconsideration. The biological opinion remains in place until December 31, 2013. NMFS must produce a new biological opinion that corrects the opinion's reliance on mitigation measures that are not reasonably certain to occur.

Two of the most significant features of the biological opinions described above are the requirement for substantial Columbia River storage and flow pattern changes to assist migration of juvenile salmon and steelhead and the effect of water quality issues associated with water spilled for fish passage at the projects upstream. 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 could affect the amount of water the Rocky Reach and Rock Island Projects may spill to aid fish passage, increase the unit cost of power from these projects, require the Hydro-Electric Systems to replace the lost power from other higher-cost sources, and reduce Hydro-Electric System revenues from non-firm energy sales. The FCRPS currently operates under the terms of the 2008 biological opinion, as supplemented by the 2010 biological opinion, which was issued on May 20, 2010.

### ***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 fish and wildlife plan is implemented by Bonneville and other federal agencies responsible for managing, operating or regulating the federal or non-federal hydroelectric facilities located on the Columbia River or its tributaries, and is generally complied with by hydro-system operators, including the District. 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 outcome of these actions and other current and possible suits and proceedings arising from threatened and endangered species listings and critical habitat designations is likely to have some direct or indirect effect on operation of the Columbia River hydroelectric system including the operation of individual Hydro-Electric Projects. It is possible under the ESA 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. The District believes the imposition of such additional mitigation measures to be unlikely. The nature and extent of such actions and their impact on the District is uncertain at this time, but could be significant.

## 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 level. 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

The price of electricity in wholesale markets throughout the Western United States declined in the last half of 2010. Electric generation was down by 4.1% in 2009 reaching its lowest level since 2003 according to the EIA Electric Power Annual report. In 2009, the demand for industrial electricity fell 9.1% to the lowest level since 1987 accounting for most of the overall decline in electricity consumption. Wind power has been the fastest-growing source of new electric power generation for several years. In 2009, generation from wind power increased 33.5% over 2008. Many of these new wind generation projects have come on line in the Pacific Northwest adding to the supply side. The recent economic downturn has reduced the demand for electricity, and pricing continued to fall into 2010.

With below normal flows on the Columbia River during 2010, the District was able to meet all of its retail load requirements during that time from its own resources and a few purchases during low flow periods. 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 so far in 2011, the District was able to sell more surplus generation in 2011. According to the National Weather Service's Northwest River Forecast Center, which is a part of the National Oceanic and Atmospheric Agency ("NOAA"), the Columbia River at Grand Coulee (Jan-July 2011) was 125% of normal runoff.

Low natural gas prices, reduced demand for electricity and abundant hydro generation have contributed to the continued decline of wholesale prices in 2011. The District cannot predict future price movements.

## **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 the Bonneville Power Administration, 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 the Bonneville Power Administration in a PEFA transmission expansion project that impacts on the District's network. On March 24, 2008, the District signed ColumbiaGrid's Open Access Same Time Information System ("OASIS") agreement. OASIS is an Internet-based tool for posting standard rates and terms for providing transmission services. The goal of the OASIS agreement is to provide the PEFA parties a common set of protocols and practices for their OASIS and a common queue for transmission service requests across multiple transmission services providers.

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. Jurisdictional transmission planners must make compliance filings. At this time, ColumbiaGrid intends to file its existing, voluntary Planning and Expansion Functional Agreement for approval by FERC, although some changes may be necessary. The District continues to follow this issue for potential effects on regional processes and potential compliance requirements.

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

EPAAct 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 EPAAct 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 a full reliability internal compliance program. The program and staff are in operations, but 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. On January 19, 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 Officer is independent from the compliance operational areas. The District also has established a Chief Risk Officer position, the holder of which was to be an executive member of the District leadership team. The position of Chief Risk Officer is currently combined with that of the Chief Financial Officer. See “THE DISTRICT—Management and Administration.” The Chief Risk Officer is responsible for the District’s enterprise risk management program and chairs the District’s Power Risk Management Committee.

### ***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 Section 111(d) of 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 (EPA Section 1251); (2) fuel diversity (EPA Section 1251); (3) fossil fuel generation efficiency (EPA Section 1251); (4) time-based metering and communications (EPA Section 1252); and (5) interconnection (EPA Section 1254).

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 based on staff’s recommendations. 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, based on staff’s recommendations. 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.

EPA 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 (“EIA 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 EIA 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, especially California’s Greenhouse Gas Cap-and-Trade Program. District staff also continue 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. Approximately 2.38 million additional megawatt hours generated at the dam as a result of operational and equipment efficiency improvements from 2003 through 2008 were registered as carbon offset credits on the exchange. Through the end of 2010, over half of these offsets were sold by the District. The Chicago Climate Exchange emission reduction program concluded following the completion of Phase II at the end of 2010. 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, 2011, nearly 175,000 of the District’s RECs have been sold.

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

On January 24, 2008, the District’s Lake Chelan Hydro Project was certified as “low impact” by the Low Impact Hydropower Institute, an independent non-profit organization (“LIHI”). 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. For more information about the certification, please see [www.lowimpacthydro.org](http://www.lowimpacthydro.org) (which website is not incorporated herein by this reference). LIHI certification has been considered an important first step toward green certification.

LIHI is a national independent nonprofit organization established in 1999 and headquartered in Portland, Maine. LIHI’s mission is to reduce the impacts of hydropower dams through market incentives. To earn certification as low-impact hydro, the District submitted an application to LIHI detailing the Lake Chelan Project’s environmental record and explaining the new license provisions. The District may choose to renew the certification after the initial five-year period expires.

### **Financial Services Reform**

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. It allows the Commodity Futures Trading Commission (“CFTC”) to regulate clearing and exchange requirements for the purchase and sale of cleared commodity derivatives, including energy derivatives. The CFTC is currently developing multiple rules for implementing this authority. This legislation will impact utilities that utilize derivatives and possibly other energy products. The CFTC has not issued a rule further defining a “swap,” which is a key term in the legislation. The absence of a definition creates uncertainty even though end-users of derivatives are exempt from mandatory clearing requirements if it is using a swap to hedge or mitigate commercial risk. Finally, significant reporting requirements and record keeping obligations, for which rules are still being defined, may raise costs for utilities.

As of September 30, 2011, 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. It is not clear whether or how the new law could affect such contracts and the District’s future energy transactions. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act may also affect the District’s interest rate swap activity. See “FINANCIAL INFORMATION—Consolidated System Payment Agreements.”

### **Cyber Security**

On June 9, 2010, the U.S. House of Representatives passed H.R. 5026, the Grid Reliability and Infrastructure Defense Act (“GRID Act”). If enacted, the GRID Act would give the FERC authority to issue emergency orders if the President determines that a “grid security threat” exists. It would also provide FERC with authority to order specific measures to be taken by industry to address grid security vulnerabilities when it

determines that the existing NERC standards are inadequate. Since FERC already has the authority to direct NERC to submit new or modified standards for approval, utilities are 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.

Also in 2010, several broad-based cyber security bills were reported out of different jurisdictional Congressional committees, and cyber security issues continue to receive attention in the 112th Congress. Senate and House congressional leadership have also signaled their intentions to resolve issues rising from multiple committees of jurisdiction by proactively engaging in legislative development. This process is expected to result in legislation influenced by the appropriate committees and relevant agencies of the administration. 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 Department of Homeland Security (“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**

FERC has issued a notice of proposed rulemaking addressing the integration of variable energy resources, such as wind and solar, into the electric grid. The notice introduces 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. If FERC-jurisdictional entities in the region are required to provide 15-minute intra-hourly scheduling, the District may need to accommodate such scheduling to participate in the marketplace. 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.

### **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 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 is evaluating 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. On November 16, 2009, the Commission held a public hearing and adopted a 10-year conservation plan and two-year conservation targets in compliance with the EIA Act 2006. In the meantime, the Washington State Department of Commerce (“DOC”) adopted rules for implementing the requirements of the EIA Act 2006 as it pertains to consumer owned utilities on March 14, 2008.

In addition, 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. Although recent efforts to amend I-937 have not had a materially affected the District, future proposals 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 is reviewing 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 its 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 subsequent to the 2008 IRP. The District completed its 2008 IRP and related public process pursuant to RCW 19.280, and it was adopted by the Commission on August 11, 2008. The adopted IRP determined that the District should retain its current mix of generating resources; build upon the initial conservation potential study performed for this IRP with more detailed analysis and prepare to meet the Washington State renewable portfolio standard (RPS) requirements; and proceed to develop and analyze strategies for additional long and/or short-term power sales contracts. The District submitted the IRP to the DOC on August 22, 2008.

In 2010, the District developed a Progress Report on the 2008 IRP. As part of this update, the District determined that it should retain its current mix of generating resources. In addition, it determined that it should

continue to refine its conservation assumptions and analysis in conjunction with a new conservation potential assessment for the next biennium reporting (in 2012) for compliance with the Washington State RPS. Finally, it determined that it should carry on its evaluation and implementation of strategies for additional power sales contracts consistent with its financial policies and energy hedging strategy. The Progress Report was presented for consideration during a public meeting in August 2010 and approved during another public meeting later that same month. A new IRP will be developed by the District in 2012.

### *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.

### *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 intends to be operational in some participating jurisdictions by 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 legislation directs six Washington State agencies to develop an initial state strategy by December 2011. Any recommendations resulting from this process could affect water and fish management considerations in the State. The District is monitoring this process and will provide input as the agencies seek comments from local governments.

### ***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 expenditures, as well as 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 to assess the likelihood and potential impact of possible fee increases, but cannot predict whether such measures will be adopted or their magnitude.

### **ECONOMIC AND DEMOGRAPHIC INFORMATION**

The Distribution Division markets approximately 36% 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 the major employer in the area. See "THE CONSOLIDATED SYSTEM—The Rocky Reach Power Sales Contracts—Alcoa." 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 October 6, 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, a 8,000-student (including part-time students) two-year institution. Central Washington University in Ellensburg, Western Washington University in Bellingham, 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>
2007	30,270	71,200	6,488,000
2008	30,810	72,100	6,587,600
2009	30,960	72,600	6,668,200
2010	31,925	72,453	6,724,540
2011 <sup>(1)</sup>	32,090	72,700	6,767,900

(1) 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>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011<sup>(2)</sup></u>
Total Civilian Resident Labor Force	40,270	40,760	42,050	41,890	43,800
Employment	38,320	38,510	38,670	38,280	40,640
Unemployment	1,960	2,250	3,380	3,610	3,170
Unemployment Rate	4.9%	5.5%	8.0%	8.6%	7.2%
<b><u>State of Washington</u></b>					
Unemployment Rate	4.6%	5.5%	9.3%	9.6%	8.9%

(1) Prepared in cooperation with The Bureau of Labor Statistics.

(2) As of August, 2011.

Source: Washington State Employment Security Department.

**Table 23  
Per Capita Personal Income**

<u>Year</u>	<u>Chelan County</u>	<u>State of Washington</u>
2005	30,023	36,766
2006	31,787	39,570
2007	33,993	42,192
2008	35,531	44,098
2009	35,237	41,795

Source: US Census Bureau.



**Table 24**  
**Chelan County**  
**Taxable Retail Sales**

<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u> <sup>(1)</sup>
\$1,494,671,178	\$1,532,758,491	\$1,300,189,738	\$1,319,346,545	\$600,735,130

(1) Data as of the second quarter of 2011. Second quarter 2010 taxable retail sales \$609,280,411.  
Source: Washington State Department of Revenue.

**Table 25**  
**Chelan County and Douglas County**  
**Major Employers**

<b>Employer</b>	<b>Project or Service</b>	<b>No. of Employees</b>
Central Washington Health Services	Hospitals, Medical Practice Management & Services	1,767
Wenatchee School District 246	Child Care Services, Elementary & Secondary Schools	1,100
Wenatchee Valley Medical Center, PS	Hospitals	900
Stemilt Growers, LLC	Farm Support & Transportation Services	731
<b>The District</b>	Electric Utilities	700 <sup>(1)</sup>
Eastmont School District 206	Child Care Services, Elementary & Secondary Schools	630
Alcoa Inc.	Aluminum Production	600
County of Chelan	Government	518
Wal-Mart Stores, Inc.	Department Stores	501
Express Locations, LLC	Consulting	400
County of Douglas	Government	300
Trout-Blue Chelan-Magi, Inc.	Farm Support Services	300
Crunch Pak, LLC	Farm Support Services	300
Washington State Department of Transportation	Government	300
Pacific Aerospace & Electronics, Inc.	Switches, Connectors & Keypads	202 <sup>(2)</sup>
Ceramic Devices, Inc	Discrete & Passive Components	200 <sup>(2)</sup>
PA&e International, Inc.	Industrial Manufacturing	200 <sup>(2)</sup>
Tree Top, Inc.	Canned & Frozen Fruits & Vegetables	200
Stemilt Management, Inc.	Farm Support Services	200

(1) As stated in "THE DISTRICT—Employees," as of September 30, 2011 the total number of District employees was 698.

(2) Subsidiaries of Power Company of Canada.

Source: Hoover's Company Records database, April 2011.

**Table 26**  
**Chelan County**  
**Building Permits**

	<u>Permits Issued</u>	<u>Valuation</u>
2006	940	64,124,525
2007	940	69,217,386
2008	791	67,735,362
2009	529	36,162,369
2010	557	30,441,094

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Source: Port of Chelan County and Chelan County Building, Fire Safety and Planning, Building Division.

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## **TAX MATTERS**

In the opinion of Bond Counsel, interest on the 2011C Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2011C Bonds. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F hereto.

### **Defeasance of 2011C Bonds**

If the District defeases any 2011C Bond, such 2011C Bond may be deemed to be retired and “reissued” for federal income tax purposes as a result of the defeasance. In that event, the Beneficial Owner of the 2011C Bond will recognize taxable gain or loss equal to the difference between the amount realized from the sale, exchange or retirement (less any accrued qualified stated interest which will be taxable as such) and the Beneficial Owner’s adjusted tax basis in the 2011C Bond. See “DESCRIPTION OF THE 2011C BONDS—Defeasance.”

### **Circular 230**

Investors are urged to obtain independent tax advice regarding the 2011C Bonds based upon their particular circumstances. The tax discussion above regarding the 2011C Bonds was not intended or written to be used, and cannot be used, for the purposes of avoiding taxpayer penalties. This discussion was written to support the promotion or marketing of the 2011C Bonds.

## **CONTINUING DISCLOSURE UNDERTAKING**

Pursuant to a certificate to be executed by the District prior to the issuance and delivery of the 2011C 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 2011C 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, 2011 (the “Annual Report”), and to provide notices of the occurrence of certain enumerated events with respect to the 2011C Bonds, if material. 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 material 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 offering of the 2011C Bonds are subject to the approval of Orrick, Herrington & Sutcliffe LLP, Seattle, Washington, Bond Counsel and Disclosure Counsel to the District. The proposed form of opinion of Bond Counsel with respect to the 2011C Bonds is attached hereto as APPENDIX F. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed on for the Underwriters by their 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 2011C 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 2011C 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. The opinion to be delivered by Orrick, Herrington & Sutcliffe LLP, as Bond Counsel, concurrently with the delivery of the 2011C Bonds, to the effect that the 2011C Bonds constitute valid and binding limited obligations of the District and that the Resolution constitutes a valid and binding obligation of the District, will be subject to such limitations, and the various other legal opinions to be delivered concurrently with the delivery of the 2011C Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in APPENDIX F. In the event the District fails to comply with its covenants under the Resolution or to pay principal or Redemption Price of or interest on the 2011C Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the 2011C 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 2011C 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 2011C 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 issuance or delivery of the 2011C 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 authorization, execution, sale and delivery of the 2011C 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 other than as described elsewhere in this Official Statement, the District does not believe that any of such other lawsuits will have a material adverse effect upon the District or its ability to pay the 2011C Bonds.

## INDEPENDENT AUDITORS

The District's combined financial statements as of December 31, 2010 and December 31, 2009 and for the two years then ended, included as Appendix A in this Official Statement, have been audited by PricewaterhouseCoopers LLP, independent auditors, as stated in their report appearing herein.

## RATINGS

Moody's, S&P and Fitch have assigned their ratings of "Aa2," "AA" and "AA+," respectively, to the 2011C 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 2011C 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 Underwriters 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 2011C Bonds.

## UNDERWRITING

Barclays Capital Inc., J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Morgan Stanley & Co. LLC (collectively, the "Underwriters") have agreed, subject to certain conditions, to purchase the 2011C Bonds from the District at a purchase price of \$164,425,000.00, which is equal to the aggregate principal amount of the 2011C Bonds. The District has agreed to pay the Underwriters an underwriting fee in the amount of \$750,435.70 in connection with the purchase of the 2011C Bonds.

***The information in the following paragraphs has been provided by the Underwriters for inclusion in this Official Statement. The District assumes no responsibility for and has not undertaken to verify the accuracy or completeness of any such information.***

The Underwriters' obligations are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all the 2011C Bonds, if any such 2011C Bonds are purchased. The 2011C Bonds may be offered and sold to certain dealers at prices lower than the public offering prices of the 2011C Bonds, and such public offering prices may be changed, from time to time, by the Underwriters. The Underwriters may offer and sell the 2011C Bonds into unit investment trusts or money market funds, certain of which may be managed or sponsored by the Underwriters, at prices lower than the public offering prices of the 2011C Bonds.

Pershing LLC, a subsidiary of the Bank of New York Mellon Corporation, and Barclays Capital Inc., one of the Underwriters of the 2011C Bonds, established a strategic alliance in May 2009, which enables Pershing LLC to participate as a selling group member and a retail distributor for all new issue municipal bond offerings underwritten by Barclays Capital Inc., including the 2011C Bonds offered hereby. Pershing LLC will receive a selling concession from Barclays Capital Inc. in connection with its distribution activities relating to the 2011C Bonds.

J.P. Morgan Securities LLC ("JPMS"), one of the underwriters of the 2011C Bonds, has entered into negotiated dealer agreements (each, a "Dealer Agreement") with each of UBS Financial Services Inc. ("UBSFS") and Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings, including the 2011C Bonds, at the original issue prices. Pursuant to each Dealer Agreement, each of UBSFS and CS&Co. will purchase 2011C Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any 2011C Bonds that such firm sells.

Morgan Stanley, parent company of Morgan Stanley & Co. LLC, one of the underwriters of the 2011C Bonds, has entered into a retail brokerage joint venture with Citigroup, Inc. As part of the joint venture, Morgan Stanley & Co. Incorporated will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became

effective on June 1, 2009. As part of this arrangement, Morgan Stanley & Co. LLC will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the 2011C Bonds.

#### **FINANCIAL ADVISOR**

Public Financial Management, Inc. has acted as financial advisor to the District in connection with the issuance of the 2011C Bonds.

#### **VERIFICATION AGENT**

As part of the refunding plan for Refunded Bonds, The Arbitrage Group, Inc., independent arbitrage consultants, will verify from the information provided to them the accuracy as of the date of the delivery of the 2011C Bonds of the mathematical computations relating to the adequacy of maturing principal amounts of and interest earned on the escrowed Government Obligations and Federal Securities (and necessary cash balance, if any) to redeem or purchase the Refunded Bonds. The Arbitrage Group, Inc. will express no opinion on the assumptions provided to them.

#### **MISCELLANEOUS**

The references, excerpts and summaries contained herein and in the appendices hereto of the Enabling Act, the Senior Consolidated System Resolution, the Master Resolution and the Ninth Supplemental Resolution and certain other statutes, licenses, permits, resolutions, agreements and contracts are brief outlines of certain provisions thereof. Such outlines do not purport to be complete statements of the provisions of such documents and reference should be made to such documents for full and complete statements thereof. Copies of such documents are available for inspection at the general office of the District.

Neither this Official Statement nor any advertisement of the 2011C Bonds is to be construed as a contract with the owners of the 2011C Bonds. Any statements made in this Official Statement involving matters of opinion or estimates, whether or not expressly so identified, are intended merely as such and not as representations of fact.

For additional information regarding the District or the 2011C Bonds, contact the Treasurer, Public Utility District No. 1 of Chelan County, 327 North Wenatchee Avenue, Wenatchee, Washington 98801, (509) 663-8121.

The execution and delivery of this Official Statement has been duly authorized by the District.

PUBLIC UTILITY DISTRICT NO. 1  
OF CHELAN COUNTY, WASHINGTON

/s/ Randy Smith

President, Board of Commissioners

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**APPENDIX A—AUDITED FINANCIAL STATEMENTS OF THE DISTRICT  
FOR THE YEAR ENDED DECEMBER 31, 2010**



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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 of the Public Utility District No. 1 of Chelan County, Washington (the "District"), present fairly, in all material respects, the financial position of the District at December 31, 2010 and December 31, 2009, and the changes in its 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 opinions.

The management's discussion and analysis for the year ended December 31, 2010 on pages 12 through 18 and the Schedule of Funding Progress for Postretirement Health Benefits Program on page 47 are not a required part of the basic financial statements as of and for the year then ended but are supplementary information required by the accounting principles generally accepted in the United States of America. 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 basic 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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*PricewaterhouseCoopers LLP*

April 5, 2011

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T: (971) 544 4000, F: (971) 544 4100, [www.pwc.com/us](http://www.pwc.com/us)*

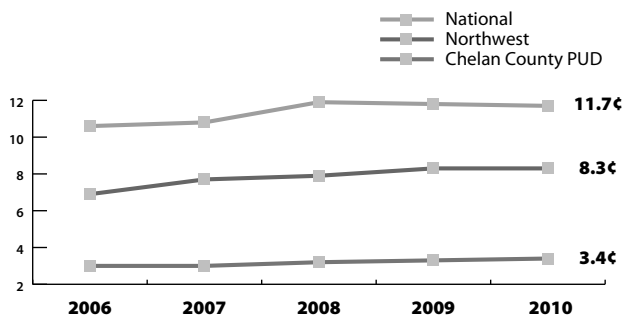
*The following discussion provides an overview and analysis of the financial activities of Public Utility District No. 1 of Chelan County (the District) for the years ended December 31, 2010 and 2009. This discussion and analysis is designed to be used in conjunction with the financial statements, notes and other supplementary information, which follow this section.*

## FINANCIAL HIGHLIGHTS

- In 2010, the District approved a plan which outlines new financial targets as part of strategic planning and working toward a more sustainable financial future. The four targets 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 60 percent or less by 2015; and provide financial liquidity (cash reserves and other sources) to cover risks and provide additional financial stability. The financial targets are designed to put the District on a reliable, sustainable path over the next several years. These targets are also designed to serve as a solid foundation for the longer term. The goals of the plan are paying down debt, building reserves for a rainy day and avoiding large, sudden rate adjustments. Consideration of these financial steps is part of the District's work on revising its strategic plan to build a solid foundation for reliable, sustainable services for the long-term.
- As part of its plan to improve financial stability, the District successfully auctioned a share of the future electric power production from Rocky Reach and Rock Island dams in September and December 2010. As a result of the auctions, the District has locked in predictable revenue of \$84 million from December 1, 2010, through the end of 2014 and \$45.5 million from January 1, 2012, through the end of 2013, in exchange for a share of power produced by the dams. The District expects that having a base level of predictable power sales revenue during the next four years will help avoid large swings in power rates charged to local customers and help stabilize overall revenues. The power was 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 all weather conditions and water supply, 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 January 2010, District commissioners approved Alcoa's plan to invest an estimated \$20 million in power system upgrades that will make it possible to operate a third pot line reliably at Alcoa's Wenatchee Works. The Interconnection Agreement is a follow-up to a long-term power sales contract signed by the District and Alcoa in July 2008 that provides for output equivalent to a 26-percent share of the Rocky Reach and Rock Island projects from November 2011 through 2028. District commissioners voiced their desire to have the community continue to benefit from the family-wage jobs provided by the Alcoa smelter. The work contemplated in this latest agreement will improve reliability of power delivery to the smelter. The District will own and operate all the facilities, and Alcoa will be responsible for all the costs. Alcoa fired up the third pot line in March 2011, to help meet an increase in the worldwide demand for aluminum. The March start is well ahead of the November activation of the new power contract. The District will continue to procure and manage the power delivery in the meantime.
- During 2008, the District began work on five construction projects at the Lake Chelan Hydro Project. The work will ensure the long-term reliability of its two generating units and improve habitat for steelhead and Chinook salmon as called for in the dam's 50-year federal license, issued in 2006. The cost of the projects was \$60 million through 2010. Installation of the first generating unit was completed in September 2009, and installation of the second unit was completed in April 2010. In October 2009, water started flowing permanently through the Chelan River Gorge to provide year-round water flow from the Chelan Dam. Nearly four acres of new fish habitat was created in the lower portion of the river. An innovative new channel was created to attract adult fish for spawning, and a pumping system provides cold water from the powerhouse tailrace to supplement the new permanent river flow.

Hundreds of salmon spawning nests were built by fall Chinook salmon in the fall, an indication that the project is working the way it was designed.

- District commissioners approved continuing for another year a temporary electric rate surcharge of 9 percent after record-low river flows the first three months of 2010. A separate rate redesign that was approved by the commissioners in 2008 and was postponed again, until the extended surcharge expires. The surcharge that had been scheduled to expire at the end of April 2011 was extended through December 2011. Even with the temporary surcharge, average residential rates for District power were approximately 3.4 cents per kilowatt hour, the second lowest rates in the nation. The Pacific Northwest average rate was 8.3 cents per kwh, and the national average was 11.7 cents per kwh.



- In October 2010, the commissioners also adopted new wholesale fiber-optic rates effective January 2011 and introduced increased Internet service speeds to improve revenue for the District's fiber-optic program and ensure that the local retail service providers have the fastest offerings available for their customers. Under the new rates, service providers will see a 5.4-percent increase for entry-level services and an average increase of 5 percent across the board for more advanced services. With the rate increase, the District will implement discounts for bundled services provided to a single customer. Service providers then determine what rates to charge their customers. With the faster offerings, those using the District's fiber-optic network will now have access to one of the lowest-cost 1 gigabit-per-second services in the nation.

- A contract that will bring customers the option of paperless billing, as well as provide substantial savings in the cost of printing and mailing paper bills and processing payments for those who choose to stay with a traditional bill, was approved by commissioners in October 2010. The first-year contract cost is expected to be about half what it costs the District now to print and mail a bill and handle electronic payments. District employees will continue to answer customer calls and respond to billing questions. Customers will also see increased security for the billing information, and the District will gain added assurance in complying with increasing requirements for protecting customer privacy. The first bills are expected to go out through the new system starting in May 2011.

### 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.

Even with continued 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 last spring and low power prices. Spring and early summer rains helped the situation somewhat, but not enough.

Despite significant cost-cutting efforts that resulted in reductions of approximately \$27.4 million from planned 2009 spending, the District experienced a \$15.1 million decrease in net assets for 2009. The decline was driven by a combination of low power prices, reduced investment yields and lower-than-normal water conditions.

The following analysis provides a three-year comparison of key financial information:

### CONDENSED COMPARATIVE FINANCIAL INFORMATION

(amounts in thousands)	2010	2009*	2008	Increase (Decrease) 2010 – 2009
Current assets	\$ 194,736	\$ 201,680	\$ 176,995	\$ (6,944)
Net utility plant	1,095,308	1,096,518	1,069,571	(1,210)
Other non-current assets	316,382	315,828	316,414	554
<b>Total assets</b>	<b>1,606,426</b>	<b>1,614,026</b>	<b>1,562,980</b>	<b>(7,600)</b>
Current liabilities	84,703	76,579	64,223	8,124
Long-term debt	992,219	1,010,158	976,958	(17,939)
Other liabilities	158,164	142,894	122,285	15,270
<b>Total liabilities</b>	<b>1,235,086</b>	<b>1,229,631</b>	<b>1,163,466</b>	<b>5,455</b>
Invested in capital assets, net of related debt	208,355	212,686	208,136	(4,331)
Restricted	106,766	107,501	100,263	(735)
Unrestricted	56,219	64,208	91,115	(7,989)
<b>Total net assets</b>	<b>\$ 371,340</b>	<b>\$ 384,395</b>	<b>\$ 399,514</b>	<b>\$ (13,055)</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. If material, retroactive application is required for all periods presented; however, the impact of applying the standard at January 1, 2008, and for the year ended December 31, 2008, is not material to the District. Therefore, the Balance Sheet for the year ending December 31, 2008, has not been adjusted for the application of SGAS 53. Implementation of the statement had no impact on the District's operating results or net cash flows for any year presented.

(amounts in thousands)	2010		2009		2008		Increase (Decrease) 2010 – 2009	
Operating revenues	\$	216,355	\$	202,760	\$	233,812	\$	13,595
Less								
Operating expenses		183,487		176,053		190,294		7,434
Other income and expenses		49,379		44,712		36,871		4,667
Net income (loss) before capital contributions		(16,511)		(18,005)		6,647		1,494
Capital contributions		3,456		2,886		8,434		570
Change in net assets		(13,055)		(15,119)		15,081		2,064
Total net assets – beginning of year		384,395		399,514		384,433		(15,119)
Total net assets – end of year	\$	371,340	\$	384,395	\$	399,514	\$	(13,055)

## ASSETS

Current assets decreased \$6.9 million in 2010, primarily due to current operating results and a shift in investment strategy given market conditions and projected liquidity requirements resulting in increased long-term investments.

On the other hand, current assets increased \$24.7 million in 2009, primarily due to a shift in investment strategy from the previous year resulting in increased short-term investments to position the District to take advantage of the eventual rise in interest rates.

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 cumulative effect of 12 months' worth of depreciation. As of December 31, 2009, the District had approximately \$1.1 billion invested in a variety of capital assets. Net utility plant increased \$26.9 million in 2009 reflecting additional investments in utility plant assets, including significant additions related to the hydro modernization projects at Rock Island and Lake Chelan.

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 are 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

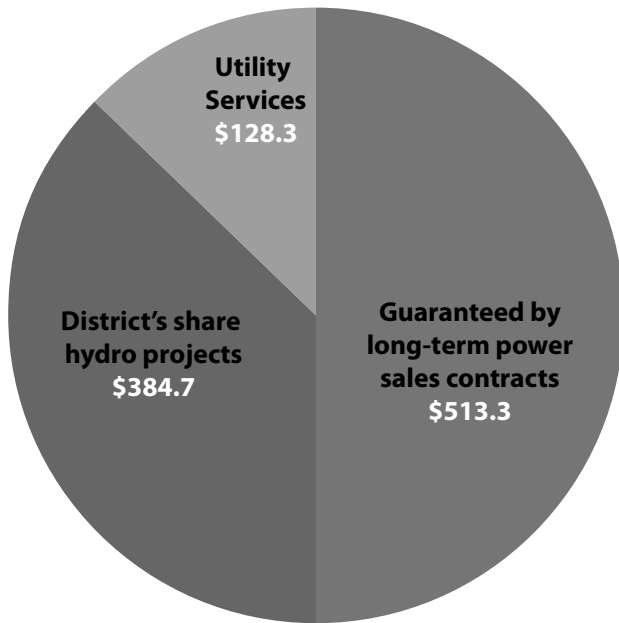
new water reservoir. On the other hand, other non-current assets decreased slightly in 2009. A reduction in long-term investments used to fund capital expenditures and the transfer of the deferred Rocky Reach relicensing costs to utility plant upon receipt of the FERC license were offset by \$63.5 million in proceeds from new bonds issued during 2009 and the restatement for the implementation of the fair value reporting requirements of Governmental Accounting Standards Board (GASB) Statement No. 53. The District's 2009 Balance Sheet was revised for the impacts of the required retroactive implementation.

## LIABILITIES

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 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 is October 31, 2011. Current liabilities increased \$12.4 million in 2009, due primarily to an increase in the current portion of

long-term obligations as a result of increased scheduled repayments of bond principal on existing debt compared to the prior year. This was offset somewhat by a decrease in warrants and accounts payable.

**TOTAL DISTRICT DEBT OUTSTANDING  
(\$1,026) AS OF 12/31/2010 (MILLIONS)**



The District did not issue additional bonds in 2010.

In June 2009, the District converted \$92.9 million of variable rate Consolidated System Revenue Bonds, Series 2008B (AMT) to non-AMT status, as allowed by the American Recovery and Reinvestment Act (ARRA). This conversion will allow the District to benefit from the expected reduction in interest expense as a result of the typical spread between AMT and non-AMT bonds.

As part of the conversion, three bond rating agencies – Fitch Ratings, Moody's Investor Service and Standard and Poor's Rating Services – reaffirmed the District's AA+, Aa2 and AA ratings. Fitch and Standard & Poor's affirmed a stable outlook. Moody's changed its outlook to negative based on "the likely lower than originally expected wholesale revenues over the next several years, the limited rate increase taken by the District to offset lower merchant cash flows and negligible hedges for 2010 and onward to minimize the volatility of wholesale revenues. The negative outlook also considers the likely decline in the District's credit metrics and significant reserves over the next several years." However, Moody's also recognized the District's fundamental strengths of low-cost hydro generation, low rates and relatively high levels of cash liquidity.

In 2010, many positive actions were taken to maintain the financial health of the District. As mentioned in the Financial Highlights, new financial targets and metrics were adopted, additional hedges to reduce volatility in wholesale revenues were implemented and the 9-percent rate surcharge was extended. These improvements, as well as updated financial forecasts, were presented to the bond rating agencies in March 2011.

In July 2009, the District successfully marketed \$29 million of Consolidated System Subordinate Revenue Notes, Series 2009AB (AMT). The notes, which were sold at a premium, were issued for the purpose of purchasing all of the series 2009AB Bonds also issued in July 2009, which refunded the series 1999AB Bonds. In April 2006, the District executed a forward-starting fixed-payor swap with an effective start date of June 1, 2009. The swap was executed in anticipation of the refunding of the 1999AB Bonds in July 2009. At the time the swap was executed, the District anticipated refunding the 1999AB Bonds with either auction rate or variable rate bonds. Due to market conditions, it was financially impractical to issue variable rate bonds in July 2009, and terminating the swap was too costly. The 2009AB Bonds issued in July 2009 with a mandatory put in 2014 were purchased by a Trust established by the District rather than being offered publicly due to market conditions and are not considered outstanding for financial reporting purposes.

In August 2009, the District issued \$33.6 million of Consolidated System Revenue Bonds, Series 2009C (Non-AMT) and 2009D (Taxable) for the purposes of providing new money for the Lake Chelan System for specified capital projects. The series 2009C Bonds were issued as fixed rate bonds and sold at a premium. The series 2009D Bonds were issued as fixed rate Taxable Direct Payment Build America Bonds (BABs). Analysis comparing the total cost of issuing BABs to traditional tax-exempt bonds showed a \$3 million net present value advantage of BABs over tax-exempt bonds.

Also in August 2009, the District issued \$15.9 million of Rocky Reach Hydroelectric Revenue Bonds, Series 2009A and \$14.0 million of Rock Island Hydroelectric Revenue Bonds, Series 2009A. The 2009A Bonds, which were sold at a premium, were issued as fixed rate bonds. The proceeds will be used for the purpose of providing new money for specified capital projects. Much of the work to be done at Rocky Reach and Rock Island dams will be for environmental enhancements.

For more information regarding the long-term debt activity see Note 6.

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. Other liabilities increased \$20.6 million in 2009 as a result of the restatement for the implementation of the fair value reporting requirements of Governmental Accounting Standards Board (GASB) Statement No. 53. The District's 2009 Balance Sheet was revised for the impacts of the required retroactive implementation.

### NET ASSETS

Invested in capital assets, net of related debt, decreased \$4.3 million in 2010 and increased \$4.6 million in 2009. The decrease in 2010 reflects somewhat reduced growth in net utility plant combined with no additional debt proceeds as compared to the prior year. The 2009 increase reflects continued growth in net utility plant. Restricted net assets represent resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements. Restricted net assets decreased \$700,000 in 2010 and increased \$7.2 million in 2009. 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 2010 and 2009, unrestricted net assets decreased approximately \$8 million and \$26.9 million, respectively, due primarily to decreased earnings.

### STATEMENT OF REVENUES AND EXPENSES

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 are now earning interest at a much lower rate. 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.

In 2009, retail energy sales increased \$5.8 million compared to 2008 as a result of continued customer growth and an electric rate surcharge. The 9-percent electric rate surcharge became effective May 1, 2009, and was to remain in effect for up to 12 months to bolster revenues and partially offset the impact of below-average runoff forecasts, declining wholesale-energy prices and lower interest income on investments. Wholesale power sales decreased \$34.4 million in 2009 compared to 2008 due primarily to lower average market prices combined with decreased hydro generation as a result of lower-than-average river flows. Purchased power costs decreased \$10.8 million in 2009 compared to the prior year when later than normal 2008 runoff necessitated the buyback of previously hedged power in order to meet spring 2008 load requirements. Significantly lower market prices also contributed to the reduction in purchased power costs. Operating expenses came in \$14.2 million lower in 2009 than in 2008 due to significant cost-cutting measures taken by the District to partially mitigate challenging 2009 economic conditions. Other expenses, which include net interest expense and income, increased in 2009 by \$7.8 million due primarily to reduced investment earnings as a result of declining market investment yields. Capital contributions decreased \$5.5 million compared to 2008 as a result of the completion of the Monitor water system in the prior year. Net income (loss) was down \$24.7 million compared to 2008 due primarily to the reduction in wholesale power sales and reduced investment earnings as described above.



## ECONOMIC FACTORS

We are proud of the District's many accomplishments in 2010. This was the second year of keeping the District in preservation mode and restricting spending. Results for 2010 were approximately \$5.1 million below budget due primarily to the mild winter weather, record low water supply, low hydro production and low power prices. During this time, the District extended a 9-percent electric rate surcharge, postponed pay increases for many employees until 2012 and cut spending.

The focus for 2010 was on keeping the District strong and reliable. The 9-percent electric rate surcharge imposed in May 2009 was extended through April 2011 and then again through December 2011. To reduce financial risk and decrease year-to-year revenue volatility, commissioners approved a plan to sell slices of surplus hydropower up to five years in the future through a competitive bidding process. Besides looking at new power sales strategies that could help stabilize revenues from year to year, the District revisited financial policies and explored additional financial tools to maintain the financial health of the District today and into the future.

During these difficult economic times, the District continues to focus on maintaining a balance between the change in net assets, reliability and cash reserves. This helps to make sure that the District doesn't use up too much of its savings to pay the bills while still

keeping the lights on, the turbines spinning, water flowing and the fiber lit. This will be the third year in a row the District has faced major belt-tightening. Thanks in part to leaving several staff positions unfilled, freezing non-union salaries, reducing capital spending, extending the 9-percent temporary surcharge and to 5-percent rate increases for water and wastewater, the 2011 results are projected to end up in the black if expected snowpack occurs and if market prices for surplus power also meet expectations. Providing some encouragement for 2011 is the end of the long-term power sales contracts at Rocky Reach Dam that expire in November 2011, to be replaced by restructured contracts with Alcoa and Puget Sound Energy that will run for nearly another 20 years. The District will regain a larger share of power production and expects to see a jump in wholesale power revenues along with it.

## 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 (AMOUNTS IN THOUSANDS)

DECEMBER 31, 2010 AND 2009

ASSETS	2010	As restated 2009
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 65,470	\$ 68,538
Investments	39,236	53,579
Accounts receivable, net	21,476	19,134
Accrued interest receivable	1,446	1,449
Materials and supplies	10,362	10,359
Prepayments and other	1,260	3,840
	<u>139,250</u>	<u>156,899</u>
<b>RESTRICTED ASSETS - CURRENT</b>		
Cash and cash equivalents	32,901	30,688
Investments	22,585	14,093
	<u>55,486</u>	<u>44,781</u>
<b>TOTAL CURRENT ASSETS</b>	<u>194,736</u>	<u>201,680</u>
<b>UTILITY PLANT</b>		
In service, at original cost	1,769,796	1,722,803
Construction work in progress	28,533	33,214
Less-accumulated depreciation	(703,021)	(659,499)
	<u>1,095,308</u>	<u>1,096,518</u>
<b>RESTRICTED ASSETS - NONCURRENT</b>		
Cash and cash equivalents	58,886	84,537
Investments	121,425	120,921
	<u>180,311</u>	<u>205,458</u>
<b>DEFERRED CHARGES AND OTHER ASSETS</b>		
Deferred financing costs	10,499	11,623
Fish protection costs	1,776	3,177
Long-term receivables, net	3,323	3,794
Long-term investments	79,003	62,739
Deferred regulatory charges	23,296	6,093
Derivative instrument asset	3,948	2,655
Deferred outflow of resources- derivatives	8,370	12,509
Other	5,856	7,780
	<u>136,071</u>	<u>110,370</u>
<b>TOTAL ASSETS</b>	<u>\$ 1,606,426</u>	<u>\$ 1,614,026</u>

The accompanying notes are an integral part of these statements.

**BALANCE SHEETS - CONT. (AMOUNTS IN THOUSANDS)****DECEMBER 31, 2010 AND 2009**

<b>LIABILITIES AND NET ASSETS</b>	<b>2010</b>	<b>As restated 2009</b>
<b>CURRENT LIABILITIES</b>		
Current portion of long-term obligations	\$ 35,401	\$ 32,364
Accounts payable	17,900	13,831
Accrued taxes	3,389	3,690
Accrued interest	16,585	16,244
Accrued vacation and other	11,428	10,450
	<u>84,703</u>	<u>76,579</u>
<b>LONG-TERM DEBT</b>		
Revenue bonds and notes payable, less current portion	992,219	1,010,158
<b>OTHER LIABILITIES</b>		
Deferred wholesale power sales revenue	111,941	111,941
Derivative instrument liability	31,664	18,602
Deferred inflow of resources-derivatives	3,948	2,655
Licensing obligation, less current portion	7,858	7,693
Regulatory liabilities	2,277	-
Other liabilities	476	2,003
	<u>158,164</u>	<u>142,894</u>
<b>TOTAL LIABILITIES</b>	<u>1,235,086</u>	<u>1,229,631</u>
<b>COMMITMENTS AND CONTINGENCIES</b> (see Note 13)		
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	208,355	212,686
Restricted	106,766	107,501
Unrestricted	56,219	64,208
	<u>371,340</u>	<u>384,395</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 1,606,426</u>	<u>\$ 1,614,026</u>

*The accompanying notes are an integral part of these statements.*

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (AMOUNTS IN THOUSANDS)**

**FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009**

	<b>2010</b>	<b>2009</b>
<b>OPERATING REVENUES</b>		
Retail sales	\$ 54,256	\$ 55,800
Wholesale sales	160,042	144,617
Other operating revenues	2,057	2,343
	<u>216,355</u>	<u>202,760</u>
<b>OPERATING EXPENSES</b>		
Purchased power	22,880	18,668
Purchased water	313	343
Generation	69,613	69,533
Utility services	28,806	25,470
Taxes	6,284	6,701
Depreciation and amortization	49,025	46,434
Other operation and maintenance	6,566	8,904
	<u>183,487</u>	<u>176,053</u>
<b>OPERATING INCOME</b>	32,868	26,707
<b>OTHER INCOME (EXPENSE)</b>		
Interest on long-term debt	(55,520)	(53,894)
Amortization of deferred debt costs	(1,123)	(1,100)
Investment income	7,692	11,044
Federal subsidy income	630	245
Other	(1,058)	(1,007)
	<u>(49,379)</u>	<u>(44,712)</u>
<b>LOSS BEFORE CAPITAL CONTRIBUTIONS</b>	(16,511)	(18,005)
<b>CAPITAL CONTRIBUTIONS</b>	<u>3,456</u>	<u>2,886</u>
<b>CHANGE IN NET ASSETS</b>	(13,055)	(15,119)
<b>TOTAL NET ASSETS</b>		
Beginning of year	<u>384,395</u>	<u>399,514</u>
<b>TOTAL NET ASSETS</b>		
End of year	\$ <u>371,340</u>	\$ <u>384,395</u>

*The accompanying notes are an integral part of these statements.*

**STATEMENTS OF CASH FLOWS (AMOUNTS IN THOUSANDS)**

**FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009**

	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 213,975	\$ 202,749
Payments to suppliers	(64,826)	(70,386)
Payments to employees	(64,606)	(64,173)
Net cash provided by operating activities	<u>84,543</u>	<u>68,190</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Additions to plant	(41,525)	(69,485)
Proceeds from sale of plant	81	272
Proceeds of new debt	-	192,282
Principal paid on debt	(31,999)	(158,794)
Interest paid on debt	(39,919)	(37,703)
Capital contributions	2,470	2,552
Other	1,725	(478)
Net cash used in capital and related financing activities	<u>(109,167)</u>	<u>(71,354)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments	(195,557)	(208,722)
Proceeds from sales and maturities of investments	184,611	303,172
Interest on investments	7,720	12,438
Long-term receivables	471	(678)
Other, net	873	(245)
Net cash (used in) provided by investing activities	<u>(1,882)</u>	<u>105,965</u>
<b>NET (DECREASE) INCREASE IN CASH &amp; CASH EQUIVALENTS</b>	(26,506)	102,801
<b>CASH &amp; CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>183,763</u>	<u>80,962</u>
<b>CASH &amp; CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 157,257</u>	<u>\$ 183,763</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income	\$ 32,868	\$ 26,707
Depreciation and amortization	49,025	46,434
(Increase) decrease in operating assets:		
Accounts receivable, net	(2,380)	(8)
Materials and supplies	(3)	(6)
Prepayments and other	2,580	(2,466)
Increase (decrease) in operating liabilities:		
Accounts payable	1,778	(1,006)
Accrued taxes	(301)	(32)
Accrued vacation and other	976	(1,433)
Net cash provided by operating activities	<u>\$ 84,543</u>	<u>\$ 68,190</u>
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES</b>		
Construction costs included in accounts payable	\$ 614	\$ (3,812)
Capital contributions	2,538	334

*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 oversee 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 an internal service system.

**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 2007, GASB issued Statement No. 51, "Accounting and Financial Reporting for Intangible Assets." Statement No. 51 establishes accounting and financial reporting requirements for intangible assets to enhance the comparability of the accounting and financial reporting of such assets among state and local governments. GASB Statement No. 51 is effective for the District beginning in fiscal year 2010.

Implementation of Statement No. 51 did not have a material impact to the District's financial results.

In June 2008, GASB issued Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments." Statement No. 53 (GASB 53) provides a comprehensive framework for the measurement, recognition and disclosure of derivative instrument transactions for the purpose of enhancing the usefulness and comparability of derivative instrument information reported by state and local governments. GASB 53 is effective for the District beginning in fiscal year 2010.

**GASB 53 TRANSITION PROVISIONS**

The District's 2009 Balance sheet was restated for the impacts of the required retroactive implementation of GASB 53. Prior to the implementation of Statement No. 53, the District had only disclosure requirements for the fair value of derivative instruments. Statement No. 53 requires that the fair value of certain derivative instruments be reported on the Balance Sheet for 2010 and any prior periods reported. Due to the regulatory deferral of the changes in fair value of investment derivatives, implementation of Statement No. 53 had no impact on the District's operating results or net cash flows from operating activities for 2010 or 2009. As presented in the Balance Sheets, the effect of the implementation had the following impact on 2009 balances:

	Restated 2009 Balance	2009 Balance as Previously Reported
<b>ASSETS</b>		
Deferred regulatory charges	\$ 6,093	\$ -
Derivative instrument asset	2,655	-
Deferred outflow of resources - derivatives	12,509	-
Total assets	1,614,026	1,592,769
<b>LIABILITIES</b>		
Derivative instrument liability	\$ 18,602	\$ -
Deferred inflow of resources - derivatives	2,655	-
Total liabilities	1,229,631	1,208,374

**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 environmental attributes and sales of electric, water, wastewater and wholesale telecommunication services. 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 \$2.6 million in 2010 and \$2.4 million in 2009. 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 power sales contracts or sales directly to the retail electric distribution system. Revenues under these contracts are determined on a cost-of-service basis including debt service costs. These firm power sales contracts extend into the future with varying expiration dates. The Rocky Reach System's contracts expire in October 2011, and the Rock Island System's 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 current power sales contracts expire. PSE will generally be responsible to pay 25% of all 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 has been 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 26% of the Rocky Reach and Columbia River-Rock Island projects, starting in 2011 and 2012, respectively, when the current power sales contracts expire. Alcoa will generally be responsible to pay 26% of all

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 \$22.9 million of an \$89 million capacity reservation charge during 2008, which has been 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.

Currently, 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 15.13%, 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, 2010 and December 31, 2009, the District had two significant customers (greater than 10% of operating revenues), collectively comprising total revenue of \$94.5 million and \$89 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. In 2010 and 2009 the District recognized non-operating revenues of \$630,000 and \$245,000, respectively.

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 change 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 60-month forward horizon. 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 Committee has an established credit policy 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.

Forward power contracts are derivative instruments. As of December 31, 2010 and 2009, 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 \$127,000 and \$126,000 at December 31, 2010 and 2009, 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.

**REVISION – RESTRICTED ASSETS**

The District has revised its 2009 balance sheets to reclassify balances of restricted assets to reflect the nature of the restriction on the funds. Certain funds that were restricted for capital projects or the liquidation of long-term debts were incorrectly presented as current restricted assets and now have been reclassified to noncurrent restricted assets. There is no change to the total reported restricted assets balance for 2009, and the reclassification is not considered to have a material effect on the 2009 financial statements.

**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:

(amounts in thousands)	2010	2009
Unrestricted assets		
Unrestricted	\$ 21,787	\$ 31,850
Board designated	161,922	153,004
Total unrestricted assets	183,709	184,854
Restricted assets	235,794	250,237
	<u>\$ 419,503</u>	<u>\$ 435,091</u>

As of December 31, 2010 and 2009, the District had the following cash and investments:

(amounts in thousands) Investment Type	Investment Maturities (in Years)				
	Fair Value 2010	Less than 1	1 - 2	3 - 4	More than 4
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>

(amounts in thousands) Investment Type	Investment Maturities (in Years)				
	Fair Value 2009	Less than 1	1 - 2	3 - 4	More than 4
U.S. Treasuries	\$ 5,903	\$ -	\$ -	\$ 900	\$ 5,003
U.S. Agency Notes	30,271	8,250	13,382	8,639	-
U.S. Agency Bills	27,006	27,006	-	-	-
Municipal Bonds	48,329	6,354	7,023	8,114	26,838
TLGP Bank Bonds	7,936	-	7,936	-	-
State Investment Pool	58,475	58,475	-	-	-
Financial Institution Deposits	237,519	170,019	29,500	30,000	8,000
Cash	19,652	19,652	-	-	-
	<u>\$ 435,091</u>	<u>\$ 289,756</u>	<u>\$ 57,841</u>	<u>\$ 47,653</u>	<u>\$ 39,841</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 and bankers' acceptances 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

## NOTES TO BASIC FINANCIAL STATEMENTS (CONT.)

with a single issuer; 12) and any other investment permitted under the laws of the State of Washington.

As of December 31, 2010 and 2009, investments in debt securities had credit quality ratings as follows:

(amounts in thousands)			
Investment Rating (S&P)	2010	2009	
Long Term			
AAA	\$ 64,244	\$ 16,136	
AA+	16,591	8,404	
AA	5,462	11,036	
AA-	14,751	13,826	
Short Term			
SP-1+	804	810	
SP-1	-	6,054	
	<u>\$ 101,852</u>	<u>\$ 56,266</u>	

### 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, 2010 and 2009, more than 5% of the District's total investment portfolio was invested with each of the following issuers:

Issuer	Credit Rating	Percentage of Portfolio	
		2010	2009
Federal National Mortgage Association	AAA	6%	3%
Federal Home Loan Bank	AAA	2%	9%
CitiBank NA – FDIC Insured	AAA	5%	1%
Federal Farm Credit Bureau	AAA	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 various forward purchase agreements for the purchase of U.S. Treasury and agency obligations. Under the terms of the agreements, 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 rates of return under the agreements.

The terms, including the counterparty credit ratings of the outstanding forward purchase agreements, as of December 31, 2010, are provided below.

#### Forward Purchase Agreements

Counterparty	Credit Rating By Moody's/S&P/Fitch	Guaranteed Yield	Notional Amount	Effective Date	Maturity	12/31/10 Fair Value	12/31/09 Fair Value
Wells Fargo Bank, N.A.	Aa2/AA/AA-	6.630%	\$ 18,820,179	12/21/1999	6/1/2029	\$ 3,846,121	\$ 2,317,940
Wells Fargo Bank, N.A.	Aa2/AA/AA-	5.445%	7,972,970	3/1/2001	7/1/2011	102,161	336,723

As of December 31, 2010 and 2009, both agreements are considered hedging derivative instruments and the fair value is recorded on the Balance Sheet as a Deferred Outflow of Resources.

**FAIR VALUES**

Due to declining interest rates, the forward purchase agreements had positive fair values to the District as of December 31, 2010 and 2009. The fair values take into consideration the prevailing investment rate environment and the specific terms and conditions of the given transactions. The fair values were estimated using the par value method.

**CREDIT RISK**

The District is exposed to credit risk in the amount of the positive fair values of the forward purchase agreements. The credit ratings of the counterparties are noted in the table on page 29.

**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, 2010 and 2009 are as follows:

(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>

(amounts in thousands)	January 1, 2009	Additions	Reductions	December 31, 2009
Hydroelectric generation	\$ 1,075,967	\$ 48,821	\$ (3,056)	\$ 1,121,732
Transmission	107,082	1,259	(133)	108,208
Distribution	189,803	10,673	(868)	199,608
General plant	109,735	7,447	(874)	116,308
Intangible	19,228	13,068	-	32,296
Telecommunications	72,617	6,950	-	79,567
Water/Wastewater	62,181	3,039	(136)	65,084
	<u>1,636,613</u>	<u>91,257</u>	<u>(5,067)</u>	<u>1,722,803</u>
Construction work in progress	52,156	60,111	(79,053)	33,214
Accumulated depreciation	(619,198)	(45,134)	4,833	(659,499)
	<u>\$ 1,069,571</u>	<u>\$ 106,234</u>	<u>\$ (79,287)</u>	<u>\$ 1,096,518</u>

Plant assets include land of \$71.4 million and \$71.2 million as of December 31, 2010 and 2009, respectively.

**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 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 second-year study on whitewater boating was conducted during 2010. 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 \$9.3 million and \$9.2 million as of December 31, 2010 and 2009, respectively.

A summary of accrued licensing obligations for the years ended December 31, 2010 and 2009 are as follows:

<u>(amounts in thousands)</u>	<u>2010</u>		<u>2009</u>	
Licensing obligation - beginning of year	\$	9,183	\$	9,538
Additions		509		-
Reductions		(405)		(355)
Licensing obligation - end of year	\$	<u>9,287</u>	\$	<u>9,183</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 and submitted to the FERC in February 2010. These plans were approved by the FERC during 2010 and are now being implemented.

**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. Regulatory asset deferrals amounted to \$23.3 million and \$6.1 million as of December 31, 2010 and 2009, respectively.

#### 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. In 2010, the District recorded deferrals of contributed capital in the amount of \$2.3 million. There were no deferrals in 2009.

## NOTE 6: LONG-TERM DEBT

### 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
Senior 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
Subordinate Chelan 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>

## NOTES TO BASIC FINANCIAL STATEMENTS (CONT.)

(amounts in thousands)	January 1, 2009	Additions	Reductions	December 31, 2009	Due Within One Year
Rocky Reach Revenue Bonds, 3% to 5%, due July 1, 2010, to July 1, 2034 (net unamortized premiums of \$697)	\$ 7,541	\$ 16,535	\$ (815)	\$ 23,261	\$ 1,545
Rock Island Revenue Bonds, 3% to 6.05%, due June 1, 2010, to July 1, 2034 (net unamortized premiums of \$203)	271,578	29,989	(22,277)	279,290	22,700
Notes Payable, 0.5% to 5.25%, due July 1, 2010, to October 1, 2027 (net unamortized premiums of \$2,997)	61,896	34,859	(1,867)	94,888	734
Senior Chelan Hydro Consolidated System Revenue Bonds, 4% to 6.05%, due June 1, 2010, to January 1, 2039 (net unamortized discounts of \$1,302, unamortized premiums of \$1,712)	481,645	941	(38,278)	444,308	3,035
Subordinate Chelan Consolidated System Revenue Bonds, 3.5% to 6.897%, due July 1, 2010, to July 1, 2042 (net unamortized discounts of \$366, unamortized premiums of \$661)	167,605	132,561	(100,881)	199,285	2,860
	<u>\$ 990,265</u>	<u>\$ 214,885</u>	<u>\$ (164,118)</u>	<u>\$ 1,041,032</u>	<u>\$ 30,874</u>

In June 2009, the District converted \$92.9 million of variable rate Chelan Consolidated System Revenue Bonds, Series 2008B (AMT) to non-AMT status, as allowed by the American Recovery and Reinvestment Act (ARRA). The converted bonds were reissued as variable rate bonds with a reset of interest rates every seven days. This conversion will allow the District to benefit from the expected reduction in interest expense as a result of the typical spread between AMT and non-AMT bonds. The interest rate on the 2008B converted variable rate bonds averaged 0.268% and 0.471% during 2010 and 2009, respectively.

In July 2009, the District issued \$29 million of Chelan Consolidated System Subordinate Revenue Notes, Series 2009AB (AMT). The notes, which were sold at a premium, have a coupon rate of 5.25% to yield 3.92% and mature on July 1, 2014. The notes were issued for the purpose of purchasing all of the series 2009AB Bonds also issued in July 2009, which refunded the series 1999AB Bonds. In April 2006, the District executed a forward-starting fixed-payer swap with an effective start date of June 1, 2009. The swap was executed in anticipation of the refunding of the 1999AB Bonds in July 2009. At the time the swap was executed, the District anticipated refunding the 1999AB Bonds with either auction rate or variable rate bonds. Due to market conditions, it was financially impractical to issue variable rate bonds in July 2009, and terminating the swap was too costly. The 2009AB Bonds issued in July 2009 with a mandatory put in 2014 were purchased by a trust established by the District rather than being offered publicly and are not considered outstanding for financial reporting purposes. The present value of these transactions

inclusive of debt service differentials, hedges and transaction costs was approximately (\$1.2) million.

In August 2009, the District issued \$33.6 million of Chelan Consolidated System Revenue Bonds, Series 2009C (Non-AMT) and 2009D (Taxable) for the purposes of providing new money for the Lake Chelan System for specified capital projects. The series 2009C Bonds in the amount of \$6.6 million were issued as fixed rate bonds with interest rates ranging from 3.5% to 4.5% and annual maturities between July 1, 2010, and July 1, 2019. The series 2009D Bonds in the amount of \$27.0 million were issued as fixed rate Taxable Direct Payment Build America Bonds (BABs) with interest rates ranging from 5.845% to 6.897% and annual maturities between July 1, 2020, and July 1, 2039.

In August 2009, the District issued \$15.9 million of Rocky Reach Hydroelectric Revenue Bonds, Series 2009A (Non-AMT). The 2009A Bonds were issued as fixed rate bonds with interest rates ranging from 3% to 5% and annual maturities between July 1, 2010, and July 1, 2034. The series 2009A Bonds were issued for the purpose of providing new money for specified capital projects.

Also in August 2009, the District issued \$14 million of Rock Island Hydroelectric Revenue Bonds, Series 2009A (Non-AMT). The 2009A Bonds were issued as fixed rate bonds with interest rates ranging from 3% to 5% and annual maturities between July 1, 2010, and July 1, 2034. The series 2009A Bonds were issued for the purpose of providing new money for specified capital projects.



A summary of scheduled debt service requirements to maturity is as follows:

**Principal and Interest**  
(amounts in thousands)

	Principal	Interest	Estimated Debt Service
2011	\$ 33,973	\$ 38,481	\$ 72,454
2012	29,550	39,054	68,604
2013	85,400	38,645	124,045
2014	101,665	35,596	137,261
2015	31,000	31,617	62,617
2016-2020	203,144	149,128	352,272
2021-2025	156,250	131,307	287,557
2026-2030	144,358	121,953	266,311
2031-2035	164,390	93,507	257,897
2036-2040	265,275	21,579	286,854
2041-2042	8,370	770	9,140
Total	<u>\$ 1,223,375</u>	<u>\$ 701,637</u>	<u>\$ 1,925,012</u>

Estimated principal retirements are based on the assumption that all bonds are called or purchased at par. Principal retirements of \$1.2 billion also include \$185 million of future appreciation on Capital Appreciation Bonds (CABs).

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 Senior 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 has 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, 2010 and 2009, 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 an 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, 2010, are included on page 35. The District's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled reductions in principal amounts of the associated bonds.

## NOTES TO BASIC FINANCIAL STATEMENTS (CONT.)

### Swap Portfolio

Related Bonds	Counterparty	Credit Rating by Moody's/S&P/Fitch	District Pays	District Receives	12/31/10 Notional Amount	Call Option	Effective Date	Maturity	12/31/10 Fair Value	12/31/09 Fair Value
Series 2008B	Bear Stearns Capital Markets, Inc.	Aa3/A+/AA-	3.752%	70% of LIBOR	\$ 63,679,000	YES	5/31/2007	7/1/2032	\$ (5,858,909)	\$ (3,449,499)
Series 2008B	The Bank of New York Mellon	Aaa/AA/AA-	3.752%	70% of LIBOR	27,291,000	YES	10/17/2008	7/1/2032	(2,510,969)	(1,478,350)
Series 2009AB	The Bank of New York Mellon Notes	Aaa/AA/AA-	70% of LIBOR	1.76%	30,355,000	NO	7/22/2009	7/1/2014	827,771	(128,299)
Series 2009AB	JP Morgan Chase Bank, NA	Aa1/AA-/AA-	4.031%	70% of LIBOR	30,355,000	NO	6/1/2009	7/1/2034	(6,034,967)	(4,291,277)
Series 2011	Goldman Sachs Mitsui Marine Derivative Products, LP	Aa1/AAA/NR	4.058%	70% of LIBOR	78,375,000	NO	6/1/2011	1/1/2036	(14,788,863)	(7,581,545)
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	(3,297,940)	(1,673,352)
Total					<u>\$258,870,000</u>				<u>\$ (31,663,877)</u>	<u>\$(18,602,322)</u>

During 2010 and 2009, the net cash outflows related to the swaps were \$3.9 million and \$3.6 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 swap became effective with the issuance of the 2007A 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 March 2008, the District issued the 2008B Bonds, which together with District cash, were used to purchase and hold in trust the 2007A Bonds. With the issuance of the 2008B Bonds, the 2007 swaps became the 2008 swaps. The 2008 swaps are considered hedging derivative instruments. As such, the fair values of the 2008 swaps are reported on the Balance Sheet as Deferred Outflows of Resources.

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 with a five-year maturity. 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 the offsetting 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.

Due to continued turmoil in the financial markets and other related risks, the District will evaluate if it will issue variable rate bonds in 2011 and 2013 as intended when the associated swaps were entered into. Therefore, the forward starting 2011 and 2013 interest rate swaps are considered investment derivative instruments. The changes in fair value of the 2011 and 2013 swaps are to be recognized in the Statement

of Revenues, Expenses and Changes in Net Assets as Investment Income, 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.

**FAIR VALUES**

Because interest rates have declined since the execution date, the swaps had negative fair values to the District as of both December 31, 2010 and 2009. The fair values as of December 31, 2010 and 2009 are included in the table on page 35. 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. For the call option component of the 2008 swaps, the Black-Derman-Toy (BDT) model is used including market volatility inputs that are regularly calibrated against market prices.

**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, 2010, the District had no net credit risk related to the outstanding swaps because the net fair values were negative. However, if interest rates change and the net fair values of the swaps become positive, the District would be exposed to credit risk in the amount of the swaps' net fair values. The credit ratings of the counterparties are noted in the table on page 35.

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, 2010, 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, 2010, the District's ratings were Aa2/AA/AA+ from Moody's, S&P's, and Fitch Ratings, respectively. The District's Swap Insurers' ratings as of December 31, 2010 were as follows:

**Swap Insurers**

Related Bonds	Credit Support Provider	Credit rating by Moody's/S&P/Fitch	Notional Amount
Series 2008B	Syncora Guarantee	Ca/NR*/NR*	\$ 63,679,000
Series 2009	Assured Guaranty Municipal Corp.	Aa3/AA+/NR*	30,355,000
Series 2011	Assured Guaranty Municipal Corp.	Aa3/AA+/NR*	78,375,000
Series 2013	Assured Guaranty Municipal Corp.	Aa3/AA+/NR*	28,815,000
Total			<u>\$ 201,224,000</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 2008 swaps are cancelable at no cost to the District, at the District’s option, with the bond and swap insurer’s approval for the Bear Stearns 2008 swap, in a minimum exercise amount of \$1 million on any date after July 1, 2017. The District also has the right to cancel any outstanding swap at the prevailing market price for swaps.

**HEDGED DEBT**

As of December 31, 2010, aggregate debt service requirements of the District’s 2008B series bonds and net receipts/payments on associated hedging derivative instruments are presented below. These amounts assume that current interest rates on the variable-rate bonds and the current reference rates of hedging derivative instruments will remain the same for their term. As these rates vary, interest payments on the variable-rate bonds and net receipts/payments on the hedging derivative instruments will vary. The hedging derivative instruments column reflects only net receipts/payments on derivative instruments that qualify for hedge accounting.

(amounts in thousands)	Principal	Interest	Hedging Derivative Instruments, Net	Total
2011	\$ 1,045	\$ 298	\$ 3,231	\$ 4,574
2012	1,110	295	3,192	4,597
2013	1,175	291	3,151	4,617
2014	1,250	287	3,108	4,645
2015	1,330	283	3,062	4,675
2016 - 2020	24,895	1,145	12,399	38,439
2021 - 2025	10,880	907	9,821	21,608
2026 - 2030	4,265	763	8,261	13,289
2031 - 2035	45,020	222	2,412	47,654
	<u>\$ 90,970</u>	<u>\$ 4,491</u>	<u>\$ 48,637</u>	<u>\$ 144,098</u>

**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. Of the total kilowatt-hours purchased by the retail electric distribution system during 2010, approximately 46% was provided by the Rocky Reach project, 31% by the Columbia River-Rock Island project, 10% by the Lake Chelan project and 13% from other sources.

Alcoa and the District entered into a Rocky Reach Power Sales Contract dated November 1957, as supplemented and amended, for 23% of the output of the Rocky Reach project. Alcoa’s interest in the 1957 contract was subsequently conditionally assigned to Colockum by an instrument entitled “Assignment” dated August 1964, and thereafter conditionally assigned to the District by an Assignment dated August 1992. Also in August 1992, Colockum and the District entered into an Industrial Power Sales Contract under which Colockum acquired certain rights to power from certain portions of the District’s system for use by Alcoa at its Wenatchee Works facilities. Effective October 2004, a Restated and Amended Industrial Power Sales Contract was entered into by Alcoa and Colockum and the District which supersedes all prior contracts. This current contract is effective through October 2011.

Under a provision of the current contract, during the operating period, the District remarkets the Surplus Rocky Reach Replacement Power (23% share of Rocky Reach output) that exceeds the load requirement at the Wenatchee Works aluminum plant. The remarketing net proceeds less cost of generation and administrative expenses are held by the District, but can be used by Colockum as a credit that can be applied to current and future purchases of energy from the District.

When Alcoa’s load exceeds the Rocky Reach Replacement Power, the District shall make available up to 42 MW of additional firm energy, to the extent needed for use at Wenatchee Works. Alcoa pays average industrial rates for this power unless the average monthly load at Wenatchee Works exceeds a threshold of 189.15 aMW.

Any portion of the additional 42 MW that is required to meet loads in excess of the threshold is sold to Alcoa at market price. The District shall purchase 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 is 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 and defined contribution 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.

The DRS CAFR and all information on the website is the responsibility of the State of Washington. Pricewaterhouse Coopers LLP (PwC), Independent accountant for the District has not audited or examined such information, and does not express an opinion or any other form of assurance with the respect thereto.

**PUBLIC EMPLOYEES' RETIREMENT SYSTEM (PERS) PLANS 1, 2 AND 3****PLAN DESCRIPTION**

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.

Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in a judicial retirement system); employees of legislative committees; employees of community and technical colleges, college and university employees not participating in national higher education retirement programs; judges of district and municipal courts; and employees of local governments.

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 exercise 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 retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

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, which is increased three percent annually. Plan 1 members may also 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 is granted at age 66 based upon years of service times the COLA amount (based on the consumer Price Index), 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 while actively serving in the military, if such credit makes them eligible to retire. 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 2 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. Effective July 22, 2007, said refund (adjusted as needed for specified legal reductions) is increased from 100 percent to 200 percent of the accumulated contributions if the member's death occurs in the uniformed service to the United States while participating in Operation Enduring Freedom or Persian Gulf, Operation Iraqi Freedom.

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 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 1,189 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2009:

Retirees and Beneficiaries Receiving Benefits	74,857
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	28,074
Active Plan Members Vested	105,339
Active Plan Members Non-vested	<u>53,896</u>
Total	<u>262,166</u>

**FUNDING POLICY**

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates and 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 Director of the Department of Retirement Systems sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 percent to 15 percent; 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, 2010, were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	5.31%	5.31%	5.31%**
Employee	6.00%	3.90%	***

\* The employer rates include the employer administrative expense fee currently set at 0.16%.  
 \*\* Plan 3 defined benefit portion only.  
 \*\*\* 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
2010	\$ 69,075	\$ 2,345,456	\$ 449,180
2009	\$ 153,035	\$ 2,951,314	\$ 562,500
2008	\$ 160,468	\$ 3,057,708	\$ 590,953

**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 \$11,000. The District's 401(a) Plan matching contributions for the years ending December 31, 2010 and 2009, were \$1.4 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 contributed 28% of the cost of 2010 and 2009 premiums for eligible retired plan members and their spouses. For the years ended December 31, 2010 and 2009, the District contributed \$126,000 and \$140,000, respectively, to the plan. Plan members receiving benefits contributed 72% of the premium costs for years 2010 and 2009. For the years ended December 31, 2010 and 2009, total member contributions were \$323,000 and \$364,000, respectively. Future contributions will be made 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 following table shows the components of the District's annual OPEB cost for years 2010 and 2009, the amount actually contributed to the plan and the changes in the District's net OPEB obligation:

	2010	2009
Annual required contribution (ARC)	\$ -	\$ -
Interest on net OPEB obligation	-	3,500
ARC adjustment	-	(53,500)
Annual OPEB cost	-	(50,000)
Contributions made	-	-
Increase/(decrease) in net OPEB obligation	-	(50,000)
Net OPEB obligation – beginning of year	-	50,000
Net OPEB obligation – end of year	\$ -	\$ -

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2010 and 2009 were as follows:

Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
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, 2010 and 2009, the plan was fully funded. The covered payroll (annual wages of active employees covered by the plan) was \$48.1 million and \$49 million for 2010 and 2009, 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. All actuarial valuations are as of the last actuarial report dated January 1, 2009.



**METHODS AND ASSUMPTIONS**

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, with generational improvements using 50% of Scale AA.

**INFLATION RATE**

An inflation rate of 2.3% was used for 2009 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, 2010 and 2009, for both projects is presented below. 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**

<b>(amounts in thousands)</b>	<b>Rocky Reach 2010</b>	<b>Columbia River- Rock Island 2010</b>	<b>Rocky Reach 2009</b>	<b>Columbia River- Rock Island 2009</b>
<b>ASSETS</b>				
Current assets	\$ 7,397	\$ 5,196	\$ 6,870	\$ 4,409
Restricted assets – current	5,557	13,708	4,566	13,341
Total Current Assets	<u>12,954</u>	<u>18,904</u>	<u>11,436</u>	<u>17,750</u>
Utility plant, net	372,085	316,599	383,613	311,510
Restricted assets – noncurrent	23,388	57,853	25,495	69,289
Deferred charges and other assets	5,727	13,999	7,032	15,163
Total assets	<u>\$ 414,154</u>	<u>\$ 407,355</u>	<u>\$ 427,576</u>	<u>\$ 413,712</u>
<b>LIABILITIES AND NET ASSETS</b>				
Current liabilities	\$ 16,571	\$ 33,504	\$ 12,386	\$ 32,574
Long-term debt	284,220	430,928	300,351	444,265
Other liabilities	-	5,120	1,642	2,624
Total liabilities	<u>300,791</u>	<u>469,552</u>	<u>314,379</u>	<u>479,463</u>
<b>Net Assets:</b>				
Invested in capital assets, net of related debt	366,594	73,821	378,494	75,798
Restricted	18,404	47,195	17,619	46,003
Unrestricted	(271,635)	(183,213)	(282,916)	(187,552)
Total net assets (deficit)	<u>113,363</u>	<u>(62,197)</u>	<u>113,197</u>	<u>(65,751)</u>
Total liabilities and net assets	<u>\$ 414,154</u>	<u>\$ 407,355</u>	<u>\$ 427,576</u>	<u>\$ 413,712</u>

## NOTES TO BASIC FINANCIAL STATEMENTS (CONT.)

### CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT)

(amounts in thousands)	Rocky Reach 2010	Columbia River- Rock Island 2010	Rocky Reach 2009	Columbia River- Rock Island 2009
Operating revenues	\$ 75,278	\$ 80,582	\$ 70,533	\$ 76,902
Less:				
Operating expenses	40,777	40,321	40,023	39,050
Depreciation and amortization	17,477	10,744	17,307	10,678
Operating income	17,024	29,517	13,203	27,174
Other expense	16,858	25,963	17,313	26,633
Change in net assets (deficit)	166	3,554	(4,110)	541
Total net assets (deficit) – beginning of year	113,197	(65,751)	117,307	(66,292)
Total net assets (deficit) – end of year	\$ 113,363	\$ (62,197)	\$ 113,197	\$ (65,751)

### CONDENSED STATEMENTS OF CASH FLOWS

(amounts in thousands)	Rocky Reach 2010	Columbia River- Rock Island 2010	Rocky Reach 2009	Columbia River- Rock Island 2009
Net cash provided (used) by:				
Operating activities	\$ 34,522	\$ 40,013	\$ 29,980	\$ 38,841
Capital and related financing activities	(35,927)	(53,964)	(16,186)	(22,124)
Investing activities	(3,243)	5,669	(3,952)	20,086
Net increase	(4,648)	(8,282)	9,842	36,803
Beginning cash and cash equivalents	13,298	47,649	3,456	10,846
Ending cash and cash equivalents	\$ 8,650	\$ 39,367	\$ 13,298	\$ 47,649

### NOTE 11: SUPPLEMENTAL DISCLOSURE OF TELECOMMUNICATION SERVICES

The District began installation of fiber-optic communications for utility use in 1999 after examining the various types of infrastructure that could be utilized to deliver advanced telecommunications services.

The resulting research showed that fiber-optic cable provided the most robust and cost-effective solution for delivering telecommunications services. Fiber has an extremely long life cycle and almost unlimited bandwidth capacity which should allow the District to migrate to new technologies without having to replace an expensive outside plant infrastructure.

In 2000, a change in state law granted PUDs wholesale telecommunications authority. The District is building out the fiber-optic network to share the benefit of the technology investment. The fiber-optic network now provides a backbone for the District's utility communication use, as well as infrastructure over which private service providers can deliver services, 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)	2010	2009
<b>Operating revenues</b>		
Wholesale fiber services	\$ 4,109	\$ 3,706
Fiber leasing	487	464
Intradistrict revenues	1,984	1,869
Total operating revenues	6,580	6,039
<b>Operating expenses</b>		
Administrative and general	1,522	1,678
Repairs and maintenance	1,043	743
Other operating	1,400	1,205
Depreciation expense	5,170	4,764
Total operating expense	9,135	8,390
Operating loss	(2,555)	(2,351)
Other expenses	4,856	4,733
Net loss before capital contributions	(7,411)	(7,084)
Capital contributions	5	10
Interfund equity transfers	94	-
Change in net assets	\$ (7,312)	\$ (7,074)

Following is a summary of the District's fiber-optic balance sheets as of December 31, 2010 and 2009.

(amounts in thousands)	2010	2009
<b>ASSETS</b>		
Current assets	\$ 3,108	\$ 7,186
Utility plant, net and other assets	60,888	63,002
Total assets	<u>\$ 63,996</u>	<u>\$ 70,188</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities	\$ 3,231	\$ 2,117
Long-term debt	91,100	91,094
Total liabilities	94,331	93,211
Net assets (deficit)*	(30,335)	(23,023)
Total liabilities and net assets	<u>\$ 63,996</u>	<u>\$ 70,188</u>

\*Includes \$18 million interfund equity transfer in 2007.

The District's capital investment in telecommunications plant and equipment for 2010 and 2009 was \$4.3 million and \$6 million, respectively. The District's cumulative capital investment in telecommunications plant and equipment as of December 31, 2010, was \$85.8 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 operates a self-insurance program covering building, property, liability and casualty losses that are below insurance deductibles and maintains a loss reserve fund in accordance with the self-insurance program policy. The District purchases several different types of property and liability insurance policies that have deductibles up to \$2.0 million depending on the line of coverage. The Hydro Systems and Utility Services participate in the program and make payments to the self-insurance fund based on monthly premiums established for the plan. These monies are invested in the Internal Service System to maintain a target balance of \$1.5 million for the payment of future claims. Interest earnings on the reserve fund, net of claims and interest paid, are returned to the Hydro Systems and Utility Services annually in the form of an interest rebate. Claims incurred as of December 31, 2010 and 2009 amounted to \$0 and \$836,000, respectively.

The District is exposed to various risks of loss related to injuries to employees and has elected self-insurance for workers compensation claims up to \$500,000 per incident. The District purchases excess workers compensation liability insurance to cover large claims in excess of the deductible. The District has a cumulative self-insurance reserve fund of \$100,000, as required by law, and a claims fund of \$1.0 million, in accordance with the program policy. The Hydro

Systems and Utility Services participate in the program and make payments to the self-insurance fund based on monthly premiums established for the plan. These monies are invested in the Internal Service System, and earnings on these investments, net of claims paid, accumulate in the fund to maintain a target balance of \$1.0 million for the payment of future claims.

The District determined an accrual for workers compensation claims based upon an estimate of actual claims incurred minus stop loss insurance coverage plus a reserve for claims incurred but not yet reported of \$151,000 and \$97,000 at December 31, 2010 and 2009, respectively.

The District has elected self-insurance for medical health benefits and established the medical self-insurance reserve fund of \$2 million, as required by law. The Hydro Systems and Utility Services participate in the program and make payments to the self-insurance fund based on monthly health insurance premiums associated with benefit plans for employees. These monies are invested in the Internal Service System, and earnings on these investments, net of claims paid, accumulate to be used for the payment of future claims.

The District determined an accrual for medical and health benefit claims based upon an estimate of actual claims incurred plus a reserve for claims incurred but not yet reported of \$1.1 million and \$1.3 million at December 31, 2010 and 2009, respectively.

The District has elected self-insurance for dental benefits. Monies from the "Stabilization Reserve" previously held by the third party plan administrator, Washington Dental Service, were used to establish the dental self-insurance reserve fund of \$75,000. The Hydro Systems and Utility Services participate in the program and make payments to the self-insurance fund based on monthly dental insurance premiums associated with benefit plans for employees. These monies are invested in the Internal Service System and earnings on these investments, net of claims paid, accumulate to be used for the payment of future claims.

The District determined an accrual for dental benefit claims based upon an estimate of actual claims incurred plus a reserve for claims incurred but not yet reported of \$60,000 and \$71,000 at December 31, 2010 and 2009, respectively.

**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 current

licenses for the Rocky Reach and Rock Island projects. 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) and the Confederated Tribes of the Colville Reservation in March 2002. The Yakama Nation subsequently signed the HCPs in April 2005. 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 HCPs are included in the Comprehensive Settlement Agreement for the 2009 Rocky Reach FERC license.

In 1998, the Columbia River Distinct Population Segment of bull trout was listed by the USFWS as a threatened species under the ESA, and a Bull Trout Recovery Team was established. 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 is an active member of the Bull Trout Recovery Team and has developed comprehensive Bull Trout Management Plans for the Rocky Reach and Rock Island projects that will be coordinated with regional efforts. These plans were developed in response to the USFWS's biological opinion on potential effects

of the HCPs on bull trout, which are not covered by the HCPs. Implementation of the plans began in May 2005. As part of the Rocky Reach Project relicensing, a Comprehensive Bull Trout Management Plan was developed as part of the Rocky Reach Comprehensive Settlement Agreement. 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 of 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 will 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, 2010, the remaining construction commitment totaled approximately \$7.2 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 is being installed and should be completed by March 2011. The fourth stator will be installed starting approximately April 2012. As of December 31, 2010, the remaining construction commitment totaled approximately \$900,000.

#### **POWER MARKETING**

As of December 31, 2010, the District had entered into forward block contracts obligating it to deliver approximately 2,564,800 MWh of energy at various times during 2011, 2012 and 2013. The District expects to receive approximately \$117.5 million from the purchasers of this power. In addition, as part of the comprehensive forward energy hedging strategy implemented during 2010, the District 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 2011, 2012, 2013 and 2014, in exchange for approximately \$129.8 million.

The District has committed to purchase approximately 269,400 MWh of energy at a cost of approximately \$11.5 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.

#### **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. The bonds became due beginning in December 2003 through December 2016, with interest due semi-annually at rates ranging from 5.05% to 7.09%. 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 January 2003, NoaNet opened a \$5 million line of credit with Bank of America to fund capital expenditures. In accordance with the terms of the 2003 line of credit, additional draws were no longer available after December 31, 2005. The final payment was paid on the 2003 line of credit in March 2009. In June 2006, NoaNet opened a second \$5 million line of credit to fund additional capital renewals and replacements. In August 2008, NoaNet opened an additional \$1.5 million non-revolving line of credit to fund upgrades and expansions of capital facilities. In June 2009, NoaNet opened a fourth \$1.5 million line of credit to provide funding for improvements and expansions to capital facilities. Draws against the four lines of credit totaled \$2.4 million and \$4.2 million as of December 31, 2010 and 2009, 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 that it has no obligation to NoaNet or otherwise with respect to the Grant 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 any assessments imposed by a two-thirds majority of the Board.

The management of NoaNet anticipates meeting debt obligations through profitable operations, but

it will be necessary for NoaNet to assess members to cover operating deficits during the initial years of operation. Member assessments totaled \$921,000 and \$1.6 million for 2010 and 2009, respectively. The District's membership percentage in NoaNet is currently 11.71%. During 2010 and 2009, the District expended \$93,000 and \$159,000, respectively, related to member assessments. NoaNet recorded changes in net assets of \$4.8 million and \$652,000 during 2010 and 2009, respectively, based on the preliminary 2010 and 2009 financial reports. NoaNet financial results for 2010 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 \$561,000 and \$76,000 for the years ended December 31, 2010 and 2009, respectively. NoaNet had a negative net equity position for 2010 and 2009 of \$1.5 million and \$7.2 million, respectively.

For the NoaNet final 2010 financial report, please write: NoaNet, 616 State Street, Centralia, Washington, 98531, or go to [www.noanet.net](http://www.noanet.net).

The NoaNet financial report and all information on the website is the responsibility of NoaNet. PwC has not audited or examined such information, and 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, 2010, the District's share of bond principal was \$8.9 million and was not to exceed \$11.1 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 PwC report included with these financial statements relates solely to historical financial information of the District.

**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**

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)
1/1/2010	\$ 1,791,487	\$ 1,573,100	\$ (218,387)	114%	\$ 48,083,582	(0.45)%
1/1/2009	\$ 1,791,487	\$ 1,573,100	\$ (218,387)	114%	\$ 49,003,415	(0.45)%
1/1/2008	\$ 2,177,526	\$ 2,227,526	\$ 50,000	98%	\$ 48,046,983	0.10%
1/1/2007	\$ 2,177,526	\$ 2,177,526	\$ -	100%	\$ 46,311,261	0.00%

**COMBINING SCHEDULE OF ASSETS AND LIABILITIES AND NET ASSETS (AMOUNTS IN THOUSANDS)**

**FOR THE YEAR ENDED DECEMBER 31, 2010, WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2009**

	<b>Rocky Reach</b>	<b>Columbia River- Rock Island</b>	<b>Lake Chelan</b>	<b>Utility Services</b>	<b>Financing Facilities</b>	<b>Internal Services</b>	<b>2010</b>	<b>2009</b>
<b>CURRENT ASSETS</b>								
Cash and cash equivalents	\$ -	\$ -	\$ 4,417	\$ 53,859	\$ -	\$ 7,194	\$ 65,470	\$ 68,538
Investments	-	-	2,647	32,278	-	4,311	39,236	53,579
Accounts receivable, net	4,921	4,729	7	11,690	-	129	21,476	19,134
Accrued interest receivable	186	224	51	826	86	73	1,446	1,449
Materials and supplies	1,955	-	-	8,133	-	274	10,362	10,359
Prepayments and other	335	243	34	643	-	5	1,260	3,840
	<u>7,397</u>	<u>5,196</u>	<u>7,156</u>	<u>107,429</u>	<u>86</u>	<u>11,986</u>	<u>139,250</u>	<u>156,899</u>
<b>RESTRICTED ASSETS - CURRENT</b>								
Cash and cash equivalents	3,481	8,579	18	237	18,492	2,094	32,901	30,688
Investments	2,076	5,129	11	142	13,972	1,255	22,585	14,093
	<u>5,557</u>	<u>13,708</u>	<u>29</u>	<u>379</u>	<u>32,464</u>	<u>3,349</u>	<u>55,486</u>	<u>44,781</u>
<b>TOTAL CURRENT ASSETS</b>	<u>12,954</u>	<u>18,904</u>	<u>7,185</u>	<u>107,808</u>	<u>32,550</u>	<u>15,335</u>	<u>194,736</u>	<u>201,680</u>
<b>UTILITY PLANT</b>								
In service, at original cost	603,573	526,903	120,418	438,610	-	80,292	1,769,796	1,722,803
Construction work in progress	1,264	19,945	156	6,975	-	193	28,533	33,214
Less-accumulated depreciation	(232,752)	(230,249)	(21,363)	(166,286)	-	(52,371)	(703,021)	(659,499)
	<u>372,085</u>	<u>316,599</u>	<u>99,211</u>	<u>279,299</u>	<u>-</u>	<u>28,114</u>	<u>1,095,308</u>	<u>1,096,518</u>
<b>RESTRICTED ASSETS - NONCURRENT</b>								
Cash and cash equivalents	5,169	30,789	929	17,830	4,169	-	58,886	84,537
Investments	18,219	27,064	1,439	27,541	45,208	1,954	121,425	120,921
	<u>23,388</u>	<u>57,853</u>	<u>2,368</u>	<u>45,371</u>	<u>49,377</u>	<u>1,954</u>	<u>180,311</u>	<u>205,458</u>
<b>DEFERRED CHARGES AND OTHER ASSETS</b>								
Deferred financing costs	3,717	4,789	898	737	294	64	10,499	11,623
Fish protection costs	1,233	543	-	-	-	-	1,776	3,177
Long-term receivables, net	-	-	-	3,323	-	-	3,323	3,794
Long-term investments	-	-	4,121	68,171	-	6,711	79,003	62,739
Deferred regulatory charges	-	-	-	23,296	-	-	23,296	6,093
Derivative instrument asset	-	3,846	-	-	102	-	3,948	2,655
Deferred outflow of resources-derivatives	-	-	-	8,370	-	-	8,370	12,509
Other	777	4,821	6	208	-	44	5,856	7,780
	<u>5,727</u>	<u>13,999</u>	<u>5,025</u>	<u>104,105</u>	<u>396</u>	<u>6,819</u>	<u>136,071</u>	<u>110,370</u>
<b>TOTAL ASSETS</b>	<u>\$ 414,154</u>	<u>\$ 407,355</u>	<u>\$ 113,789</u>	<u>\$ 536,583</u>	<u>\$ 82,323</u>	<u>\$ 52,222</u>	<u>\$ 1,606,426</u>	<u>\$ 1,614,026</u>

COMBINING SCHEDULE OF ASSETS AND LIABILITIES AND NET ASSETS - CONT. (AMOUNTS IN THOUSANDS)

FOR THE YEAR ENDED DECEMBER 31, 2010, WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2009

	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	2010	2009
<b>CURRENT LIABILITIES</b>								
Current portion of long-term obligations	\$ 3,551	\$ 25,375	\$ 3,116	\$ 2,968	\$ -	\$ 391	\$ 35,401	\$ 32,364
Accounts payable	4,282	4,160	2,069	3,837	-	3,552	17,900	13,831
Accrued taxes	1,088	616	102	1,382	-	201	3,389	3,690
Accrued interest	492	314	-	25	15,754	-	16,585	16,244
Intersystem payables (receivables)	7,138	3,010	1,790	7,045	(15,677)	(3,306)	-	-
Accrued vacation and other	20	29	5	30	-	11,344	11,428	10,450
	16,571	33,504	7,082	15,287	77	12,182	84,703	76,579
<b>LONG-TERM DEBT</b>								
Revenue bonds and notes payable, less current portion	18,069	246,781	(1,688)	6,168	723,280	(391)	992,219	1,010,158
Intersystem loans payable (receivable)	266,151	184,147	85,419	76,161	(645,970)	34,092	-	-
	284,220	430,928	83,731	82,329	77,310	33,701	992,219	1,010,158
<b>OTHER LIABILITIES</b>								
Deferred wholesale power sales revenue	-	-	-	111,941	-	-	111,941	111,941
Derivative instrument liability	-	-	-	31,664	-	-	31,664	18,602
Deferred inflow of resources-derivatives	-	3,846	-	-	102	-	3,948	2,655
Licensing obligation, less current portion	-	-	7,858	-	-	-	7,858	7,693
Regulatory liabilities	-	798	-	1,479	-	-	2,277	-
Other liabilities	-	476	-	-	-	-	476	2,003
	-	5,120	7,858	145,084	102	-	158,164	142,894
<b>TOTAL LIABILITIES</b>	300,791	469,552	98,671	242,700	77,489	45,883	1,235,086	1,229,631
<b>TOTAL NET ASSETS</b>	113,363	(62,197)	15,118	293,883	4,834	6,339	371,340	384,395
<b>TOTAL LIABILITIES AND NET ASSETS</b>	\$ 414,154	\$ 407,355	\$ 113,789	\$ 536,583	\$ 82,323	\$ 52,222	\$ 1,606,426	\$ 1,614,026



**COMBINING SCHEDULE OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS (AMOUNTS IN THOUSANDS)**

**FOR THE YEAR ENDED DECEMBER 31, 2010, WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2009**

	<b>Rocky Reach</b>	<b>Columbia River- Rock Island</b>	<b>Lake Chelan</b>	<b>Utility Services</b>	<b>Financing Facilities</b>	<b>Internal Services</b>	<b>Intra- District Trans- actions(1)</b>	<b>2010</b>	<b>2009</b>
<b>OPERATING REVENUES</b>									
Retail sales	\$ -	\$ -	\$ -	\$ 54,989	\$ -	\$ -	\$ (733)	\$ 54,256	\$ 55,800
Wholesale sales	74,983	80,413	10,198	77,504	-	-	(83,056)	160,042	144,617
Other operating revenues	295	169	342	1,630	-	16,116	(16,495)	2,057	2,343
	<u>75,278</u>	<u>80,582</u>	<u>10,540</u>	<u>134,123</u>	<u>-</u>	<u>16,116</u>	<u>(100,284)</u>	<u>216,355</u>	<u>202,760</u>
<b>OPERATING EXPENSES</b>									
Purchased power and water	-	-	-	104,265	-	-	(81,072)	23,193	19,011
Generation	39,729	39,738	3,432	-	-	-	(13,286)	69,613	69,533
Utility services	-	-	-	33,032	-	-	(4,226)	28,806	25,470
Other operation and maintenance	-	-	-	-	-	8,266	(1,700)	6,566	8,904
Taxes	1,048	583	91	4,562	-	-	-	6,284	6,701
Depreciation and amortization	17,477	10,744	1,653	13,994	-	5,157	-	49,025	46,434
	<u>17,477</u>	<u>10,744</u>	<u>1,653</u>	<u>13,994</u>	<u>-</u>	<u>5,157</u>	<u>-</u>	<u>49,025</u>	<u>46,434</u>
<b>OPERATING INCOME (LOSS)</b>	17,024	29,517	5,364	(21,730)	-	2,693	-	32,868	26,707
<b>OTHER INCOME (EXPENSE)</b>									
Interest on long-term debt	(1,014)	(16,068)	-	(44)	(38,460)	-	66	(55,520)	(53,894)
Interest on intersystem loans	(17,078)	(11,892)	(5,218)	(2,590)	38,460	(1,616)	(66)	-	-
Amortization of deferred debt costs	(402)	(373)	(110)	(226)	-	(12)	-	(1,123)	(1,100)
Investment income	316	1,971	151	3,293	1,669	292	-	7,692	11,044
Federal subsidy income	-	-	-	-	630	-	-	630	245
Other	561	(274)	904	434	(2,298)	(385)	-	(1,058)	(1,007)
	<u>(17,617)</u>	<u>(26,636)</u>	<u>(4,273)</u>	<u>867</u>	<u>1</u>	<u>(1,721)</u>	<u>-</u>	<u>(49,379)</u>	<u>(44,712)</u>
<b>INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND INTERFUND EQUITY TRANSFERS</b>	(593)	2,881	1,091	(20,863)	1	972	-	(16,511)	(18,005)
<b>CAPITAL CONTRIBUTIONS</b>	759	673	-	2,024	-	-	-	3,456	2,886
<b>CHANGE IN NET ASSETS</b>	166	3,554	1,091	(18,839)	1	972	-	(13,055)	(15,119)
<b>TOTAL NET ASSETS</b>									
Beginning of year	113,197	(65,751)	14,027	312,722	4,833	5,367	-	384,395	399,514
<b>TOTAL NET ASSETS</b>									
End of year	\$ 113,363	\$ (62,197)	\$ 15,118	\$ 293,883	\$ 4,834	\$ 6,339	\$ -	\$ 371,340	\$ 384,395

1. Eliminating entries reduce operating revenue and expense to account for intradistrict transactions.

**COMBINING SCHEDULE OF CASH FLOWS (AMOUNTS IN THOUSANDS)**

**FOR THE YEAR ENDED DECEMBER 31, 2010, WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2009**

	<b>Rocky Reach</b>	<b>Columbia River-Rock Island</b>	<b>Lake Chelan</b>	<b>Utility Services</b>	<b>Financing Facilities</b>	<b>Internal Services</b>	<b>Intra-District Trans-actions(1)</b>	<b>2010</b>	<b>2009</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>									
Receipts from customers	\$ 74,871	\$ 79,738	\$ 10,542	\$ 133,112	\$ -	\$ 15,996	\$ (100,284)	\$ 213,975	\$ 202,749
Payments to suppliers	(19,003)	(17,766)	(1,678)	(119,812)	-	(6,851)	100,284	(64,826)	(70,386)
Payments to employees	(21,346)	(21,959)	(2,059)	(18,529)	-	(713)	-	(64,606)	(64,173)
Net cash provided by (used in) operating activities	34,522	40,013	6,805	(5,229)	-	8,432	-	84,543	68,190
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>									
Additions to plant	(3,820)	(14,683)	(10,033)	(11,018)	-	(1,971)	-	(41,525)	(69,485)
Additions to pooled assets	(362)	(296)	(22)	-	-	680	-	-	-
Proceeds from sale of plant	4	20	57	-	-	-	-	81	272
Proceeds of new third party debt	-	-	-	-	-	-	-	-	192,282
Principal (paid) received on debt & intersystem loans	(16,704)	(29,448)	(2,567)	257	18,355	(1,892)	-	(31,999)	(158,794)
Interest paid on debt & intersystem loans	(16,341)	(11,251)	(5,018)	(1,189)	40	(6,160)	-	(39,919)	(37,703)
Capital contributions	-	673	-	1,797	-	-	-	2,470	2,552
Other	1,296	1,021	1,119	222	(1,587)	(346)	-	1,725	(478)
Net cash provided by (used in) capital and related financing activities	(35,927)	(53,964)	(16,464)	(9,931)	16,808	(9,689)	-	(109,167)	(71,354)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>									
Investments, net	(3,512)	2,756	4,266	2,486	(15,989)	(953)	-	(10,946)	94,450
Interest on investments	269	2,038	215	3,425	1,473	300	-	7,720	12,438
Long-term receivables	-	-	-	471	-	-	-	471	(678)
Other, net	-	875	-	(2)	-	-	-	873	(245)
Net cash provided by (used in) investing activities	(3,243)	5,669	4,481	6,380	(14,516)	(653)	-	(1,882)	105,965
<b>NET (DECREASE) INCREASE IN CASH &amp; CASH EQUIVALENTS</b>									
	(4,648)	(8,282)	(5,178)	(8,780)	2,292	(1,910)	-	(26,506)	102,801
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>									
	13,298	47,649	10,542	80,706	20,370	11,198	-	183,763	80,962
<b>CASH &amp; CASH EQUIVALENTS, END OF YEAR</b>									
	\$ 8,650	\$ 39,367	\$ 5,364	\$ 71,926	\$ 22,662	\$ 9,288	\$ -	\$ 157,257	\$ 183,763
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>									
Operating income (loss)	\$ 17,024	\$ 29,517	\$ 5,364	\$ (21,730)	\$ -	\$ 2,693	\$ -	\$ 32,868	\$ 26,707
Depreciation and amortization	17,477	10,744	1,653	13,994	-	5,157	-	49,025	46,434
(Increase) decrease in operating assets:									
Accounts receivable, net	(406)	(844)	1	(1,011)	-	(120)	-	(2,380)	(8)
Materials and supplies	(75)	-	-	87	-	(15)	-	(3)	(6)
Prepayments and other	(18)	19	3	2,199	-	377	-	2,580	(2,466)
Increase (decrease) in operating liabilities:									
Accounts payable	696	812	(61)	931	-	(600)	-	1,778	(1,006)
Accrued taxes	(78)	-	19	(197)	-	(45)	-	(301)	(32)
Accrued vacation and other	(98)	(235)	(174)	498	-	985	-	976	(1,433)
Net cash provided by (used in) operating activities	\$ 34,522	\$ 40,013	\$ 6,805	\$ (5,229)	\$ -	\$ 8,432	\$ -	\$ 84,543	\$ 68,190

1. Eliminating entries reduce operating revenue and expense to account for intradistrict transactions.

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**APPENDIX B—UNAUDITED FINANCIAL DATA OF THE DISTRICT  
FOR THE SIX MONTHS ENDED JUNE 30, 2011**

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**CONDENSED COMBINING STATEMENTS OF REVENUES,  
EXPENSES AND CHANGES IN NET ASSETS (Unaudited)**

Six months ended June 30, 2011  
(in thousands)

	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra-District Transactions (1)	6 Months Ended 06/30/11	6 Months Ended 06/30/10
<b>OPERATING REVENUES</b>	\$ 37,845	\$ 38,049	\$ 5,731	\$ 72,135	\$ -	\$ 7,912	\$ (49,298)	\$ 112,374	\$ 108,635
<b>OPERATING EXPENSES</b>	28,740	23,214	3,195	72,557	-	7,072	(49,298)	85,480	92,612
<b>NET OPERATING INCOME</b>	9,105	14,835	2,536	(422)	-	840	-	26,894	16,023
<b>OTHER INCOME (EXPENSE) (2)</b>	(9,002)	(13,360)	(2,203)	276	52	(618)	-	(24,855)	(23,837)
<b>CAPITAL CONTRIBUTIONS</b>	-	7	-	764	-	-	-	771	1,534
<b>CHANGE IN NET ASSETS</b>	\$ 103	\$ 1,482	\$ 333	\$ 618	\$ 52	\$ 222	\$ -	\$ 2,810	\$ (6,280)

**CONDENSED COMBINING BALANCE SHEETS (Unaudited)**

June 30, 2011  
(in thousands)

ASSETS	Rocky Reach	Columbia River-Rock Island	Lake Chelan	Utility Services	Financing Facilities	Internal Services	Intra-District Transactions (1)	06/30/11	06/30/10
<b>CURRENT ASSETS</b>	\$ 6,917	\$ 3,567	\$ 6,799	\$ 93,743	\$ 229	\$ 12,126	\$ -	\$ 123,381	\$ 150,207
<b>RESTRICTED ASSETS - CURRENT</b>	4,362	7,076	7	272	34,388	3,904	-	50,009	45,052
<b>TOTAL CURRENT ASSETS</b>	11,279	10,643	6,806	94,015	34,617	16,030	-	173,390	195,259
<b>NET UTILITY PLANT</b>	367,211	316,442	98,493	275,637	-	26,043	-	1,083,826	1,092,595
<b>RESTRICTED ASSETS - NONCURRENT</b>	20,813	49,564	1,623	43,364	52,697	2,861	-	170,922	181,485
<b>DEFERRED CHARGES &amp; OTHER ASSETS</b>	4,891	13,877	5,690	96,195	30	8,639	-	129,322	142,888
<b>TOTAL ASSETS</b>	\$ 404,194	\$ 390,526	\$ 112,612	\$ 509,211	\$ 87,344	\$ 53,573	\$ -	\$ 1,557,460	\$ 1,612,227
<b>LIABILITIES AND NET ASSETS</b>									
<b>CURRENT LIABILITIES</b>	\$ 9,770	\$ 27,579	\$ 4,572	\$ 4,760	\$ 12,307	\$ 16,034	\$ -	\$ 75,022	\$ 71,053
<b>INTERSYSTEM PAYABLE (RECEIVABLE) - CURRENT</b>	4,547	2,673	1,656	5,641	(12,115)	(2,402)	-	-	-
<b>LONG-TERM DEBT</b>	276,411	415,279	83,196	81,943	82,266	33,380	-	972,475	996,001
<b>DEFERRED REVENUES</b>	-	-	-	111,941	-	-	-	111,941	111,941
<b>OTHER LIABILITIES</b>	-	5,710	7,737	10,425	-	-	-	23,872	55,117
<b>TOTAL LIABILITIES</b>	290,728	451,241	97,161	214,710	82,458	47,012	-	1,183,310	1,234,112
<b>TOTAL NET ASSETS</b>	113,466	(60,715)	15,451	294,501	4,886	6,561	-	374,150	378,115
<b>TOTAL LIABILITIES &amp; NET ASSETS</b>	\$ 404,194	\$ 390,526	\$ 112,612	\$ 509,211	\$ 87,344	\$ 53,573	\$ -	\$ 1,557,460	\$ 1,612,227

<b>ELECTRIC</b>	2011	2010
As of June 30		
Number of Customers	48,181	48,020
Number of Residential Customers	35,803	35,663
YTD Average Residential Rate (Cents/kWh)	3.42	3.39

<b>POWER GENERATION (MWh)</b>	2011	2010
12 months ended June 30		
Lake Chelan	467,296	357,243
Rocky Reach	6,317,584	4,664,862
Rock Island	3,034,265	2,430,212

<b>HYDRO COST/MWH GENERATED (\$/MWh)</b>	2011	2010
12 months ended June 30		
Lake Chelan	\$ 23	\$ 25
Rocky Reach	12	15
Rock Island	26	32

**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, 2010. 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 NINTH SUPPLEMENTAL RESOLUTION**

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## APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF THE MASTER RESOLUTION AND THE NINTH SUPPLEMENTAL RESOLUTION

The following is a summary of certain provisions of the Master Resolution and the Ninth 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.

### 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.

**“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 \$5,000 and any integral multiple thereof.

**“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.

**“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 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.

**“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.

**“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”** 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.

**“Escrow Agreement”** means an Escrow Agreement between the District and U.S. Bank, National Association, as Escrow Agent, relating to one or more series of the Refunded Bonds.

**“Event of Default”** means each event defined as such in “THE MASTER RESOLUTION—Events of Default” below.

**“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.

**“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.

**“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 January 1 and July 1 of each year, commencing January 1, 2012.

**“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 and supplemented, including by Resolution No. 07-13099, adopted by the Commission on April 30, 2007 (the “First Supplemental Resolution”), and as further supplemented, including by the Ninth Supplemental Resolution.

**“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).

**“Ninth Supplement”** or **“Ninth Supplemental Resolution”** means the Ninth Supplemental Resolution, adopted by the District’s Commission on October 24, 2011, and any amendments, modifications or supplements thereto.

**“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.

**“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).

**“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 the fifteenth day of the calendar month before each 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.

**“1998A Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Series 1998A, currently outstanding in the aggregate principal amount of \$28,050,000.

**“Refunded Bonds”** means the Series, maturities and principal amounts of the 2002A Bonds, the 2002B Bonds, the 2002C Bonds, the 2003A Bonds, the 2004A Bonds and the 2004B Bonds designated as such in the 2011C Delivery Certificate.

**“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.

**“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.

**“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.

**“Swap Agreement”** means the Master Agreement, dated as of April 13, 2006, between the Swap Counterparty and the District, including the Counterparty Schedule and Amendments, dated as of April 13, 2006 between the Swap Counterparty and the District.

**“Swap Counterparty”** means Goldman Sachs Mitsui Marine Derivative Products, L.P.

**“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 the certificate delivered by the District regarding compliance with applicable provisions of the Code in connection with the issuance of the Bonds.

**“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.

**“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.

**“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.

**“2002A Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Series 2002A, currently outstanding in the aggregate principal amount of \$44,905,000.

**“2002B Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Series 2002B, currently outstanding in the aggregate principal amount of \$35,000,000.

**“2002C Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Series 2002C, currently outstanding in the aggregate principal amount of \$25,240,000.



**“2003A Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Refunding Series 2003A, currently outstanding in the aggregate principal amount of \$29,440,000.

**“2004A Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Refunding Series 2004A, currently outstanding in the aggregate principal amount of \$5,510,000.

**“2004B Bonds”** means the Public Utility District No. 1 of Chelan County, Washington Chelan Hydro Consolidated System Revenue Bonds, Revenue and Refunding Series 2004B, currently outstanding in the aggregate principal amount of \$24,330,000.

**“2011C Bond Fund”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2011C Bond Fund” established pursuant to the Ninth Supplemental Resolution.

**“2011C Bonds”** means the District’s Consolidated System Revenue Bonds, Refunding Series 2011C authorized pursuant to the Master Bond Resolution and the Ninth Supplemental Resolution.

**“2011C Construction Fund”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2011C Construction Fund” established pursuant to the Ninth Supplemental Resolution.

**“2011C Delivery Certificate”** means a Certificate or Order of the District delivered at the time of issuance of the 2011C Bonds setting forth certain terms with respect to the 2011C Bonds as provided in the Ninth Supplemental Resolution.

**“2011C Reserve Account”** means the “Public Utility District No. 1 of Chelan County Consolidated System Revenue Bonds, Refunding Series 2011C Reserve Account” established pursuant to the Ninth Supplemental Resolution.

**“2011C Reserve Requirement”** means the maximum amount of interest payable in any Fiscal Year on the 2011C Bonds and on any Series of Bonds designated as a 2011C Reserve Account Series (as defined in the Ninth Supplemental Resolution), determined as of the dates of issuance thereof, unless otherwise specified in the 2011C Delivery Certificate.

**“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.

## **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 2011C 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 2011C 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 2011C 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) 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 NINTH SUPPLEMENTAL RESOLUTION

### General

The Ninth Supplemental Resolution authorized the issuance of the 2011C Bonds. Certain terms and provisions of the 2011C Bonds are contained in the 201C Delivery Certificate, which will be executed on the date of delivery of the 2011C Bonds.

### Terms of the 2011C Bonds

**General.** The 2011C Bonds will be issued in the form of fully registered bonds only, will be dated the date of delivery, and will mature and bear interest on the unpaid principal amount thereof as set forth in the 2011C Delivery Certificate.

Interest will be computed on the basis of a 360-day year consisting of twelve (12) 30-day months.

**Method of Payment.** The principal of and redemption premium, if any, on any 2011C Bond will be payable to the Owner thereof at the corporate office of the Trustee. Interest on the 2011C 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, however, that payment of interest to each Owner who owns of record \$1,000,000 or more in aggregate principal amount of 2011C 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.

### Registrar; Bond Registration Books

The Trustee is to be the initial Registrar for the 2011C Bonds. While any of the 2011C Bonds issued under the Ninth Supplemental Resolution are Outstanding, the Registrar will keep and maintain the Bond Register. The Registrar will make the Bond Register available to the District for its inspection during normal business hours.

### Establishment and Application of 2011C Bond Fund

The Ninth 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 2011C Bond Fund” (the “2011C Bond Fund”) to be held in trust by the Trustee. From Revenues, the Treasurer will transfer to the Trustee funds for deposit into the 2011C Bond Fund in the amounts and at the times necessary to pay the principal of, premium, if any, and interest on the 2011C Bonds as the same will become due and payable on each Interest Payment Date, redemption date or maturity date. On each Interest Payment Date, redemption date or maturity date, the Trustee will apply moneys in the 2011C Bond Fund to pay the principal of, premium, if any, and interest due on the 2011C Bonds on such date. The 2011C Bond Fund and the amounts on deposit therein will be subject to the pledge of the Master Bond Resolution for the benefit of the Owners of the 2011C Bonds.

### Establishment and Application of 2011C Construction Fund

The Ninth 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 2011C Construction Fund” (the “2011C Construction Fund”) to be held by the District. All amounts on deposit in the 2011C Construction Fund will be applied to pay the costs of issuance of the 2011C Bonds and to pay, or to reimburse the District for the payment of, the termination payment, if any, relating to the Swap Agreement.

**APPENDIX E—SUMMARY OF CERTAIN PROVISIONS OF  
THE LOAN RESOLUTIONS AND FINANCING AGREEMENTS**

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## **APPENDIX E - SUMMARY OF CERTAIN PROVISIONS OF THE LOAN RESOLUTIONS AND FINANCING AGREEMENTS**

The provisions of the Rock Island Loan Resolution and Rock Island Financing Agreement with Puget Sound Energy, Inc. (“Puget Sound Energy”), the sole power purchaser of the Rock Island System, are substantially the same as those in the Rocky Reach Loan Resolution and Rocky Reach Financing Agreement. However, the obligations of the District and Puget Sound Energy under the Rock Island Loan Resolution and the Rock Island Financing Agreement are divided between System I and System II, reflecting the differing percentages of output from each such system available to each of the District and Puget Sound Energy. See “CONSOLIDATED SYSTEM—Consolidated System Energy Resources—The Rock Island Power Sales Contract” in the body of the Official Statement. Because the provisions of both sets of loan resolutions and financing agreements are substantially similar, only certain definitions and operative provisions of the Rocky Reach Loan Resolution and Rocky Reach Financing Agreement have been summarized below. 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.

### **Definitions**

“Bonds” shall mean, collectively, (i) the Senior Bonds, (ii) the 1997A Bonds and (iii) any Additional Bonds.

“Capital Items” shall mean the capital items related to the Rocky Reach System the District determines to finance out of the Rocky Reach Construction Fund.

“Consolidated System Construction Funds” shall mean, collectively, (i) the construction funds established for the Senior Bonds pursuant to the Senior Resolution, (ii) the Chelan Hydro Consolidated System Revenue Bonds, Series 1997A, Capital Fund, established by the Third Supplemental Resolution and (iii) any additional construction fund established pursuant to a Supplemental Resolution authorizing the issuance of additional Bonds.

“Expense Payment” shall mean each expense payment required to be made by the Rocky Reach System Revenue Fund to the Chelan Hydro System Revenue Fund or if such fund is no longer maintained, to the general fund of the Chelan Hydro System as set forth in the Rocky Reach Loan Resolution.

“Interest Payment Date” shall have the meaning assigned thereto in each Supplemental Resolution.

“Loan Payment” shall mean each loan payment required to be made by the Rocky Reach System to the Chelan Hydro System Revenue Fund or if such fund is no longer maintained, to the general fund of the Chelan Hydro System as set forth in the Rocky Reach Loan Resolution.

“1997A Bonds” shall mean the District’s Chelan Hydro Consolidated System Revenue Bonds, Series 1997A.

“Project Output” shall have the meaning assigned thereto in the Rocky Reach Power Sales Contracts.

“Purchaser’s Allotment” shall have the meaning set forth in the Rocky Reach Power Sales Contracts.

“Rocky Reach Construction Fund” shall mean the Rocky Reach Construction Fund established and maintained by the District pursuant to the Rocky Reach Loan Resolution.

“Rocky Reach Loan Resolution” shall mean Resolution No. 97-10819 of the District, adopted by the Commission on September 15, 1997, as such resolution has been or may be amended or supplemented.

“Rocky Reach Portion” shall, at any time, mean with respect to any series of Bonds, that portion of the Outstanding Bonds of such series obtained by multiplying the aggregate principal amount of such Bonds by the fraction, the numerator of which is the then outstanding principal amount of the Loans made with the proceeds of such Bonds and the denominator of which is the aggregate principal amount of the Bonds of such series.

“Senior Bonds” shall mean bonds of the District issued pursuant to the Senior Resolution the proceeds of which were loaned to the Rocky Reach System pursuant to the 1990 Loan Resolution.

## **Loans**

Pursuant to the Rocky Reach Loan Resolution, the Chelan Hydro System shall from time to time loan proceeds of Bonds to the Rocky Reach System (each such loan, as reduced or increased from time to time, being a “Loan” and, collectively, the “Loans”) for the purpose of financing capital items for the Rocky Reach System. The proceeds of each Loan shall be used as follows: (i) a portion will constitute (x) costs of issuance (including underwriters’ discount) on the Bonds allocable to the Loan and (y) interest expense on the Bonds allocable to the Loan in the event investment earnings on amounts in the applicable Consolidated System Construction Fund were less than interest due on the Bonds for the period prior to such Loan (in no event to exceed 180 days of such shortfall), both as determined by the District; (ii) to fund a Reserve Fund, if any, for the related series of Bonds; and (iii) the remainder shall be deposited in the Rocky Reach Construction Fund. The Rocky Reach Construction Fund shall be part of the Rocky Reach System.

The proceeds of a Loan deposited in the Rocky Reach Construction Fund shall be used only to finance the cost of capital items with respect to the Rocky Reach System. Notwithstanding the foregoing, proceeds of any Loan on deposit in the Rocky Reach Construction Fund may be used to redeem or to purchase (and cancel) the principal of the Bonds with respect to which such Loan was made in an amount not to exceed the Rocky Reach Portion of such Bonds and the outstanding principal amount of such Loan shall be correspondingly reduced by the principal amount of the Loan so applied.

## **Payments by Purchasers; Financing Agreements**

Pursuant to separate financing agreements with each of the Rocky Reach Purchasers (each, a “Rocky Reach Financing Agreement”) each Purchaser shall pay to the District for deposit in the Rocky Reach Revenue Fund, as additional mutually agreed-upon costs of the Project under Section 6(d)(3) of the Power Sales Contracts, an amount equal to its respective Purchaser’s Allotment multiplied by the amount of the Expense Payments and the Loan Payments due from time to time.

The Purchasers and the District acknowledge in the Rocky Reach Financing Agreement that, as required by the terms of the Rocky Reach Loan Resolution, the Expense Payments will be sufficient in time and amount to pay or reimburse the Chelan Hydro System for any premium paid to the holders of the Rocky Reach Portion of the Bonds upon the redemption thereof and for all expenses incurred by it in connection with issuing and servicing the Rocky Reach Portion of the Bonds (including such costs incurred for proposed bonds not issued), including, without limitation, (i) all costs of issuance with respect to the Bonds allocable to the Rocky Reach Portion of the Bonds, less any portion of such costs paid from the proceeds of the Loans or from amounts on deposit in the Rocky Reach Construction Fund, (ii) the portion allocable to the Rocky Reach Portion of the Bonds of the fees and expenses (including legal fees) of any trustee, any tender agent, any paying agent, any remarketing agent and the other fees related to the maintenance of the Bonds, (iii) any rebate amount required to be paid to the United States of America in excess of amounts on deposit in any excess earnings fund with respect to the Rocky Reach Portion of the Bonds and (iv) any costs of issuance of refunding bonds.

The Purchasers and the District acknowledge in the Rocky Reach Financing Agreement that, pursuant to the Rocky Reach Loan Resolution, the Loan Payments will consist of an interest component (“Interest Component”), a cover component (“Cover Component”) and a principal component (“Principal Component”).

The Interest Component of the Loan Payments due in each year will be an amount sufficient to pay the interest due on the Outstanding Rocky Reach Portion of the Bonds during that year. Such Interest

Component shall constitute all interest due and accruing on or with respect to the Loan Payments and the Interest Component of Loan Payments due in any year shall be payable in installments on or before each Interest Payment Date during that year, with each installment to be sufficient in time and amount to pay the interest on the Outstanding Rocky Reach Portion of the Bonds due and payable on that Interest Payment Date.

The Cover Component of the Loan Payments due in each year will be an amount equal to .15 times the Interest Component payable by the Rocky Reach System during that year and the Cover Component of the Loan Payments due in any year shall be payable in installments on or before each Interest Payment Date, with each installment to be sufficient in time and amount to pay .15 times the installment of the Interest Component due and payable on that date. Notwithstanding the foregoing, the Cover Component of the Loan Payments shall only be applied to pay principal and interest with respect to the Loan in the event that amounts received as the Principal Component and Interest Component are insufficient for such purpose.

Any amounts paid as the Cover Component by the Rocky Reach System shall be retained by the Chelan Hydro System and shall be deposited in a separate fund to be maintained within the Chelan Hydro System. Any interest earnings on amounts in such fund shall be retained in such fund. On the twenty-fifth day of each month any amounts in such fund (including the installment of the Cover Component due from the Purchasers and the District on such date) in excess of 0.15 times the Interest Component due in such year shall be credited against amounts due from the Purchasers.

The total amount of the Principal Components of the Loan Payments due will be an amount equal to the principal amount of the Rocky Reach Portion of the Bonds payable (a) upon the final maturity of Bonds, or (b) upon the redemption of the Bonds pursuant to any Supplemental Resolution, or (c) in the event that any Bonds cannot be remarketed on a Purchase Date and such Bonds are (x) purchased by the District and surrendered to the Registrar or (y) are purchased by a bank providing a credit facility securing such Bonds and the reimbursement agreement with respect to such credit facility requires such Bonds must be paid, redeemed or purchased by the District and surrendered to the Registrar.

The Principal Component shall be (a) reduced by the total amount of principal which would be required to be paid from the date of the Loan through the date of the Principal Component payment of the Bonds if the Rocky Reach Portion of the Bonds were amortized under a level debt service schedule using an interest rate equal to the weighted-average interest rate of the Bonds with respect to which the related Loans were made over a period of time equal to the weighted average service life of the related capital items and (b) reduced by the total amount of principal which would be required to be paid from the date of the expiration of the Power Sales Contracts through the expiration of the weighted average service life of the capital items with respect to which the related Loans were made if such Rocky Reach Portion of the Bonds were amortized under a level debt service schedule using an interest rate equal to the weighted average interest rate of the then Outstanding Bonds with respect to which the related Loans were made over a period of time equal to the weighted average service life of the related capital items, and (c) increased by an amount which reflects all payments due between the date of the Principal Component payment and the expiration of the Power Sales Contract with respect to additional loans for the purpose of funding additional capital items.

Notwithstanding the foregoing, prior to the date any Principal Component shall become due, the District will use its best efforts to issue refunding bonds (either taxable or tax-exempt) to refund the Bonds with respect to such Principal Component. If the District determines that it cannot issue refunding bonds prior to the due date of a Principal Component, the District will use its best efforts to thereafter issue such refunding bonds for the purpose of reimbursing the Purchasers for such Principal Component.

On the day prior to the expiration of the Power Sales Contracts, each Purchaser shall pay to the District an amount equal to all accrued but unpaid Expense Payments and Loan Payments up through the expiration of the Power Sales Contracts multiplied by such Purchaser's respective Purchaser's Allotment.

### **Refunding Bonds**

The District may issue bonds for the purpose of refunding any Rocky Reach Portion of Bonds ("Refunding Bonds") providing present value savings to the Purchasers through the end of the term of the Power

Sales Contracts. Such Refunding Bonds shall constitute Bonds under the Rocky Reach Loan Resolution in replacement of the Bonds so refunded. Costs of issuance of such Refunding Bonds shall be paid from the following sources in the following priority: (i) from the proceeds available thereof, if any, (ii) other available funds of the Rocky Reach System and (iii) as an Expense Payment. Upon the issuance of such Refunding Bonds, the District will issue to the Purchasers a revised Loan Certificate reflecting the new interest rate.

The District may issue Refunding Bonds which do not provide savings, provided, however, unless otherwise agreed to by the Purchasers who are purchasing two-thirds of the power purchased by the Purchasers pursuant to the Power Sales Contracts, such refunding shall not increase the Purchasers Loan Payment obligations (other than Expense Payments) under the Purchaser Financing Agreement.

### **Remarketing of Bonds**

The District shall use its reasonable best efforts and take all reasonable steps to establish or provide for the remarketing of the Bonds on each date of mandatory or optional tender for purchase unless, in its sole discretion, it shall decide to pay or redeem such Bonds on a date of mandatory or optional tender for purchase. If, however, the District attempts to remarket any Bonds and remarketing efforts fail, the District shall use its best efforts to refund the Bonds which are the subject of the failed remarketing prior to the cancellation thereof so long as the District can legally issue such refunding obligations for that purpose and the same can be remarketed.

### **Disputes**

The District and the Purchasers shall use their best efforts to resolve any dispute arising under the Rocky Reach Financing Agreement in a timely manner. In the event of an unresolved dispute relating to individual new capital items or modification having a total project cost of \$5,000,000 or less, as an alternative to the arbitration procedure provided for in the Power Sales Contracts, the District and the Purchasers agree that such dispute shall be resolved utilizing the following method of dispute resolution:

(a) The services of an independent third party mediator shall be retained by the parties. The selection of the mediator shall be agreed upon within 30 days from the date the District receives written notice that Purchasers who are purchasing two-thirds of the power purchased by the Purchasers pursuant to the Power Sales Contracts dispute an item(s). If the District and the Purchasers cannot agree on a mediator, the District shall instruct its consulting engineer to appoint a mediator who, in their opinion, shall have no bias to either the District or the Purchasers and shall possess professional qualifications and experience with electric utility projects which qualify the mediator to preside in the matter.

(b) The District and the Purchasers agree to meet with the mediator within 15 days after selection to discuss rejection, modification or substantiation of a disputed item. Such discussion shall not exceed 5 working days in duration.

(c) The mediator shall consider all comments, written or oral, of the Purchasers and the District. At any time during discussions the mediator may offer suggestions of compromise. A compromise resolve to any dispute must be mutually agreed upon by the Purchasers and the District to resolve a dispute. If a compromise is not offered or accepted by both parties, the mediator shall decide in favor of the District or the Purchasers and both parties shall abide by the decision to the extent that they can legally do so. The mediator shall use its best effort to utilize the Power Sales Contract directives to make judgment upon a disputed item.

Where disputed item(s) have an estimated total project cost in excess of \$5,000,000, the District and the Purchasers shall use their best efforts to resolve the dispute within 90 days of the District's receipt of written notice that the Purchasers who are purchasing two-thirds of the power purchased by the Purchasers pursuant to the Power Sales Contracts disputed such item(s). If such dispute is not resolved within 90 days (or such greater period as shall be agreed to by the District and the Purchasers), the Purchasers shall immediately seek arbitration of such dispute pursuant to Section 9 of the Power Sales Contracts. Failure to so act shall constitute approval by the Purchasers of the disputed capital item. Subject to the foregoing, the dispute resolution provisions of the Power Sales Contracts shall extend to all matters covered by the Rocky Reach Financing Agreement.

## **Power Sales Contract**

The Rocky Reach Financing Agreement is subject to the terms and provisions of the Power Sales Contracts. The Rocky Reach Financing Agreement is also subject to the terms and provisions of the Rocky Reach Resolution and the FERC License. Any conflict in terms between the Rocky Reach Financing Agreement and the Rocky Reach Resolution, the Power Sales Contracts or the FERC License shall be resolved in favor of the Rocky Reach Resolution, the Power Sales Contracts and the FERC License.

## **District's Obligations**

The District acknowledges and agrees that at all times the District is taking a percentage of the Project Output, the District shall have all the rights and obligations of a Purchaser under the Rocky Reach Financing Agreement (except for the rights of the Purchasers to consent to various actions or matters under the Rocky Reach Financing Agreement and the rights of the Purchasers arising under the Rocky Reach Financing Agreement which pertain to Sections 9, 22 and 23 of the Power Sales Contracts).

## **Term**

The initial term of the Rocky Reach Financing Agreement expired December 31, 2001. The ability of the District to make additional Loans was automatically renewed for a subsequent period of five (5) years from the initial renewal date of December 31, 2001 and is automatically renewed for subsequent periods of five (5) years on each renewal date thereafter unless the District or any Purchaser prior to 90 days before the next applicable renewal date provides notice in writing to the other parties of its intent not to renew the ability of the District to make additional Loans. In such case, the ability of the District to make additional Loans will terminate at 2400 hours Pacific Time on the next applicable renewal date. Notwithstanding the foregoing, the obligation of the District and the Purchasers under the Rocky Reach Financing Agreement with respect to Loans made prior to termination of the ability of the District to make additional Loans shall remain unaffected by any termination of the ability of the District to make additional Loans.



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**APPENDIX F—PROPOSED FORM OF OPINION OF BOND COUNSEL**

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[Delivery Date]

Public Utility District No. 1 of  
Chelan County, Washington  
Wenatchee, Washington

Re: Public Utility District No. 1 of Chelan County, Washington  
Consolidated System Revenue Bonds, Refunding Series 2011C (Taxable)  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to Public Utility District No. 1 of Chelan County, Washington (the “District”) in connection with issuance of \$164,425,000 aggregate principal amount of its Consolidated System Revenue Bonds, Refunding Series 2011C (Taxable) (the “2011C Bonds”), issued 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”), including as amended by Resolution No. 07-13099, adopted by the Commission on April 30, 2007 (the “First Supplemental Resolution”), as amended by Resolution No. 09-13481, adopted by the Commission on July 13, 2009 (the “Seventh Supplemental Resolution”), and as supplemented by Resolution No. 11-13684, adopted by the Commission on October 24, 2011 (the “Ninth Supplemental Resolution”), as supplemented by the Certificate of the District to be delivered at the time of issuance of the 2011C Bonds setting forth certain terms with respect to the 2011C Bonds (the “2011C Delivery Certificate,” and together with the Master Resolution, as supplemented and amended, including as amended by the First Supplemental Resolution and the Seventh Supplemental Resolution and as supplemented by the Ninth Supplemental Resolution, the “Resolution”). U.S. Bank National Association (the “Trustee”) has previously been appointed to serve as Trustee for the 2011C 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, opinions of counsel to the District and the Trustee, 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 2011C Bonds has concluded with their issuance, 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. We call attention to the fact that the rights and obligations under the 2011C Bonds and the Resolution 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 Official Statement or other offering material relating to the 2011C 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:

1. The 2011C 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 2011C 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 2011C Bonds are special limited obligations of the District payable from and secured by Revenues, subject to the prior payment of (i) Operation and Maintenance Expenses and (ii) debt service and reserve requirements with respect to the Senior Consolidated System Bonds. The 2011C 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 2011C 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 2011C Bonds. The 2011C 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 2011C Bonds is not excluded from gross income for federal income tax purposes. We express no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2011C Bonds.

**Circular 230 Disclaimer:**

Investors are urged to obtain independent tax advice regarding the 2011C Bonds based upon their particular circumstances. The tax discussion above regarding the 2011C Bonds was not intended or written to be used, and cannot be used, for the purposes of avoiding taxpayer penalties. The advice was written to support the promotion or marketing of the 2011C Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

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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 2011C (Taxable) (the “2011C Bonds”). The 2011C 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 Official Statement or in Appendix C – “Summary of Certain Provisions of the Master Resolution and the Ninth Supplemental Resolution.”

**The following information has been provided by DTC, and none of the District or any of the Underwriters 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 2011C Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2011C 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 2011C 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 2011C Bonds, except in the event that use of the book-entry system for the 2011C Bonds is discontinued.

To facilitate subsequent transfers, all 2011C 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 2011C 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 2011C Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such 2011C 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 2011C 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 2011C 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 2011C Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the 2011C 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 2011C 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 2011C Bonds, payment of the principal, interest and other payments on the 2011C Bonds to DTC Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interests in such 2011C 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 2011C 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 Official Statement. 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 2011C 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 2011C BONDS.**

So long as Cede & Co. is the registered owner of the 2011C Bonds, as nominee of DTC, references herein to the Owners or registered Bondholders of the 2011C Bonds (other than under the heading "TAX MATTERS" in the front portion of this Official Statement) shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the 2011C 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 UNDERWRITERS 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. (“PSE”), a utility company. Puget Energy has no significant assets other than the stock of PSE. Puget Energy and PSE 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 PSE, 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 PSE. Puget Energy had no employees and PSE had approximately 2,800 full-time equivalent employees as of December 31, 2010.

PSE is a public utility incorporated in the State of Washington in 1960. PSE 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, 2010, Puget Sound Energy had approximately 1,080,700 electric customers, and approximately 753,600 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**

PSE 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 PSE, are incorporated by reference herein:

- PSE’s Annual Report on Form 10-K for the year ended December 31, 2010;

- PSE's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011;
- PSE's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011; and
- PSE's Current Reports on Form 8-K filed on March 10, 2011 and March 25, 2011 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 2010 was approximately 59,000 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, 2010;
- Alcoa's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011;

- Alcoa's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011; and
- Alcoa's Current Reports on Form 8-K filed on January 11, 2011 and any other such reports.

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 NEW POWER SALES CONTRACT  
WITH PUGET SOUND ENERGY, INC.**



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## APPENDIX I - SUMMARY OF NEW 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 NEW POWER SALES CONTRACT  
WITH ALCOA, INC.**



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## APPENDIX J - SUMMARY OF NEW POWER SALES CONTRACT WITH ALCOA, INC.

The following is a summary of certain provisions of the Power Sales Agreement with Alcoa Power Generating Inc. and Alcoa Inc. (the “Power Sales Agreement”). 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 Agreement, 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 Agreement.

“**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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement

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 Agreement.

**“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 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 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement. 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 Agreement. “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 Agreement. For purposes of the Power Sales Agreement, 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 Agreement and described in “THE POWER SALES AGREEMENT—Determination of Chelan Power System Net Costs,” as such principal amount may have theretofore been reduced in accordance with the Power Sales Agreement and described in “THE POWER SALES AGREEMENT—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 AGREEMENT—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 Agreement 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and in blatant disregard for its express obligations under the Power Sales Agreement. Such term only relates to the failure to deliver Purchaser’s Share of Output to the extent required under the Power Sales Agreement, 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 Agreement.

**“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 Agreement 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 AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—Output, Scheduling, Planning and Transmission," subject to the limitations set forth in the Power Sales Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement 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 Agreement 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 AGREEMENT—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 Agreement.

“**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 AGREEMENT—Output; Surplus Energy Sales; Credits” as such amount may be adjusted from time to time pursuant to the terms of the Power Sales Agreement.

“**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 Agreement. This term will specifically include that certain Power Sales Agreement 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 Agreement. 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 Agreement.

**“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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement, which will be deemed to be the date recited in the first paragraph of the Power Sales Agreement.

**“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 Agreement.

**“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 AGREEMENT

### Term and Termination

**Term.** The Power Sales Agreement 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 Agreement pursuant to its terms. Unless terminated or extended, the Power Sales Agreement 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 Agreement 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 Agreement 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 AGREEMENT—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 Agreement; (3) the representations contained in the Power Sales Agreement 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 Agreement 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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement in accordance with the provisions of the Power Sales Agreement and described in "THE POWER SALES AGREEMENT—Term and Termination—Termination." Any such termination will apply to the Power Sales Agreement as a whole, and not severally as to the Output determined in relation to Rocky Reach or Rock Island.

**Termination.** The Power Sales Agreement 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 Agreement 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 Agreement and described in "THE POWER SALES AGREEMENT—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 AGREEMENT—Terms and Termination—Condition Precedent to Effectiveness;"; (iv) by the District pursuant to "THE POWER SALES AGREEMENT—Output; Surplus Energy Sales, Credits;"; (v) by the District pursuant to "THE POWER SALES AGREEMENT—Terms and Termination—Condition Precedent to Effectiveness." In the event the Power Sales Agreement 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 Agreement 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 Agreement 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 Agreement, 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 Agreement, 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 AGREEMENT—Output; Surplus Energy Sales; Credits—Mandatory Step-up."

PURCHASER ACKNOWLEDGES THAT, NOTWITHSTANDING ANY OTHER PROVISION OF THE POWER SALES AGREEMENT 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 Agreement, 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 AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement will be used by Purchaser solely at Wenatchee Works. Except as specifically provided in the Power Sales Agreement, 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 Agreement. 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 AGREEMENT—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 Agreement.

**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 Agreement 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 Agreement.

*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 Agreement 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and described in “THE POWER SALES AGREEMENT—Excess Energy Sales and Supplemental Power Purchases.” Pursuant to the Power Sales Agreement, 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 AGREEMENT—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 AGREEMENT—Excess Energy Sales and Supplemental Power Purchases.” Pursuant to the Power Sales Agreement, 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 Agreement, 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 Agreement 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 Agreement 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 Agreement described in “THE POWER SALES AGREEMENT—Output; Surplus Energy Sales; Credits” is required under the Power Sales Agreement, 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 Agreement described in “THE POWER SALES AGREEMENT—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 AGREEMENT—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 AGREEMENT—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 AGREEMENT—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 AGREEMENT—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 AGREEMENT—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 Agreement will be subject to set off and counterclaims for any payments due from Purchaser under the Power Sales Agreement, 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 Agreement will be forfeited by the Purchaser pursuant to the provisions described in “THE POWER SALES AGREEMENT—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 Agreement 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 AGREEMENT—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 Agreement 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 Agreement, 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 Agreement will be subject to set off and counterclaims arising from a default by Purchaser in the performance of its obligations under the Power Sales Agreement.

Surplus Proceeds and all Purchaser credits at the expiration or termination of the Power Sales Agreement will be subject to forfeiture pursuant to the Power Sales Agreement and described in “THE POWER SALES AGREEMENT—Payment” below.

***Special Rules During Shutdown Period.*** The parties recognize that the Capacity Reservation Charge contemplated in the Power Sales Agreement 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 Agreement and described in “THE POWER SALES AGREEMENT—Capacity, Reservation Charge Escalation Factor.”

***District’s Right to Terminate.*** The District may, in its sole discretion, terminate the Power Sales Agreement, 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 Agreement described in “THE POWER SALES AGREEMENT—Assignment”). The District’s termination of the Power Sales Agreement pursuant to the provisions described in “THE POWER SALES AGREEMENT—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 Agreement (other than the provisions described in “THE POWER SALES AGREEMENT—Payment”), for a term equal to the lesser of the Defaulting Participant’s remaining contract term or the remaining term of the Power Sales Agreement.

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 Agreement and described in “THE POWER SALES AGREEMENT—Output; Surplus Energy Sales; Credits,” will be determined under the Power Sales Agreement 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 AGREEMENT—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 Agreement (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 Agreement 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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement, 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 Agreement 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 Agreement.

### **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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—Curtailed and Decommissioning" will not limit or modify the scope of and limitations on the District's obligations under the Power Sales Agreement as otherwise set forth in "THE POWER SALES AGREEMENT—Output; Surplus Energy Sales; Credits" and the Power Sales Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—Curtailed and Decommissioning."

**Decommissioning.** Over the term of this Power Sales Agreement, 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 Agreement; 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 Agreement and described in "THE POWER SALES AGREEMENT—Output; Surplus Energy Sales; Credits."

**Load Shedding.** In addition to the foregoing and other rights of curtailment set forth in the Power Sales Agreement, 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 Agreement.

## **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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement 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 Agreement or an Intentional Breach of the Power Sales Agreement by the District.

“**Initial Shutdown Amount**” means the amount specified in the Power Sales Agreement 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 Agreement 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 Agreement 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 AGREEMENT—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 AGREEMENT—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 AGREEMENT—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 AGREEMENT—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 Agreement 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 AGREEMENT—Payments."

(iii) All amounts paid by the Purchaser to the District pursuant to "THE POWER SALES AGREEMENT—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 Agreement 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 Agreement, until a different calculation is made pursuant to the Power Sales Agreement.

**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 Agreement, 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement 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 Agreement (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 Agreement and described in “THE POWER SALES AGREEMENT—Default and Termination.” The Periodic Payments payable by Purchaser pursuant to the Power Sales Agreement for any month, will be independent of and not related to the amount of Output, if any, delivered to Purchaser under the Power Sales Agreement during such month.

**Final Payment.** Within ninety (90) days following the expiration or earlier termination of the Power Sales Agreement, 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 Agreement and described in “THE POWER SALES AGREEMENT—Payment” “—Determination of Chelan Power System Net Costs,” the District may use the Periodic Payments paid to the District under the Power Sales Agreement in any manner that the District, in its sole discretion, will determine.

**Disposition of Fund Balances Upon Expiration or Termination of Power Sales Agreement.** Upon the expiration or prior termination of the Power Sales Agreement at any time for any reason, all amounts collected pursuant to the Power Sales Agreement, 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 Agreement.

**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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement as described in “THE POWER SALES AGREEMENT—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 Agreement (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 Agreement, 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 Agreement.

***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 Agreement. 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 Agreement 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement or verification of Purchaser’s or the District’s compliance with the Power Sales Agreement; 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement is for a sale of Output as described in “THE POWER SALES AGREEMENT—Output, Surplus Energy Sales, Credits.” Nothing in the Power Sales Agreement 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement will be construed to create any implied obligations by the District with respect to the Purchaser's recommendations.

Nothing contained in the Power Sales Agreement 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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement will be to bring an action for mandamus to specifically enforce the District's covenants under the Power Sales Agreement.

### **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 Agreement, 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 Agreement 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 Agreement.

The District will not be liable to Purchaser for any damages or losses sustained by Purchaser (except as provided in the Power Sales Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement, 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 Agreement are expressly disclaimed.

The Parties confirm that the express remedies and measures of damages provided in the Power Sales Agreement against the Purchaser, and the express limitations as to remedies and damages provided in the Power Sales Agreement 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 Agreement, 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 AGREEMENT. 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 Agreement and described in “THE POWER SALES AGREEMENT—Output, Surplus Energy Sales, Credits,” “—Curtailment and Decommissioning” and “—Limitation of Liability.”

### **Assignment**

Neither Party will assign the Power Sales Agreement or its rights under the Power Sales Agreement 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 Agreement), pledge or encumber the Power Sales Agreement 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 Agreement as Purchaser under the Power Sales Agreement, 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 Agreement 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 Agreement 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 Agreement 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 Agreement 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 Agreement 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 Agreement.

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 Agreement.

### **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 Agreement if such failure is not remedied within three (3) Business Days after receipt of written notice, as required in the Power Sales Agreement;

(B) any representation or warranty made by such Party in the Power Sales Agreement 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 Agreement (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 Agreement;

(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 Agreement;

(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 Agreement 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 Agreement. Termination of the Power Sales Agreement by the District will not constitute a breach of the Power Sales Agreement.

**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 Agreement, other than any payment obligations that may be due or become due under the Power Sales Agreement, 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 Agreement and sue for damages as contemplated in “THE POWER SALES AGREEMENT—Default and Termination;”

(C) maintain successive proceedings against the Defaulting Party for recovery of damages (to the extent permitted under the Power Sales Agreement) or for a sum equal to any and all payments required to be made pursuant to the Power Sales Agreement; 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 Agreement, 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 Agreement.

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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement 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 Agreement 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 Agreement, 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 Agreement, 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 Agreement, or to exercise any right or remedy provided for in the Power Sales Agreement 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 Agreement with knowledge of the breach of any provisions of the Power Sales Agreement, will not be deemed a waiver of such breach. In addition to all other remedies provided in the Power Sales Agreement, 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 Agreement, or to a decree requiring performance of any of the provisions of the Power Sales Agreement or to any other remedy legally allowed to such Party.

*Calculation of District's Loss upon Termination.*

If the District terminates the Power Sales Agreement pursuant to the provisions of the Power Sales Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement. 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 Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement. 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 Agreement, 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 Agreement and the protection of its rights under the Power Sales Agreement (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 Agreement, 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 AGREEMENT—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 Agreement as described in “THE POWER SALES AGREEMENT—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 Agreement as a result of the District’s failure to consent to a Change in Control pursuant to the Power Sales Agreement and described in “THE POWER SALES AGREEMENT—Default and Termination.”

### **Dispute Resolution**

**General.** Any dispute arising out of, or relating to, the Power Sales Agreement, with the exception of those specifically excluded under the Power Sales Agreement, will be subject to the dispute resolution procedures specified in the Power Sales Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement (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 Agreement, 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 Agreement without first complying with the provisions of the Power Sale Agreement.

### **No Dedication of Facilities**

No undertaking under any provision of the Power Sales Agreement 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 Agreement 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 Agreement.

## **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 Agreement, 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 Agreement 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 Agreement.

**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 Agreement 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 Agreement and described in "THE POWER SALES AGREEMENT—Default and Termination" will be deemed to have occurred and the District will be entitled to the remedies set forth in the Power Sales Agreement and described in "THE POWER SALES AGREEMENT—Default and Termination" of the Power Sales Agreement.

## **Limitation of Liability**

**Limitation of Liability.** Except as provided in the Power Sales Agreement and described in "THE POWER SALES AGREEMENT—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 Agreement, 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 Agreement), 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 Agreement.



## **Entire Agreement; Modifications**

Except as may be expressly provided in the Power Sales Agreement, all previous communications between the Parties hereto, either verbal or written, with reference to the subject matter of the Power Sales Agreement are abrogated. The Purchaser's entitlement to Output under the Power Sales Agreement will only become effective on the expiration of the Prior Agreement, and nothing in the Power Sales Agreement will be deemed to supersede or supplement that agreement. Upon each respective Effective Date, the Power Sales Agreement will constitute the entire agreement between the Parties hereto with respect to the applicable Project. No modifications of or amendments to the Power Sales Agreement 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 Agreement, 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 Agreement, 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 Power Sales Agreement that are unique to Purchaser or Purchaser's performance (or failure to perform) under the Power Sales Agreement. 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 Agreement. 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 Agreement.

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 Agreement, 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 Agreement and described in “THE POWER SALES AGREEMENT—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 Agreement, the District, in its sole discretion, may use payments received from the Purchaser under the Power Sales Agreement in any manner that the District will determine.
- B. The moneys in any fund or account established pursuant to the Power Sales Agreement 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 Agreement 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 Agreement 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 Agreement 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 AGREEMENT—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 Agreement. 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 Agreement 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 Agreement.

## **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 Agreement. 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 Agreement. 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 Agreement, 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 Agreement.
  - 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 Agreement. 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 Agreement.
- 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.



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## APPENDIX K—FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this “Disclosure Certificate”) is entered into as of November 1, 2011, 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 \$164,425,000 aggregate principal amount of Consolidated System Revenue Bonds, Series 2011C (the “2011C 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. 09-13481, adopted by the Commission on July 13, 2009 (the “Seventh Supplemental Resolution”), and as supplemented by Resolution No. 11-13684, adopted by the Commission on October 24, 2011 (the “Ninth Supplemental Resolution” and together with the First Supplemental Resolution, the Seventh Supplemental Resolution and the Master Resolution, the “Resolution”), the District has provided for the issuance of the Bonds; and

WHEREAS, the underwriters with respect to the Bonds (the “Underwriters”) 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 Official Statement with respect to the Bonds dated October 26, 2011.

“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, 2011, 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 G 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 2011C

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

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