

**ERRATA
(Dated September 29, 2010)**

to Official Statement dated April 15, 2010

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

**\$40,265,000
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE AND REFUNDING BONDS, 2010 SERIES A
(NOT SUBJECT TO AMT)**

**\$10,665,000
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE REFUNDING BONDS, 2010 SERIES B
(SUBJECT TO AMT)**

**\$173,915,000
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE BONDS, 2010 SERIES L
(TAXABLE BUILD AMERICA BONDS—DIRECT PAYMENT)**

**\$90,000,000
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE BONDS, 2010 SERIES M
(NEW CLEAN RENEWABLE ENERGY BONDS – DIRECT PAYMENT)**

AND

**\$34,585,000
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE AND REFUNDING BONDS, 2010 SERIES Z
(TAXABLE)**

The Public Utility District No. 2 of Grant County, Washington (the “District”) hereby amends the following sections of the Official Statement dated April 15, 2010, for the above-referenced bonds.

In the “**Maturity Schedules, Interest Rates, Yields and CUSIP Numbers**” on the inside cover page relating to the 2010 Series L Bonds, the interest rate for the January 1, 2020 maturity has been corrected to **4.611%** (from 4.661%). The amended maturity schedule is shown below.

\$173,915,000
Revenue Bonds, 2010 Series L
(Taxable Build America Bonds – Direct Payment)

Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield/Price	CUSIP No.*	Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield/Price	CUSIP No.*
2018	\$3,050,000	4.361%	100.00%	387883PC9	2023	\$3,540,000	5.111%	100.00%	387883PH8
2019	3,140,000	4.461	100.00	387883PD7	2024	3,655,000	5.261	100.00	387883PJ4
2020	3,230,000	4.611	100.00	387883PE5	2025	3,785,000	5.411	100.00	387883PK1
2021	3,330,000	4.761	100.00	387883PF2	2026	3,920,000	5.530	5.536	387883PL9
2022	3,430,000	4.961	100.00	387883PG0	2027	4,055,000	5.630	5.636	387883PM7

\$26,370,000 5.73% Term Bonds due January 1, 2030 at a yield of 5.736%; CUSIP No.*: 387883PN5

\$112,410,000 5.83% Term Bonds due January 1, 2040 at a yield of 5.836%; CUSIP No.*: 387883PP0

In the “**Application of the Bond Proceeds**” subsection under the section “**PURPOSE AND APPLICATION OF BOND PROCEEDS**,” the Deposit to the Reserve Account for the 2010L Bonds is amended to **\$14,905,327** (from \$14,906,942), and the Underwriters’ Discount and Costs of Issuance for the 2010L Bonds is now **\$1,570,567** (instead of \$1,568,952). These amendments also change the total amount of the Deposit to the Reserve Account to **\$18,625,900** (from \$18,627,515) and the total of the Underwriters’ Discount and Costs of Issuance to **\$3,073,332** (from \$3,071,717). The amended table is shown below.

Application of the Bond Proceeds

The proceeds of the Bonds and other funding sources are expected to be applied as follows:

Sources and Uses

Sources	2010A Bonds	2010B Bonds	2010L Bonds	2010M Bonds	2010Z Bonds	Total
Par Amount of Bonds	\$ 40,265,000	\$ 10,665,000	\$ 173,915,000	\$ 90,000,000	\$ 34,585,000	\$ 349,430,000
Net Original Issue						
Premium/(Discount)	1,660,237	707,556	(132,584)	(66,600)	(26,336)	2,142,273
Transfer of 2010Z Bond						
Proceeds	0	737,152	0	0	0	737,152
Bond Fund	809,798	617,162	0	0	0	1,426,960
Total	\$ 42,735,035	\$ 12,726,870	\$ 173,782,416	\$ 89,933,400	\$ 34,558,664	\$ 353,736,385
Uses	2010A Bonds	2010B Bonds	2010L Bonds	2010M Bonds	2010Z Bonds	Total
Deposit to the Project Account	\$ 18,000,000	\$ 0	\$ 157,306,522	\$ 89,104,969	\$ 31,588,509	\$ 296,000,000
Deposit to the Refunding Account	23,139,425	12,160,576	0	0	0	35,300,001
Deposit to the Reserve Account	1,311,925	493,750	14,905,327	0	1,914,898	18,625,900
Transfer of 2010Z Bond Proceeds to 2010B Refunding Account	0	0	0	0	737,152	737,152
Underwriters’ Discount and Costs of Issuance (1)	283,685	72,544	1,570,567	828,431	318,105	3,073,332
Total	\$ 42,735,035	\$ 12,726,870	\$ 173,782,416	\$ 89,933,400	\$ 34,558,664	\$ 353,736,385

(1) Includes underwriter’s discount, financial advisor fees, rating fees, legal fees, escrow agent fees, and verification agent fees and costs of posting and printing the official statement.

In the “*Debt Service Requirements for the Priest Rapids Project*” subsection under the section “*THE PRIEST RAPIDS BONDS,*” the Interest and Total amounts for The Bonds, and the Aggregate Debt Service on Parity Bonds, for the years 2011 through 2020, inclusive, and the Total, have been corrected as shown in the following table.

Debt Service Requirements for the Priest Rapids Project

The following table gives debt service requirements for the Outstanding Parity Bonds and for the Bonds.

**Table 10
PRIEST RAPIDS PROJECT TOTAL DEBT SERVICE REQUIREMENTS**

Year (1)	Outstanding Parity Bonds (2)		The Bonds			Aggregate Debt Service on Parity Bonds (4)
	Priest Rapids	Wanapum	Principal	Interest	Total (3)	
2010	\$ 22,201,721	\$ 32,421,451	--	--	--	\$ 54,623,172
2011	22,198,118	32,401,795	\$ 3,740,000	\$ 12,674,172	\$ 16,414,172	71,014,085
2012	22,257,422	32,391,259	5,600,000	18,625,900	24,225,900	78,874,581
2013	22,243,344	32,408,769	5,750,000	18,477,127	24,227,127	78,879,240
2014	20,557,005	30,751,003	5,940,000	18,280,351	24,220,351	75,528,359
2015	20,566,916	30,767,647	6,150,000	18,074,621	24,224,621	75,559,184
2016	20,552,940	30,744,168	6,370,000	17,859,771	24,229,771	75,526,879
2017	19,512,285	30,002,416	6,595,000	17,635,671	24,230,671	73,745,372
2018	17,070,304	28,464,447	6,860,000	17,377,671	24,237,671	69,772,422
2019	17,066,494	28,458,419	5,300,000	17,056,972	22,356,972	67,881,885
2020	17,073,458	28,470,163	5,485,000	16,820,476	22,305,476	67,849,097
2021	14,089,438	25,447,401	5,680,000	16,582,708	22,262,708	61,799,547
2022	14,091,062	25,466,600	5,895,000	16,305,187	22,200,187	61,757,849
2023	10,604,456	20,239,919	6,130,000	16,010,213	22,140,213	52,984,588
2024	10,591,375	20,241,273	4,080,000	15,698,139	19,778,139	50,610,787
2025	10,587,437	20,243,714	4,230,000	15,482,853	19,712,853	50,544,004
2026	10,606,139	20,231,729	4,390,000	15,253,968	19,643,968	50,481,836
2027	10,603,418	20,243,864	94,555,000(5)	15,010,261	109,565,261	140,412,543
2028	10,593,090	20,238,989	9,970,000	9,686,314	19,656,314	50,488,393
2029	10,598,087	20,241,613	10,370,000	9,115,033	19,485,033	50,324,733
2030	10,106,671	19,832,832	10,790,000	8,520,832	19,310,832	49,250,335
2031	6,476,784	18,469,139	11,225,000	7,902,565	19,127,565	44,073,488
2032	6,480,036	18,467,746	11,685,000	7,248,148	18,933,148	43,880,930
2033	4,068,759	18,466,992	12,165,000	6,566,912	18,731,912	41,267,663
2034	4,061,963	18,470,359	12,675,000	5,857,693	18,532,693	41,065,015
2035	4,066,055	16,849,272	13,190,000	5,118,740	18,308,740	39,224,067
2036	--	16,849,962	13,735,000	4,349,763	18,084,763	34,934,725
2037	--	16,853,659	14,305,000	3,549,013	17,854,013	34,707,672
2038	--	9,869,629	14,895,000	2,715,031	17,610,031	27,479,660
2039	--	9,868,225	15,515,000	1,846,653	17,361,653	27,229,878
2040	--	9,870,771	16,160,000	942,128	17,102,128	26,972,899
2041	--	9,870,954	--	--	--	9,870,954
2042	--	9,867,711	--	--	--	9,867,711
Total (3)	\$ 358,924,772	\$ 723,483,884	\$ 349,430,000	\$ 356,644,884	\$ 706,074,884	\$ 1,788,483,546

(1) January 1 payments each year are allocated to the prior calendar year.

(2) Excludes the Refunded Bonds.

(3) Before the federal credit payments.

(4) Columns may not add due to rounding.

(5) The 2010M Bonds are New Clean Renewable Energy Bonds and the District has covenanted to deposit approximately equal sinking fund installments into a subaccount in the Principal and Bond Retirement Account no later than January 1 in the years 2011 through 2027 sufficient to pay the \$90,000,000 of such Bonds maturing on January 1, 2027. See “DESCRIPTION OF THE BONDS—Sinking Fund Payments-2010M Bonds.”

In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Internal Revenue Code of 1986, as amended (the “Code”), that must be satisfied subsequent to the issue date of the 2010A Bonds (except any 2010A Bond for any period during which it is held by a “substantial user” of the Priest Rapids Project or by a “related person” within the meaning of Section 147(a) of the Code), interest on the 2010A Bonds is excluded from gross income for federal income tax purposes. However, interest on the 2010A Bonds received by certain S corporations may be subject to tax, and interest on the 2010A Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. In the further opinion of Bond Counsel, interest on the 2010A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes. Bond Counsel expresses no opinion as to whether some or all interest on the 2010A Bonds is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income. Receipt of interest on the 2010A Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS—The 2010A Bonds.”

In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Code that must be satisfied subsequent to the issue date of the 2010B Bonds, interest on the 2010B Bonds (except any 2010B Bond for any period during which it is held by a “substantial user” of the Priest Rapids Project or by a “related person” within the meaning of Section 147(a) of the Code) is excluded from gross income for federal income tax purposes. However, interest on the 2010B Bonds received by individuals and corporations will constitute an item of tax preference for purposes of the federal alternative minimum tax applicable to individuals and corporations, interest on the 2010B Bonds received by certain S corporations may be subject to tax, and interest on the 2010B Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the 2010B Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS—The 2010B Bonds.”

In the further opinion of Bond Counsel, interest on the 2010L Bonds, 2010M Bonds and 2010Z Bonds is not excludable from gross income under Section 103 of the Code. See “TAX MATTERS—The 2010L Bonds, 2010M Bonds and 2010Z Bonds.”



**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE AND REFUNDING BONDS, 2010**

\$40,265,000		\$10,665,000
Series A (Not Subject to AMT)		Series B (Subject to AMT)
\$173,915,000	\$90,000,000	\$34,585,000
Series L (Taxable Build America Bonds – Direct Payment)	Series M (New Clean Renewable Energy Bonds – Direct Payment)	Series Z (Taxable)

Bonds Dated: Date of Delivery **Due: January 1, as shown on the inside cover pages**

The Bonds are issuable only as fully registered bonds without coupons and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company (“DTC”), New York, New York. DTC will act as securities depository of the Bonds. Individual purchases will be made in book-entry form only, in the principal amount of \$5,000 and integral multiples thereof. Purchasers will not receive certificates representing their interest in the Bonds purchased. The fiscal agent of the State of Washington in New York, New York, currently The Bank of New York Mellon, has been appointed as the Paying Agent and Registrar for the Bonds. The Bank of New York Mellon Trust Company, N.A., Seattle, Washington, has been appointed as Trustee for the Bonds.

Interest on the Bonds, first payable on January 1, 2011, and thereafter semiannually on July 1 and January 1 of each year, and principal of the Bonds are payable by the Paying Agent to DTC or its nominee, which is obligated to remit such principal and interest to its broker dealer Participants, which are obligated in turn to remit such principal and interest to the Beneficial Owners of the Bonds, as described in APPENDIX E—“BOOK-ENTRY SYSTEM.” Certain of the Bonds are subject to redemption prior to maturity. See “DESCRIPTION OF THE BONDS.”

The Bonds are being issued by the District to finance improvements to the Priest Rapids Project and to refund certain outstanding revenue bonds of the District. See “PURPOSE AND APPLICATION OF BOND PROCEEDS.” As permitted by the resolutions authorizing the Outstanding Parity Bonds, the District has consolidated the Priest Rapids Development and the Wanapum Development into one system called the Priest Rapids Project. The Bonds are payable from and secured by a lien and charge on the Gross Revenues of the Priest Rapids Project, after payment of Operating Expenses, and on certain other money, funds and accounts of the Priest Rapids Project. The Bonds are issued on a parity with the Outstanding Parity Bonds, currently outstanding in the principal amount of \$626,500,000 (of which \$34,470,000 will be refunded with proceeds of the Bonds) and any Future Parity Bonds. The District has covenanted not to issue any bonds with a lien on Gross Revenues senior to the lien securing the Parity Bonds. See “SECURITY FOR THE PARITY BONDS.”

THE 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, AND NEITHER THE FULL FAITH AND CREDIT OF THE DISTRICT NOR THE TAXING POWER OF THE DISTRICT IS PLEDGED TO THE PAYMENT THEREOF.

The maturity schedules for the Bonds are set forth in the inside cover pages.

This cover page is not intended to be a summary of the terms of, or security for, the Bonds. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of legality by Foster Pepper PLLC, Seattle, Washington, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by their counsel, K&L Gates LLP, Seattle, Washington. The Bonds are expected to be delivered on or about April 27, 2010, through the facilities of DTC in New York, New York, by Fast Automated Securities Transfer.

Citi

J.P. Morgan

Goldman, Sachs & Co.

MATURITY SCHEDULES, INTEREST RATES, YIELDS AND CUSIP NUMBERS

\$40,265,000
Revenue and Refunding Bonds, 2010 Series A
(Not Subject to AMT)

Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*	Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*
2011	\$2,705,000	2.00%	0.55%	387883QE4	2019	\$ 980,000	4.00%	3.49%	387883QN4
2012	4,035,000	2.00	1.20	387883QF1	2019	850,000	5.00	3.49	387883QP9
2013	4,115,000	3.00	1.54	387883QG9	2020	1,505,000	3.50	3.65	387883QQ7
2014	4,235,000	3.00	1.96	387883QH7	2020	405,000	5.00	3.65	387883QR5
2015	4,370,000	3.00	2.30	387883QJ3	2021	1,990,000	5.00	3.76**	387883QS3
2016	4,500,000	3.00	2.75	387883QK0	2022	2,085,000	5.00	3.83**	387883QT1
2017	4,550,000	3.50	3.04	387883QL8	2023	2,190,000	5.00	3.90**	387883QU8
2018	1,750,000	5.00	3.27	387883QM6					

\$10,665,000
Revenue Refunding Bonds, 2010 Series B
(Subject to AMT)

Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*	Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*
2011	\$ 790,000	2.00%	1.56%	387883QV6	2015	\$1,405,000	5.00%	3.00%	387883QZ7
2012	1,220,000	5.00	1.96	387883QW4	2016	1,470,000	5.00	3.50	387883RA1
2013	1,275,000	5.00	2.25	387883QX2	2017	1,545,000	5.00	3.79	387883RB9
2014	1,340,000	5.00	2.65	387883QY0	2018	1,620,000	5.00	4.05	387883RC7

* The CUSIP numbers herein 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 the 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.

** Priced to the par call date of January 1, 2020.

MATURITY SCHEDULES, INTEREST RATES, YIELDS AND CUSIP NUMBERS

\$173,915,000
Revenue Bonds, 2010 Series L
(Taxable Build America Bonds – Direct Payment)

Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield/Price	CUSIP No.*	Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield/Price	CUSIP No.*
2018	\$3,050,000	4.361%	100.00%	387883PC9	2023	\$3,540,000	5.111%	100.00%	387883PH8
2019	3,140,000	4.461	100.00	387883PD7	2024	3,655,000	5.261	100.00	387883PJ4
2020	3,230,000	4.661	100.00	387883PE5	2025	3,785,000	5.411	100.00	387883PK1
2021	3,330,000	4.761	100.00	387883PF2	2026	3,920,000	5.530	5.536	387883PL9
2022	3,430,000	4.961	100.00	387883PG0	2027	4,055,000	5.630	5.636	387883PM7

\$26,370,000 5.73% Term Bonds due January 1, 2030 at a yield of 5.736%; CUSIP No.*: 387883PN5

\$112,410,000 5.83% Term Bonds due January 1, 2040 at a yield of 5.836%; CUSIP No.*: 387883PP0

\$90,000,000
Revenue Bonds, 2010 Series M
(New Clean Renewable Energy Bonds – Direct Payment)

Maturity (January 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*
2027	\$90,000,000	5.63%	5.636%	387883PQ8

\$34,585,000
Revenue and Refunding Bonds, 2010 Series Z
(Taxable)

Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield/Price	CUSIP No.*	Maturity (Jan. 1)	Amount	Interest Rate	Initial Reoffering Yield/Price	CUSIP No.*
2011	\$245,000	1.55%	100.00%	387883PR6	2016	\$400,000	3.90%	100.00%	387883PW5
2012	345,000	2.05	100.00	387883PS4	2017	500,000	4.30	100.00	387883PX3
2013	360,000	2.66	100.00	387883PT2	2018	440,000	4.361	100.00	387883PY1
2014	365,000	3.20	100.00	387883PU9	2019	330,000	4.461	100.00	387883PZ8
2015	375,000	3.60	100.00	387883PV7	2020	345,000	4.611	100.00	387883QA2

\$2,010,000 5.411% Term Bonds due January 1, 2025 at a price of 100.00%; CUSIP No.*: 387883QB0

\$5,730,000 5.73% Term Bonds due January 1, 2030 at a yield of 5.736%; CUSIP No.*: 387883QC8

\$23,140,000 5.83% Term Bonds due January 1, 2040 at a yield of 5.836%; CUSIP No.*: 387883QD6

* The CUSIP numbers herein 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 the 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.

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 representation, other than the information and representations contained herein, in connection with the offering of the 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 solicitation of an offer to buy any of the Bonds in any jurisdiction in which it is unlawful to make such offer, solicitation or sale.

The information set forth herein has been obtained from the District and other sources that the District believes to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as a representation by the Underwriters. The information herein is 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. 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.

In connection with the offering of the Bonds, the Underwriters may overallocate or effect transactions which stabilize or maintain the market price of such Bonds at levels above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

The achievement of certain results or other expectations contained in forward-looking statements in this Official Statement involves known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The District does not plan to issue any updates or revisions to those forward-looking statements if or when its expectations or events, conditions or circumstances on which such statements are based occur.

The Bonds will not be registered under the Securities Act of 1933, as amended, or any state securities laws in reliance upon exemptions contained in such laws. The Bonds will not have been recommended by the Securities and Exchange Commission (“SEC”) or any other federal, state or foreign securities commission or regulatory authority, and no such commissions and regulatory authorities will have reviewed or passed upon the accuracy or adequacy of this Official Statement. Any representation to the contrary may be a criminal offense.

No action has been taken by the District that would permit a public offering of the Bonds or possession or distribution of this Official Statement or any other offering material in any foreign jurisdiction where action for that purposes is required. Accordingly, each of the Underwriters has agreed that it will comply with all applicable laws and regulations in force in any foreign jurisdiction in which it purchases, offers or sells the Bonds or possesses or distributes this Official Statement or any other offering material and will obtain any consent, approval or permission required by it for the purchase, offer or sale by it of the Bonds under the laws and regulations in force in any foreign jurisdiction to which it is subject to or in which it makes such purchases, offers or sales and the District shall have no responsibility therefor. See APPENDIX F—“INFORMATION CONCERNING OFFERING RESTRICTIONS IN CERTAIN JURISDICTIONS OUTSIDE THE UNITED STATES AND GLOBAL CLEARANCE PROCEDURES.”

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY
30 "C" Street S.W.
Ephrata, Washington 98823
(509) 754-0500

Commissioners

Bob Bernd..... President
Randall M. Allred..... Vice President
Thomas W. Flint..... Secretary
Terry Brewer..... Commissioner
Greg P. Hansen..... Commissioner

Senior Management

Tim J. Culbertson..... General Manager
Chuck Berrie..... Assistant General Manager
Joseph A. Lukas..... Senior Policy Advisor and Interim Director of Natural Resources
Jim A. Bunch..... Treasurer/Controller
Mitch Delabarre..... General Counsel
Kim K Justice..... Auditor
Andrew Munro..... Director of External Affairs
Kevin Nordt..... Director of Power Management
Anthony J. Webb..... Director of Customer Service
Dawn M. Woodward..... Director of Hydro
Michael V. Woywod..... Director of Support Services

Bond and Disclosure Counsel

Foster Pepper PLLC
Seattle, Washington

Paying Agent and Registrar

The Bank of New York Mellon
New York, New York

Bond Trustee

The Bank of New York Mellon Trust Company, N.A.
Seattle, Washington

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PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

OFFICIAL STATEMENT

RELATING TO

\$40,265,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE AND REFUNDING BONDS, 2010 SERIES A
(NOT SUBJECT TO AMT)**

\$10,665,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE REFUNDING BONDS, 2010 SERIES B
(SUBJECT TO AMT)**

\$173,915,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE BONDS, 2010 SERIES L
(TAXABLE BUILD AMERICA BONDS—DIRECT PAYMENT)**

\$90,000,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE BONDS, 2010 SERIES M
(NEW CLEAN RENEWABLE ENERGY BONDS – DIRECT PAYMENT)**

AND

\$34,585,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE AND REFUNDING BONDS, 2010 SERIES Z
(TAXABLE)**

INTRODUCTION

The purpose of this Official Statement, which includes the cover pages, inside cover pages and appendices, is to set forth information concerning Public Utility District No. 2 of Grant County, Washington (the “District” or “Grant County PUD”), the District’s Priest Rapids Hydroelectric Project (the “Priest Rapids Project”), which consists of the Priest Rapids Development and the Wanapum Development, certain of the purchasers of the output of the Priest Rapids Project other than the District (the “Power Purchasers”), the District’s electric transmission, distribution, telecommunications and generating system (the “Electric System”), and the District’s \$40,265,000 principal amount of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series A (Not Subject to AMT) (the “2010A Bonds”), \$10,665,000 principal amount of Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2010 Series B (Subject to AMT) (the “2010B Bonds”), \$173,915,000 principal amount of Priest Rapids Hydroelectric Project Revenue Bonds, 2010 Series L (Taxable Build America Bonds—Direct Payment) (the “2010L Bonds”), \$90,000,000 principal amount of Priest Rapids Hydroelectric Project Revenue Bonds, 2010 Series M (New Clean Renewable Energy Bonds – Direct Payment) (the “2010M Bonds”), and \$34,585,000 principal amount of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series Z (Taxable) (the “2010Z Bonds,” and together with the 2010A Bonds, the 2010B Bonds, the 2010L Bonds and the 2010M Bonds, the “Bonds”). Capitalized terms used herein and not defined have the meanings ascribed thereto in APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION.”

The Bonds are to be issued pursuant to Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington and Chapters 39.46 and 39.53 of the Revised Code of

Washington (collectively, the “Enabling Act”). The Bonds are authorized by Resolution No. 8475 of the District, adopted on April 15, 2010 (the “Bond Resolution”).

As permitted by the resolutions authorizing the Outstanding Parity Bonds, the District has consolidated the Priest Rapids Development and the Wanapum Development into one system called the Priest Rapids Project. See “SECURITY FOR THE PARITY BONDS—Pledge of Revenues; Consolidation of Developments.” The District has previously issued \$23,315,000 principal amount of its Priest Rapids Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series A, B and C (the “2001 Priest Rapids Bonds”), \$31,290,000 principal amount of its Priest Rapids Hydroelectric Development Second Series Revenue Bonds, 2003 Series A and Z (the “2003 Priest Rapids Bonds”), \$139,515,000 principal amount of its Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z (the “2005 Priest Rapids Bonds”), \$66,610,000 principal amount of its Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z (the “2006 Priest Rapids Bonds”), \$18,750,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 1999 Series D (the “1999 Wanapum D Bonds”), \$17,165,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series B and C (the “2001 Wanapum Bonds”), \$57,280,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Bonds, 2003 Series A, B and Z (the “2003 Wanapum Bonds”), \$127,780,000 principal amount of its Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z (the “2005 Wanapum Bonds”), and \$186,430,000 principal amount of its Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z (the “2006 Wanapum Bonds”). The 2001 Priest Rapids Bonds, 2003 Priest Rapids Bonds, 2005 Priest Rapids Bonds and 2006 Priest Rapids Bonds, 1999 Wanapum D Bonds, 2001 Wanapum Bonds, 2003 Wanapum Bonds, 2005 Wanapum Bonds and 2006 Wanapum Bonds are referred to as the “Outstanding Parity Bonds,” and the Outstanding Parity Bonds, the Bonds and any other bonds hereafter issued on a parity with such bonds (“Future Parity Bonds”) are collectively referred to herein as the “Parity Bonds.” The Outstanding Parity Bonds are currently outstanding in the aggregate principal amount of \$626,500,000 (of which \$34,470,000 will be refunded with proceeds of certain of the Bonds). For a summary of currently Outstanding Parity Bonds, see Table 17.

The Parity Bonds are secured by a lien and charge on the Gross Revenues, after payment of Operating Expenses, and on certain other money, funds and accounts of the Priest Rapids Project. The Bonds and the Outstanding Parity Bonds of the Priest Rapids and Wanapum Developments are payable from Gross Revenues of the Priest Rapids Project. See “SECURITY FOR THE PARITY BONDS.”

PURPOSE AND APPLICATION OF BOND PROCEEDS

Purpose of the Bonds

The Bonds are being issued to finance improvements to the Priest Rapids Project, refund certain outstanding revenue bonds of the District, fund the Reserve Account and pay costs of issuance of the Bonds. A portion of the proceeds of the 2010A Bonds, 2010B Bonds and 2010Z Bonds will be used to refund certain outstanding revenue bonds of the District, as described below. A portion of the proceeds from the 2010A Bonds and the proceeds of the 2010L Bonds will be used to finance capital improvements to the Priest Rapids Project. The proceeds from the 2010M Bonds will be used to finance capital improvements to the Wanapum Development as described in the application to the United States Treasury for a portion of the New Clean Renewable Energy Bond allocation. The net proceeds of the 2010Z Bonds will be used to finance the portion of the costs of such improvements and bonds being refinanced allocable to the use of the Priest Rapids Project output by investor-owned utilities and other private purchasers and to pay costs of issuance and refunding of the Refunded Bonds.

Refunding Plan

The bonds to be refunded with the proceeds of certain of the Bonds are identified below (“Refunded Bonds”).

Refunded Bonds

<u>Series</u>	<u>Principal Amount</u>	<u>Interest Rates</u>	<u>Maturities</u>	<u>Redemption Date</u>	<u>Price</u>
Priest Rapids 1999B	\$ 6,555,000	5.20-5.375%	2011-2012, 2014, 2016, 2018	May 27, 2010	101%
Wanapum 1998A	22,680,000	4.625-5.20	2011-2018, 2023	May 27, 2010	100
Wanapum 1999B	5,235,000	5.20-5.375	2011-2012, 2014, 2016, 2018	May 27, 2010	101

A portion of the net proceeds from the sale of the 2010A Bonds, 2010B Bonds and 2010Z Bonds will be deposited in the 2010 Refunding Account (the “Refunding Account”) and used to purchase Escrow Obligations (as defined below) to be held by The Bank of New York Trust Company, N.A. (the “Escrow Agent”) under an escrow agreement (the “Escrow Agreement”), dated the date of delivery of the Bonds, between the District and the Escrow Agent. Funds will be irrevocably deposited in the Refunding Account and will be used to purchase direct, noncallable, obligations of the United States of America (the “Escrow Obligations”). The Escrow Obligations will mature at such times and pay interest in such amounts so that, with other available funds held by the Escrow Agent under the Escrow Agreement, sufficient money will be available to pay the interest on the Refunded Bonds coming due on and prior to their respective redemption dates and to redeem and retire the Refunded Bonds on the respective redemption dates set forth above. Since all payments of principal of and interest on the Refunded Bonds will thereafter be provided for from money and securities on deposit with the Escrow Agent under the Escrow Agreement, the liens, pledges and covenants securing the Refunded Bonds will terminate and be discharged and released.

An independent verification shall be obtained from Causey Demgen & Moore Inc. stating that the Escrow Obligations held by the Escrow Agent and the interest to be earned thereon, together with any money held by the Escrow Agent, will be sufficient to make all such interest payments to the redemption date for the Refunded Bonds and to pay the principal and premium, if any, of the Refunded Bonds on the dates fixed for redemption. The verification will also confirm the correctness of the mathematical computations supporting the conclusion of Bond Counsel that the 2010A Bonds and 2010B Bonds are not “arbitrage bonds” as defined by Section 148 of the Internal Revenue Code of 1986, as amended.

Application of the Bond Proceeds

The proceeds of the Bonds and other funding sources are expected to be applied as follows:

Sources and Uses						
Sources	2010A Bonds	2010B Bonds	2010L Bonds	2010M Bonds	2010Z Bonds	Total
Par Amount of Bonds	\$ 40,265,000	\$ 10,665,000	\$ 173,915,000	\$ 90,000,000	\$ 34,585,000	\$ 349,430,000
Net Original Issue Premium/(Discount)	1,660,237	707,556	(132,584)	(66,600)	(26,336)	2,142,273
Transfer of 2010Z Bond Proceeds	0	737,152	0	0	0	737,152
Bond Fund	809,798	617,162	0	0	0	1,426,960
Total	\$ 42,735,035	\$ 12,726,870	\$ 173,782,416	\$ 89,933,400	\$ 34,558,664	\$ 353,736,385

Uses	2010A Bonds	2010B Bonds	2010L Bonds	2010M Bonds	2010Z Bonds	Total
Deposit to the Project Account	\$ 18,000,000	\$ 0	\$ 157,306,522	\$ 89,104,969	\$ 31,588,509	\$ 296,000,000
Deposit to the Refunding Account	23,139,425	12,160,576	0	0	0	35,300,001
Deposit to the Reserve Account	1,311,925	493,750	14,906,942	0	1,914,898	18,627,515
Transfer of 2010Z Bond Proceeds to 2010B Refunding Account	0	0	0	0	737,152	737,152
Underwriters' Discount and Costs of Issuance (1)	283,685	72,544	1,568,952	828,431	318,105	3,071,717
Total	\$ 42,735,035	\$ 12,726,870	\$ 173,782,416	\$ 89,933,400	\$ 34,558,664	\$ 353,736,385

(1) Includes underwriter's discount, financial advisor fees, rating fees, legal fees, escrow agent fees, and verification agent fees and costs of posting and printing the official statement.

DESCRIPTION OF THE BONDS

General Terms

The 2010A Bonds will be issued in the aggregate principal amount of \$40,265,000 and will be dated the date of their delivery. The 2010A Bonds will bear interest at the rates per annum set forth on the inside cover pages hereof, payable January 1, 2011, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover pages hereof. Interest on the 2010A Bonds is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals or corporations. See "TAX MATTERS—The 2010A Bonds."

The 2010B Bonds will be issued in the aggregate principal amount of \$10,665,000 and will be dated the date of their delivery. The 2010B Bonds will bear interest at the rates per annum set forth on the inside cover pages hereof, payable January 1, 2011, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover pages hereof. The 2010B Bonds are private activity bonds, and interest on the 2010B Bonds is a preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations. See "TAX MATTERS—The 2010B Bonds."

The 2010L Bonds will be issued in the aggregate principal amount of \$173,915,000 and will be dated the date of their delivery. The 2010L Bonds will bear interest at the rates per annum set forth on the inside cover pages hereof, payable January 1, 2011, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover pages hereof. Interest on the 2010L Bonds is not excludable from gross income for purposes of federal income taxation under Section 103 of the Code. The District will make elections so that the 2010L Bonds are treated as “Build America Bonds.” See “—Designation of 2010L Bonds as ‘Build America Bonds’ and 2010M Bonds as ‘New Clean Renewable Energy Bonds’” and “TAX MATTERS—The 2010L Bonds, 2010M Bonds and 2010Z Bonds.”

The 2010M Bonds will be issued in the aggregate principal amount of \$90,000,000 and will be dated the date of their delivery. The 2010M Bonds will bear interest at the rates per annum set forth on the inside cover pages hereof, payable January 1, 2011, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in the year set forth on the inside cover pages hereof. Interest on the 2010M Bonds is not excludable from gross income for purposes of federal income taxation under Section 103 of the Code. The District will make elections so that the 2010M Bonds are treated as “New Clean Renewable Energy Bonds” and for which the District will receive a credit from the federal government. See “—Designation of 2010L Bonds as ‘Build America Bonds’ and 2010M Bonds as ‘New Clean Renewable Energy Bonds’” and “TAX MATTERS—The 2010L Bonds, 2010M Bonds and 2010Z Bonds.”

The 2010Z Bonds will be issued in the aggregate principal amount of \$34,585,000 and will be dated the date of their delivery. The 2010Z Bonds will bear interest at the rates per annum set forth on the inside cover pages hereof, payable January 1, 2011, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover pages hereof. Interest on the 2010Z Bonds is not excludable from gross income for purposes of federal income taxation under Section 103 of the Code. See “TAX MATTERS—The 2010L Bonds, 2010M Bonds and 2010Z Bonds.”

The Bonds will be issuable in registered form, in the denomination of \$5,000 or any integral multiple thereof within a single series and maturity. Interest is calculated based on a 360-day year consisting of 12 months of 30 days each. The fiscal agent of the State of Washington in New York, New York, currently The Bank of New York Mellon, is the initial Registrar and Paying Agent for the Bonds.

The Bonds will be issued in fully registered form initially in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Bonds. Individual purchases may be made in book-entry form only as described below. Purchasers will not receive certificates representing their interest in the Bonds purchased. So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the “registered owners” or “bondowners” shall mean Cede & Co. and shall not mean the “Beneficial Owners” of the Bonds. In this Official Statement, the term “Beneficial Owner” shall mean the person for whom a DTC participant or indirect participant acquires an interest in the Bonds.

So long as Cede & Co. is the registered owner of the Bonds, principal of and interest on the Bonds are payable by wire transfer by the Registrar to DTC, which in turn is obligated to remit such principal and interest to the DTC participants for subsequent disbursements to Beneficial Owners of the Bonds. See APPENDIX E—“BOOK-ENTRY SYSTEM.”

Designations of 2010L Bonds as “Build America Bonds” and 2010M Bonds as “New Clean Renewable Energy Bonds”

2010L Bonds Designated as “Build America Bonds.” The District has made irrevocable elections to have Section 54AA of the Code apply to the 2010L Bonds so that the 2010L Bonds are treated as “Build America Bonds,” and to have Subsection 54AA(g) of the Code apply to the 2010L Bonds so that the 2010L Bonds are treated as “qualified bonds” with respect to which the District will be allowed a credit payable by the United States Treasury to the District pursuant to Section 6431 of the Code. The District will be allowed a credit in an amount equal to 35% of the interest payable on the 2010L Bonds on each 2010L Bond interest payment date.

2010M Bonds as “New Clean Renewable Energy Bonds.” The District has received an allocation of new clean renewable energy bonds in the amount of \$140,046,217.24 (the District’s “allocation”). The District has made an irrevocable election to have Section 6431(f) of the Code apply to the 2010M Bonds so that the 2010M Bonds are treated as “specified tax credit bonds,” with respect to which the District will be allowed a credit payable by the United States Treasury to the District pursuant to Section 6431 of the Code. The credit allowed to the District shall be in an amount equal to the lesser of (i) the amount of interest payable on the 2010M Bonds on each interest payment date or (ii) 70% of the amount of interest which would have been payable on the 2010M Bonds on such date if such interest were determined at the applicable credit rate determined under Section 54A(b)(3) of the Code with respect to the 2010M Bonds.

As a result of these elections, interest on the 2010L Bonds and 2010M Bonds is not excludable from gross income of Owners of the 2010L Bonds and 2010M Bonds under Section 103 of the Code, and Owners of the 2010L Bonds and 2010M Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2010L Bonds and 2010M Bonds. *See* “TAX MATTERS—The 2010L Bonds, 2010M Bonds and 2010Z Bonds” herein. The obligation of the United States Treasury under Section 6431 of the Code to make direct payments to the District in respect of interest payments on the 2010L Bonds and 2010M Bonds does not constitute a full faith and credit guarantee of the 2010L Bonds and 2010M Bonds by the United States of America.

The Code establishes certain ongoing requirements that must be met subsequent to the delivery of the 2010L Bonds and 2010M Bonds in order for the District to continue to receive federal credit payments. These requirements are substantially the same as those applicable to tax-exempt bonds, but with significant exceptions from those requirements with respect to the new clean renewable energy bonds such as the 2010M Bonds.

The Internal Revenue Service has advised that, in general, the federal credit payments made in respect of Build America Bonds, such as the 2010L Bonds, and specified tax credit bonds, such as the 2010M Bonds, are to be treated as a refund of an overpayment of federal taxes against which liabilities to the federal government are required to be offset. Therefore, noncompliance by the District with applicable requirements as necessary to claim the federal credit payments, or the existence of an internal revenue tax liability of the District (such as a federal payroll tax liability) that is required to be applied as an offset against federal credit payments, may result in the District not receiving expected federal credit payments.

The District will authorize the General Manager or Treasurer, or his or her designee, to take such actions as are necessary or appropriate for the District to receive from the United States Treasury the applicable federal credit payments in respect of the 2010L Bonds and 2010M Bonds, such as the timely filing with the Internal Revenue Service of Form 8038-CP – “Return for Credit Payments to Issuers of Qualified Bonds,” or any other required form, in the manner prescribed by the Internal Revenue Service.

The federal subsidy payment is considered Gross Revenues under the Bond Resolution.

Termination of Book-Entry Transfer System

If DTC or its successor resigns as the securities depository or if the District determines that it is no longer in the best interests of owners of beneficial interests in the Bonds to continue the system of book-entry transfers through DTC or its successor, the District will deliver at no cost to the beneficial owners of the Bonds or their nominees Bonds in registered certificate form, in the denomination of \$5,000 or any integral multiple thereof within a single series and maturity. Thereafter, the principal of the Bonds will be payable upon due presentment and surrender thereof at the principal office of the Paying Agent. Interest on the Bonds will be payable by check or draft mailed on the interest payment date to the persons in whose names the Bonds are registered, at the address appearing upon the Bond Register on the 15th day of the month prior to such interest payment date or, at the request of the owner of \$1,000,000 or more in aggregate principal amount of Bonds, by wire transfer.

Transfer and Exchange

As long as DTC (or a successor or substitute depository) is not the registered owner of the Bonds, any Bond may be transferred at the principal office for such purpose of the Registrar by surrender of such Bond for cancellation,

accompanied by a written instrument of transfer, in form satisfactory to the Registrar, duly executed by the registered owner in person or by his/her duly authorized attorney, and thereupon the District will issue and the Registrar will authenticate and deliver at the principal office of the Registrar (or send by registered or first class insured mail to the owner thereof at his expense), in the name of the transferee or transferees, a new Bond or Bonds of the same interest rate, aggregate principal amount, series and maturity, and on which interest accrues from the last interest payment date to which interest has been paid so that there shall result no gain or loss of interest as a result of such transfer, upon payment of any applicable tax or governmental charge.

Optional Redemption

2010A Bonds

The 2010A Bonds are subject to redemption prior to maturity, at the option of the District, in whole or in part on January 1, 2020, or any date thereafter, at 100% of the principal amount thereof, plus accrued interest, if any, to the date of redemption.

2010B Bonds

The 2010B Bonds are not subject to redemption prior to their stated maturities.

2010L Bonds

The 2010L Bonds are subject to redemption prior to their respective maturities at the option of the District, in whole or in part, on any Business Day, at the Make-Whole Redemption Price for the 2010L Bonds (as defined herein) determined by the Designated Investment Banker (as defined herein). The "Make-Whole Redemption Price" for the 2010L Bonds is the greater of (i) the issue price as shown on the inside cover pages of this Official Statement (but not less than 100% of the principal amount of the 2010L Bonds to be redeemed), or (ii) the sum of the present values of the remaining scheduled payments of principal and interest on the 2010L Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which the 2010L Bonds are to be redeemed, discounted to the date on which such 2010L Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the "Treasury Rate" (defined below) plus 25 basis points, plus accrued and unpaid interest on the 2010L Bonds to be redeemed on the redemption date.

2010M Bonds

The 2010M Bonds are subject to redemption prior to their respective maturities at the option of the District, in whole or in part, on any Business Day, at the Make-Whole Redemption Price for the 2010M Bonds (as defined herein) determined by the Designated Investment Banker (as defined herein). The "Make-Whole Redemption Price" for the 2010M Bonds is the greater of (i) the issue price as shown on the inside cover pages of this Official Statement (but not less than 100% of the principal amount of the 2010M Bonds to be redeemed), or (ii) the sum of the present values of the remaining scheduled payments of principal and interest on the 2010M Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which the 2010M Bonds are to be redeemed, discounted to the date on which such 2010M Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the "Treasury Rate" (defined below) plus 25 basis points, plus accrued and unpaid interest on the 2010M Bonds to be redeemed on the redemption date.

2010Z Bonds

The 2010Z Bonds are subject to redemption prior to their respective maturities at the option of the District, in whole or in part, on any Business Day, at the Make-Whole Redemption Price for the 2010Z Bonds (as defined herein) determined by the Designated Investment Banker (as defined herein). The "Make-Whole Redemption Price" for the 2010Z Bonds is the greater of (i) the issue price as shown on the inside cover pages of this Official Statement (but not less than 100% of the principal amount of the 2010Z Bonds to be redeemed), or (ii) the sum of the present values

of the remaining scheduled payments of principal and interest on the 2010Z Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which the 2010Z Bonds are to be redeemed, discounted to the date on which such 2010Z Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the “Treasury Rate” (defined below) plus 25 basis points, plus accrued and unpaid interest on the 2010Z Bonds to be redeemed on the redemption date.

Definitions for 2010L Bonds, 2010M Bonds and 2010Z Bonds

“Treasury Rate” means, with respect to any redemption date for a particular 2010L Bond, 2010M Bond or 2010Z Bond, the rate per annum, expressed as a percentage of the principal amount, equal to the semi-annual equivalent yield to maturity or interpolated maturity of the Comparable Treasury Issue (defined below), assuming that the Comparable Treasury Issue is purchased on the redemption date for a price equal to the Comparable Treasury Price (defined below), as calculated by the Designated Investment Banker (defined below).

“Comparable Treasury Issue” means, with respect to any redemption date for a particular 2010L Bond, 2010M Bond or 2010Z Bond, the U.S. Treasury security or securities selected by the Designated Investment Banker that has an actual or interpolated maturity comparable to the remaining average life of the 2010L Bonds, 2010M Bonds or 2010Z Bonds to be redeemed, and that would be utilized in accordance with customary financial practice in pricing new issues of debt securities of comparable maturity to the remaining average life of such 2010L Bonds, 2010M Bonds or 2010Z Bonds to be redeemed.

“Comparable Treasury Price” means, with respect to any redemption date for a particular 2010L Bond, 2010M Bond or 2010Z Bond, (i) if the Designated Investment Banker receives at least five Reference Treasury Dealer Quotations (defined below), the average of such quotations for such redemption date, after excluding the highest and lowest such Reference Treasury Dealer Quotations, or (ii) if the Designated Investment Banker obtains fewer than five Reference Treasury Dealer Quotations, the average of all such quotations.

“Designated Investment Banker” means one of the Reference Treasury Dealers appointed by the District.

“Reference Treasury Dealer” means each of five firms, specified by the District from time to time, that are primary U.S. Government securities dealers in the City of New York (each, a “Primary Treasury Dealer”); provided, however, that if any of them ceases to be a Primary Treasury Dealer, the District will substitute another Primary Treasury Dealer.

“Reference Treasury Dealer Quotations” means, with respect to each Reference Treasury Dealer and any redemption date for a particular 2010L Bond, 2010M Bond or 2010Z Bond, the average, as determined by the Designated Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the District by such Reference Treasury Dealer at 3:30 p.m. (New York City time) on a date that is no earlier than four days prior to the date the redemption notice is mailed.

Extraordinary Optional Redemption – 2010L Bonds and 2010M Bonds

The 2010L Bonds and 2010M Bonds are subject to extraordinary optional redemption at any time prior to their maturity at the option of the District, in whole or in part, upon the occurrence of an Extraordinary Event, at a redemption price (the “Extraordinary Optional Redemption Price”) equal to the greater of (i) 100% of the principal amount of the 2010L Bonds or 2010M Bonds to be redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal of and interest on the 2010L Bonds or 2010M Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which the 2010L Bonds or the 2010M Bonds are to be redeemed, discounted to the date on which the 2010L Bonds or 2010M Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the Treasury Rate (defined above) plus 100 basis points, plus, in each case, accrued and unpaid interest on the 2010L Bonds or 2010M Bonds to be redeemed to the redemption date.

An “Extraordinary Event” will have occurred if (a) Section 54AA or 6431 of the Code (as such Sections were added by Section 1531 of the American Recovery and Reinvestment Act of 2009, pertaining to “Build America Bonds” and as Section 6431 of the Code was amended by Section 301 of the Hiring Incentives to Restore Employment Act pertaining to “New Clean Renewable Energy Bonds”) is modified or amended in a manner pursuant to which the District’s applicable cash subsidy payments from the United States Treasury are reduced or eliminated, or (b) guidance published by the Internal Revenue Service or the United States Treasury with respect to such sections places one or more substantive new conditions on the receipt by the District of such applicable cash subsidy payments and such condition(s) that are unacceptable to the District.

Mandatory Redemption

The 2010L Bonds maturing on January 1, 2030 and January 1, 2040 (which shall be deemed to be Term Bonds) shall be redeemed prior to maturity (or paid at maturity), no later than January 1 in the years and in the sinking fund installment amounts set forth below (to the extent such 2010L Bonds have not been previously redeemed or purchased), by payment of the principal amount thereof, together with the interest accrued thereon to the date fixed for redemption.

2010L Bonds 2030 Term Bonds

Year	Sinking Fund Installment
2028	\$ 8,470,000
2029	8,785,000
2030*	9,115,000

* Maturity.

2010L Bonds 2040 Term Bonds

Year	Sinking Fund Installment
2031	\$ 9,455,000
2032	9,810,000
2033	10,185,000
2034	10,575,000
2035	10,970,000
2036	11,385,000
2037	11,820,000
2038	12,265,000
2039	12,730,000
2040*	13,215,000

* Final Maturity.

The 2010Z Bonds maturing on January 1, 2025, January 1, 2030 and January 1, 2040 (which shall be deemed to be Term Bonds) shall be redeemed prior to maturity (or paid at maturity), no later than January 1 in the years and in the sinking fund installment amounts set forth below (to the extent such 2010Z Bonds have not been previously redeemed or purchased), by payment of the principal amount thereof, together with the interest accrued thereon to the date fixed for redemption.

2010Z Bonds 2025 Term Bonds

Year	Sinking Fund Installment
2021	\$ 360,000
2022	380,000
2023	400,000
2024	425,000
2025*	445,000

* Maturity.

2010Z Bonds 2030 Term Bonds

<u>Year</u>	<u>Sinking Fund Installment</u>
2026	\$ 470,000
2027	500,000
2028	1,500,000
2029	1,585,000
2030*	1,675,000

* Maturity.

2010Z Bonds 2040 Term Bonds

<u>Year</u>	<u>Sinking Fund Installment</u>
2031	\$ 1,770,000
2032	1,875,000
2033	1,980,000
2034	2,100,000
2035	2,220,000
2036	2,350,000
2037	2,485,000
2038	2,630,000
2039	2,785,000
2040*	2,945,000

* Final Maturity.

Upon the purchase or redemption of 2010L Bonds, 2010M Bonds or 2010Z Bonds for which mandatory sinking fund installments have been established, other than by reason of the mandatory sinking fund installment redemption described above, an amount equal to the principal amount of the 2010L Bonds, 2010M Bonds or 2010Z Bonds so purchased or redeemed shall be credited toward each of the mandatory sinking fund installments with respect to such 2010L Bonds, 2010M Bonds or 2010Z Bonds of such maturity on a pro rata basis. Amounts used to purchase or redeem 2010A Bonds or 2010B Bonds that are Term Bonds shall be credited against mandatory sinking fund installments by lot.

Sinking Fund Payments--2010M Bonds

In the Bond Resolution the District has covenanted that no later than January 1 in the years 2011 through 2027, it will deposit approximately equal sinking fund installments into a subaccount in the Principal and Bond Retirement Account so that the total sinking fund installments, together with expected interest earnings, will equal the principal amount due on the 2010M Bonds on January 1, 2027; provided that such subaccount shall be funded at a rate not more rapid than equal annual installments, with the installment for any partial year to be pro rated. Upon the purchase or redemption of 2010M Bonds for which sinking fund installments have been established, an amount equal to the principal amount of the 2010M Bonds so purchased or redeemed shall be credited toward each of the sinking fund installments with respect to such 2010M Bonds on a pro rata basis.

Partial Redemption

If less than all of the Bonds of a series are to be redeemed, the District may select the series and maturity or maturities to be redeemed. If less than all of the Bonds of a series of any maturity are to be redeemed, the Bonds or portions thereof to be redeemed are to be selected by the Registrar or DTC, as applicable, by lot (except in the case of the 2010L Bonds, 2010M Bonds and 2010Z Bonds), or in accordance with their respective standard procedures. The Bond Resolution provides that the portion of any Bonds of a denomination of more than \$5,000 to be redeemed will be in the principal amount of \$5,000 or any integral multiple thereof and that in selecting portions of such Bonds for redemption, the Registrar will treat each such Bonds as representing that number of such Bonds of \$5,000 denomination that is obtained by dividing the principal amount of such Bonds to be redeemed in part by \$5,000.

If the 2010L Bonds, 2010M Bonds or 2010Z Bonds are not registered in book-entry only form, any redemption of less than all of a maturity of the 2010L Bonds, 2010M Bonds or 2010Z Bonds shall be allocated among the registered owners of such 2010L Bonds, 2010M Bonds or 2010Z Bonds as nearly as practicable in proportion to the principal amounts of the 2010L Bonds, 2010M Bonds or 2010Z Bonds owned by each registered owner, subject to the authorized denominations applicable to the 2010L Bonds, 2010M Bonds or 2010Z Bonds. This will be calculated based on the following formula:

$$\frac{(\text{principal amount to be redeemed}) \times (\text{principal amount owned by owner})}{(\text{principal amount outstanding})}$$

The particular 2010L Bonds, 2010M Bonds or 2010Z Bonds to be redeemed shall be determined by the Registrar, using such method as it shall deem fair and appropriate. If the 2010L Bonds, 2010M Bonds or 2010Z 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 2010L Bonds, 2010M Bonds or 2010Z Bonds, partial redemptions will be done in accordance with DTC procedures. It is the District's intent that redemption allocations made by DTC, the DTC Participants or such other intermediaries that may exist between the District and the Beneficial Owners be made in accordance with these same proportional provisions. However, the District can provide no assurance that DTC, the DTC Participants or any other intermediaries will allocate redemptions among Beneficial Owners on such a proportional basis.

Notice of Redemption

Notice of redemption is to be given at least 30 and not more than 60 days prior to the redemption date by first class mail to the registered owners of any Bonds to be redeemed at their last addresses appearing on the registration records of the Registrar. The District makes no assurances that DTC Participants or other nominees of the Beneficial Owners will distribute such redemption notices to the Beneficial Owners of the Bonds or that they will do so on a timely basis. Actual receipt of such notice by the registered owner of any Bond shall not be a condition precedent to the redemption of such Bond. Notice of redemption shall also be sent to the Municipal Securities Rulemaking Board.

If, on the redemption date, money for the redemption of Bonds or portions thereof, together with interest to the redemption date, shall be held by the Paying Agent so as to be available therefor on such date and if notice of redemption shall have been given as aforesaid, then, from and after the redemption date, interest on the Bonds or portions thereof so called for redemption shall cease to accrue and become payable.

Notice of any optional redemption may be cancelled by the District at any time prior to the designated redemption date by giving written notice of such cancellation to all parties who were given notice of redemption.

Open Market Purchases

The District has reserved the right to purchase Bonds in the open market in an amount and at such price as the District shall determine.

Defeasance of the Bonds

The District may set aside with a trustee or escrow agent in a special trust account irrevocably pledged to the payment of certain Bonds, cash, Government Obligations and/or Refunded Municipals, if permitted by law, sufficient, together with the earnings thereon, to provide funds to pay when due the interest on part or all of the Bonds and to redeem and retire such Bonds at or prior to maturity in accordance with their terms. Prior to any defeasance, the District must obtain a verification from an independent certified public accountant that the escrowed cash and securities are sufficient to pay the Bonds and an opinion of nationally-recognized bond counsel that such defeasance will not cause interest on any tax-exempt Parity Bonds then outstanding to become subject to federal income taxes. In such event no further payment need be made into the Bond Fund for the payment of the principal of and interest on the Bonds so provided for and such Bonds shall cease to be entitled to any lien, benefit or security of the Bond Resolutions except the right to receive payment from such special account, and such Bonds shall not be deemed to be outstanding for purposes of the Bond Resolution.

The term “Government Obligations” has the meaning given in chapter 39.53 RCW, as amended, currently: (i) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by the United States of America and bank certificates of deposit secured by such obligations; (ii) bonds, debentures, notes, participation certificates, or other obligations issued by the Banks for Cooperatives, the Federal Intermediate Credit Bank, the Federal Home Loan Bank system, the Export-Import Bank of the United States, Federal Land Banks, or the Federal National Mortgage Association; (iii) public housing bonds and project notes fully secured by contracts with the United States; and (iv) obligations of financial institutions insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, to the extent insured or to the extent guaranteed as permitted under any other provision of State law.

2010L Bonds, 2010M Bonds and 2010Z Bonds

If the District defeases any 2010L Bonds, 2010M Bonds or 2010Z Bonds, such Bonds may be deemed to be retired and “reissued” for federal income tax purposes as a result of the defeasance. See “TAX MATTERS—The 2010L Bonds, 2010M Bonds and 2010Z Bonds.”

SECURITY FOR THE PARITY BONDS

Pledge of Revenues; Consolidation of Developments

As permitted by the resolutions authorizing the Outstanding Parity Bonds, the District has consolidated the Priest Rapids Development and the Wanapum Development into one system called the Priest Rapids Project. Prior to consolidation, the gross revenues of each development were accounted for separately, and the Outstanding Parity Bonds of each series were secured by the gross revenues of a single development. Pursuant to the Bond Resolution, the revenues of both Developments have been pledged to pay and secure the payment of debt service on all Parity Bonds, and the operation and maintenance expenses, capital costs and other obligations of both Developments are payable from the revenues of both Developments.

The Parity Bonds are special limited obligations of the District payable from and secured solely by a lien and charge on (i) Gross Revenues, which include all income, revenues, receipts and profits received by the District through the ownership and operation of the Priest Rapids Project, together with the proceeds received by the District from the sale, lease or other disposition of any properties, rights or facilities of the Priest Rapids Project and certain investment income, subject only to the prior payment of Operating Expenses, and (ii) the money and assets, if any, credited to the Bond Fund, the Project Account and the Priest Rapids Project Repair, Renewal and Contingency Fund (the “RR&C Fund”), and the income therefrom. Gross Revenues include payments from the District’s Electric System as described under “Obligations of the Electric System.” The items described above are pledged as security for the payment of the principal of, premium, if any, and interest on all Parity Bonds in accordance with the provisions of the Bond Resolution. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION” for a description of the security for the Parity Bonds and “Flow of Funds” below for a description of the priority of payments from the Gross Revenues of the Priest Rapids Project.

All Parity Bonds are equally and ratably payable and secured under the Bond Resolution without priority, except as otherwise expressly provided or permitted in the Bond Resolution and except as to municipal bond insurance and reserve account surety policies that may be obtained by the District to insure the repayment of one or more series or maturities within a series.

State law provides that the revenue obligations issued by a public utility district and interest thereon 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 (i) such pledge of the revenues or other money or obligations shall be valid and binding from the time made, (ii) the revenues or other money or obligations so pledged and thereafter received by a public utility district shall immediately be subject to the lien of such pledge without any physical delivery or further act, and (iii) 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 a district irrespective

of whether such parties have notice thereof. The Bonds are not secured by a mortgage, deed of trust, or security interest in the Priest Rapids Project or any of the physical plant and facilities thereof.

Obligations of the Electric System

The following covenants in the Bond Resolution set forth the Electric System's obligations to make payments to the Priest Rapids Project:

- If any power and energy is produced or capable of being produced in any given Fiscal Year by the Priest Rapids Project, the District has covenanted (1) to pay to the Priest Rapids Project from the Electric System that portion of the annual costs of the Priest Rapids Project for such Fiscal Year, including without limitation for operating and maintenance expenses and debt service on the Parity Bonds, that is not otherwise paid or provided for from payments received by the Priest Rapids Project from the sale of power and energy and related products from the Priest Rapids Project to purchasers other than the District and (2) to establish, maintain and collect rates and charges for electric power and energy and related products sold through the Electric System sufficient to make any such payments to the Priest Rapids Project; provided, however, that once the District's Electric System Revenue and Refunding Bonds, Series 2001-H are no longer outstanding, the Electric System shall be obligated to pay as provided in this section whether or not the Priest Rapids Project has produced or is capable of producing power and energy in a Fiscal Year.
- The Electric System is not obligated to pay any costs of the Priest Rapids Project for any Fiscal Year (1) if the Electric System does not receive power from the Priest Rapids Project during such Fiscal Year and (2) no power or energy is produced or capable of being produced by the Priest Rapids Project during such Fiscal Year.
- Payments made by the Electric System for its share of the output of the Priest Rapids Project and other costs of purchased power and energy from the Priest Rapids Project are operating expenses of the Electric System, and, therefore, are payable prior to debt service on the Electric System bonds (as long as power or energy is produced or capable of being produced). The obligation of the Electric System to pay for all other costs associated with the Priest Rapids Project is junior in rank to all other obligations of the Electric System. For a summary of outstanding debt of the District, see Table 17.

Flow of Funds

The District has covenanted that so long as any of the Parity Bonds are Outstanding and unpaid it will continue to pay into the Revenue Fund all Gross Revenues. Earnings on money in the RR&C Fund and the Bond Fund may remain in such funds as provided by the Bond Resolution.

The Bond Resolution creates a charge and obligation against the Revenue Fund in an amount equal to the Coverage Requirement. The Coverage Requirement is defined as (a) 1.15 times Annual Debt Service plus (b) any amounts required to be deposited into the Reserve Account less (c) amounts transferred to the Bond Fund from the RR&C Fund in excess of the RR&C Fund Cap (currently \$12,000,000). The amounts in the Revenue Fund may be used only for the following purposes and in the following order of priority:

- (1) to pay or provide for Operating Expenses;
- (2) to make all payments required to be made into the Interest Account in the Bond Fund and to make any District Payments;
- (3) to make all payments required to be made into the Principal and Bond Retirement Account in the Bond Fund;
- (4) to make all payments required to be made into the Reserve Account in the Bond Fund and to make all payments required to be made pursuant to a reimbursement agreement(s) in connection with Qualified Insurance or a Qualified Letter of Credit;

(5) to make all payments required to be made into the RR&C Fund (currently an amount in each month equal to .0125 of Annual Debt Service); and

(6) to make all payments required to be made into any special fund or account created to pay or secure the payment of junior lien obligations of the Priest Rapids Project.

After all of the above payments and credits have been made, amounts remaining in the Revenue Fund may be used for any other lawful purpose of the District relating to the Priest Rapids Project.

If required by contract with the purchasers of power from the Priest Rapids Project, the District may rebate money in any fund except the Bond Fund to those purchasers. If the rebate is paid from the RR&C Fund, the District may again establish in the RR&C Fund an amount equal to the RR&C Fund Cap (currently \$12,000,000) from the proceeds of Parity Bonds, from Gross Revenues, or from any other sources. Any rebates may be paid to the Electric System on the same basis as to the other purchasers of power.

Under the Bond Resolution, the District is not permitted to issue additional bonds with a lien and charge upon Gross Revenues prior to the lien and charge of the Parity Bonds.

Limited Obligations

The Parity Bonds do not in any manner or to any extent constitute general obligations of the District or of the State of Washington, or any political subdivision of the State of Washington, or a charge upon any general fund or upon any money or other property of the District or of the State of Washington, or of any political subdivision of the State of Washington, not specifically pledged thereto by the Bond Resolution.

Rate Covenants

The District has covenanted in the Bond Resolution to establish, maintain and collect rates and charges in connection with the ownership and operation of the Priest Rapids Project that are fair and nondiscriminatory and adequate to provide Gross Revenues sufficient for the payment of the principal of and interest on all Outstanding Parity Bonds, all amounts which the District is obligated to set aside in the Bond Fund, the payment of all Operating Expenses of the Priest Rapids Project, and for the payment of any amounts that the District may now or hereafter become obligated to pay from Gross Revenues.

The District has also covenanted to establish, maintain and collect rates and charges in connection with the ownership and operation of the Priest Rapids Project sufficient to provide Net Revenues in any Fiscal Year in an amount that is at least equal to (i) 1.15 times Annual Debt Service, plus (ii) any amounts required to be deposited into the Reserve Account in that Fiscal Year, less (iii) amounts transferred to the Bond Fund from the RR&C Fund in excess of the RR&C Fund Cap at the end of the preceding Fiscal Year, in addition to the amounts required to pay debt service on any junior lien obligations of the Priest Rapids Project.

Retail electric rates and charges of the District 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 the Federal Energy Regulatory Commission ("FERC"). Wholesale electric rates and charges, however, are subject to certain regulations by FERC. See "THE PRIEST RAPIDS PROJECT—Regulatory Proceedings Affecting the Priest Rapids Project—Proceedings Related to Allocation of Output." Additionally, the Priest Rapids Project is owned and operated by the District under a long-term license from FERC. See "THE PRIEST RAPIDS PROJECT—License Status." See "THE ELECTRIC SYSTEM—Electric Rates" for a discussion of telecommunication rates.

Reserve Account

A single Reserve Account in the Bond Fund secures all Parity Bonds. The Bond Resolution requires that there be deposited into the Reserve Account for each series of Parity Bonds an amount equal to the Reserve Account Requirement, calculated as of the date of issuance of such series. "Reserve Account Requirement" means, with

respect to the Bonds and each issue of Outstanding Parity Bonds, the maximum amount of interest due in any Fiscal Year on such Parity Bonds computed as of the date of Closing of such issue, and with respect to an issue of Future Parity Bonds, the amount set forth in the resolution authorizing such Future Parity Bonds. However, so long as any 2001 Priest Rapids Bonds or 2001 Wanapum Bonds are insured by Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. ("FSA"), any 2005 Priest Rapids Bonds or 2005 Wanapum Bonds are insured by Financial Guaranty Insurance Company ("FGIC"), or any 2006 Priest Rapids Bonds or 2006 Wanapum Bonds are insured by MBIA Insurance Corporation ("MBIA"), the Reserve Account Requirement with respect to any Future Parity Bonds secured by the Reserve Account shall be an amount equal to the maximum amount of interest due in any Fiscal Year on such Future Parity Bonds. The District will fund the Reserve Account Requirement for the Bonds on the date of issuance of the Bonds with Bond proceeds.

The Reserve Account Requirement may be funded either from Parity Bond proceeds or from Gross Revenues over a five-year period following the date of issuance, except that so long as the 2001 Priest Rapids Bonds or 2001 Wanapum Bonds are insured by FSA, the 2005 Priest Rapids Bonds or 2005 Wanapum Bonds are insured by FGIC, or 2006 Priest Rapids Bonds or 2006 Wanapum Bonds are insured by MBIA, the Reserve Account Requirement must be fully funded on the date of issuance of any Parity Bonds. As an alternative, the District may fund all or a portion of the Reserve Account through the purchase of Qualified Insurance or a Qualified Letter of Credit. See "Certain Definitions" and "Bond Fund" in APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION" relating to the satisfaction of the Reserve Account Requirement through the deposit of a letter of credit or insurance policy. To meet the Reserve Account Requirement for the Outstanding Parity Bonds, the District issued reserve account surety policies in the original aggregate amount of \$4,621,258.05 with Ambac Assurance Corporation ("Ambac Assurance"), surety policies in the original aggregate amount of \$1,978,509.89 with FSA, surety policies in the original aggregate amount of \$17,557,614.52 with MBIA and surety policies in the original aggregate amount of \$13,356,821.45 with FGIC. Moody's Investors Service ("Moody's") and Standard & Poor's Ratings Services ("S&P") currently rate FSA "Aa3" and "AAA," respectively. Fitch Ratings ("Fitch") has withdrawn its rating for FSA. Moody's, S&P and Fitch have withdrawn their rating for FGIC. Moody's and S&P currently rate Ambac Assurance "Caa2" and "R," respectively. Moody's and S&P currently rate MBIA "B3" and "BB+," respectively. Fitch has withdrawn its ratings for Ambac Assurance and MBIA. See "Reserve Account Sureties for Outstanding Parity Bonds" below. The resolutions authorizing the outstanding Parity Bonds do not require that the reserve surety policies be replaced when the insurers are downgraded. There is no cash in the Reserve Account.

The valuation of the amount on deposit in the Reserve Account is required to be made by the District on each December 31, and after certain withdrawals, and may be made on each June 30. Such valuation shall be at the market value thereof (including accrued interest) for obligations maturing more than six months from the valuation date or at par for obligations maturing within six months of the valuation date.

The District has covenanted to make up any deficiency in the Interest Account and the Principal and Bond Retirement Account from the funds available in the Reserve Account. The District has covenanted to replenish such withdrawals from money in the Revenue Fund, the RR&C Fund or the Project Account created for the Bonds, in not more than six equal monthly installments.

The owners of the Bonds by taking and holding the same shall be deemed to have consented to the adoption by the District of any Supplemental Resolution amendatory to the Bond Resolution to provide that Qualified Insurance or Qualified Letter of Credit may be obtained if the provider is rated in one of the two highest categories by Moody's Investor's Service or Standard & Poor's Ratings Services or their comparable recognized business successors or both Moody's Investor's Service or Standard & Poor's Ratings Services at the time the letter of credit or insurance is obtained.

Money in the Bond Fund may, at the option of the District, be invested and reinvested as permitted by law in Permitted Investments maturing, or which are retireable at the option of the owner, prior to the date needed or prior to the maturity date of the final installment of principal of the Parity Bonds payable out of the Bond Fund. Earnings on investments in the Bond Fund shall be transferred to the Revenue Fund, except that earnings on investments in the Reserve Account shall first be applied to remedy any deficiency in such account.

Reserve Account Sureties for Outstanding Parity Bonds

The surety bonds issued by Ambac Assurance, FSA, MBIA and FGIC provide that upon the later of (i) one day (three days for MBIA) after the receipt by the applicable surety of a demand for payment executed by the Paying Agent certifying that provision for the payment of principal of or interest on the Parity Bonds when due has not been made or (ii) the interest payment date specified in the demand for payment submitted to the applicable surety, the applicable surety will promptly deposit funds with the Paying Agent sufficient to enable the Paying Agent to make such payments due on the Parity Bonds, but in no event exceeding the policy limit of the surety bond so drawn on.

Pursuant to the terms of the surety bonds, the policy limits of each are automatically reduced to the extent of each payment made by the applicable surety under the terms of the surety bonds, and the District is required to reimburse the applicable surety for any draws under the surety bonds with interest at a market rate. Upon such reimbursement, the surety bonds are reinstated to the extent of each reimbursement up to but not exceeding the applicable policy limits. The reimbursement obligation of the District under the surety bonds is subordinate to the District's obligations with respect to the Parity Bonds.

In the event the amount on deposit in, or credited to, the Reserve Account exceeds the amount of the surety bonds, any draw on the surety bonds shall be made only after all the funds in the Reserve Account have been expended. In the event that the amount on deposit in, or credited to, the Reserve Account, in addition to the amount available under the surety bonds, includes amounts available under a letter of credit, insurance policy, surety bond or other such funding instrument, draws on the surety bonds and additional funding instruments shall be made on a pro rata basis to fund the insufficiency. The Bond Resolution provides that the Reserve Account shall be replenished by payments of principal of and interest on the surety bonds and on the additional funding instruments from first-available Gross Revenues on a pro rata basis. The surety bonds do not insure against nonpayment caused by the insolvency or negligence of the Paying Agent.

Ambac Assurance, FSA, MBIA and FGIC are subject to the informational requirements of the Exchange Act and in accordance therewith file reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Certain SEC filings of Ambac Assurance are available on the company's website, www.ambac.com (which is not incorporated herein by this reference). Certain SEC filings of FSA are available on the company's website, www.assuredguaranty.com (which is not incorporated herein by this reference). Certain SEC filings of MBIA are available on the company's website, www.mbia.com (which is not incorporated herein by this reference). Certain SEC filings of FGIC are available on the company's website, www.fgic.com (which is not incorporated herein by this reference). Such reports, proxy statements and other information may also be inspected and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Bond Fund."

RR&C Fund

The Bond Resolution provides that the Renewal, Replacement and Contingency Fund (the "RR&C Fund") must be maintained at a balance not to exceed the RR&C Fund Cap (currently \$12,000,000) or such greater or lesser amount as may be authorized by resolution of the Commission. Money in the RR&C Fund must be used to make up any deficiency in the Bond Fund and to the extent not required for such purpose may be applied to other specified purposes. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—RR&C Fund."

Future Parity Bonds

Under the Bond Resolution, the District is not permitted to issue additional bonds with a lien and charge upon Gross Revenues prior to the lien and charge of the Parity Bonds.

Future Parity Bonds may be issued for any lawful purpose relating to the Priest Rapids Project upon the terms and conditions stated in the Bond Resolution. Such conditions include the delivery of an opinion of a Professional Utility Consultant to the effect that the issuance of such Future Parity Bonds and the expenditure of the proceeds thereof will not result in a violation of the District's rate covenants; provided, however, that once the 2001 Priest

Rapids Bonds and 2001 Wanapum Bonds are no longer Outstanding, such report will not be required where contracts with the Electric System (which may include a resolution of the District with respect to such obligation of the Electric System) and/or other purchasers are in effect for a term at least as long as the term of the proposed Future Parity Bonds and require the Electric System and/or other purchasers to purchase 100% of the power from and to pay 100% of the costs of the Priest Rapids Project, including the cost of maintaining Net Revenues in the amounts required under the Bond Resolution. See “Rate Covenants” above and “Additional Parity Bonds” in APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION.”

The District expects to issue approximately \$50 million in additional New Clean Renewable Energy Bonds for the Priest Rapids Project in the next two years, which bonds are expected to be issued as Parity Bonds.

The District may issue bonds, notes, warrants or other obligations having a lien and charge against the Gross Revenues of the Priest Rapids Project junior to the Parity Bonds upon the terms and conditions stated in the Bond Resolution.

Derivative Products

To the extent permitted by Washington State law, the District may enter into Derivative Products secured by a pledge of and lien on Gross Revenues on a parity with the Parity Bonds subject to the satisfaction of certain conditions precedent. A “Derivative Product” is a written contract between the District and a third party obligating the District to make District Payments (subject to certain conditions) on one or more scheduled and specified payment dates in exchange for a Reciprocal Payor’s obligation to pay or cause to be paid Reciprocal Payments to the District on scheduled and specified payment dates. Derivative Products include agreements providing for an exchange of payments based on interest rates (known as interest rate swaps) or providing for ceilings or floors on such payments. For a definition of terms used in this paragraph and a summary of the conditions precedent to the District’s entering into a Derivative Product, see APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Derivative Products.” The District does not have any Derivative Products.

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. These agreements may include interest rate swaps and other similar agreements, agreements with respect to the delivery of electric energy or other energy, letter of credit agreements and other financial and energy hedging transactions. Such contingent payments or posting of collateral may be conditioned upon the future credit ratings of the District and/or other parties, maintenance by the District of specified financial ratios, future changes in energy prices, and other factors. The amount of any such payments or posting of collateral can be substantial. Some such payments may be characterized as Operating Expenses, and thus may be payable from Gross Revenues prior to the payment of debt service on the Parity Bonds. Other such payments may be payable on a parity with debt service on the Parity Bonds, including any “regularly scheduled payments” with respect to Derivative Products. The District has entered into the Western Systems Power Pool Agreements and contracts with the Bonneville Power Administration (“Bonneville”) that include such contingent payment obligations. The agreements include obligations on the part of the District to post collateral or a letter of credit contingent upon the occurrence or nonoccurrence of certain future events, such as future credit ratings below investment grade or defaults under power marketing contracts or indebtedness. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Derivative Products.”

No Acceleration Upon Default

Upon the occurrence and continuance of an Event of Default under the Bond Resolution, payment of the principal amount of the Parity Bonds is not subject to acceleration. The District thus would be liable only for principal and interest payments as they became due, and the Bondowners’ Trustee would be required to seek a separate judgment for each payment, if any, not made. Any such action for money damages would be subject to limitations on legal claims and remedies against public bodies under Washington law. Amounts recovered would be applied to unpaid installments of interest prior to being applied to unpaid principal and premium, if any, which had become due. The

District has never defaulted in the payment of principal, premium or interest on any of its bonds. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Events Of Default, Bondowners’ Trustee, Remedies.”

THE DISTRICT

General

The District is a Washington State municipal corporation. It was organized in 1938 pursuant to a general election in accordance with the Enabling Act and commenced operations in 1942. The District has its administrative offices in Ephrata, Washington, the county seat of Grant County (the “County”), which is located in central Washington. The District’s Electric System serves all of the County.

Pursuant to Washington State statutes, the District is administered by a Board of Commissioners (the “Commission”) of five elected members. 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 establishes policy, approves plans, budgets and expenditures and reviews the District’s operations. The District has the power of eminent domain.

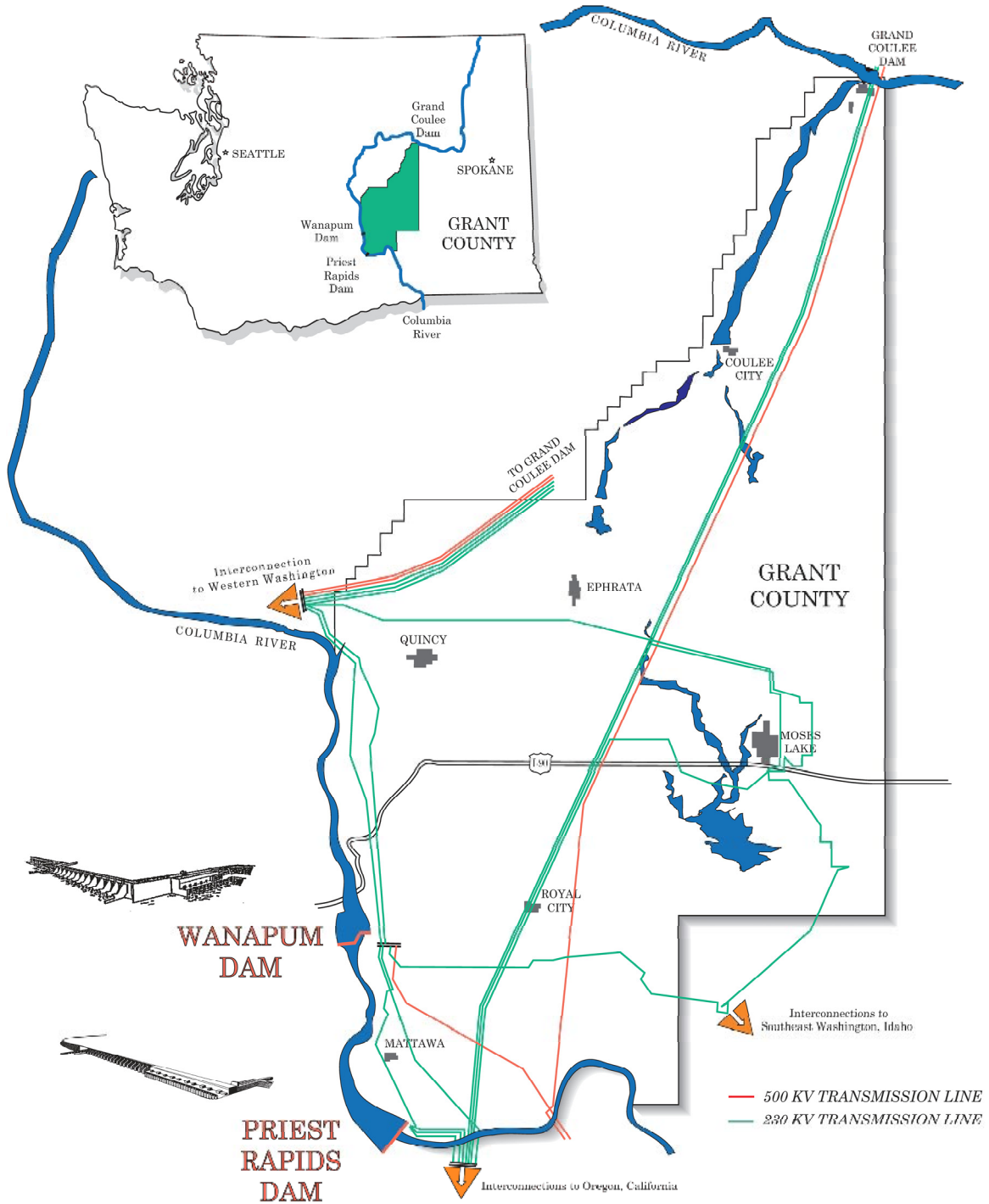
The District’s electric utility properties and operations consist of two operating systems, each of which is accounted for and financed separately. The systems are the Electric System and the Priest Rapids Project, which consists of the Priest Rapids Development and the Wanapum Development. The present combined total nameplate generating capacity of the Priest Rapids Project is approximately 1,993.6 megawatts (“MW”). The revenues of the Priest Rapids Project are not pledged to or available for the payment of the bonds of the Electric System. See “THE ELECTRIC SYSTEM” and “THE PRIEST RAPIDS PROJECT.”

Although cities in the District’s service area have statutory authority to provide electric service, only the town of Coulee Dam, which is located partially in Grant County, has its own electric distribution system. The District is not aware of any other city that is considering providing electric service. The District also has statutory rights of eminent domain which, subject to certain limitations, enable the District to acquire various assets and property rights, including electric distribution facilities in Grant County of any investor-owned utility company that may seek to serve Grant County. The District’s facilities in any city and its right to provide electric service in any city are subject to the reasonable police power of such city.

Under Washington law, public utility districts (such as the District) are authorized to provide retail electrical service beyond their boundaries. Further, investor-owned utilities are not prohibited from providing retail electrical service beyond their current service area.

The following map shows the District’s service area and location of the Priest Rapids and Wanapum Developments.

Electric System Retail Service Area and Major Transmission Lines



Management and Administration

The Commissioners of the District, their titles and the expiration of their respective terms of office are listed below.

Name	Title	Expiration of Term of Office (12/31)
Bob Bernd	President	2010
Randall M. Allred	Vice President	2014
Thomas W. Flint	Secretary	2012
Terry Brewer	Commissioner	2012
Greg P. Hansen	Commissioner	2010

Bob Bernd, President. Commissioner Bernd joined the Commission in January 2007. A County native, he is retired from a career in moving and storage, waste disposal and recycling. He is a graduate of Washington State University and holds a degree in business management. He served 26 years on the Moses Lake Planning Commission, is a board member and former chair for the Boys and Girls Club of the Columbia Basin, former board member and chair of the Grant County Housing Authority and past president and member of the Moses Lake Lions Club.

Randall M. Allred, Vice President. Commissioner Allred, elected to the Commission in the fall of 2002, has been a resident of Grant County for more than 40 years and has over 30 years of experience in agribusiness. He owns and manages five related businesses in Washington and Oregon, and is a former President and current member serving more than 20 years on the Quincy Columbia Basin Irrigation District Board of Directors.

Thomas W. Flint, Secretary. Commissioner Flint joined the Commission after being elected in the fall of 2000. He is a fifth generation farmer actively farming in Grant County. Commissioner Flint serves as a director on the AgFarming Project, the Blacksands Irrigation District and the Columbia Basin Development League. Commissioner Flint has a B.A. in Industrial Technology from Central Washington University. Mr. Flint is immediate past president of the Washington Public Utility District Association.

Terry Brewer, Commissioner. Commissioner Brewer joined the Commission after being elected to the Commission in 2006. He has over 30 years of experience in the electric utility industry. He is the Executive Director for the Grant County Economic Development Council where he assists existing Grant County businesses expand and recruits new businesses to the County. He graduated from Indiana University with a degree in business management and administration. He serves on the Washington Economic Development Association, is a board member for the North Central Workforce Development Council and is a member of the Soap Lake Planning Advisory Committee.

Greg P. Hansen, Commissioner. Commissioner Hansen joined the Commission after being elected to the Commission in the fall of 2004. He has been a Grant County resident for the past 61 years and is retired from a real estate and insurance career and grew up on a farm near Moses Lake. He received a degree in accounting and business administration from the University of Washington.

The senior management team of the District is as follows:

Tim J. Culbertson, General Manager, has been employed with the District since 2000. Prior to assuming the role of General Manager in 2004, he served as the District's Manager of Power Marketing and Operations. Mr. Culbertson has more than 35 years of experience in operations and wholesale power transactions in the West Coast markets and control area management. He has served in a leadership capacity at a number of investor-owned utilities throughout the West. Mr. Culbertson presently serves on committees in various industry organizations, including: the Public Power Council Executive Committee, the Pacific Northwest Utilities Conference Committee Executive Committee, the Public Generating Pool Administrative Committee and the Washington Public Utility District Association Manager's Section.

Chuck Berrie, Assistant General Manager, joined the District in 2007. Mr. Berrie is a Grant County native and has more than 20 years of utility experience at two eastern Washington public utility districts. Prior to joining the utility, he served as general manager of Okanogan Public Utility District. At the District, Mr. Berrie manages the

customer service, hydro, natural resources and power management divisions. He has a Bachelor of Science degree from Washington State University.

Joseph A. Lukas, Senior Policy Advisor and Interim Director of Natural Resources, has worked for the District since 1995. He has more than 15 years of experience working on natural resources, hydroelectric operations, relicensing and District management. He served as the District's Assistant General Manager from 2004 through 2007 responsible for management oversight of the Hydro, Customer Service, Natural Resources and Support Services Divisions. His current work focuses on regional and national initiatives and various special projects assigned by the General Manager. He also serves as the interim Director of Natural Resources. Mr. Lukas has a Bachelor of Science degree from the University of Idaho and a Master of Science degree from Virginia Tech.

Jim A. Bunch, Treasurer/Controller, joined the District in 1983. During his career at the District, he has worked primarily in the accounting and finance areas. Mr. Bunch's experience includes network administration, program development for treasury operations, financial forecast modeling, budgeting, rate development and analysis of the cost of providing electrical service. He has a Bachelor of Arts degree from Central Washington University.

Mitch Delabarre, General Counsel, joined the District in 2009. He has more than 23 years of legal experience, including 17 years working with municipal organizations in Grant County. Mr. Delabarre holds a Bachelors degree from San Diego State University and obtained his law degree from Willamette University College of Law.

Kim Justice, Auditor, joined the District in 1998. She is a Certified Public Accountant and holds a Bachelor of Science degree in accounting from City University. She has extensive experience in legal and financial audits of government agencies.

Andrew Munro, Director of External Affairs, joined the District in 2007. He has nearly 20 years of legislative and regulatory experience, including a third of those years in public power. He holds a Bachelors of Arts degree from the University of Washington.

Kevin Nordt, Director of Power Management, joined the District in 2004 and has nearly 20 years of experience in the Northwest energy market. He has a Bachelor of Science degree from St. John's University and a Master of Science degree from the University of Wisconsin.

Anthony J. Webb, Director of Customer Service, has been with the District since 1990 and previously served as Director of Human Resources and Support Services. He has a Bachelor of Arts degree from Eastern Washington University and experience in aerospace industrial engineering management.

Dawn Woodward, Director of Hydro, has been with the District since 1981. She has extensive experience throughout the District's operations and has represented the District in a wide variety of civic organizations.

Michael Woywod, Director of Support Services, has been with the District since 2006. He manages the support services and information technology divisions. Mr. Woywod has more than 25 years experience in community relations, purchasing and contracting, warehousing, transportation, safety and health, facilities, security and personnel. He has a Bachelor of Science degree from Old Dominion University and holds several master's degrees.

Accounting and Financial Statements

The accounting and reporting policies of the District conform to generally accepted accounting principles for municipal governments and are regulated by the Washington State Auditor's Office. The State Auditor's Office has the responsibility to audit the District's financial operations. The audited financial statements of the District for the fiscal year ended December 31, 2008 are included as a part of this Official Statement as Appendix C. In addition, the District's financial statements are audited by an independent auditing firm. The District's current independent auditor is PricewaterhouseCoopers LLP, which has been the District's auditor since 2003. Financial information for 2009 is included in various tables throughout this Official Statement. The information for 2009 has not been audited by PricewaterhouseCoopers. As a result of the adoption of GASB 53, *Accounting and Financial Reporting for Derivative Instruments*, on January 1, 2009 the unaudited data presented as of and for the year then ended December 31, 2009 is stated on a different basis. The standard requires retroactive adoption to the earliest period presented. As such, the 2008 financial statements, as presented in Appendix C, will be adjusted to reflect the effect

of this standard when such information is included in the 2009 audited financial statements. The impact of this accounting standard did not have a material impact on the 2008 audited financial statements as issued.

District Employees and Retirement Plans and Other Post-Employment Benefits

Following are the number of District employees by function as of January 4, 2010.

Function	Number of Regular Employees (FTE)	Part-Time and Temporary (FTE)
Manager's Division	7	0.49
Assistant General Managers	1	0.00
Strategic Planning	6	0.00
Power Management	37	0.54
Communications and External Affairs	5	0.63
Accounting, Finance and Human Resources	27	0.00
Hydro Generation	248	26.31
Natural Resources	36	3.35
Support Services	96	6.11
Customer Service	185	13.39
Total	648	50.82

In addition to its regular staff, the District employs a number of employees by contract for transmission and distribution line construction work, pole-testing and tree-trimming, turbine rehabilitation, and environmental and other projects.

Of the 648 regular employees, as of January 4, 2010, 60% are bargaining unit employees under a Collective Bargaining Agreement ("CBA") with the International Brotherhood of Electric Workers (the "IBEW"). The current IBEW three-year CBA runs through March 31, 2011. There has not been a significant labor stoppage at the District since 1978.

Pensions for the District's employees are provided by the Washington State Public Employees Retirement System ("PERS") through three different retirement plan options. PERS Plan 1 and Plan 2 are defined benefit plans. PERS Plan 3 is both a defined pension plan (employer share) and defined contribution plan (employee share). The employer share is the same for all three plans. The Priest Rapids Project shares these costs in proportion to its share of direct payroll costs. While the District's 2009 contribution of \$3,916,740, on a covered payroll of \$58,067,178, represents its full current liability under the system, any unfunded benefit obligation could be reflected in future years as higher contribution rates. The State Actuary's website (which is not incorporated into this Official Statement by reference) includes information regarding the values and funding levels of the three PERS plans. For additional information, see Note 10 to the Consolidated Audited Financial Statements for the Years Ended December 31, 2008 and 2007, attached hereto as Appendix C.

The District administers a single-employer defined benefit premium program that covers a portion of healthcare insurance for retirees ages 60 to 65 and their spouses. For the year ended December 31, 2008, the District paid \$256,945 in retiree subsidies. The District's net accrued OPEB obligation at the year ended December 31, 2008 was \$343,672. See Note 11 to the Consolidated Audited Financial Statements for the Years Ended December 31, 2008 and 2007, attached hereto as Appendix C.

Insurance

The District carries excess liability coverage in the amount of \$60 million with a self-insured retention of \$500,000. It carries underlying liability policies for specific loss types such as automobile, foreign travel and non-owned aviation liability to protect the District from losses associated with these common risks. The District has established an insurance reserve fund at a minimum balance of \$1 million and a maximum of \$1.5 million to cover the self-insured portion of liability losses not covered by various underlying policies. The insurance reserve fund had a balance of \$1.18 million at 2008 year end. The District also maintains property, boiler and machinery insurance

coverage with an aggregate limit of \$200 million, protecting against significant losses at the Priest Rapids Project, the Electric System, and all of the various District real properties, with deductibles ranging from \$25,000 to \$250,000.

Strategic Planning and Financial Policies

The District adopted a strategic plan in January 2006 which is reviewed annually and modified as necessary by staff and the Commission. This strategic plan addresses key District issues associated with complying with the new license requirements for the Priest Rapids Project, resource management issues, operations and maintenance, capital improvements, power supply, customer service, reliability and institutional matters such as community relationships, employee development and succession planning, legislative and external affairs. The District's financial strategy includes rate stabilization and continued assurance of meeting the District's financial obligations and goals. Financial parameters for the Electric System include a 2.0x debt service coverage, a retail operating ratio of 100%, working capital minimum of \$35 million (excluding special funds), increasing the rate stabilization fund balance to \$150 million, and minimum of 50% revenue funding of capital expenditures. Financial parameters for the Priest Rapids Project include that outstanding debt shall be less than the net book value of the Priest Rapids Project, 100% debt financing of capital projects, and a debt service coverage no less than 1.15x, which is the debt service coverage required by the Bond Resolution.

Investments

The District invests its available funds in a manner that emphasizes preserving principal, maintaining necessary liquidity, matching investment maturities to estimated cash flow requirements, and achieving maximum yield consistent with the foregoing criteria. Eligible investments include U.S. Treasury bonds, notes, bills or other obligations of the U.S. government or agencies of the U.S. government; interest bearing demand or time deposits issued by certain banks, trust companies or savings and loan associations; fully-secured repurchase agreements; banker's acceptances having a term of 180 days or less; taxable money market portfolios restricted to obligations of one year or less, issued and guaranteed by the full faith and credit of the U.S. government; and any other investments permitted to a municipality under the laws of the State of Washington. Investments generally are made so that securities can be held to maturity. The District does not derive funds for investment from reverse repurchase agreements. In addition, the District does not invest in complex and/or volatile financial products such as "inverse floaters" or structured notes. The Bond Resolution provides that money in the Bond Fund, Revenue Fund and project accounts be invested in "Permitted Investments." See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Certain Definitions."

The following summarizes the par value of the District's investments as of December 31, 2009:

Federal Home Loan Bank	\$ 28,000,000
Fed. Nat. Mortgage Assoc.	28,500,000
Freddie Mac Discount Notes	21,500,000
Treasuries	149,000,000
Certificates of Deposit	4,100,000
Repurchase Agreements	39,500,000
Money Market	<u>38,431,401</u>
	\$ 309,031,401

For information relating to the District's investments, see Note 2 to the Consolidated Audited Financial Statements for the Years Ended December 31, 2008 and 2007, attached hereto as Appendix C.

Hazardous Waste Issues

A substantial number of federal, state, and local laws and regulations regarding waste management have been enacted. Some of these laws and regulations impose strict liability on generators, transporters, storers, and disposers of hazardous wastes. Many normal activities in connection with the generation and transmission of electricity and maintenance of associated facilities generate both non-hazardous and hazardous wastes. The District has established

systems to ensure compliance and control activities that fall under the purview of these environmental laws and regulations.

The District has completed a program to remove and/or control polychlorinated biphenyl (“PCB”) equipment according to the guidelines in the United States Environmental Protection Agency (“EPA”) regulations and to dispose of the PCBs and contaminated equipment in a timely manner at EPA approved facilities.

Security Efforts at the District

While the District has been involved in emergency action plans and region-wide security programs for years, the District reviewed its security procedures at all facilities following the September 11, 2001 terrorist attacks and has implemented certain measures. The District continues to work with public agencies and the Pacific Northwest Security Coordinator (an independent position that uses federal North American Electric Reliability Council guidelines) to maintain an integrated security program. No assurance can be given that the procedures put in place will be effective.

State Performance Audit

In 2005, the voters of Washington State approved Initiative 900, giving the Washington State Auditor’s Office (“SAO”) the authority to conduct independent, comprehensive performance audits of government agencies on behalf of citizens. The purpose of these audits is to ensure accountability and guarantee that tax dollars are spent as cost-effectively as possible. The District does not receive tax money from the State of Washington or any other source. The performance audit is designed to examine the economy, efficiency and effectiveness of the policies, management, fiscal affairs and operations of state and local governments. The District, along with Chelan County PUD and Douglas County PUD, were selected by the SAO for a combined performance audit. The audit is being conducted by a contractor of the SAO. The audit began in 2008 and the District is still waiting for the final audit report, which is expected in early May 2010.

THE PRIEST RAPIDS PROJECT

Description

The Priest Rapids Project consists of the Priest Rapids Development and the Wanapum Development (the “Developments”). In the Bond Resolution, the District has combined the two Developments into one system, the Priest Rapids Project. The Priest Rapids Development consists of a dam and hydroelectric generating station that has been in commercial operation since 1961. The Wanapum Development consists of a dam and hydroelectric generating plant that has been in commercial operation since 1963. The two developments are on the Columbia River approximately 18 miles apart.

The Priest Rapids Project is operated under a single license from the Federal Energy Regulatory Commission (“FERC”). The original license for the two Developments expired on October 31, 2005, and the District operated with annual licenses from 2005-2008. In 2008, the District was granted a new 44-year FERC license for the consolidated Priest Rapids Project. See “FERC License” below.

The Priest Rapids Development

The Priest Rapids Development consists of a dam and hydroelectric generating station having a nameplate rating of 955.6 MW and net peaking capacity of 932 MW. The nameplate rating has increased as a consequence of upgrading work performed in recent years. Located on the Columbia River in Grant and Yakima Counties about 150 air miles northeast of Portland, Oregon, 130 air miles southeast of Seattle, Washington and 18 miles downstream of the Wanapum Development, the Priest Rapids Development includes certain switching, transmission and other facilities necessary to deliver the electric output to the transmission networks of the District, Bonneville and certain other power purchasers.

The Priest Rapids Development has been in commercial operation since September 1961. The District believes that the expected useful life of the Priest Rapids Development should extend beyond the final maturity of the Bonds, assuming that the District continues to perform required periodic repair, maintenance, renewal and replacement.

The following table shows the energy production from the Priest Rapids Development for the years 2005 to 2009. The major factors affecting Average Cost are annual variations in Columbia River waterflows and increased debt service from bond issues to fund major rehabilitation and fish mitigation measures.

Table 1
PRIEST RAPIDS DEVELOPMENT HISTORICAL ENERGY PRODUCTION

	2005	2006	2007	2008	2009
Net Peaking Production (MW)	884	901	896	914	897
Net Energy Production (000's MWh)	3,792	4,482	4,624	4,289	3,894
Annual Availability Factor (1)	90%	93%	97%	97%	96%
Plant Factor (2)	51%	62%	64%	58%	54%
Average Cost (\$/MWh)	\$8.10	\$8.96	\$10.10	\$12.62	\$13.43
Bonneville Power PF Rate (\$/MWh) (3)	\$28.70	\$28.30	\$27.00	\$27.10	\$26.60

- (1) The ratio of the actual hours that the generating units of the Priest Rapids Development are available for service during the period indicated to the total hours in the period.
- (2) The average energy output of a generating facility to the net peaking capability of that facility. It reflects the facility's availability, the actual need for the power production by the facility and the availability of water. Plant factor is calculated by dividing gross generation by the maximum one-hour production divided by 8,760 (the hours in one year).
- (3) Bonneville's published Priority Firm power rates.

The Wanapum Development

The Wanapum Development consists of a dam and hydroelectric generating station having a nameplate rating of 1,038 MW and net peaking capacity of 985 MW. Located on the Columbia River in Grant and Kittitas Counties about 160 air miles northeast of Portland, Oregon, 129 air miles southeast of Seattle, Washington, and 18 miles upstream of the Priest Rapids Development, the Wanapum Development includes certain switching, transmission and other facilities necessary to deliver the electric output to the transmission networks of the District, Bonneville and certain other power purchasers.

The Wanapum Development has been in commercial operation since September 1963. The District believes that the expected useful life of the Wanapum Development should extend beyond the final maturity of the Bonds, assuming that the District continues to perform required periodic repair, maintenance, renewal and replacement.

The following table shows the energy production for the Wanapum Development for the years 2005 to 2009. The major factors affecting Average Cost are annual variations in Columbia River waterflows and increased debt service from bond issues to fund major rehabilitation and fish mitigation measures.

Table 2
WANAPUM DEVELOPMENT HISTORICAL ENERGY PRODUCTION

	2005	2006	2007	2008	2009
Net Peaking Production (MW)	968	893	894	885	885
Net Energy Production (000's MWh)	4,109	4,346	4,521	4,008	3,675
Annual Availability Factor (1)	94%	86%	87%	88%	84%
Plant Factor (2)	59%	66%	68%	61%	57%
Average Cost (\$/MWh)	\$8.59	\$9.82	\$12.09	\$16.38	\$17.41
Bonneville Power PF Rate (\$/MWh) (3)	\$28.70	\$28.30	\$27.00	\$27.10	\$26.60

- (1) The ratio of the actual hours that the generating units of the Wanapum Development are available for service during the period indicated to the total hours in the period.
- (2) The average energy output of a generating facility to the net peaking capability of that facility. It reflects the facility's availability, the actual need for the power production by the facility and the availability of water. Plant factor is calculated by dividing gross generation by the maximum one-hour production divided by 8,760 (the hours in one year).
- (3) Bonneville's published Priority Firm power rates.

Power Sales Contracts

Pursuant to the 1956 Power Sales Contracts, which expired on October 31, 2005, the District sold 63.5% of the power and energy output of the Priest Rapids Development to the Power Purchasers and reserved the remaining 36.5% of the output for its use. The District sold 63.5% of the power and energy output of the Wanapum Development to the Power Purchasers pursuant to the 1959 Power Sales Contracts and reserved the remaining 36.5% of the output for its use. The 1959 Power Sales Contracts expired by their terms on October 31, 2009. The District's new contracts with the original Power Purchasers and ten purchasers in Idaho for the purchase and sale of output from the Priest Rapids Development became effective on November 1, 2005 (the "New Power Sales Contracts"). The New Power Sales Contracts (which also apply to output from the Wanapum Development beginning November 1, 2009) consist of two separate contracts with terms that extend until the expiration of the new long-term license for the Priest Rapids Project (April 1, 2052).

The New Power Sales Contracts consist of the "Product Sales Contract" and the "Reasonable Portion Contract." The New Power Sales Contracts are summarized in Appendix B. In accordance with the FERC order in the Public Law 83-544 proceeding, following the expiration of the 1956 Power Sales Contracts, the District dedicates 30% of the output of the Priest Rapids Project (the "Reasonable Portion") for sales within the region based on market principles. 62% of the output of the Priest Rapids Project is used by the District's Electric System and sold to the Power Purchasers to the extent surplus to the Electric System's needs. The remaining 8% is allocated among various power purchasers. See "Regulatory Proceedings Affecting the Developments—Proceedings Before FERC."

The following table lists the Power Purchasers under the New Power Sales Contracts and their percentage shares of the costs of the Priest Rapids Project.

**Table 3
PARTICIPATION IN COSTS OF PRIEST RAPIDS PROJECT (2010)**

Power Purchaser	Percent Share	Priest Rapids Development Nameplate Rating (1) (MW)	Wanapum Development Nameplate Rating (2) (MW)	Priest Rapids Project Nameplate Rating (MW)
PacifiCorp Electric Operations	9.65%	92.260	100.215	192.475
Portland General Electric	9.65	92.260	100.215	192.475
Puget Sound Energy, Inc.	5.56	53.156	57.739	110.895
Tacoma Power	2.38	22.743	24.704	47.447
Seattle City Light	2.36	22.552	24.497	47.049
Avista Corporation	4.24	40.494	43.986	84.480
Public Utility District No. 1 of Cowlitz County	1.79	17.070	18.542	35.612
Eugene Water and Electric Board	1.19	11.324	12.300	23.624
Other Power Purchasers (3)	2.48	23.706	25.752	49.458
The District's Electric System	60.70	580.035	630.050	1,210.085
Total	100.00%	955.600	1,038.000	1,993.600

(1) Based on installed nameplate rating of 955.600 MW. The nameplate rating allocation is based on the percentage of power costs attributable to each power purchaser divided by the total nameplate rating. The allocation will change annually since each power purchaser's percentage of the total power costs will change as a result of the New Power Sales Contracts.

(2) Based on installed nameplate rating of 1,038 MW.

(3) Cities of Forest Grove, McMinnville, and Milton-Freewater; Kittitas County PUD, Snake River Power, Clearwater Power, Idaho County Light, Kootenai Electric Cooperative, and Northern Lights.

The New Power Sales Contracts include the following provisions:

- Under the Reasonable Portion Contract, the Power Purchasers receive the net revenues from the sale of the 30% Reasonable Portion. The District offers the Reasonable Portion output for sale based on market principles. The District has the ability to claim the net revenues from sale of the Reasonable Portion to the extent that the District must acquire additional power to meet its firm energy load requirements. The Power Purchasers are responsible for paying their proportionate share of all costs of the Priest Rapids Project regardless of the revenues produced from the Reasonable Portion Contract. The District pays its share of the costs of the Priest Rapids Project. See "SECURITY FOR THE PARITY BONDS—Obligations of the Electric System."
- Under the Product Sales Contract, the District has the ability to take up to 62% of the firm output based upon the District's load. To the extent the District does not take the full 62%, the difference between the District's share and 62% is allocated to the Power Purchasers (for 2010 the Power Purchasers are allocated 1.3% of the 62%). The amount of firm energy output required by the District each year is based on one-year projections of the District's load compared to the projected firm energy output of the Priest Rapids Project based on critical water planning. In addition, if displacement capacity and energy resources are available to the District, the District will offer the Power Purchasers output from the Priest Rapids Project that otherwise would be used by the District ("Displacement Product").

- Some of the smaller Power Purchasers have signed Exchange Agreements with the District, which assign to the District all of their rights and obligations under the New Power Sales Contracts in exchange for a fixed percentage of output from the Priest Rapids Project for the term of the New Power Sales Contracts. This makes up the 8% of the output of the Priest Rapids Project remaining after the 30% Reasonable Portion and the 62% allocated to the District under the Product Sales Contract.

The New Power Sales Contracts provide that each Power Purchaser will be obligated to make payments equal to annual power costs, which include all operating expenses and debt service on the Parity Bonds and debt service coverage (currently 15% of Annual Debt Service) for the life of the New Power Sales Contracts, multiplied by the percentage of output or revenue, as applicable, the purchaser is entitled to that year. The New Power Sales Contracts provide that the Power Purchasers shall pay their portion of the estimated costs of the Priest Rapids Project irrespective of the condition of the Priest Rapids Project and whether or not the Priest Rapids Project is capable of producing power or revenues. If the Priest Rapids Project is not operating, estimated costs will be based on output in the last full year of operation. See “SECURITY FOR THE PARITY BONDS—Obligations of the Electric System” for a description of the Electric System covenant to take power and pay costs associated with its share of power received from the Priest Rapids Project.

Sale of Reasonable Portion

Pursuant to federal legislation and FERC order, the District is required to sell 30% of the Priest Rapids Project power pursuant to market-based principles. The District offers a minimum of 3% of the power pursuant to an auction. In addition, the District also sells at auction the amount of power that the Power Purchasers elect not to take. The District has seen active participation in the auction of the Reasonable Portion. Auctions covering the period of November 1, 2005 to October 31, 2009 were for a slice of the Priest Rapids Development. Auctions covering the period of November 1, 2009 forward are for a slice of the Priest Rapids Project, which includes both Priest Rapids and Wanapum Developments. The following table summarizes the auction winners to date.

Table 4
REASONABLE PORTION AUCTION WINNERS

Period Covered	Auction Winner	Slice of Priest Rapids Development	Auction Price Priest Rapids Development	Slice of Priest Rapids Project (1)	Auction Price Priest Rapids Project	Total Reasonable Portion Revenues Generated (2)
14 mos. ending Dec. 2006	Constellation Energy	6.52%	\$21,051,369	–	\$ –	\$ 96,862,127
12 mos. ending Dec. 2007	Powerex	8.86	23,333,666	–	–	79,007,898
12 mos. ending Dec. 2008	Highland Energy	12.33	38,854,741	–	–	94,537,083
10 mos. ending Oct. 2009	Macquarie Cook	11.32	28,639,308	–	–	–
10 mos. ending Oct. 2009	Cargill	11.32	26,860,987	–	–	61,052,286
2 mos. ending Dec. 2009	Macquarie Cook	–	–	10.51%	5,727,862	–
2 mos. ending Dec. 2009	Cargill	–	–	10.51	5,372,197	29,295,284
12 mos. ending Dec. 2010	PacifiCorp	–	–	6.00	20,332,744	–
12 mos. ending Dec. 2010	Powerex	–	–	12.43	43,684,755	104,206,455

(1) Output from combined Priest Rapids Development and Wanapum Development.

(2) Total Reasonable Portion Revenues Generated represent the auction proceeds plus the remaining portion of the 30% sold to other power purchasers based on the auction price.

Reasonable Portion Revenues are available to the Electric System for the purchase of energy to meet its estimated load requirements in excess of the firm generation from the Priest Rapids Project in any given year, which are referred to as the District’s Estimated Unmet Load (“EUDL”). The Electric System can then use these revenues to purchase power in the open market. The District’s Electric System is then responsible to pay the costs associated with the power production to the Priest Rapids Project in proportion to the Reasonable Portion revenues taken. Total Reasonable Portion revenues used by the Electric System to meet EUDL requirements were \$11,645,038 for

2006, \$33,071,852 for 2007, \$52,341,435 for 2008, and \$32,089,771 for 2009. In 2010, the Electric System is not using Reasonable Portion Revenues because it does not have EUDL due to the higher percentage of firm Wanapum generation that became available to the District on November 1, 2009 under the New Power Sales Contracts.

Priest Rapids Development Output

The actual amounts of energy sold to the Power Purchasers for the fiscal years 2005 through 2009 are shown in Table 5. During the years 2005 through 2009, the Priest Rapids Development delivered to the Power Purchasers and the District an average of 4,216,621 MWh of net energy annually. See “Coordination Agreements,” “FERC License” and “Regulatory Proceedings Affecting the Developments” for a description of certain of the factors that result in the net energy figures.

Table 5
PRIEST RAPIDS DEVELOPMENT HISTORICAL ENERGY SALES
(MWh)

	2005	2006	2007	2008	2009
Gross Generation (1)	3,961,721	4,867,903	5,043,752	4,652,049	4,265,182
Less: Encroachment on Wanapum (2)	(127,736)	(118,934)	(121,691)	(115,287)	(95,599)
Plus: Pond Transfer (3)	28,768	51,374	3,609	38,380	(19,895)
Coordination Exchange (4)	1,424	1,177	(241)	(463)	932
Less: Canadian Entitlements (5)	(262,897)	(253,492)	(247,888)	(242,494)	(252,612)
Spill Past Unloaded Units (6)	(3,530)	(65,537)	(53,166)	(42,849)	(3,586)
Plus: Fish Spill Transfer (7)	194,731	3	0	0	0
Net Energy to Purchasers	3,792,481	4,482,494	4,624,375	4,289,336	3,894,422
Maximum One-Hour Production (MW)	884	901	896	914	897
Plant Factor (8)	51%	62%	64%	58%	54%
Annual Availability Factor (9)	90%	93%	97%	97%	96%
Disposition of Net Energy (10)					
District’s Electric System	1,345,915	2,715,012	2,828,820	2,598,576	2,293,632
PacifiCorp Electric Operations	554,749	373,381	386,723	353,307	72,391
Portland General Electric Co.	515,689	351,982	317,192	284,999	292,801
Puget Sound Energy, Inc.	329,721	203,262	182,144	208,513	40,098
City of Seattle	270,893	24,505	25,396	23,195	25,709
City of Tacoma	295,133	183,207	191,505	24,970	27,114
Avista Corporation	226,476	130,260	135,104	138,352	140,331
Cowlitz County PUD	71,399	70,531	71,701	66,135	61,587
Eugene Water & Electric Board	63,240	44,826	6,701	5,236	8,175
Other Power Purchasers (11)	119,266	385,528	479,089	586,053	932,584
Total	3,792,481	4,482,494	4,624,375	4,289,336	3,894,422

- (1) Excludes station service energy requirements and includes energy produced at the Wanapum Development credited to the Priest Rapids Development equivalent to one-half of the energy that would have been produced at the Priest Rapids Development if no water releases to the spawning channel occurred. Variations from year to year are a result of changing fish spill requirements and Columbia River flows.
- (2) Energy produced at the Priest Rapids Development credited to the Wanapum Development equivalent to a portion of the energy that would have been produced at the Wanapum Development if the Priest Rapids Development’s reservoir had not encroached on the Wanapum Development’s tailrace.
- (3) Purchases of generating capability from neighboring hydroelectric projects.
- (4) Priest Rapids Development energy exchanged by the District with parties to the Mid-Columbia Hourly Coordination Agreement.
- (5) One-half of the computed power benefits produced at the Priest Rapids Development as a result of upstream Canadian storage.
- (6) Spill among the Mid-Columbia Projects is reallocated based on the requests of the participants through an hourly coordination calculation.
- (7) In 2006, Fish Spill Transfer between the Developments ceased due to the implementation of top spill at the Wanapum Development, which reduces the amount of gases and overall water flows and allows a greater percentage of fish passage.

- (8) Gross generation divided by the maximum one-hour production divided by 8,760 (the hours in one year).
- (9) Actual hours that the generating units of the Priest Rapids Development are available for service during the period divided by the total hours in the period.
- (10) The Disposition of Net Energy between power purchasers changed in 2005 due to the New Power Sales Contracts that took effect November 1, 2005.
- (11) Cities of Forest Grove, McMinnville, and Milton-Freewater, Kittitas County PUD, Snake River Power, Clearwater Power, Idaho County Light, Kootenai Electric Cooperative, and Northern Lights, and the power auction winners.
- Certain columns may not add due to rounding.

Wanapum Development Output

The actual amounts of energy sold to the Power Purchasers for the fiscal years 2005 through 2009 are shown in Table 6. During the years 2005 through 2009, the Wanapum Development delivered to the Power Purchasers and the District an average of 4,131,687 MWh of net energy annually.

Table 6
WANAPUM DEVELOPMENT HISTORICAL ENERGY SALES (MWh)

	2005	2006	2007	2008	2009
Gross Generation (1)	5,003,434	5,139,299	5,298,541	4,742,912	4,445,431
Plus: Encroachment by Priest Rapids Development (2)	127,736	118,934	121,691	115,287	95,599
Plus: Pond Transfer (3)	28,768	51,379	3,611	38,384	(19,897)
Less: Rock Island Encroachment (4)	(598,089)	(653,795)	(612,604)	(608,844)	(601,733)
Coordination Exchange (5)	1,424	1,173	(241)	(462)	934
Net Generation	4,563,273	4,656,990	4,810,998	4,287,277	3,920,334
Less: Canadian Entitlement (6)	(256,331)	(245,128)	(237,286)	(236,586)	(241,696)
Less: Spill Past Unloaded Units (7)	(3,529)	(65,537)	(53,167)	(42,850)	(3,592)
Less: Fish Spill Transfer (8)	(194,731)	(3)	0	0	0
Net Energy to Purchasers	4,108,682	4,346,322	4,520,545	4,007,841	3,675,046
Maximum One-Hour Production (MW)	968	893	894	885	885
Plant Factor (9)	59%	66%	68%	61%	57%
Annual Availability Factor (10)	94%	86%	87%	88%	84%
Disposition of Net Energy:					
District's Electric System	1,444,517	1,614,180	1,618,929	1,401,568	1,357,504
PacifiCorp	802,407	824,466	887,162	781,976	660,273
Portland General Electric Co.	763,349	803,072	862,336	755,257	651,216
Puget Sound Energy, Inc.	473,933	464,315	471,566	456,451	334,654
Avista Corporation	334,691	328,182	354,497	326,279	279,695
Cowlitz County PUD	109,964	119,365	123,500	108,999	94,522
Eugene Water & Electric Board	94,213	100,428	105,088	92,220	74,425
Other Purchasers (11)	85,608	92,314	97,467	85,091	222,757
Total	4,108,682	4,346,322	4,520,545	4,007,841	3,675,046

- (1) Excludes station service energy requirements and includes energy produced at the Wanapum Development credited to the Priest Rapids Development equivalent to one-half of the energy that would have been produced at the Project Rapids Development if no water releases to the spawning channel occurred. Variations from year to year are a result of changing fish spill requirements and Columbia River flows.
- (2) Energy produced at the Priest Rapids Development credited to the Wanapum Development equivalent to a portion of the energy that would have been produced at the Wanapum Development if the Priest Rapids Development's reservoir had not encroached on the Wanapum Development's tailrace.
- (3) Purchases of generating capability from neighboring hydroelectric projects.
- (4) Energy produced at the Wanapum Development credited to the Rock Island project of Chelan County PUD equivalent to a portion of the energy that would have been produced at the Rock Island project if the Wanapum Development's reservoir had not encroached on the Rock Island project's tailrace.
- (5) Wanapum Development energy exchanged by the District with parties to the Mid-Columbia Hourly Coordination Agreement.
- (6) One-half of the computed power benefits produced at the Wanapum Development as a result of upstream Canadian storage.

- (7) Spill among the Mid-Columbia Projects is reallocated based on the requests of the participants through an hourly coordination calculation.
 - (8) In 2006, Fish Spill Transfer between the Developments ceased due to the implementation of top spill at the Wanapum Development which reduces the amount of gases and overall water flows and allows a greater percentage of fish passage.
 - (9) Plant factor is calculated by dividing gross generation by the maximum one-hour production divided by 8,760 (the hours in one year).
 - (10) Actual hours that the generating units of the Wanapum Development are available for service during the period indicated divided by the total hours in the period.
 - (11) Cities of Forest Grove, McMinnville, and Milton-Freewater and as of Nov 1, 2009 Kittitas County PUD, Snake River Power, Clearwater Power, Idaho County Light, Kootenai Electric Cooperative, and Northern Lights, and the power auction winners.
- Certain columns may not add due to rounding.

Coordination Agreements

A number of publicly and privately owned utilities in the Pacific Northwest, including the District, have joined with Bonneville, the United States Army Corps of Engineers and the United States Bureau of Reclamation in a long-term Pacific Northwest Coordination Agreement. This agreement became effective on January 4, 1965, and had an original termination date of June 30, 2003. The agreement was amended to continue until July 31, 2003. A replacement agreement began on August 1, 2003, which extends the term to 2024.

In 1973, the District entered into the Mid-Columbia Hourly Coordination Agreement to provide for moment-by-moment coordination of the seven federal and nonfederal hydroelectric projects on the Mid-Columbia River, including the Priest Rapids and Wanapum Developments, with the District designated as the “central” control point under the contract. The agreement calls for continuously analyzing the total electric requirements of the seven plants and allocating generation to individual plants in a manner that results in less fluctuation of reservoirs at each dam, operation of the reservoirs at a higher average level and greater total power production. This efficient operating method increases the total generation from the Priest Rapids and Wanapum Developments, simplifies power dispatching communications, and alleviates potential technical control difficulties between the projects. This agreement was renewed for an additional 20 years ending June 30, 2017.

Transmission of Power from Priest Rapids Project

The Priest Rapids Project’s 230-kV transmission lines interconnect transmission systems of the District, Bonneville and certain Power Purchasers. These transmission lines currently have sufficient capacity to integrate fully the Priest Rapids Project’s output into the Pacific Northwest’s high-voltage transmission system. A portion of the Priest Rapids Project’s power is delivered directly to the District and certain Power Purchasers via lines owned by the respective parties, with the remainder delivered to the District and the Power Purchasers through the Bonneville transmission system.

The District entered into new transmission agreements with Bonneville effective October 1, 2001. These transmission agreements provide transmission services for the block power purchase from Bonneville, and the purchase of Bonneville power to serve the District’s loads at Grand Coulee. See “THE ELECTRIC SYSTEM—The Electric System’s Power Supply.” These agreements are standard transmission agreements offered by Bonneville for similar requirements of other public and private utilities. The District worked with Bonneville on a reconfiguration of the District’s internal transmission system and the associated increase in internal power flows that result from the new configuration.

Bonneville’s transmission facilities interconnect with the British Columbia Hydro and Power Authority (“B.C. Hydro”) in the Canadian province of British Columbia and with utilities in the Pacific Southwest. Bonneville’s transmission system includes approximately 360 substations, 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 the Priest Rapids Project, is transmitted over Bonneville’s transmission facilities to various investor-owned and municipally-owned utilities in the Pacific Northwest. Bonneville routinely provides both long and short-term transmission access to utilities for the purpose of wheeling power within the Pacific Northwest.

The Pacific Northwest-Pacific Southwest Intertie (the “Intertie”) provides the primary bulk transmission link between the Pacific Northwest and the Pacific Southwest. Bonneville owns approximately 73% of the portions of the Intertie located north of California and Nevada. The Intertie consists of four high-voltage transmission lines and associated facilities, and has a combined capacity of about 7,900 MW. Due to operational limitations, Bonneville operates the Intertie at varying levels during the year. The actual transfer capability varies by season and by the amount of generation available on the lower Columbia River. Depending upon the season, the Intertie is rated between 5,200 MW and 6,900 MW.

The National Energy Policy Act of 1992 (the “Energy Policy Act”) included provisions that promoted competition in wholesale electric markets by, among other things, easing restrictions on wholesale power producers and by allowing FERC to order transmission access for wholesale buyers and sellers of electricity over transmission systems owned by “transmitting utilities.” In 1996, FERC issued its Order 888, which requires jurisdictional utilities to file wholesale transmission tariffs providing pricing and terms for transmission access for wholesale purposes. FERC Order 888 also requires non-jurisdictional utilities (including municipal and consumer owned utilities such as the District) that purchase transmission services from a jurisdictional utility to provide, in turn, non-discriminatory, open access transmission services back to the jurisdictional utility upon terms and conditions that are comparable to the transmission service that they provide to themselves. FERC Order 889 (1) imposes certain standards of conduct intended to restrict transmission-owning utilities from using those facilities to obtain an unfair competitive advantage in power sales transactions and (2) requires utilities to post information electronically regarding the availability and pricing of their transmission services.

In 1999, FERC issued its Order 2000, which initiated the formation of regional transmission organizations (“RTOs”) and set forth various standards for their organization and operation. In 2000 and in compliance with the requirements of Order 2000, Bonneville and nine investor-owned utilities in the Pacific Northwest proposed the organization of a regional transmission organization to be known as “Grid West.” The members agreed to discontinue this effort in 2005. A group of investor and consumer owned utilities, along with Bonneville, initiated a new effort called “ColumbiaGrid” in 2006. Currently, this organization, of which the District is a member, is providing transmission planning services in the Pacific Northwest and is considering additional transmission-related service offerings. ColumbiaGrid is not an RTO and provides services on a bilateral, contractual basis.

FERC License

Summary

On November 4, 1955, the Federal Power Commission (now FERC) issued a 50-year license to the District authorizing the construction, operation, and maintenance of the Priest Rapids and Wanapum Developments. Upon expiration of the original license on October 31, 2005, the District operated the Priest Rapids Project under annual licenses pending the disposition of its new license application, filed in 2003. This license application contained a thorough review of Priest Rapids Project resource needs and impacts, as well as a proposed package of resource mitigation measures based on scientific research. On April 17, 2008, FERC issued a new 44-year license for the Priest Rapids Project, subject to the terms and conditions of the 401 Water Quality Certification issued by the State of Washington Department of Ecology (“Ecology”), the Section 18 Fishway Prescriptions and incidental take statements submitted by NOAA Fisheries and U.S. Fish and Wildlife Service, and the Salmon and Steelhead and Hanford Reach settlement agreements described below.

Fish, Wildlife and Water Quality

The Priest Rapids Project license requires mitigation and enhancement measures including: operation of the Wanapum Fish Bypass and spill to improve downstream passage of juvenile salmon and steelhead; continued evaluations of permanent downstream passage facility designs for the Priest Rapids Dam; continued operation and improvements to upstream passage facilities; sluiceway spills for fallback and kelt passage; operations and monitoring to improve conditions for fall Chinook salmon in the Hanford Reach; implementation of a plan to improve anadromous fish habitat; implementation of a performance evaluation program, including various anadromous fish monitoring and evaluation studies; implementation of hatchery programs for five species of salmon and steelhead; implementation of management plans for bull trout, Pacific lamprey, white sturgeon, and native resident fish; implementation of a total dissolved gas abatement program; monitoring of water temperature,

dissolved oxygen, and pH; and implementation of numerous plans to protect and enhance wildlife and associated habitat. The capital cost of these measures from 2010 to 2012 is estimated at \$37.6 million.

Priest Rapids Fishway Modification

The Priest Rapids and Wanapum Developments employ fish attraction water supply pumps at the left bank fishways to augment the water supply to the lower end of the fish ladders. The Priest Rapids pumphouse was equipped with two extra bays in the event additional pumps were required. The Priest Rapids ladder also employs a gravity intake gate (“GIG”) at the forebay to provide additional water in the lower section of the ladder. Fisheries agencies have expressed concern over the use of the GIG because of its potential impact on downstream migrating fish. During relicensing, the District proposed installation of new pumps in the empty pumping bays at an estimated cost of \$10.5 million. In the new license, FERC requested a plan for installing a pumping system at each fishway water supply. The District will be studying other options for the fishways while proceeding with the addition of the pumps on the left bank fishway, which is currently scheduled to occur by 2012.

Section 401 Water Quality Certification

As part of the relicensing process for the Priest Rapids Project, the District applied to Ecology for water quality certification. Under Section 401(a)(1) of the Clean Water Act (“CWA”), FERC may not issue a license authorizing the construction or operation of a hydroelectric project unless the state water quality certifying agency either has issued water quality certification for the project or has waived certification by failing to act on a request for certification within a reasonable period of time, not to exceed one year. Section 401(d) of the CWA provides that the certification shall become a condition of any federal license that authorizes construction or operation of the Project.

On April 3, 2007, Ecology issued a certification for the Priest Rapids Project. On March 17, 2008, Ecology filed a revised certification, which contains the conditions that are incorporated into the FERC license. The certification requires that the Priest Rapids Project be operated pursuant to: (1) the Salmon Agreement for spring, summer, and fall Chinook salmon; steelhead; sockeye salmon; and coho salmon; and (2) the bull trout, white sturgeon, Pacific lamprey, and native resident fish management plans to be developed as provided in the water quality certification. The certification requires the establishment of groups for coordination and implementation of the requirements under the Salmon Agreement, as well as implementation of measures to determine attainment of specified biological objectives. These measures include the requirement to provide funds (not to exceed \$1,500,000) to renovate the existing Columbia Basin Hatchery facility to ensure stable operations at current capacity for the term of the license.

Recreation Resources

The Priest Rapids Project is an important regional recreation resource. The District supports the development of public recreation facilities when implemented in the broader public interest that do not interfere with operations of the Priest Rapids Project or conservation objectives. The District developed a Recreation Resource Management Plan as part of the relicensing application. The plan identified measures for recreation sites located within or adjacent to the existing Priest Rapids Project boundary. At the Wanapum Development, there are 23 developed and undeveloped recreation sites, including boat launches, campgrounds, picnic areas, and the Wanapum Dam Heritage Center, located at the dam. At the Priest Rapids Development, there are 12 developed and undeveloped recreation sites, including boat launches, campgrounds, and picnic areas. Of these 35 total recreation sites, 23 recreation sites are project-related and located within the boundary of the Priest Rapids Project, including the Crab Creek Corridor. A total of \$11.8 million is budgeted for recreation improvements during 2010-2012 as required by the new license. In addition, the new license requires the District to file a shoreline management plan with FERC to protect the scenic quality of the mid-Columbia River. A component of the shoreline management plan is to file a plan for the future use of Crescent Bar Island after 2012. This plan will include additional public recreation and wildlife habitat enhancement measures on Crescent Bar Island. This plan will be finalized and submitted to FERC by the end of 2010.

Cultural Resources

During relicensing of the Priest Rapids Project, the District initiated cultural resource identification surveys. These surveys identified more than 350 new archaeological sites and several hundred isolated artifacts, bringing the total number of identified cultural resources areas within the Priest Rapids Project boundary to 1248. The Programmatic Agreement for Cultural Resources (“PA”) was executed on April 12, 2007 and outlined specific actions related to cultural resources preservation and management, each with target dates. The focus of the PA is evaluation of all cultural resources for their national register eligibility status, determination of adverse effects to significant resources and development of comprehensive treatment plans to mitigate adverse effects. The new license also calls for the development of a Historic Properties Management Plan (“HPMP”) that provides guidelines for long-term management of the District’s cultural resources. The HPMP governs how cultural resources are addressed during all construction activities related to the Priest Rapids Project. Over \$9.6 million is budgeted for the 2010-2012 time period for cultural resource protection, which involves extensive shoreline modification through use of rip-rap and other natural materials.

Wanapum Agreement

The new license requires the District to develop a new agreement with the Wanapum Indians committing to the “identification, protection and management of cultural resources, gravesites, and relics at the Priest Rapids Project which are significant to the Wanapum Indians.” The New Wanapum Heritage Center will be a facility dedicated to the protection, preservation, interpretation and perpetuation of the Wanapum culture and the cultural resources of the Columbia River from the confluence of the Snake River northwards to the Rock Island area. The existing Wanapum Heritage Center is composed of the Cultural Resources Program, a Museum, the Repository, and the Living Culture Program. Currently, these facilities are dispersed within the Priest Rapids Project area with some components housed within the dam, in various houses and in the existing Museum which is near the secure area where future access will be restricted. Under this program, the District is planning for development of a new, comprehensive facility for the program near Priest Rapids Dam and adjacent to the Columbia River. This site is owned by the District, near the current Wanapum Indian Village, and has cultural significance to the Wanapum Indians. Interior space includes a new permanent exhibit, expanded repository, library, oral history work room, and other functional space as needed. The total estimated cost of this project from 2010 through 2012 is \$20 million.

Yakama Nation Agreement

In 2007, the District entered into an agreement with the Confederated Tribes and Bands of the Yakama Nation (the “Yakama Nation”) to settle several issues including previous lawsuits, claims, allegations, filings, and other actions by the Yakama Nation against the District. The agreement expires at the end of the new license term. The benefit to the Yakama Nation is the financial equivalent of 20 aMW for 2007-2009, 15 aMW for 2010-2015 and 10 aMW throughout the term of the agreement. After 2015, the Yakama Nation can request to have actual physical power delivered. The Yakama Nation is responsible to pay the costs associated with producing the benefit received (either financial or physical delivery).

Considerations to be provided by the Yakama Nation to the District throughout the life of the agreement include providing the District with the right of first refusal to participate in the development of new generation resources, to cooperatively develop Pacific lamprey and white sturgeon management plans with the District, and to represent itself on committees, subcommittees and groups involved with implementation of the various agreements associated with the Priest Rapids Project and the new license requirements.

The agreement went into effect on July 1, 2007. The net payments to the Yakama Nation totaled \$3,388,989 for 2009 and \$8,512,384 for 2008. These costs were charged to Priest Rapids Project administrative and general expense.

From 2010 through 2015, the District values the power allocation on behalf of the Yakama Nation and pays the monthly net revenues by multiplying the power allocation (15 aMW through 2015) by the IntercontinentalExchange (“ICE”) Daily Power Indices for the Mid-Columbia at peak and off-peak for the month less the average annual melded power costs for the Priest Rapids Project for the prior calendar year and any costs associated with the

marketing and administration of the power allocation. The annual costs during the next five years for this agreement are estimated at approximately \$3.5 million per year.

Regulatory Proceedings Affecting the Developments

Proceedings Before FERC

Advanced Turbine Replacement. As discussed under “Rehabilitation Program—Priest Rapids Project,” FERC’s 2004 order authorizing the installation of advanced turbines at the Wanapum Dam allows staged installation of new, more efficient turbines. The District is replacing all ten of the existing turbines at Wanapum Dam. The new turbines have increased power output and efficiency, and include features intended to improve the survival of fish. The order from FERC also incorporates conditions in the 2007 Water Quality Certification issued by Ecology requiring, among other conditions, a study of the Total Dissolved Gas (“TDG”) production of the new turbines and mitigation for any increases associated with increased TDG production from the new turbines as compared to the existing turbines. The TDG Study that was conducted following the first new turbine installation concluded the new turbine did not increase TDG production and, therefore, no mitigation was required. Turbine Units 8, 4, 10, 9 and 6 have been successfully replaced. The advanced turbine is an important measure projected to improve conditions for fish and water quality within the Wanapum Development’s project area, and the District expects to complete the remaining units over the next four years. The estimated cost of this program from 2010-2012 is \$64 million.

Wanapum Fish Passage Facility. The District operates a fish passage facility, consisting of a 20,000 cubic feet per second (“cfs”) ogee-crested weir constructed through the center slot of future Unit 11 at Wanapum Dam. The bypass is designed to improve downstream passage of migrating smolts and improve water quality by reducing the amount of spill, TDG entrainment, fish injury and erosion at the Wanapum Dam. Construction began in 2005 and was completed in 2008. The completed future unit non-turbine fish bypass spills 20,000 cfs of water and replaces the spill agreement that required spill up to 43% of river flow in the spring and up to 49% in the summer at Wanapum Dam. The spill reduction from the amounts identified above provide a measurable increase in spring and summer power generation at Wanapum Dam.

Proceedings Related to Allocation of Output. Public Law 83-544 (“PL 83 544”) is federal legislation enacted in 1954 that enabled the District to construct the Priest Rapids and Wanapum Developments. PL 83-544 requires the District, among other things, to offer a “reasonable portion” of the output of the Priest Rapids Project for sale in neighboring states. On February 11, 1998, in response to a complaint filed by several electric cooperatives seeking an allocation of power under a new license, FERC issued an order regarding distribution of the Priest Rapids Development power post 2005 and the Wanapum Development power post 2009. FERC ruled that the licensee can retain 70% of the Priest Rapids Project’s firm and non-firm power. The remaining 30% is designated as the “reasonable portion,” and, pursuant to the order, must be sold in a fair, equitable and nondiscriminatory manner, pursuant to market based principles and procedures with a preference in the marketing of such power being given to the utilities and the Power Purchasers that participated in the PL 83 544 proceeding. The D.C. Circuit Court of Appeals affirmed FERC’s rulings in all respects. No further appeals were filed and the litigation is now concluded. See “—Power Sales Contracts.”

Endangered Species and Other Fish Issues

Endangered or Threatened Species of Fish. In 1997 and 1999, the Upper Columbia River (“UCR”) Steelhead and Spring Chinook, respectively, were listed as endangered. In 1998, the UCR bull trout was listed as threatened. Bull trout occurrences in the Priest Rapids Project area consist of extremely small numbers frequenting the upper reaches of the Wanapum reservoir. The ESA makes it unlawful for any person subject to the jurisdiction of the United States to “take” any endangered species which, under the ESA, includes an intentional or negligent act that will harm or harass, or that creates the likelihood of injury to a species by significantly disrupting normal behavior patterns. Violations of the ESA can be enforced by governmental and citizen suits. There are both civil and criminal penalties.

National Oceanic and Atmospheric Administration (“NOAA”) Fisheries, under certain circumstances, has the power to approve any “incidental taking” of a listed species. NOAA Fisheries can only approve the action if it determines, after required consultation, that the action is not likely to jeopardize the continued existence of any listed species or

result in the destruction or adverse modification of its critical habitat. If jeopardy or adverse modification is found, NOAA Fisheries can suggest reasonable and prudent alternatives so as to avoid jeopardy. If jeopardy is not avoided through the implementation of reasonable and prudent alternatives, no incidental take statement can be issued. In such event, project operations would continue to be subject to being enjoined or altered, and the District would remain exposed to fines and penalties for ESA violations.

During its environmental and administrative review of the District's relicensing application, FERC initiated ESA consultation with NOAA Fisheries for spring Chinook and steelhead and with the United States Fish and Wildlife Service for bull trout. These reviews resulted in issuance of Biological Opinions and Incidental Take Statements for these ESA listed species affected by the Priest Rapids Project and incorporated protection, mitigation and enhancement measures as requirements of the new license issued in April 2008. The District continues to interact with these regulatory agencies for the implementation of these measures.

Federal Project ESA Litigation. With several salmon species listed under the ESA, Bonneville, the United States Bureau of Reclamation, and the United States Army Corps of Engineers have undertaken and are implementing certain measures to protect salmon. Many of these measures have been mandated by NOAA Fisheries pursuant to the ESA in the Biological Opinions produced under the ESA. These regulatory requirements are required by the ESA in order for these federal agencies to avoid actions that would jeopardize the listed species. There has been extensive and on-going litigation of the Biological Opinions produced for federal hydroelectric projects. Most of this litigation centers on legal issues associated with ESA interpretations and required fish passage measures and river flow requirements. Some of these required measures affect river operations on the Snake and Columbia Rivers. Even though the Priest Rapids Project is located upstream from the confluence of the Snake and Columbia Rivers, some measures, such as substantial seasonal flow augmentations, do affect that portion of the Columbia River where the Priest Rapids Project is located. In particular, the flow augmentations cause over-generation in the spring and early summer when there is an abundance of hydroelectric generation and the value of such energy therefore is low, and a reduction of generation in the winter when the energy is needed and the price of replacement energy therefore is high.

Hanford Reach Fall Chinook Protection Agreement. In March 2004, the Hanford Reach Fall Chinook Protection Agreement was signed by Grant, Chelan, and Douglas County PUDs, Bonneville, Washington Department of Fish and Wildlife, NOAA Fisheries, and the Colville Confederated Tribe. The agreement replaced an existing agreement by combining the spawning period flow regime with the flow re-shaping program developed from 1999-2003 to reduce stranding and entrapment of fall Chinook fry. The agreement involves close coordination among the District, Bonneville, Chelan and Douglas County PUDs to provide a flow regime that protects Fall Chinook from spawning through emergence and early rearing and is based on the experience learned from 1999-2003 and is supported by an extensive body of research, modeling and evaluation. Additional signatories to the Hanford Reach Agreement are the U.S. Fish and Wildlife Service and the Yakama Nation.

Salmon and Steelhead Agreement. In 2006, the District entered into an agreement (the "Salmon and Steelhead Agreement") with the United States Department of Interior, U.S. Fish and Wildlife Service, NOAA Fisheries, the Washington Department of Fish and Wildlife, the Yakama Nation, and the Confederated Tribes of the Colville Reservation, for the purpose of resolving all issues between the District and the other signatories related to anadromous salmonid fish species in connection with the District's new license for the Priest Rapids Project. The Salmon and Steelhead Agreement constitutes a comprehensive and long-term adaptive management program for the protection, mitigation, and enhancement of fish species which pass or may be affected by the Priest Rapids Project.

In order to implement the Salmon and Steelhead Agreement, the District is obligated to establish separate restricted funds (the "Habitat funds") into which the District will deposit payments for further distribution in accordance with the requirements of the Salmon and Steelhead Agreement and the Biological Opinion. The Priest Rapids Coordinating Committee ("PRCC") oversees the distribution of the Habitat funds created through the Salmon and Steelhead Agreement. The voting members of the PRCC include the District, the U.S. Fish and Wildlife Service, NOAA Fisheries, Washington Department of Fish and Wildlife, the Confederated Tribes of the Colville Reservation, and the Yakama Nation. The Habitat funds cannot be spent without the unanimous consent of all voting members. All interest earned by the Habitat funds increase the balance of these funds and is not recognized as income by the District. Expenditures of these funds must be made in accordance with the Salmon and Steelhead Agreement and the Biological Opinion for the protection and restoration of habitats along the mainstem and

tributaries within the Upper Columbia River watershed including the Okanogan, Methow, Entiat, and Wenatchee River watersheds. These funds are intended to compensate for 2% of the unavoidable mortality to salmonids due to the operation of the Priest Rapids Project. The District anticipates funding the Habitat funds through the new license term. The District's required contributions to the Habitat funds are comprised of a fixed portion and a portion which is variable based on annual salmonid mortality within the Priest Rapids Project.

The District's total contributions to the Habitat funds for the years ended December 31, 2009 and December 31, 2008 equaled \$2,689,092 and \$2,485,770, respectively. The District expects to contribute approximately \$10,407,000 during the period 2010 through 2014.

Draw-Down and Dam Removal Proposals. Removal or drawdown of dams is a controversial issue that has been subject to much discussion in the Pacific Northwest and the nation. Neither is a significant issue in the case of the mid-Columbia River. However, the removal of any of the 11 federal hydroelectric projects on the Columbia River and/or permanent draw-downs could have a significant effect on any or all of the following: local and/or regional economies, power supplies, navigation, flood control, wildlife habitat and irrigation, dam owners and operators and power purchasers. The District believes that it is unlikely that any federal or state regulatory agency would order dam removal or draw-down of the Priest Rapids or Wanapum Developments in connection with any pending or future ESA listings. Removal or permanent draw down of either Development would preclude any power generation and would have a material adverse effect on the financial condition of the District and the security for the Parity Bonds.

Potential Effects on District of ESA Proceedings. The District has committed substantial resources to mitigate the impacts of the Priest Rapids Project on anadromous fish, including species listed as threatened or endangered. Nonetheless, it is possible under the ESA that the continued operation of the Priest Rapids Project, at least during certain periods each year, could be jeopardized. During the relicensing process, the District obtained a Biological Opinion and Incidental Take Statement covering Priest Rapids Project operations under the 44-year license issued in 2008. This Biological Opinion contained numerous measures including: interim spill and bypass system requirements, which have a direct effect on power generation at the Priest Rapids Project. While ESA litigation has been avoided, there is some future risk of adverse court rulings. To the extent the unit cost of power from the Priest Rapids Project increases to the point where it is not competitive with other firm power resources in the region, it could have a material adverse effect on the security for the Parity Bonds, including the Bonds.

Rehabilitation Program – Priest Rapids Project

In the early 1980s, the District began a program of equipment renewal and rehabilitation to improve generating unit availability and overall plant operation to minimize unscheduled outages of generating units due to generator winding failures.

The major programs at the Priest Rapids Development include generating unit restoration, generating unit equipment improvements, powerhouse improvements, power plant modernization, and communication/control system improvements. The District began replacement of the generator stator core and windings in 1986 and completed the last unit in 1998. Rehabilitation work on the hydraulic governors and wicket gate servos and replacement of the main excitation systems (completed in 1995) and main circuit breakers (completed in 1998) have also been performed.

All ten of the Wanapum Development generators were rewound between 1983 and 1994. During the rehabilitations, problems were discovered with cracking of the turbine trunnion keyways. Initial repairs on the first eight units were not successful as the cracking reoccurred after several years of operation; however the last two units were successfully repaired using a different method. In addition to the cracking of the turbine trunnion keyways, cracking of the turbine blades themselves was discovered to be occurring. The cracks were found on both the pressure and suction sides of the blades and extended into the blade root area in all cases. In 1996 the District began working on designs for replacing the turbines at the Wanapum Development. In 2004 the District received approval from FERC for a license amendment to install, test and operate a new advanced turbine in Wanapum Unit 8. Unit 8 was placed in service with the new turbine in February 2005. Testing of turbine performance was completed with satisfactory results and FERC authorized the District to install the remaining nine new turbines. To date, new turbines have been

successfully installed for five of the ten Wanapum Units with the most recent being placed in service in August 2009.

The new license requires the District to complete the five remaining turbine upgrades at the Wanapum Development. The District is currently installing the sixth advanced turbine, which is expected to begin generating in April 2010. The District anticipates replacing the remaining units at a rate of one every nine months, until all ten have been replaced, with projected completion in 2013. As of December 31, 2009, the cost of the remaining turbines to be replaced is estimated at \$64 million. To get full use of the new turbines, the District is also replacing and upgrading the generators at the Wanapum Development. In January 2009 a contract was awarded to Alstom Hydro US, Inc. for \$150 million to upgrade all ten generators at Wanapum Development. The on-site construction is scheduled for May 2010 through January 2018. The turbine and generator schedules will match up on the seventh turbine. The existing generators are currently rated at 109.25 megavolt-amperes (“MVA”). The new generators will have a name plate rating of 128.6 MVA, an increase of 17.7%.

In addition to the Wanapum turbine and generator replacement project, the District is initiating design and engineering work on turbine and generator replacement for the Priest Rapids Development. Initial modeling has begun and the District expects to be working through the design and contracting process in 2010 and 2011, with turbine upgrade installation at the Priest Rapids Development beginning in 2014 and completed by 2023.

Main generating unit circuit breakers have been replaced at the Wanapum and Priest Rapids Developments. From 2005-2009 the five main step-up transformers were replaced at the Priest Rapids Development. The main step-up transformers are also being replaced at the Wanapum Development beginning in 2012. The hydraulic governors at both plants have been approved for upgrades to digital hydraulic models. This work will follow the generator upgrade projects at both plants and will also include upgraded generator protection and unit control systems. Over the next five years the plant 600 V and 13.2 KV switchgear is scheduled for replacement at both developments. All major plant cranes have been rebuilt, and spillway gates are being rehabilitated. A fiber optic data/communications cable has been installed between the Wanapum and Priest Rapids Developments to replace the existing microwave path as the primary link. The District continues to work on rehabilitation of station service (air, water, oil and electric) systems for both plants.

During a FERC inspection in 1999, the Priest Rapids Development spillway gate trunnion thrust washers were noted to have severe cracking. Installation of the new bearings and thrust washers was finished at the Priest Rapids Development in 2004. The Wanapum spillway gate trunnions contained the same original type of bearings and thrust washers. Cracking was observed in the washers in 1999 and bearings during disassembly. Replacement of the bearings and washers was included as part of the gate rehabilitation contract that started in the fall of 2004. This spillway gate trunnion work at Wanapum is scheduled to be completed in the spring of 2011. Following the trunnion work, the Wanapum spillway gates will be due for a new paint system. Replacing the paint system on the Wanapum spillway gates is a major undertaking because of their size. The gates are 50 feet wide by 68 feet tall and the original paint system contains lead. Wanapum spillway gate painting will begin in 2012 and is expected to be completed in 2016.

Estimated Capital and Financing Requirements

The District projects that the cost of the renewal and rehabilitation programs and fish, wildlife and other environmental programs undertaken at the Priest Rapids Project during the period 2010 through 2012 will be approximately \$296 million, as shown in Table 7, which will be financed by proceeds of the Bonds.

Table 7
PRIEST RAPIDS HYDROELECTRIC PROJECT
2010-2012 FORECAST CAPITAL PROGRAM EXPENDITURES

Turbine/Generator Restoration	\$ 133,341,000
Fish and Wildlife	47,839,000
Recreational/Cultural	49,886,000
Powerhouse Improvements	44,324,000
Miscellaneous (1)	20,632,000
	\$ 296,022,000

(1) Includes buildings and property improvements, computer hardware and software, tools, equipment, office furniture, security and communication/control systems improvements.

Future Borrowings

The District may issue additional New Clean Renewable Energy Bonds in the next two years in the approximate amount of \$50,000,000 to finance a portion of additional improvements to the Priest Rapids Project.

Operating Results

Table 8 shows actual operating results for the Priest Rapids Development for the fiscal years 2005 through 2009. Revenues from the Power Purchasers and the District's Electric System are currently equal to the cost of power from the Priest Rapids Development. Such cost of power is a function of operating expenses, annual debt service and coverage requirements on the Parity Bonds and reserve requirements imposed by the Bond Resolution and the 1956 Power Sales Contracts and the New Power Sales Contract (which went into effect on November 1, 2005). The Power Sales Contracts established the costs to be included in the cost of power from the Priest Rapids Development. This table differs from the financial statements in Appendix C and is designed to show compliance with the debt service coverage requirements in the Bond Resolution. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION" and APPENDIX B—"SUMMARY OF CERTAIN PROVISIONS OF THE POWER CONTRACTS."

Table 8
PRIEST RAPIDS DEVELOPMENT OPERATING RESULTS
(\$000)

	2005	2006	2007	2008	2009 (1)
Operating Revenues					
Sales of Power (2)	\$ 30,732	\$ 40,183	\$ 46,712	\$ 54,150	\$ 52,313
Interest and Other Income (3)	<u>895</u>	<u>2,467</u>	<u>4,446</u>	<u>2,374</u>	<u>954</u>
Total Revenues and Other Income	\$ 31,627	\$ 42,650	\$ 51,158	\$ 56,524	\$ 53,267
Operating Expenses (4)					
Generation	\$ 12,076	\$ 13,150	\$ 14,484	\$ 18,212	\$ 12,566
Transmission	829	912	956	932	971
Administrative and General	6,335	8,954	12,288	14,366	7,506
License Compliance and Related Agreements (5)	0	0	0	0	9,181
Taxes	<u>807</u>	<u>964</u>	<u>992</u>	<u>918</u>	<u>892</u>
Total Operating Expenses	\$ <u>20,047</u>	\$ <u>23,980</u>	\$ <u>28,720</u>	\$ <u>34,428</u>	\$ <u>31,116</u>
Net Revenues	\$ <u>11,580</u>	\$ <u>18,670</u>	\$ <u>22,438</u>	\$ <u>22,096</u>	\$ <u>22,151</u>
Transfer Requirements (6)	1,426	157	48	0	0
Excess Available in Supplemental R&R Fund	\$ <u>1,956</u>	\$ <u>1,885</u>	\$ <u>2,728</u>	\$ <u>3,321</u>	\$ <u>3,320</u>
Remaining Net Revenues Available for Debt Service on Parity Bonds	\$ <u>14,962</u>	\$ <u>20,712</u>	\$ <u>25,214</u>	\$ <u>25,417</u>	\$ <u>25,471</u>
Debt Service on Parity Bonds	\$ 12,916	\$ 17,998	\$ 21,976	\$ 22,132	\$ 22,170
Debt Service Coverage on Parity Bonds (7)	1.15x	1.15x	1.15x	1.15x	1.15x
Net Energy Output (MWh)	3,792,481	4,482,494	4,624,375	4,289,336	3,894,422
Average Cost (\$/MWh) (8)	\$8.10	\$8.96	\$10.10	\$12.62	\$13.43

(1) Based on unaudited financial statements

(2) Revenues from all Power Purchasers including the Electric System (Annual Power Costs).

(3) Interest on various funds of the Priest Rapids Development.

(4) Excludes repairs, renewals, replacements, and extraordinary maintenance costs paid from the 1956 Renewal and Replacement Fund and construction funds.

(5) Began to account for these FERC license related expenses separately in 2009. Previously included in Administrative and General expense.

(6) Represents amounts transferred to the 1956 Renewal and Replacement Fund or to be credited to power costs. In 2005, 2006 and 2007, the money was used for payment of extraordinary items out of the construction funds.

(7) Annual charges for sales of power are set at levels sufficient to produce revenues providing debt service coverage of 1.15x.

(8) Revenues from sales of power divided by net energy output.

Certain columns may not add due to rounding.

Monthly payment by the Power Purchasers and the Electric System of their respective shares of Annual Power Costs is required by the New Power Sales Contracts, even if no power and energy are actually delivered. Annual Power Costs are estimated one year in advance and are payable in equal monthly portions of such estimate. Payments are adjusted annually to reflect actual costs.

Table 9 shows actual operating results for the Wanapum Development for the fiscal years 2005 through 2009. Revenues from the Power Purchasers and the Electric System are currently equal to the cost of power from the Wanapum Development. Such cost of power is a function of operating expenses, annual debt service and coverage requirements on the Parity Bonds and reserve requirements imposed by the Bond Resolution and the 1959 Power Sales Contracts. The 1959 Power Sales Contracts established the costs to be included in the cost of power from the Wanapum Development. This table differs from the financial statements in Appendix C and is designed to show

compliance with the debt service coverage requirements in the Bond Resolution. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION” and APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE POWER CONTRACTS.”

Table 9
WANAPUM DEVELOPMENT OPERATING RESULTS
(\$000)

	2005	2006	2007	2008	2009 (1)
Operating Revenues					
Sale of Power (2)	\$ 35,301	\$ 42,691	\$ 54,638	\$ 65,664	\$ 58,063
Interest and Other Income (3)	3,066	2,667	7,557	4,019	2,530
Total Operating Revenues	<u>\$ 38,367</u>	<u>\$ 45,358</u>	<u>\$ 62,195</u>	<u>\$ 69,683</u>	<u>\$ 60,593</u>
Operating Expenses (4)					
Generation	\$ 11,702	\$ 11,776	\$ 13,856	\$ 19,711	\$ 14,233
Transmission	868	1,042	1,069	1,048	1,089
Administrative and General	5,454	8,039	12,895	15,699	8,802
License Compliance & Related					
Agreements (5)	0	0	0	0	9,181
Taxes	875	937	972	861	843
Total Operating Expenses	<u>\$ 18,899</u>	<u>\$ 21,794</u>	<u>\$ 28,792</u>	<u>\$ 37,319</u>	<u>\$ 34,148</u>
Net Revenues	<u>\$ 19,468</u>	<u>\$ 23,564</u>	<u>\$ 33,403</u>	<u>\$ 32,364</u>	<u>\$ 26,445</u>
Transfer Requirements (6)	775	116	0	0	6,000
Excess Available in Supplemental R&C Fund	<u>\$ 1,934</u>	<u>\$ 2,883</u>	<u>\$ 3,400</u>	<u>\$ 4,868</u>	<u>\$ 4,863</u>
Remaining Net Revenues Available for Debt Service on Parity Bonds	<u>\$ 22,177</u>	<u>\$ 26,563</u>	<u>\$ 36,803</u>	<u>\$ 37,232</u>	<u>\$ 37,308</u>
Parity Bonds Debt Service	\$ 19,260	\$ 23,148	\$ 31,977	\$ 32,419	\$ 32,472
Debt Service Coverage on Parity Bonds (7)	1.15x	1.15x	1.15x	1.15x	1.15x
Net Energy Output (MWh)	4,108,682	4,346,322	4,520,545	4,007,841	3,675,046
Average Cost (\$/MWh) (8)	\$ 8.59	\$ 9.82	\$ 12.09	\$ 16.38	\$ 17.41

(1) Based on unaudited financial statements

(2) Revenues from all Power Purchasers including the Electric System (Annual Power Costs).

(3) Interest on various funds of the Wanapum Development.

(4) Excludes repairs, renewals, replacements, depreciation, and extraordinary maintenance costs paid from the 1963 Reserve and Contingency Fund and construction funds.

(5) Began to account for these FERC license related expenses separately in 2009. Previously included in Administrative and General expense.

(6) Represents amounts transferred to the 1963 Reserve and Contingency Fund and the 1963 Bond Reserve Account, or to be credited to power costs. In 2005 and 2006 the money was used for payment of extraordinary items out of the construction funds. In 2009, the balances represents the refunding of the 1963 R&C Fund to the power purchasers as set forth in the original power sales contract that expired on October 31, 2009.

(7) Annual charges for sales of power are set at levels sufficient to produce revenues providing debt service coverage of 1.15x.

(8) Revenues from sales of power divided by net energy output. For 2009, Sale of Power was reduced by a \$6 million refund to Power Purchasers from a reserve account as of end of the original power sales contract in 2009. This one time refund was added back into sales of power for the calculation of Average Cost.

Certain columns may not add due to rounding.

Monthly payment by the Power Purchasers and the Electric System of their respective shares of Annual Power Costs is required by the New Power Sales Contracts. Annual Power Costs are estimated one year in advance and are payable in equal monthly portions of such estimate. Payments are adjusted annually to reflect actual costs.

The District expects that the average cost of power from the Priest Rapids Project will increase over the next five years, primarily as a result of increased debt service, rising to approximately \$20 per MWh under average water conditions.

Debt Service Requirements for the Priest Rapids Project

The following table gives debt service requirements for the Outstanding Parity Bonds and for the Bonds.

**Table 10
PRIEST RAPIDS PROJECT TOTAL DEBT SERVICE REQUIREMENTS**

Year (1)	Outstanding Parity Bonds (2)		The Bonds			Aggregate Debt Service on Parity Bonds (4)
	Priest Rapids	Wanapum	Principal	Interest	Total (3)	
2010	\$ 22,201,721	\$ 32,421,451	--	--	--	\$ 54,623,172
2011	22,198,118	32,401,795	\$ 3,740,000	\$ 12,675,266	\$ 16,415,266	71,015,179
2012	22,257,422	32,391,259	5,600,000	18,627,515	24,227,515	78,876,196
2013	22,243,344	32,408,769	5,750,000	18,478,742	24,228,742	78,880,855
2014	20,557,005	30,751,003	5,940,000	18,281,966	24,221,966	75,529,974
2015	20,566,916	30,767,647	6,150,000	18,076,236	24,226,236	75,560,799
2016	20,552,940	30,744,168	6,370,000	17,861,386	24,231,386	75,528,494
2017	19,512,285	30,002,416	6,595,000	17,637,286	24,232,286	73,746,987
2018	17,070,304	28,464,447	6,860,000	17,379,286	24,239,286	69,774,037
2019	17,066,494	28,458,419	5,300,000	17,058,587	22,358,587	67,883,500
2020	17,073,458	28,470,163	5,485,000	16,822,091	22,307,091	67,850,712
2021	14,089,438	25,447,401	5,680,000	16,582,708	22,262,708	61,799,547
2022	14,091,062	25,466,600	5,895,000	16,305,187	22,200,187	61,757,849
2023	10,604,456	20,239,919	6,130,000	16,010,213	22,140,213	52,984,588
2024	10,591,375	20,241,273	4,080,000	15,698,139	19,778,139	50,610,787
2025	10,587,437	20,243,714	4,230,000	15,482,853	19,712,853	50,544,004
2026	10,606,139	20,231,729	4,390,000	15,253,968	19,643,968	50,481,836
2027	10,603,418	20,243,864	94,555,000(5)	15,010,261	109,565,261	140,412,543
2028	10,593,090	20,238,989	9,970,000	9,686,314	19,656,314	50,488,393
2029	10,598,087	20,241,613	10,370,000	9,115,033	19,485,033	50,324,733
2030	10,106,671	19,832,832	10,790,000	8,520,832	19,310,832	49,250,335
2031	6,476,784	18,469,139	11,225,000	7,902,565	19,127,565	44,073,488
2032	6,480,036	18,467,746	11,685,000	7,248,148	18,933,148	43,880,930
2033	4,068,759	18,466,992	12,165,000	6,566,912	18,731,912	41,267,663
2034	4,061,963	18,470,359	12,675,000	5,857,693	18,532,693	41,065,015
2035	4,066,055	16,849,272	13,190,000	5,118,740	18,308,740	39,224,067
2036	--	16,849,962	13,735,000	4,349,763	18,084,763	34,934,725
2037	--	16,853,659	14,305,000	3,549,013	17,854,013	34,707,672
2038	--	9,869,629	14,895,000	2,715,031	17,610,031	27,479,660
2039	--	9,868,225	15,515,000	1,846,653	17,361,653	27,229,878
2040	--	9,870,771	16,160,000	942,128	17,102,128	26,972,899
2041	--	9,870,954	--	--	--	9,870,954
2042	--	9,867,711	--	--	--	9,867,711
Total (3)	\$ 358,924,772	\$ 723,483,884	\$ 349,430,000	\$ 356,660,513	\$ 706,090,513	\$ 1,788,499,182

(1) January 1 payments each year are allocated to the prior calendar year.

(2) Excludes the Refunded Bonds.

(3) Before the federal credit payments.

(4) Columns may not add due to rounding.

(5) The 2010M Bonds are New Clean Renewable Energy Bonds and the District has covenanted to deposit approximately equal sinking fund installments into a subaccount in the Principal and Bond Retirement Account no later than January 1 in the years 2011 through 2027 sufficient to pay the \$90,000,000 of such Bonds maturing on January 1, 2027. See "DESCRIPTION OF THE BONDS—Sinking Fund Payments-2010M Bonds."

THE ELECTRIC SYSTEM

The Electric System consists of substations, transmission and distribution lines, telecommunication facilities, and associated general plant, together with a 40 year contract interest in the Potholes East Canal (“P.E.C.”) Headworks Powerplant Project, a 40 year contract interest in the Quincy Chute Project and the right to receive power from a wind farm. The Electric System is owned and operated by the District and serves all of Grant County. During 2009, the Electric System operated approximately 4,155 miles of lines and served approximately 45,254 retail customers. Gross operating revenues for 2009 totaled \$208 million. As of December 31, 2009, the District’s gross investment in the Electric System was \$780 million and its net investment was \$468 million. The Electric System has established as a goal the funding of (on average) no more than 50% of capital improvements from bond proceeds, excluding generation projects.

Retail Energy Sales and Customers

The Electric System’s gross operating revenues (excluding interest income) for 2009 totaled \$207.9 million. Of this total, approximately \$114.9 million (56%) was derived from retail energy sales to an average of 45,576 customers. Sales to other utilities provided \$87.9 million of revenues (42% of the total). See “Power Supply Management and Power Marketing.” Non energy retail sales provided \$5.2 million (3% of the total). Of the retail customers, 76% were residential customers, providing 28.9% of all retail energy revenues. The number of retail customers, energy sales and revenues for the year ended December 31, 2009, for each major retail customer class, are listed below. In its base case projections, the District expects its Electric System load to increase approximately 27% between 2009 through 2012.

**Table 11
ELECTRIC SYSTEM
2009 RETAIL CUSTOMERS, ENERGY SALES AND REVENUES**

Customer Class (1)	Average Number of Customers		Energy Sold		Revenue (2)	
	Number	%	GWh (3)	%	\$000	%
Residential	34,901	76.58	819.4	22.05	\$ 33,211	28.91
Commercial	5,899	12.94	467.1	12.57	15,658	13.63
Irrigation	4,541	9.96	541.9	14.58	16,422	14.30
Industrial	117	0.26	1,881.3	50.63	48,602	42.31
Other	118	0.26	5.9	0.17	971	0.85
Total	45,576	100.00	3,715.6	100.00	\$ 114,864	100.00

(1) Statistics reported by class of service classification.

(2) Includes municipal taxes.

(3) Gigawatt hour equal to 1,000 MWh.

The 11 largest customers, based on retail revenue of the Electric System for the 12 months ended December 31, 2009, are shown in the following table.

Table 12
ELECTRIC SYSTEM LARGEST CUSTOMERS
(Listed alphabetically)

Customer	Location	Product
Basic American Foods, Inc.	Moses Lake	Dehydrated potatoes and fresh packed potatoes
Chemi-Con Materials Corp.	Moses Lake	Process aluminum foil for capacitors
City of Moses Lake	Moses Lake	Municipality
Columbia Colstor, Inc.	Quincy	Refrigerated frozen storage and refrigeration to J.R. Simplot freeze tunnels
EKA Chemicals, Inc.	Moses Lake	Crystal sodium chlorate and liquid sodium chlorate
J.R. Simplot	Quincy	Vegetables processor
Lamb-Weston, BSW	Warden	Potato products
Lamb-Weston, Inc.	Quincy	French fried potatoes
Microsoft Corp.	Quincy	Data Center
REC Solar Grade Silicon LLC	Moses Lake	Polycrystalline silicon and saline gas
Yahoo!	Quincy	Data Center

The Electric System's 11 largest customers used approximately 42% of total retail energy sold and provided approximately 35% of retail revenues in 2009. The District's rate structure for industrial customers is designed to include the marginal cost of additional power purchases.

Several large industrial and manufacturing customers have recently located or enlarged operations in Grant County. REC Solar Grade Silicon LLC constructed a large expansion to its facilities that is expected to nearly double its electrical load by 2012. Microsoft Corporation and Yahoo! each constructed internet server farms, which have substantial electrical loads and utilize the District's telecommunications infrastructure and low cost electricity. See "—Telecommunications" below. An increase in system load of 25% to 30% is expected over the next three to five years, primarily due to a large increase in industrial and manufacturing loads. The District believes that this growth is manageable based on the availability of resources and the structure of the New Power Sales Contracts.

The following table sets forth the customers, energy sales and revenues of the Electric System as derived from the financial statements of the Electric System for the fiscal years indicated.

Table 13
ELECTRIC SYSTEM
RETAIL CUSTOMERS, ENERGY SALES, AND REVENUES

	2005	2006	2007	2008	2009 (1)
Number of Customers					
(Average) (2)					
Residential	31,665	32,523	33,457	34,326	34,901
Commercial	5,458	5,523	5,628	5,782	5,899
Irrigation	4,391	4,414	4,446	4,493	4,541
Industrial	89	95	103	115	117
Other (2)	119	119	120	121	118
Total Customers	41,722	42,674	43,754	44,837	45,576
Energy Sales (MWh) (2)					
Residential	668,698	691,436	721,885	750,149	819,448
Commercial	407,899	411,738	424,166	444,447	467,134
Irrigation	503,299	476,558	521,363	555,748	541,930
Industrial	1,539,961	1,539,856	1,574,663	1,773,930	1,881,258
Other (3)	5,286	5,297	5,459	5,648	5,896
Total Energy Sales	3,125,143	3,124,885	3,247,536	3,529,922	3,715,666
System Peak (MW)					
Winter	505	550	523	589	660
Summer	440	579	572	623	640
Revenues from Energy					
Sales (\$000) (2)					
Residential	\$ 28,154	\$ 29,536	\$ 30,323	\$ 31,926	\$ 33,211
Commercial	13,842	14,305	14,568	15,346	15,658
Irrigation	15,990	15,049	15,881	16,556	16,422
Industrial	36,209	38,303	39,458	46,427	48,602
Other (3)	871	886	905	931	971
Total Revenues	\$ 95,066	\$ 98,079	\$ 101,135	\$ 111,186	\$ 114,864

(1) Revenue figures are from unaudited financial statements.

(2) Statistics reported by class of service classification.

(3) "Other" includes street lighting, public authorities and non-firm retail energy sales.

The Electric System has experienced a stable residential customer base over the past five years. It is estimated that over 90% of all homes in the District's service area are electrically heated. Only Moses Lake, Quincy and Warden have natural gas service available. The single most important variable in power sales to residential accounts from year to year is weather as it relates to heating and cooling requirements. The average annual residential power bill in 2009 was \$951 and the average cost per kWh for residential service was 4.05 cents. The MWh usage in industrial accounts from 2005 to 2009 grew 22%. Variations in energy sales are due in part to changes in weather patterns.

Power Supply Management and Power Marketing

The power generated at the Priest Rapids Project is a low cost resource for the Electric System. However, the amount of generation that is available to deliver over any given time period is highly variable. Minimal storage is available in the Developments' reservoirs and the Developments are considered a "run of the river" operation. The amount of energy generated at the Priest Rapids Project depends on the amount of water released from upstream reservoirs. See "THE PRIEST RAPIDS PROJECT." The river flows are coordinated to meet a number of constraints, including optimizing generation, providing minimum flows for fish, and meeting other operation constraints. Regional water conditions also influence the amount of flow made available for generation, varying

from high water conditions to drought conditions. This variation in flow generates surplus energy in some periods and a need for the Electric System to purchase energy in other time periods. To manage Electric System resources in this variable environment, the Electric System uses a statistically produced exceedance curve based on historical and projected data to produce the most likely scenario for the following year. The statistical curve is updated to include current year information as actual data becomes available. This statistical curve is used as a baseline to project available power from the Priest Rapids Project. Additional firm resources, such as the Bonneville contract, are included in this planning. Market purchases are made in periods that are forecast to be deficit, and sales are made in time periods where critical planning would forecast a surplus.

The Electric System’s retail load, serving Grant County customers, is also variable. Some industrial loads served by the Electric System have an elastic demand curve for electricity. Residential, commercial and irrigation consumption are significantly affected by weather. To manage this variable resource and system requirements, the District enters into a number of wholesale energy transactions. These include purchases and sales in the daily and pre-schedule market. The District is also routinely a party to a number of other short-term power and capacity contracts.

The District’s power marketing activities are confined to balancing District loads and resources with the intent of maximizing the benefit for Electric System retail customers. Power is purchased only to meet Electric System projected loads. Power surplus to the Electric System’s needs is resold in a manner that seeks to provide the greatest return.

Because the District plans its energy resource requirements on critical water at its various generating projects, in almost all years, the Electric System has surplus power to sell. As a result, the District has historically generated substantial revenues from energy sales to other utilities. However, the revenues vary from year to year based on variations in generation and wholesale prices.

The District and PacifiCorp have entered into an agreement for the sale of 14 MW of firm capacity and 87,600 MWh of energy annually to PacifiCorp. This contract can be terminated upon two years’ written notice given by the District. The District projects that this contract will remain in place at least through 2010. The District also sells surplus firm and non-firm energy on an “as available” basis to various municipally-owned and investor-owned utilities both within and without the Pacific Northwest. The District’s low-cost power supply has made it possible for the District to sell its surplus power to utilities in the Pacific Northwest and Southwest.

The table below summarizes wholesale power sales, including the portion of the District’s share of the Priest Rapids Project’s output in excess of the Electric System’s needs, and the average price for the calendar years 2005 through 2009.

Table 14
ELECTRIC SYSTEM
WHOLESALE ENERGY SALES (1)

	2005	2006 (2)	2007 (2)	2008 (2)	2009 (3)
Wholesale Energy Sales (\$000) (1)	\$ 67,010	\$ 114,541	\$ 119,195	\$ 115,636	\$ 87,908
Total MWh	1,432,997	3,209,775	3,317,929	3,360,177	3,111,968
Average Revenue (\$/MWh)	\$ 46.76	\$ 35.69	\$ 35.92	\$ 34.41	\$ 28.25

(1) Sales to other utilities and power marketing entities.

(2) The increases during 2006-2008 were primarily due to the displacement product within the New Power Sales Contracts that took effect on November 1, 2005.

(3) Decrease due to lower generation from the Priest Rapids Project and lower market prices.

To mitigate risks associated with power marketing activities, the District has established risk management guidelines that have been adopted by the Commission. In recognition of the increasing number of power transactions, price volatility and changing power supply contracts, the District established a Risk Oversight Committee in 2001 to review and update the energy risk management policies of the District and to provide greater ongoing monitoring and review of power transactions. The Risk Oversight Committee undertook a review by a utility consultant of the

District's policies and controls, which was completed in the summer of 2001. Utilizing the recommendations of this report, the Risk Oversight Committee developed Energy Risk Management Policies that were adopted by the District. The Energy Risk Management policies address exposure to financial risks. Key elements of the policies include: (1) sales and purchases shall only be made to meet the District's prospective needs, to dispose of surplus power and to maximize use of the Priest Rapids and Wanapum Development reservoirs; no speculative sales or purchases are to be made; (2) power transactions shall not exceed a duration of 18 months; (3) the District's net position in MWhs is actively monitored using a probabilistic forecast based upon a statistically produced exceedance curve for a rolling 18-month period; position limits are set to ensure prudent action by District personnel; (4) counterparty credit must be established and maintained to District requirements or acceptable credit enhancements must be obtained and individual counterparty credit limits have been established and are reviewed by the Risk Oversight Committee and individual credit exposure is monitored in relation to a percentage of total outstanding transactions; (5) monitoring reports describing all concluded transactions and expected future transactions (priced to current market prices) as compared to the District's adopted budget for that year are reviewed by District management on a frequent basis. The District believes that, if these policies are followed, the risk of any substantial financial loss resulting from the District's power supply management activities will be limited.

Rates

The District is empowered and required under the Enabling Act and by the covenants of the Bond Resolution to establish, maintain, and collect rates and charges for electric power and energy and other services adequate to provide revenues sufficient for the punctual payment of the principal of, premium, if any, and interest on all outstanding indebtedness, to pay for the proper operation and maintenance expenses of the Electric System and to make all necessary repairs, replacements and renewals thereof. Under present law, the District has the exclusive authority to set retail rates and charges for retail electric energy and services and is by law free from the rate-making jurisdiction and control of the Washington Utilities and Transportation Commission or any other state or local agency having the authority to set rates and charges for retail electric energy and services. Under the Enabling Act, the District is required to establish, maintain and collect rates or charges that are fair and nondiscriminatory and adequate to provide revenues sufficient for the payment of the principal of and the interest on revenue obligations for which the payment has not otherwise been provided and for other purposes set forth in the Enabling Act.

A person or entity that has requested wholesale telecommunications services from a public utility district may petition the Washington Utilities and Transportation Commission if it believes that the District's rates, terms and conditions are unduly or unreasonably discriminatory or preferential. The commission may issue an order finding non-compliance. The District charges wholesale providers of telecommunications services based on a published rate schedule.

The Public Utility Regulatory Policies Act of 1978 ("PURPA") requires certain utilities, including the District, to consider and make determinations after public hearings regarding a set of federal standards that have three statutory purposes: end-use conservation, utility efficiency and equitable rates. The District has adopted certain standards relating to, among other things, rates, metering and advertising.

The following table shows a comparison of the District's monthly electric rates for selected residential, commercial and industrial loads with the rates charged by certain major municipal and investor-owned Pacific Northwest utilities. The comparative monthly electric bills shown are based on specific rate schedules for each utility; the use of other schedules applicable to particular customers will yield different results.

Table 15
ELECTRIC SYSTEM
MONTHLY ELECTRIC BILLS COMPARISON (1)
As of January 2010 ⁽¹⁾
(Winter Rates where applicable)

	Residential (1,500 kWh)	Commercial (30 kW 9,000 kWh)	Industrial (400 kW 150,000 kWh)
The District	\$ 63	\$ 354	\$ 3,708
Washington State Public Utility Districts			
Benton County PUD No. 1	100	509	8,070
Chelan County PUD No. 1	44	249	4,599
Clark Public Utilities	123	680	8,683
Douglas County PUD No. 1	38	185	3,334
Franklin County PUD No. 1	121	641	8,831
Grays Harbor County PUD No. 1	107	606	5,610
Kittitas County PUD No. 1	131	704	8,096
Klickitat County PUD No. 2	114	662	8,474
Lewis County PUD No. 1	87	439	6,757
Mason County PUD No. 3	105	636	8,878
Snohomish County PUD No. 1	130	722	11,176
Washington Cities			
City of Ellensburg	100	618	8,354
City of Richland	96	408	6,620
City of Seattle	117	574	8,613
City of Tacoma	99	577	7,247
Private Power Companies			
Avista	119	1,009	12,619
Pacific Power (a PacifiCorp Company)	111	626	8,733
Portland General Electric	161	768	11,648
Puget Sound Energy	140	821	12,843

(1) Computed from the rate schedules provided by or found on the websites of the utilities listed. There are some variations in rate schedules and rate classification of the various utilities.

Source: The District and individual utilities.

The District maintains rates for electric service that are designed to recoup costs associated with power production/purchases, operations, maintenance and debt service for the Electric System. For years the District’s electrical rates have been among the lowest in the nation. The following table shows the District’s rate increases since 1999.

Table 16
ELECTRIC SYSTEM
RECENT RETAIL RATE INCREASES

Date	Percentage Increase
April 1, 1999	6%
April 1, 2000	3
April 1, 2003	4
April 1, 2010	4

The District has not had a rate increase since 2003. However, due to increasing costs of power production, attributable in part to license compliance and replacing aging turbines and generators at the Priest Rapids Project, the Commission increased retail electrical rates in 2010. In addition to the rate increase effective April 1, 2010, the Commission approved 4% rate increases effective each April 1, 2011, 2012 and 2013; however, such increases are subject to change based on future financial conditions.

The Electric System’s Power Supply

Until November 2005, power supply for Electric System load growth that could not be met from District resources (including Bonneville and other contracts) was purchased from the market. Effective November 1, 2005, the District began using a larger share of benefits of the power and energy from the Priest Rapids Development. In addition, the Wanapum Power Sales Contracts expired on October 31, 2009, at which time the District began using a larger share of the benefits of the power and energy from the Wanapum Development. The New Power Sales Contracts provide for the District to continue to make use of its existing Bonneville contract (which expires in 2011) to meet load requirements. In return, the Electric System provides a like amount of its share of the Priest Rapids Project output to the Power Purchasers at the Bonneville price. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE POWER CONTRACTS.”

In 2010, the District expects the Electric System to obtain approximately 58% of its firm energy requirements from the District’s share of the Priest Rapids Project and approximately 3% from the Quincy Chute Hydroelectric Project, P.E.C. Headworks Powerplant Project, Nine Canyon Wind Project, and market purchases. The remainder of the Electric System’s power supply for 2010 is expected to be obtained from Bonneville. The cost of Bonneville power to the Electric System is offset directly by the additional wholesale power sales revenues provided by the New Power Sales Contracts. See “THE PRIEST RAPIDS PROJECT—Power Sales Contracts.”

Quincy Chute Project

Under an agreement with three irrigation districts, the District purchases the entire capability and output of and operates the Quincy Chute Project, a 9.4 MW hydroelectric generating facility operating seasonally during the irrigation season (March through October). The District financed, designed and constructed the project and is responsible for operation and maintenance during the period of the agreement, which expires in 2025. The Quincy Chute Project began commercial operation on October 1, 1985, and its net energy generation was 35,570 MWh in 2008.

P.E.C. Headworks Powerplant Project

Under an agreement with three irrigation districts, the District purchased the entire capability and output of and operates a 6.5 MW generating facility at the P.E.C. Headworks at the O’Sullivan Dam, which operates during the irrigation season (March through October). The District financed, designed and constructed the project and is responsible for operation and maintenance during the period of the agreement, which expires in 2030. The P.E.C.

Headworks Project began commercial operation on September 1, 1990, and its net energy generation was 23,549 MWh in 2008.

Bonneville Power Administration Contracts

Bonneville was established by the Bonneville Project Act of 1937. Bonneville markets power from 31 federal hydroelectric projects, several non-federally owned hydroelectric and thermal projects in the Pacific Northwest, and various contractual rights having an expected aggregate output of about 10,600 annual aMW under average water conditions and about 8,550 annual aMW under critical water conditions (the “Federal System”). These projects, built and operated by the United States Bureau of Reclamation and the United States Army Corps of Engineers, are located in the Columbia River basin. The Federal System currently produces more than one-third of the region’s electric energy requirements. Bonneville’s transmission system includes over 15,000 circuit miles of transmission lines, provides about 75% of the Pacific Northwest’s high-voltage bulk transmission capacity, and serves as the main power grid for the Pacific Northwest. Bonneville sells electric power at wholesale rates to more than 125 utility, industrial and governmental customers in the Pacific Northwest. Its service area covers over 300,000 square miles and has a population of about 12 million.

The District is a statutory preference customer of Bonneville and, as such, has priority for power over Bonneville’s nonpreference customers. Effective September 30, 2001, the District entered into a contract with Bonneville to purchase 161.8 aMW of a Shaped Block Product and a Full Requirements Product for the District’s Grand Coulee load. The Shaped Block portion of the District’s Bonneville contract is for monthly fixed amounts of power and expires on September 30, 2011. The Electric System met most of its increasing load requirements until 2005, when the Priest Rapids Development’s 1956 Power Sales Contracts expired, by purchasing additional amounts of firm power from other parties. Since the majority of the District’s current contract with Bonneville is for fixed amounts of power through 2011, the District’s ability to use Bonneville power for load growth was limited to a purchase quantity increase in 2006 of approximately 10 aMW. The cost of the District’s power from Bonneville currently is approximately twice the cost of the Priest Rapids Project’s power and is expected to remain significantly more expensive than the Priest Rapids Project’s power. In 2009 the Electric System purchased about 44% of its energy from Bonneville. The District executed a new contract with Bonneville effective October 1, 2011, which provides that Bonneville will serve only the District’s loads in the Grand Coulee area, which is a small area that is not easily served by the Priest Rapids Project. Effective October 1, 2011, the District will not have a contract with Bonneville to serve any other District loads.

Bonneville Rate Increases

Bonneville is required by federal law to recover all of its costs through the rates it charges its customers. Under Bonneville’s adopted rate methodology, which is in effect for the term of the current customer contracts, Bonneville’s rates have been subject to revision every six months in order to enable Bonneville to recover its actual costs of service. Bonneville has recently concluded a rate case and increased its rate for contracts such as the District’s approximately 6.95% effective October 1, 2009. No other rate adjustments are expected through the remaining term of the current Bonneville contract. Under the new Bonneville contracts effective October 1, 2011, Bonneville will conduct a rate case every two or three years. The first rate case will be conducted in 2010 and the rates established will be effective October 1, 2011.

See “THE PRIEST RAPIDS PROJECT—Transmission of Power from Priest Rapids Project” for a discussion of the District’s transmission contract with Bonneville.

Canadian Treaty

The Columbia River Treaty (the “Treaty”), a 60-year treaty between the United States and Canada relating to cooperative development of the water resources of the Columbia River basin, was placed in effect by an exchange of notes and ratifications on September 16, 1964. Pursuant to the Treaty, Canada has constructed three water storage facilities in Canada and is entitled, among other things, to receive one-half of the downstream power benefits defined in the Treaty.

The United States and Canada have designated entities that are empowered and obligated to carry out the operating arrangements necessary to implement the Treaty. The U.S. entity is composed of the Administrator of Bonneville and the Division Engineer, North Pacific Division, United States Army Corps of Engineers; the Administrator is chairman. The Canadian entity is B.C. Hydro.

Operation of the Priest Rapids Project is affected by the Treaty. In general, the Treaty and its implementing agreements are implemented via the Pacific Northwest Coordination Agreement, which provides a means to coordinate the operation of all major power plants and transmission systems in the Pacific Northwest for the mutual benefit of the participants and a method to obtain and distribute the increased power benefits resulting from construction of the Canadian water storage facilities. These agreements expire in 2024 if termination notice is supplied by either party 10 years prior to 2024, and the agreements may terminate after this date with a 10 year termination notice by either party.

Conservation and Energy Reacquisition

The District is adapting its long-term customer advisory programs with a greater focus to educate its communities on the economic and societal benefits of conservation and efficiency and to empower them to make smarter, cost-effective decisions about their power consumption. The District has offered and continues to offer a variety of conservation programs in an effort to meet the needs of its residential, commercial, agricultural and industrial customers. These programs are designed primarily to provide customers with cost-effective assistance to reduce their energy costs and to acquire cost-effective supplemental power resources to meet the District's loads.

The District has been actively involved in conservation programs since the Residential Conservation Service Program required by the National Energy Conservation Policy Act of 1978. As a result of the Pacific Northwest Electric Power Planning and Conservation Act (1980), Bonneville began implementing conservation programs for resource acquisition purposes. Utilities, including the District, carried out these programs on a local level. In 1995, Bonneville reduced conservation programs to a minimum with hopes that utilities would maintain them without its support. The District, recognizing the value of promoting cost-effective energy conservation, voluntarily continued to promote and finance programs without Bonneville's financial assistance.

In February 2001, the District increased conservation activities based upon an early start option included in the Bonneville Conservation and Renewables Discount ("C&RD") program. This five-year program provided a rate discount that enabled the District to spend less on wholesale energy purchases and use the savings to fund local conservation and renewable energy resource activities. The District chose to use the nearly \$3,650,000 for conservation related activities. The C&RD program expired on September 30, 2006. On March 14, 2006, the District continued its conservation activities and added a new program by implementing an early start option in the Bonneville Conservation Rate Credit ("CRC") program which replaced the C&RD program on October 1, 2006. The CRC program continued for the period of 2006-2009. The District received approximately \$846,600 per year from the CRC program. Bonneville has renewed the CRC funding for 2010 and 2011 at the same level as the rate period ending in 2009. Bonneville also offered additional conservation funding for the five year rate period ending in 2014. This was offered through the Energy Conservation Agreement (ECA funds) and has a beginning balance of \$2,000,000 with the option to apply for more funding, if needed, during the rate period. The District has signed this agreement.

Conservation opportunities are being actively pursued by the District to achieve a least-cost power supply. Conservation cost-effectiveness will be measured against the avoided cost of the next new resource available to the District, as defined by the Washington Constitution and state law. The amount spent for programs each year is established through the District's annual budgeting process. Pursuant to requirements in Washington State Initiative 937, the District has set conservation MWh targets for the years 2010 through 2019 and will review and set new ten-year targets every two years after 2010. The ten-year target was set at 262,717 MWh with a first biennium target of 52,543 MWh. These targets will be met by conservation coming from any existing programs and any new conservation programs created during the target period. See "State Legislation and Initiatives" below.

Nine Canyon Wind Project

The District entered into a power purchase agreement with Energy Northwest for the purchase of 25% of the generating capacity of Phase I of the 48.1 MW Nine Canyon Wind Project. The power purchase agreement will terminate on July 1, 2030. The Nine Canyon Wind Project is a wind energy generation project located approximately eight miles southeast of Kennewick, Washington in the Horse Heaven Hills. Average wind speeds on the site at a level of 50 meters measured between 14 and 16 miles per hour. This will produce an expected annual capacity factor for the wind turbines of between 25% and 35%, with an overall project average of about 30%.

Phase I of the project became commercially operable in 2002. Costs of constructing the project were financed through the issuance of \$70,675,000 of revenue bonds by Energy Northwest, which mature on July 1, 2023. Annual costs, including repayment of debt service, is paid by the purchasers. The District is obligated under the power purchase agreement to pay 25% of the annual costs of the project in return for 25% of the project's output whether or not the project is operating or capable of operating. The District could be required to pay up to an additional 25% of the District's share of Phase I in the event of a default by another purchaser or purchasers. The actual net cost of power for the 12 months ended December 31, 2009 was \$67.56 per MWh. Transmission costs vary depending on the variation of the wind resource.

Phase II of the Nine Canyon Wind Project went into commercial operation on December 31, 2003 with an additional 15.6 MW. Phase III of the Nine Canyon Wind Project became commercially operable in May 2008 and consists of an additional 14 wind turbines. While the District did not elect to participate in Phase II or Phase III, it did change the costs to the District. The District is responsible for 25% of the debt service costs of Phase I and 12.54% of the annual operating costs of the combined Phase I, Phase II and Phase III Nine Canyon Wind Project. In 2009, the District received approximately 30,349 MWh of wind generation output from the project.

Energy Northwest

The District is a member of Energy Northwest and a participant in Energy Northwest's Nuclear Projects Nos. 1 and 3, which have been terminated. The District, Energy Northwest, and Bonneville have entered into separate Net Billing Agreements with respect to \$3.9 billion in outstanding bonds for Energy Northwest's Project No. 1 and 70% ownership share of Project No. 3 (collectively, the "Net Billed Projects"). Under the agreements, the District is unconditionally obligated to pay Energy Northwest its pro rata share of the total costs of the projects, including debt service, whether or not construction is terminated. The District's assignment of these project costs have been assumed by Bonneville at the levels of 0.486% and 0.420% of the capability of Project No. 1 and Energy Northwest's ownership share of Project No. 3, respectively. Under the Net Billing Agreements, Bonneville is responsible for the District's percentage share of the total annual cost of each project, including debt service on revenue bonds issued to finance the costs of construction. The District's electric revenue requirements are not directly affected by the cost of completion of the Net Billed Projects. The revenue requirements are affected only to the extent that the costs of the projects result in increases in Bonneville's wholesale power rates. Notwithstanding the assignment of the District's share of the capability of a Net Billed Project to Bonneville, the District remains unconditionally obligated to pay to Energy Northwest its share of the total annual cost of the Net Billed Project to the extent payments or credits relating to such annual cost are not received by Energy Northwest from Bonneville.

Recent Legislation and Initiatives

Initiative 937 (Renewable Portfolio Standards)

State Initiative 937 ("I-937"), which was approved at the November 6, 2006, election, requires electric utilities that serve more than 25,000 customers to obtain at least (a) 3% of their electricity from renewable resources by January 1, 2012, and each year thereafter through December 31, 2015; (b) 9% of their electricity from renewable resources by January 1, 2016, and each year thereafter through December 31, 2019; and (c) 15% of their electricity from renewable resources by January 1, 2020, and each year thereafter. I-937 also requires qualifying electric utilities to undertake various cost-effective energy conservation efforts. The Commission approved the District's 10-year conservation plan and two-year conservation target, pursuant to the provisions for I-937. To satisfy the I-937 requirements the District intends to rely on its share of the Nine Canyon Wind Project and the incremental hydroelectric generation resulting from turbine and generator upgrades at the Priest Rapids Project. The District

expects its available qualifying renewable generation will meet the requirements of I-937. See “INITIATIVE AND REFERENDUM.”

Climate Change

Federal, regional, state and international initiatives have been proposed or adopted to address global climate change by controlling or monitoring greenhouse gas emissions, by encouraging renewable energy development and by implementing other measures. The District cannot predict whether or when new laws and regulations or proposed initiatives would take effect in a manner that would affect the District, and if so, how they would affect the District. The physical effects of climate change could affect the amount, timing, cost and availability of hydroelectric power.

Other Recent Legislation

The Washington Legislature recently enacted legislation requiring the Governor to develop policy recommendations for achieving specific greenhouse gas reduction targets and requiring that power supply contracts of five years or more comply with certain emission standards. Various federal energy legislation proposed could set national standards for renewable energy generation, conservation efforts, and encourage greenhouse gas reduction. While the District’s resources are primarily hydroelectric based, it is possible that legislation regarding greenhouse gas reduction could impact the District.

Wapato Hydroelectric Project

The District entered into a long-term purchase power agreement with the Yakama Nation for the output of the Wapato Hydroelectric Project. The Wapato Hydroelectric Project consisting of two plants and is located within the boundaries of the Yakama Indian Reservation in Yakima County, Washington, and irrigates about 142,000 acres. The hydroelectric output from the Wapato Hydroelectric Project is expected to be around 0.8 aMW in 2010 and grow to approximately 3 aMW by 2011. The output is seasonal and concurrent with the irrigation season that runs from March through October. The rated capacity of the Wapato Hydroelectric Project are 1.6 MW and 2.5 MW, respectively.

Future Resources

The District is currently evaluating resource additions to minimize District exposure to volatile fuel prices in serving residual energy demand in excess of Priest Rapids Project capacity. Under evaluation are clean, renewable energy projects such as in-county solar, wind and biomass projects which would assist the District in meeting the requirements of the Renewable Portfolio Standard as set by I-937. One project the District is considering is a 300 MW combined cycle combustion gas turbine project. It is possible that the District could issue debt to finance one or more projects. See “—Recent Legislation and Initiatives.” Other energy sources under consideration are a natural gas fired resource, small agricultural waste fired steam turbines, and hydro-kinetic energy within the in-county canal system.

Telecommunications

The Wholesale Fiber Optic Network

The District began developing an internal fiber optic telecommunications system in the 1980s. That system now links the Priest Rapids and Wanapum Developments, most of its substations, all local offices and the District’s headquarters building. This system created a fiber optics “backbone” which has significant excess capacity. The District began installing a Wholesale Fiber Optic Network (formerly referred to as the “Zipp Network”) in its service area starting in 2000. The Wholesale Fiber Optic Network was established to provide wholesale telecommunications services to retail providers of high speed internet, wireless, security, video and telephone services to businesses and residents within Grant County.

The District has strung fiber on its existing electric utility poles and has installed community “hubs” at various locations around the District. Commercial and residential customers are connected to the Wholesale Fiber Optic

Network's fiber run by the District directly to their homes and businesses from the hubs. Wholesale Fiber Optic Network users thus receive various telecommunications services at rates hundreds of times faster than those available, for example, through traditional dial-up connections (that is, at up to one gigabit, as compared to 56 kilobytes, per second).

As of December 31, 2009, the District's Wholesale Fiber Optic Network was available to over 18,000 homes within Grant County, out of approximately 40,000. Over 5,000 users currently subscribe to services from the existing group of retail providers. The Wholesale Fiber Optic Network currently has about 15 internet service providers, two wireless service providers, four telephone service providers, and one video service provider, all of which are smaller local or regional companies. The retail service providers are charged for use of the Wholesale Fiber Optic Network system pursuant to a generally applicable rate schedule approved from time to time by the Commission. These wholesale rates are generally set by the Commission to allow the retail services to be competitive from a cost standpoint with other available options. The District currently is free from any significant Federal or State regulation with respect to the Wholesale Fiber Optic Network.

In 2004, the District substantially reduced the rate of build-out of the Wholesale Fiber Optic Network. In March 2005, the Commission elected to cease construction of additional hubs for the Wholesale Fiber Optic Network, although the installation of connections within existing hub areas continued. District management also was directed to significantly reduce operating costs. Between fiscal years 2004 and 2005, annual operating expenses for the Wholesale Fiber Optic Network were reduced by more than \$2 million. This "stand pat" directive remained in place until March 2008. The Commission established financial goals for the Wholesale Fiber Optic Network and expectations for funding expansion over the next several years. In 2008 and 2009, the District spent \$23.5 million for Wholesale Fiber Optic Network expansion and capital improvements. The approved capital budget for 2010 includes \$4.9 million and forecasts an additional \$28.4 million through 2013. The District experienced a 14% growth in revenue for December 2009 compared to December 2008. The District is exploring the possibility of applying for a grant from the federal government that would allow for the completion of the build-out to all areas of the County.

The Wholesale Fiber Optic Network is operated and accounted for as part of the Electric System. Through the year ended December 31, 2009, the District had invested more than \$137 million in its telecommunications system facilities and equipment, including from Electric System bond proceeds and other available funds. This amount does not include the "backbone" part of the system that was built to serve internal District purposes, or net operating losses incurred by the Electric System with respect to the Wholesale Fiber Optic Network since it was first established. These net operating losses (including depreciation) currently amount to approximately \$4 to \$4.5 million each year. Excluding depreciation, there is no annual net operating loss. These losses are expected to continue for the foreseeable future. See APPENDIX C—"AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF THE DISTRICT AS OF DECEMBER 31, 2008 AND 2007," including in particular Note 10, for additional financial and other information regarding the District's telecommunications system.

NoaNet

The District, along with 11 other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network ("NoaNet"). NoaNet, a Washington nonprofit mutual corporation, was established in 2000 to provide its members with a broadband communications backbone throughout the State of Washington using "public benefit" fibers leased by NoaNet from Bonneville. This was done to assist NoaNet's members in the more efficient management of loads, energy conservation measures, and the acquisition of electric energy, as well as for other purposes. The network began commercial operations in 2001.

In 2001, NoaNet issued \$27 million in bonds to finance, among other things, the acquisition and construction of necessary facilities and systems. The Electric System has guaranteed the repayment of up to approximately \$4.75 million of such bonds (which amount includes a potential 25% step up if another member defaults) plus accrued interest. In addition, NoaNet has established approximately \$7.5 million of non-revolving lines of credit with a commercial lender in order to finance capital expenditures and network upgrades, of which the District has guaranteed, or to which the NoaNet board has pledged to assess the District for, the repayment of up to 14.17% of the outstanding balance to the extent NoaNet's revenues are insufficient to pay the loans. The District contributed \$361,583 and \$220,855 to NoaNet in 2008 and 2009, respectively.

Outstanding Long-Term Debt of the District

Table 17 below lists the outstanding long term debt of the District prior to the issuance of the Bonds.

Table 17
SUMMARY OF OUTSTANDING LONG TERM DEBT OF THE DISTRICT
As of January 1, 2010

System	Series	Date of Final Maturity	Principal Amount		Total Original (\$000)	Total Outstanding (\$000)
			Original (\$000)	Outstanding (\$000)		
Electric System	2001-H	1/1/2019	\$ 217,320	\$127,225	\$ 217,320	\$ 127,225
Priest Rapids Development	1999-B	1/1/2018	11,385	6,555*		
	2001-A	1/1/2012	10,480	2,345		
	2001-B	1/1/2023	12,335	9,305		
	2003-A	1/1/2021	12,840	9,545		
	2003-Z	1/1/2021	18,450	14,710		
	2005-A	1/1/2033	69,050	59,405		
	2005-B	1/1/2033	26,780	24,460		
	2005-Z	1/1/2033	43,685	38,620		
	2006-A	1/1/2036	24,770	23,395		
	2006-B	1/1/2017	5,470	4,645		
	2006-Z	1/1/2036	36,370	34,690	271,615	227,675
Wanapum Development	1998-A	1/1/2023	31,620	22,680*		
	1999-B	1/1/2018	9,100	5,235*		
	1999-D	1/1/2023	18,750	13,640		
	2001-B	1/1/2023	16,465	12,420		
	2003-A	1/1/2035	20,465	16,945		
	2003-B	1/1/2035	16,680	14,725		
	2003-Z	1/1/2021	20,135	16,055		
	2005-A	1/1/2038	52,325	48,625		
	2005-B	1/1/2038	71,050	66,090		
	2005-Z	1/1/2018	4,405	3,325		
	2006-A	1/1/2043	71,395	68,445		
	2006-B	1/1/2031	18,190	16,740		
	2006-Z	1/1/2043	96,845	93,900	447,425	398,825
Total			\$ 936,360	\$ 753,725	\$ 936,360	\$ 753,725

* Refunded with the Bonds.

Electric System Operating Results

The following table shows the Electric System's historical operating results for fiscal years 2005–2009. This table is designed to show compliance with the debt service coverage requirements in the resolution authorizing the Electric System bonds. As a result, it differs from the financial statements in Appendix C, because it does not follow all of the accounting principles generally accepted in the United States.

Table 18
ELECTRIC SYSTEM HISTORICAL OPERATING RESULTS
(\$000)

	2005	2006	2007	2008	2009 (1)
Revenues					
Retail Energy Sales	\$ 95,066	\$ 98,079	\$ 101,135	\$ 111,186	\$ 114,864
Miscellaneous Electrical Revenues (2)	7,566	15,694	15,099	15,063	5,172
Sales to Other Utilities (3)	67,010	114,541	119,195	115,636	87,908
Total Revenues	\$ 169,642	\$ 228,314	\$ 235,429	\$ 241,885	\$ 207,944
Expenses					
Power Supply Costs	\$ 78,711	\$ 97,393	\$ 93,327	\$ 109,808	\$ 127,015
Power Cost Deferral (4)	46,000	7,480	0	0	0
Operation and Maintenance (5)	22,623	23,303	26,040	26,614	29,457
Taxes	7,267	7,920	7,887	8,395	8,800
Total Expenses	\$ 154,601	\$ 136,096	\$ 127,254	\$ 144,817	\$ 165,272
Net Revenues	\$ 12,574	\$ 92,218	\$ 108,175	\$ 97,068	\$ 42,672
Interest and Other Income	\$ 2,793	\$ 6,194	\$ 7,170	\$ 5,436	\$ 1,644
Transfer to Rate Stabilization Fund (6)	0	(23,000)	(48,000)	0	0
Revenues Available for Debt Service					
Service	15,367	75,412	67,345	102,504	44,316
Less Debt Service	(11,589)	(11,587)	(17,696)	(17,667)	(17,634)
Uncommitted Revenues	\$ 6,245	\$ 63,825	\$ 49,649	\$ 84,837	\$ 26,682
Beginning Working Capital	\$ 66,013	\$ 95,242	\$ 107,763	\$ 155,337	\$ 183,107
Bond Proceeds – Construction Fund	0	0	0	0	0
Funds Available for Construction	72,258	159,067	157,412	240,174	209,789
Less Capital Construction	(16,435)	(10,223)	(36,651)	(46,849)	(62,530)
Change in Deferred Power Cost Asset (4)	(46,000)	(7,480)	0	0	0
Change in Other Balance Sheet Accounts	85,419	(33,601)	34,576	(10,218)	4,072
Ending Working Capital	\$ 95,242	\$ 107,763	\$ 155,337	\$ 183,107	\$ 151,331
R&C Fund (6)	\$ 17,890	\$ 42,164	\$ 92,199	\$ 94,319	\$ 95,072
Debt Service Coverage	1.33x	6.51x	3.81x	5.80x	2.51x
Debt Service Coverage without SFAS 71 Deferral	5.51x	7.15x	N/A	N/A	N/A
Retail Energy Sales (MWh)	3,125,143	3,124,885	3,247,536	3,529,922	3,715,666
Average Retail Energy Rate Increase	0%	0%	0%	0%	0%
Average Retail Revenue Requirement (cents/kWh)	3.04¢	3.14¢	3.11¢	3.15¢	3.09¢

(1) Based on unaudited financial statements.

- (2) The District recognized earned contributions in aid of construction of \$993,576, \$9,058,551, \$10,173,455, \$9,550,683 and \$3,783,760 in 2009, 2008, 2007, 2006 and 2005, respectively.
- (3) The increases during 2006-2008 were primarily due to the displacement product within the New Power Sales Contracts that took effect on November 1, 2005.
- (4) Purchased power was deferred as permitted under SFAS No. 71 in both 2001 and 2002 totaling \$92 million and this non-cash transaction is reflected in the financial statements as a reduction of purchase power expense. Amortization of the deferral, which was reflected in the financial statements as additional purchased power expense, began in 2003 in the amount of \$16,203,545, \$22,283,355, \$46,000,000 and \$7,480,000 in 2003, 2004, 2005 and 2006 respectively. The deferred power expense was entirely amortized by December 31, 2006. Debt service coverage without the effect of the power cost deferral was 7.15, 5.51, 3.18, and 3.15 in 2006, 2005, 2004, and 2003, respectively.
- (5) Excludes noncash items of depreciation and amortization.
- (6) In 2007 and 2006, pursuant to Commission resolutions, \$48,000,000 and \$23,000,000, respectively, was transferred to the R&C Fund from the Revenue Fund and classified rate stabilization funds.

The following table shows the Electric System's historical energy requirements, resources and power costs for fiscal years 2005 through 2009.

Table 19
ELECTRIC SYSTEM
HISTORICAL ENERGY REQUIREMENTS, RESOURCES AND POWER COSTS

	2005	2006	2007	2008	2009
Annual Energy Requirements (MWh)					
Retail Sales (1)	3,018,611	3,143,916	3,256,927	3,553,474	3,693,343
Electrical System Usage	10,968	11,987	12,719	11,067	11,892
Sales for Resale (2)	1,258,416	3,275,078	3,337,221	4,020,567	3,111,968
Distribution/Transmission Line Losses	173,844	127,022	183,009	164,848	175,698
Total Energy Requirements	4,461,839	6,558,003	6,789,876	7,749,956	6,992,901
Annual Resources (MWh)					
Priest Rapids Development (3)	1,345,915	2,715,012	2,828,820	2,598,576	2,293,632
Wanapum Development	1,444,517	1,614,180	1,618,929	1,401,568	1,357,504
Quincy Chute Project	31,490	30,297	29,742	35,570	32,805
PEC Headworks Project	21,983	21,751	19,373	23,533	20,700
Bonneville/CSPE	1,478,858	1,568,398	1,714,918	1,718,103	1,704,937
Other (4)	139,076	608,365	578,094	1,972,606	1,583,323
Total Energy Resources	4,461,839	6,558,003	6,789,876	7,749,956	6,992,901
Average Power Cost by Resources (cents/kWh)					
Priest Rapids Development	0.85¢	0.99¢	1.23¢	1.63¢	1.72¢
Wanapum Development	0.89	0.97	1.23	1.71	1.68
Quincy Chute Project	2.76	3.71	3.25	2.53	2.35
PEC Headworks Project	3.33	3.12	3.66	2.89	2.94
Bonneville/CSPE	2.48	2.58	2.40	2.38	2.64
Other	41.31	2.44	(1.99)	(0.22)	0.71
Annual Power Cost by Resource (\$000)					
Priest Rapids Development	\$ 11,393	\$ 26,786	\$ 34,926	\$ 42,249	\$ 39,508
Wanapum Development	12,885	15,582	19,943	23,967	22,809
Quincy Chute Project	870	1,123	968	899	771
PEC Headworks Project	733	679	709	681	609
Bonneville/CSPE	36,642	40,541	41,187	40,923	45,039
Other (5)	57,459	14,829	(11,508)	(4,334)	11,220
Wheeling	4,729	5,333	7,102	5,423	7,059
Total Power Costs (\$000)	\$ 124,711	\$ 104,873	\$ 93,327	\$ 109,808	\$ 127,015
Average Power Costs (cents/kWh) (6)	2.80¢	1.60¢	1.37¢	1.42¢	1.82¢

- (1) Reflects total retail energy requirements.
- (2) The increases in 2006 and 2007 were primarily due to the displacement product within the New Power Sales Contracts that took effect on November 1, 2005. The increase in 2008 was attributable to additional utility and marketer sales, and bookout sales. Decrease in 2009 due to decreased water for generation.
- (3) The increases in 2006 and 2007 was a result of the New Power Sales Contracts that took effect on November 1, 2005, pursuant to which the Electric System receives a greater portion of power generation from the Priest Rapids Project.
- (4) The increase in 2008 was necessary to satisfy the increase in annual energy requirements in addition to a reduction of power resources received from the Priest Rapids and Wanapum Developments during 2008 compared to 2007 as a result of less power generation.
- (5) By virtue of the New Power Sales Contracts, the Electric System's estimated unmet load is met through cash proceeds from the auction of power from the Priest Rapids Project. The Electric System's contractual share of these proceeds exceeded the actual power purchases necessary for 2007 and 2008.
- (6) The decreases in 2006 and 2007 were due to the Electric System having an increased share of Priest Rapids Project. The Electric System was able to satisfy more load with Priest Rapids Project power.

Management's Discussion of Results

The Electric System has historically demonstrated consistently superior financial results with high debt service coverage ratios and a substantial buildup in reserves. The operating results for 2005 to 2009 reflect the benefits of the New Power Sales Contract that went into effect on November 1, 2005. The New Power Sales Contracts have effectively enabled the Electric System to meet its load requirements with the low cost power from the Priest Rapids Project. The years 2006 through 2008 were exceptional years for generation of net operating revenue in the Electric System. Near average run-off provided generation sufficient to meet the Electric System's loads and provide ample surplus sales at healthy market prices. The year 2009, while still profitable, reflected lower surplus sales revenues. Run-off was below average and the wholesale power prices were significantly lower than in prior years. This combination produced a \$54 million decrease in Net Operating Revenues.

The District has always met its debt service coverage covenants. Once the Power Cost Deferral, which was being amortized from 2003 – 2006, was retired, the District began adding to its Rate Stabilization Fund in 2006 and 2007. From 2007 to 2009, the Electric System's debt service coverage ranged from 2.51x to 5.8x, far in excess of the 1.25x required by the Electric System bond resolution.

From 2004 to the present, the Electric System has been able to finance capital improvements from revenue. The District's financial parameters require a minimum of 50% revenue financing of capital expenditures for the Electric System. The District does not have any immediate financing required for the Electric System. The District may, however, issue refunding bonds and bonds to finance a new generating resource for the Electric System.

The Commission has approved a 4% rate increase effective April 1, 2010. This increase is the first increase since 2003. Three more 4% rate increases are scheduled to take effect in each of the consecutive years. These increases are designed to help the Electric System meet requirements for capital improvements, increasing cost of generation at the Priest Rapids Project, and to increase the reserves of the Electric System. The increase in reserves is prudent to mitigate generation output fluctuations at the Priest Rapids Project due to water availability or spill requirements. Decreases in generation from the Priest Rapids Project below forecast levels require the Electric System to meet its load requirements with market purchases. This exposure to the market is best buffered by an adequate reserve fund to help cushion rates from market volatility. The Wanapum Development bypass system is functioning better than expected and has resulted in a long-term reduction in fish spill. A similar program is being put in place for the Priest Rapids Development. These future rate increases may be modified to reflect future financial conditions.

Under its base case assumptions, the District projects that its debt service coverage for 2010 will be approximately 2.6 times. As of December 31, 2009, the District had \$153,929,033 in working capital and cash reserves. As described in the following section, the District anticipates using cash to finance Electric System capital improvements. Total working capital and cash reserves are expected to vary from approximately \$115 million to \$160 million over the next five years.

Capital Requirements

As part of its planning process, the District has prepared its annual estimate of the capital requirements for the Electric System. As shown in the table below, the capital requirements include provisions for major projects involving transmission and electrical distribution lines and substations as well as normal equipment purchases, system additions, customer extensions, and general plant purchases. The District expects the cost of these expenditures in 2010-2012 to be \$173 million. The District currently does not anticipate additional bond financing to fund proposed capital improvements to the Electric System. The District is undertaking substantial capital improvements to serve expected load growth. See "THE ELECTRIC SYSTEM—Retail Energy Sales and Customers."

Table 20
ELECTRIC SYSTEM PROJECTED
CAPITAL IMPROVEMENTS PROGRAM 2010-2012

Distribution	\$ 79,516,000
Transmission	48,780,000
Fiber	27,663,000
General Plant	17,127,000
	\$ 173,086,000

ECONOMIC AND DEMOGRAPHIC INFORMATION

Grant County (the “County”) is the fourth largest county in the State by land area, encompassing a total of 2,681 square miles. Within the County are 15 incorporated cities and towns. Moses Lake is the largest city with an estimated 2009 population of 18,930 and Ephrata, the County seat, is the second largest with an estimated 2009 population of 7,110. The County’s total population has grown from 74,698 in 2000 to 86,100 in 2009, an increase of over 15%. Population density in the County in 2009 is 32.11 persons per square mile ranking it 21st of the 39 counties in the State. The total civilian labor force in the County in 2009 was 42,450.

The County’s economy is based on diversified agriculture, food processing, manufacturing, hydroelectric generation projects and a strong service sector. The County’s prominence in agriculture is due in large part to the U.S. Bureau of Reclamation’s Columbia Basin Irrigation Project, which has turned raw land into high yield farmland through irrigation. Recently, several technology data centers have opened in the County.

Following are economic indicators for the County.

Table 21
GRANT COUNTY
SELECTED ECONOMIC INDICATORS

	Population (1)	Per Capita Personal Income (2)	Taxable Retail Sales (\$000) (3)	Building Permits (\$000) (4)	Personal Income (\$000) (2)
2009	86,100	—	\$ 1,220,990	\$ 41,432	—
2008	84,600	—	1,551,865	76,211	—
2007	82,500	\$ 24,733	1,537,951	121,243	\$ 2,037,000
2006	80,600	23,507	1,107,853	78,601	1,900,400
2005	79,100	22,861	872,602	78,572	1,818,126
2004	78,300	22,276	800,596	66,819	1,754,644
2003	77,100	22,128	744,458	52,264	1,726,060
2002	76,400	21,427	727,045	49,151	1,650,884
2001	75,900	21,011	772,135	48,521	1,599,811
2000	74,698	20,190	714,116	42,587	1,513,579

(1) Source: Washington State Employment Security Department, Labor Market & Economical Analysis Branch

(2) Source: Washington State Bureau of Economic Analysis; 2007 is most recent data available.

(3) Source: Washington State Department of Revenue.

(4) Source: Grant County Building Department.

**Table 22
GRANT COUNTY MAJOR PROPERTY TAXPAYERS(1)**

Taxpayer	Business	Assessed Valuation	% of County Assessed Valuation
REC Solar Grade Silicon, LLC	Chemical Manufacturing	\$ 436,544,850	6.29%
Microsoft Corporation	Data Center/Technology	304,722,180	4.39
J. R. Simplot	Potato Products	62,129,280	0.90
Yahoo, Inc.	Data Center/Technology	56,071,885	0.81
Inflation Systems	Air Bag Products	49,417,045	0.71
Quincy Data Center, LLC	Data Center/Technology	48,418,200	0.70
Lamb-Weston Inc.	Potato Products	44,769,225	0.65
Columbia Colstor, Inc.	Cold Storage	42,722,860	0.62
Chemi-Con Materials Corp.	Chemical Manufacturing	36,781,000	0.53
BNSF Railway Company Tax Dept.	Railroads	35,384,957	0.51
Moses Lake Industries	Chemical Manufacturing	31,541,905	0.45
EKA Chemicals, Inc.	Chemicals	28,123,140	0.41
American Potato Co.	Potato Products	22,082,730	0.32
Lamb-Weston BSW, LLC	Potato Products	18,495,900	0.27
Quincy Foods, LLC	Frozen Vegetables	17,911,625	0.26
William G. and Jeannette Evans	Real Estate	16,733,945	0.24
REC Adv Silicon Materials Inc.	Chemical Manufacturing	16,423,950	0.24
Qwest Corporation Inc.	Telecommunications	15,584,792	0.22
Oregon Potato Company	Potato Products	12,968,935	0.19
Wal-Mart Real Est Bus Trust	Real Estate Investment	12,087,450	0.17
		\$ 1,308,915,854	18.86%

Source: Grant County Assessor for tax collection year 2009.

(1) Total County assessed valuation for 2009 taxes is \$6,939,463,594.

Table 23
GRANT COUNTY MAJOR EMPLOYERS

Employer	Product/Service	Employees
Moses Lake School District	Education	1,000
The District	Electric Utility	648
Wal-Mart	General Retail & Grocery Retail	615
Grant County Government	Government	550
Quincy Foods, LLC	Frozen Vegetable Processing	550
Samaritan Hospital	Health Care	532
REC Silicon	Polysilicon Manufacturing	520
Genie Industries, Inc.	Construction & Industrial Material Lifts & Aerial Work Platforms	425
ConAgra Foods, Inc.	Frozen Potato Processing	400
Big Bend Community College	Education	375
J.R. Simplot Co.	Frozen French Fries & Dehydrated Potato Products	330
Lamb Weston BSW	Frozen Potato Processing	300
Moses Lake Community Health	Health Care	264
Columbia Foods, Inc.	Corn & Peas Processing	250
Inflation Systems, Inc.	Automotive Air Bags	245
Quincy School District	Education	242
Moses Lake Clinic	Health Care	200
Columbia Basin Hospital	Health Care	160
Ephrata School District	Education	144
D&L Foundry, Inc.	Manhole Cover Manufacturing	125
Washington Potato Co.	Dehydrated Potato Flake Processing	125
Northwest Stone & Brick, LLC	Stone and Brick Processing	115
Katana	Windmill Tower Manufacturing	114
Weyerhaeuser Co.	Corrugated Box Manufacturing	113
Moses Lake Industries, Inc.	Corporate Headquarters & Industrial Chemical	100
Home Depot	Home Building & Repair Retail	100

Source: Grant County Economic Development Council as of August 2009.

Table 24
GRANT COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT

	Annual Averages						
	2003	2004	2005	2006	2007	2008	2009
Total Labor Force	36,980	37,550	38,440	38,950	40,150	40,970	42,200
Employment	33,540	34,480	35,660	36,410	37,840	38,340	38,160
Unemployment	3,440	3,080	2,790	2,540	2,310	2,630	4,040
Unemployment Rate	9.3%	8.2%	7.2%	6.5%	5.7%	6.4%	9.6%

Source: Washington State Employment Security Department, Labor Market and Economic Analysis Branch.

**Table 25
GRANT COUNTY NONAGRICULTURAL EMPLOYMENT**

NAICS Industry Title	Annual Averages						
	2003	2004	2005	2006	2007	2008	2009 (1)
Total Nonfarm	24,420	24,410	25,010	26,080	26,950	26,850	26,050
Total Private	17,180	17,150	17,760	18,750	19,500	19,220	18,280
Goods Producing	5,010	4,930	5,120	5,490	5,850	6,220	5,560
Services Providing	19,410	19,480	19,890	20,590	21,090	20,630	20,490
Trade, Transportation & Utilities	4,970	4,880	5,030	5,060	5,270	5,380	5,430
Information & Financial Activities	890	880	900	990	1,010	1,020	970
Government	7,230	7,260	7,260	7,330	7,450	7,640	7,770

(1) Preliminary.

Source: Washington State Employment Security Department, Labor Market and Economic Analysis Branch.

LITIGATION

There is no litigation pending or threatened in any court (either state or federal) concerning the issuance or the validity of any Parity Bonds, or questioning the creation, organization, existence or 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 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 Priest Rapids Project or the Electric System.

The District is a party to pending litigation in Grant County Superior Court Case No. 08-2-01339-8 titled *General Construction Company v. Public Utility District No. 2 of Grant County, Washington*. General Construction Company alleges damages of approximately \$20 million arising from a contract dispute with the District. The District contends the allegations are without merit and intends to vigorously defend the matter. The District has asserted a counter claim for damages against General Construction Company alleging damages of approximately \$4 million. The District does not believe the outcome of this litigation will have a significant adverse impact upon the District's ability to pay the Bonds.

The District is a party to lawsuits arising out of its normal course of business, but the District does not believe any of such litigation will have a significant adverse impact upon the District's ability to pay the 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% (initiative) and 4% (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.

LIMITATIONS ON REMEDIES

Any remedies available to the owners of the Bonds upon the occurrence of an event of default under the Bond 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. If the District fails to comply with its covenants

under the Bond Resolution or to pay principal of or interest on the Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the Bonds.

In addition to the limitations on remedies contained in the Bond Resolution, the rights and obligations under the Bonds and the Bond Resolution may be limited by and are subject to bankruptcy, insolvency, reorganization, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, and to the exercise of judicial discretion in appropriate cases. The opinion to be delivered by Foster Pepper PLLC, Seattle, Washington as Bond Counsel, concurrently with the issuance of the Bonds, will be subject to limitations regarding bankruptcy, insolvency and other laws relating to or affecting creditors' rights. The various other legal opinions to be delivered concurrently with the issuance of the Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D.

TAX MATTERS

The 2010A Bonds

Exclusion From Gross Income. In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issue date of the 2010A Bonds (except any 2010A Bond for any period during which it is held by a "substantial user" of the Priest Rapids Project or by a "related person" within the meaning of Section 147(a) of the Code), interest on the 2010A Bonds is excluded from gross income for federal income tax purposes.

Continuing Requirements. The District is required to comply with certain requirements of the Code after the date of issuance of the 2010A Bonds in order to maintain the exclusion of the interest on the 2010A Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2010A Bond proceeds and the facilities financed or refinanced with 2010A Bond proceeds, limitations on investing gross proceeds of the 2010A Bonds in higher yielding investments in certain circumstances, and the requirement to comply with the arbitrage rebate requirement to the extent applicable to the 2010A Bonds. The District has covenanted in the Bond Resolution to comply with those requirements, but if the District fails to comply with those requirements, interest on the 2010A Bonds could become taxable retroactive to the date of issuance of the 2010A Bonds. Bond Counsel has not undertaken and does not undertake to monitor the District's compliance with such requirements.

Alternative Minimum Tax. Interest on the 2010A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes. Bond Counsel expresses no opinion as to whether some or all interest on the 2010A Bonds is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income.

Tax on Certain Passive Investment Income of S Corporations. Under Section 1375 of the Code, certain excess net passive investment income, including interest on the 2010A Bonds, received by an S corporation (a corporation treated as a partnership for most federal tax purposes) that has Subchapter C earnings and profits at the close of the taxable year may be subject to federal income taxation at the highest rate applicable to corporations if more than 25% of the gross receipts of such S corporation is passive investment income.

Foreign Branch Profits Tax. Interest on the 2010A Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2010A Bonds are owned by, and effectively connected with a trade or business of, a United States branch of a foreign corporation.

Possible Consequences of Tax Compliance Audit. The Internal Revenue Service (the "IRS") has established a general audit program to determine whether issuers of tax-exempt obligations, such as the 2010A Bonds, are in compliance with requirements of the Code that must be satisfied in order for interest on those obligations to be, and continue to be, excluded from gross income for federal income tax purposes. Bond Counsel cannot predict whether the IRS would commence an audit of the 2010A Bonds. Depending on all the facts and circumstances and the type

of audit involved, it is possible that commencement of an audit of the 2010A Bonds could adversely affect the market value and liquidity of the 2010A Bonds until the audit is concluded, regardless of its ultimate outcome.

2010A Bonds Not “Qualified Tax Exempt Obligations” for Financial Institutions. Section 265 of the Code provides that 100% of any interest expense incurred by banks and other financial institutions for interest allocable to tax exempt obligations acquired after August 7, 1986, will be disallowed as a tax deduction. However, if the tax exempt obligations are obligations other than private activity bonds, are issued by a governmental unit that, together with all entities subordinate to it, does not reasonably anticipate issuing more than \$30,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) in the current calendar year, and are designated by the governmental unit as “qualified tax exempt obligations,” only 20% of any interest expense deduction allocable to those obligations will be disallowed. The District has not designated the 2010A Bonds as “qualified tax exempt obligations.”

Original Issue Discount. The 2010A Bonds maturing in the year 2020 (with the interest rate of 3.50%) have been sold at prices reflecting original issue discount (“2010A Discount Bonds”). Under existing law, the original issue discount in the selling price of each 2010A Discount Bond, to the extent properly allocable to each owner of such 2010A Discount Bond, is excluded from gross income for federal income tax purposes with respect to such owner. The original issue discount is the excess of the stated redemption price at maturity of such 2010A Discount Bond over the initial offering price to the public, excluding underwriters and other intermediaries, at which price a substantial amount of the 2010A Discount Bonds of such maturity were sold.

Under Section 1288 of the Code, original issue discount on tax-exempt bonds accrues on a compound basis. The amount of original issue discount that accrues to an owner of a 2010A Discount Bond during any accrual period generally equals (i) the issue price of such 2010A Discount Bond plus the amount of original issue discount accrued in all prior accrual periods, multiplied by (ii) the yield to maturity of such 2010A Discount Bond (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), less (iii) any interest payable on such 2010A Discount Bond during such accrual period. The amount of original issue discount so accrued in a particular accrual period will be considered to be received ratably on each day of the accrual period, will be excluded from gross income federal income tax purposes, and will increase the owner's tax basis in such 2010A Discount Bond. Any gain realized by an owner from a sale, exchange, payment or redemption of a 2010A Discount Bond will be treated as gain from the sale or exchange of such 2010A Discount Bond.

The portion of original issue discount that accrues in each year to an owner of a 2010A Discount Bond may result in certain collateral federal income tax consequences. The accrual of such portion of the original issue discount will be included in the calculation of alternative minimum tax liability as described above, and may result in an alternative minimum tax liability even though the owner of such 2010A Discount Bond will not receive a corresponding cash payment until a later year.

Owners who purchase 2010A Discount Bonds in the initial public offering but at a price different from the first offering price at which a substantial amount of those 2010A Discount Bonds were sold to the public, or who do not purchase 2010A Discount Bonds in the initial public offering, should consult their own tax advisors with respect to the tax consequences of the ownership of such 2010A Discount Bonds. Owners of 2010A Discount Bonds who sell or otherwise dispose of such 2010A Discount Bonds prior to maturity should consult their own tax advisors with respect to the amount of original issue discount accrued over the period such 2010A Discount Bonds have been held and the amount of taxable gain or loss to be recognized upon that sale or other disposition of 2010A Discount Bonds. Owners of 2010A Discount Bonds also should consult their own tax advisors with respect to state and local tax consequences of owning such 2010A Discount Bonds.

Original Issue Premium. The 2010A Bonds maturing in 2011 through 2019, inclusive, 2020 (with the interest rate of 5.00%) and in 2021 through 2023, inclusive, have been sold at prices reflecting original issue premium (“2010A Premium Bonds”). An amount equal to the excess of the purchase price of a 2010A Premium Bond over its stated redemption price at maturity constitutes premium on such 2010A Premium Bond. A purchaser of a 2010A Premium Bond must amortize any premium over such 2010A Premium Bond's term using constant yield principles, based on the purchaser's yield to maturity. The amount of amortizable premium allocable to an interest accrual period for a 2010A Premium Bond will offset a like amount of qualified stated interest on such 2010A Premium Bond allocable to that accrual period, and may affect the calculation of alternative minimum tax liability described above. As

premium is amortized, the purchaser's basis in such 2010A Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such 2010A Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of 2010A Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult with their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning such 2010A Premium Bonds.

Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies. Under Section 832 of the Code, interest on the 2010A Bonds received by property and casualty insurance companies will reduce tax deductions for loss reserves otherwise available to such companies by an amount equal to 15% of tax exempt interest received during the taxable year.

Effect on Certain Social Security and Retirement Benefits. Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2010A Bonds into account in determining gross income.

Other Possible Federal Tax Consequences. Receipt of interest on the 2010A Bonds may have other federal tax consequences as to which prospective purchasers of the 2010A Bonds may wish to consult their own tax advisors.

The 2010B Bonds

Exclusion from Gross Income. In the opinion of Bond Counsel, under existing federal law and assuming compliance by the District with applicable requirements of the Code that must be satisfied subsequent to the issue date of the 2010B Bonds, interest on the 2010B Bonds (except any 2010B Bond for any period during which it is held by a “substantial user” of the Project or by a “related person” within the meaning of Section 147(a) of the Code) is excluded from gross income for federal income tax purposes. Interest on the 2010B Bonds received by individuals and corporations also may be subject to the federal alternative minimum tax. See “—Alternative Minimum Tax” below.

Continuing Requirements. The District is required to comply with certain requirements of the Code after the date of issuance of the 2010B Bonds in order to maintain the exclusion of the interest on the 2010B Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2010B Bond proceeds and the facilities financed or refinanced with 2010B Bond proceeds, limitations on investing gross proceeds of the 2010B Bonds in higher yielding investments in certain circumstances, and the requirement to comply with arbitrage rebate requirements to the extent applicable to the 2010B Bonds. The District has covenanted in the Bond Resolution to comply with those requirements, but if the District fails to comply with those requirements, interest on the 2010B Bonds could become taxable retroactive to the date of issuance of the 2010B Bonds. Bond Counsel has not undertaken and does not undertake to monitor the District's compliance with such requirements.

Alternative Minimum Tax. Interest on the 2010B Bonds received by both individuals and corporations may be subject to an alternative minimum tax. Under the federal alternative minimum tax provisions of the Code, interest on certain bonds issued by or on behalf of governmental units to finance facilities used by nongovernmental persons (“specified private activity bonds”) will constitute a tax preference item for purposes of the alternative minimum tax applicable to both individuals and corporations. The 2010B Bonds are specified private activity bonds, and these alternative minimum tax provisions will apply to recipients of interest on the 2010B Bonds.

Tax on Certain Passive Investment Income of S Corporations. Under Section 1375 of the Code, certain excess net passive investment income, including interest on the 2010B Bonds, received by an S corporation (a corporation treated as a partnership for most federal tax purposes) that has Subchapter C earnings and profits at the close of its taxable year may be subject to federal income taxation at the highest rate applicable to corporations, if more than 25% of the gross receipts of such S corporation is passive investment income.

Foreign Branch Profits Tax. Interest on the 2010B Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2010B Bonds are owned by, and effectively connected with a trade or business of, a United States branch of a foreign corporation.

Possible Consequences of Tax Compliance Audit. The IRS has established a general audit program to determine whether issuers of tax-exempt obligations, such as the 2010B Bonds, are in compliance with requirements of the Code that must be satisfied in order for interest on those obligations to be, and continue to be, excluded from gross income for federal income tax purposes. Bond Counsel cannot predict whether the IRS would commence an audit of the 2010B Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the 2010B Bonds could adversely affect the market value and liquidity of the 2010B Bonds until the audit is concluded, regardless of its ultimate outcome.

2010B Bonds Not “Qualified Tax-Exempt Obligations” for Financial Institutions. Section 265 of the Code provides that 100% of any interest expense incurred by banks and other financial institutions for interest allocable to tax-exempt private activity bonds, such as the 2010B Bonds, acquired after August 7, 1986, will be disallowed as a tax deduction.

Original Issue Premium. The 2010B Bonds have been sold at prices reflecting original issue premium (“2010B Premium Bonds”). An amount equal to the excess of the purchase price of a 2010B Premium Bond over its stated redemption price at maturity constitutes premium on such 2010B Premium Bond. A purchaser of a 2010B Premium Bond must amortize any premium over such 2010B Premium Bond's term using constant yield principles, based on the purchaser's yield to maturity. The amount of amortizable premium allocable to an interest accrual period for a 2010B Premium Bond will offset a like amount of qualified stated interest on such 2010B Premium Bond allocable to that accrual period, and may affect the calculation of alternative minimum tax liability described above. As premium is amortized, the purchaser's basis in such 2010B Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such 2010B Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of 2010B Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult with their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning such 2010B Premium Bonds.

Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies. Under Section 832 of the Code, interest on the 2010B Bonds received by property and casualty insurance companies will reduce tax deductions for loss reserves otherwise available to such companies by an amount equal to 15% of tax-exempt interest received during the taxable year.

Effect on Certain Social Security and Retirement Benefits. Section 86 of the Code requires Owners of the 2010B Bonds who are also recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2010B Bonds into account in determining gross income.

Other Possible Federal Tax Consequences. Receipt of interest on the 2010B Bonds may have other federal tax consequences as to which prospective purchasers of the 2010B Bonds may wish to consult their own tax advisors.

The 2010L Bonds, 2010M Bonds and 2010Z Bonds

This advice was written to support the promotion or marketing of the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds. This advice is not intended or written to be used, and may not be used, by any person or entity for the purpose of avoiding any penalties that may be imposed on any person or entity under the U.S. Internal Revenue Code of 1986, as amended (the “Code”). Prospective purchasers of the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds should seek advice based on their particular circumstances from an independent tax advisor.

The following discussion generally describes certain aspects of the principal U.S. federal tax treatment of U.S. persons that are beneficial owners (“Owners”) of bonds who have purchased 2010L Bonds, the 2010M Bonds and

the 2010Z Bonds in the initial offering and who hold the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds as capital assets within the meaning of Section 1221 of the Code. For purposes of this discussion, a “U.S. person” means an individual who, for U.S. federal income tax purposes, is (i) a citizen or resident of the United States, (ii) a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, (iii) an estate, the income of which is subject to U.S. federal income taxation regardless of its source of income, or (iv) a trust, if either: (A) a United States court is able to exercise primary supervision over the administration of the trust, and one or more United States persons have the authority to control all substantial decisions of the trust or (B) a trust has a valid election in effect to be treated as a United States person under the applicable treasury regulations.

This summary is based on the Code, published revenue rulings, administrative and judicial decisions, and existing and proposed Treasury regulations (all as of the date hereof and all of which are subject to change, possibly with retroactive effect). This summary does not discuss all of the tax consequences that may be relevant to an Owner in light of its particular circumstances, such as an Owner who may purchase 2010L Bonds, the 2010M Bonds and the 2010Z Bonds in the secondary market, or to Owners subject to special rules, such as certain financial institutions, insurance companies, tax-exempt organizations, non-U.S. persons, taxpayers who may be subject to the alternative minimum tax or personal holding company provisions of the Code, or dealers in securities. **Accordingly, before deciding whether to purchase any 2010L Bonds, the 2010M Bonds and the 2010Z Bonds, prospective purchasers should consult their own tax advisors regarding the United States federal income tax consequences, as well as tax consequences under the laws of any state, local or foreign taxing jurisdiction or under any applicable tax treaty, of purchasing, holding, owing and disposing of the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds.**

In General – 2010L Bonds. As described herein under the heading “DESCRIPTION OF THE BONDS— Designation of the 2010L Bonds as ‘Build America Bonds’ and 2010M Bonds as ‘New Clean Renewable Energy Bonds,’” the District has made irrevocable elections to have the 2010L Bonds treated as “Build America Bonds” within the meaning of Section 54AA(d) of the Code that are “qualified bonds” within the meaning of Section 54AA(g) of the Code. As a result of these elections, interest on the 2010L Bonds is not excludable from the gross income of the Beneficial Owners for federal income tax purposes under Section 103 of the Code, and Beneficial Owners of the 2010L Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2010L Bonds.

In General – 2010M Bonds. As described herein under the heading DESCRIPTION OF THE BONDS— Designation of the 2010L Bonds as ‘Build America Bonds’ and 2010M Bonds as “New Clean Renewable Energy Bonds,” the District has made an irrevocable election to have the 2010M Bonds, which are “qualified tax credit bonds” within the meaning of Section 54A(d) of the Code, treated as “specified tax credit bonds” within the meaning of Section 6431(f)(3) of the Code. As a result of these elections, interest on the 2010M Bonds is not excludable from the gross income of the Owners under Section 103 of the Code, and Owners of the 2010M Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2010M Bonds.

In General – 2010Z Bonds. Interest on the 2010Z Bonds is not excludable from the gross income of the Beneficial Owners for federal income tax purposes under Section 103 of the Code, and Beneficial Owners of the 2010Z Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2010Z Bonds.

Payments of Interest. Interest paid on the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds will generally be taxable to Owners as ordinary interest income at the time it accrues or is received, in accordance with the Owner’s method of accounting for U.S. federal income tax purposes. Owners who are cash-method taxpayers will be required to include interest in income upon receipt of such interest payment; Owners who are accrual-method taxpayers will be required to include interest as it accrues, without regard to when interest payments are actually received.

Original Issue Discount. A 2010L Bond, 2010M Bond or 2010Z Bond will be treated as having been issued at an original issue discount if the excess of its stated redemption price at maturity over its issue price (defined as the initial offering price to the public at which a substantial amount of the 2010L Bonds, 2010M Bonds or 2010Z Bonds

of the same maturity have first been sold to the public, excluding bond houses and brokers) equals or exceeds one quarter of one percent of such 2010L Bond's, 2010M Bond's or 2010Z Bond's stated redemption price at maturity multiplied by the number of complete years to its maturity. Any original issue discount which is less than the forgoing amount is de minimis and treated as zero. Because no original discount on any 2010L Bond, 2010M Bond or 2010Z Bond exceeds such de minimis amount, the original issue discount is treated as zero.

Disposition or Retirement of 2010L Bonds, the 2010M Bonds and the 2010Z Bonds. Upon the sale, exchange or other disposition of a 2010L Bond, a 2010M Bond or a 2010Z Bond, or upon the retirement of a 2010L Bond, the 2010M Bond or a 2010Z Bond (including by redemption), an Owner will recognize capital gain or loss equal to the difference, if any, between the amount realized upon the disposition or retirement (excluding any amounts attributable to accrued but unpaid interest, which will be taxable as such) and the Owner's adjusted tax basis in the 2010L Bond, 2010M Bond or 2010Z Bond. Any such gain or loss will be United States source gain or loss for foreign tax credit purposes.

Defeasance of 2010L Bonds, 2010M Bonds or 2010Z Bonds. If the District defeases any 2010L Bonds, 2010M Bonds and 2010Z Bonds, such bonds may be deemed to be retired and "reissued" for federal income tax purposes as a result of the defeasance. In such event, the Owner of a 2010L Bond, 2010M Bond or a 2010Z Bond would recognize a gain or loss on the 2010L Bond, the 2010M Bond or the 2010Z Bond at the time of defeasance.

Backup Withholding. An Owner may, under certain circumstances, be subject to "backup withholding" (currently the rate of this withholding tax is 28%, but may change in the future) with respect to interest or original issue discount on the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds. This withholding generally applies if the Owner of a 2010L Bond, 2010M Bond or a 2010Z Bond (i) fails to furnish the Bond Registrar or other payor with its taxpayer identification number; (ii) furnishes the Bond Registrar or other payor an incorrect taxpayer identification number; (iii) fails to report properly interest, dividends or other "reportable payments" as defined in the Code; or (iv) under certain circumstances, fails to provide the Bond Registrar or other payor with a certified statement, signed under penalty of perjury, that the taxpayer identification number provided is its correct number and that the Owner is not subject to backup withholding. Any amount withheld may be creditable against the Owner's U.S. federal income tax liability and be refundable to the extent it exceeds the Owner's U.S. federal income tax liability. The amount of "reportable payments" for each calendar year and the amount of tax withheld, if any, with respect to payments on the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds will be reported to the Owners and to the Internal Revenue Service.

Reporting of Interest Payments. Subject to certain exceptions, interest payments made to beneficial owners with respect to the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds will be reported to the IRS. Such information will be filed each year with the IRS on Form 1099, which will reflect the name, address and Taxpayer Identification Number of the beneficial owner. A copy of Form 1099 is required to be sent to each beneficial owner of a 2010L Bond, a 2010M Bond or a 2010Z Bond.

ERISA CONSIDERATIONS

The Employees Retirement Income Security Act of 1974, as amended ("ERISA"), and the Code generally prohibit certain transactions between a qualified employee benefit plan under ERISA or tax-qualified retirement plans and individual retirement accounts under the Code (collectively, the "Plans") and persons who, with respect to a Plan, are fiduciaries or other "parties in interest" within the meaning of ERISA or "disqualified persons" within the meaning of the Code. All fiduciaries of Plans should consult their own tax advisors with respect to the consequences of any investment in the 2010L Bonds, the 2010M Bonds and the 2010Z Bonds.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization, issuance and sale of the Bonds by the District are subject to the approving legal opinion of Foster Pepper PLLC, Seattle, Washington, Bond Counsel. The form of the opinion of Bond Counsel with respect to the Bonds is attached as Appendix D. The opinion of Bond Counsel is given based on

factual representations made to Bond Counsel, and under existing law, as of the date of initial delivery of the Bonds, and Bond Counsel assumes no obligation to revise or supplement its opinion to reflect any facts or circumstances that may thereafter come to its attention, or any changes in law that may thereafter occur. The opinion of Bond Counsel is an expression of its professional judgment on the matters expressly addressed in its opinion and does not constitute a guarantee of result. Bond Counsel will be compensated only upon the issuance and sale of the Bonds. Bond Counsel periodically serves as underwriters' counsel to certain of the Underwriters on non-District issues.

Certain legal matters will be passed upon for the Underwriters by their counsel, K&L Gates LLP, Seattle, Washington. Any opinion of K&L Gates will be rendered solely to the Underwriters, will be limited in scope, and cannot be relied upon by investors.

UNDERWRITING

The Underwriters have agreed, subject to certain conditions, to purchase the 2010A Bonds, 2010B Bonds, 2010L Bonds, 2010M Bonds and 2010Z Bonds from the District at Underwriters' discounts of \$183,763, \$47,610, \$1,160,302, \$618,018 and \$227,109, respectively. The Underwriters' obligations are subject to certain conditions precedent, and they will be obligated to purchase all 2010A Bonds, 2010B Bonds, 2010L Bonds, 2010M Bonds and 2010Z Bonds, if any Bonds of such series are purchased. The Bonds may be offered and sold to certain dealers at prices lower than the public offering prices, and the public offering prices may be changed, from time to time, by the Underwriters. The Underwriters may offer and sell the 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.

Citigroup Inc., parent company of Citigroup Global Markets Inc., one of the underwriters of the Bonds, has informed the District that it has entered into a retail brokerage joint venture with Morgan Stanley. As part of the joint venture, Citigroup Global Markets Inc. will distribute municipal securities to retail investors through the financial advisor network of new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, Citigroup Global Markets Inc. will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Bonds.

J.P. Morgan Securities Inc., one of the underwriters of the Bonds, has informed the District that it has entered into an agreement (the "Distribution Agreement") with UBS Financial Services Inc. for the retail distribution of certain municipal securities offerings, including the Bonds, at the original issue prices. Pursuant to the Distribution Agreement, if applicable for this transaction, J.P. Morgan Securities Inc. will share a portion of its underwriting compensation with respect to the Bonds with UBS Financial Services Inc.

CONTINUING DISCLOSURE

In accordance with Section (b)(5) of Securities and Exchange Commission ("SEC") Rule 15c2-12 under the Securities Exchange Act of 1934, as the same may be amended from time to time (the "Rule"), the District has agreed in the Bond Resolution to provide or cause to be provided (including through a transmitting service approved by the SEC) to the Municipal Securities Rulemaking Board (the "MSRB"), in accordance with the Rule, the following historical annual financial information and operating data for the prior fiscal year (commencing in 2010 for the fiscal year ended December 31, 2009):

(1) The audited financial statements of the Priest Rapids Project and Electric System prepared in accordance with generally accepted accounting principles applicable to government entities, with regulations prescribed by the Washington State Auditor pursuant to RCW 43.09.200 (or any successor statute) and substantially in accordance with the system prescribed by the FERC; provided, that if the audited financial statements of the Priest Rapids Project and/or Electric System are not yet available, the District shall provide unaudited financial statements in substantially the same format, and audited financial statements when they become available;

(2) The outstanding long term indebtedness of the Priest Rapids Project and the Electric System;

(3) Participation in the Priest Rapids Project by customer name and percentage share of output and disposition of net energy;

(4) Maximum one-hour production and average production costs, net generation, plant availability factor and annual availability factor for the Priest Rapids Project;

(5) Priest Rapids Project operating results and debt service coverage on the outstanding Priest Rapids Parity Bonds;

(6) Electric System retail customers, energy sales, peak loads and revenues;

(7) Electric System operating results and debt service coverage on the outstanding Electric System parity bonds;

(8) Electric System energy requirements, resources and power costs; and

(9) The aggregate amount and percentage of total energy sold and of retail revenues provided by the Electric System's ten largest customers.

Items 2 through 9, inclusive, shall be required only to the extent that such information is not included in the information provided pursuant to item 1 above.

Such annual information and operating data described above shall be available on or before nine months after the end of the District's fiscal year. The District's current fiscal year ends December 31. The District may adjust such fiscal year by providing written notice of the change of fiscal year to the MSRB. In lieu of providing such annual financial information and operating data, the District may specifically refer to documents available to the public on the Internet Web site of the MSRB or filed with the SEC.

The District further agrees to provide or cause to be provided to the MSRB information with respect to each "Obligated Person" (if any) as follows: (1) To the extent the Obligated Person is a publicly traded company and that such information is at the time on file with the SEC pursuant to the Securities Exchange Act of 1934 (the "Exchange Act") references to such party's most recent annual report, quarterly reports and current reports. (2) To the extent that an Obligated Person is not required to file information with the SEC pursuant to the Exchange Act, the District agrees to provide or cause to be provided to the MSRB 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:

(a) 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;

(b) Such Obligated Person's outstanding long term indebtedness;

(c) Such Obligated Person's retail customers, energy sales, peak loads and revenues;

(d) Such Obligated Person's operating results and debt service coverage on its outstanding indebtedness;

(e) Such Obligated Person's energy requirements, resources and power costs.

Items (b) through (e), inclusive, shall be required only to the extent that such information is not included in the information provided pursuant to item 1 above. "Obligated Person" means any person who, or entity which, 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. There currently are no Obligated Persons.

The District agrees to provide or cause to be provided, in a timely manner, to the MSRB notice of its failure to provide the annual financial information described above on or prior to the date set forth above.

The District further agrees to provide or cause to be provided, in a timely manner, to the MSRB notice of the occurrence of any of the following events with respect to the Bonds, as applicable, if material:

- ◆ Principal and interest payment delinquencies;
- ◆ Nonpayment related defaults;
- ◆ Unscheduled draws on debt service reserves reflecting financial difficulties;
- ◆ Substitution of credit or liquidity providers, or their failure to perform;
- ◆ Unscheduled draws on credit enhancements reflecting financial difficulties;
- ◆ Adverse tax opinions or events affecting the tax-exempt status of the 2010A Bonds and 2010B Bonds;
- ◆ Modifications to the rights of bondowners;
- ◆ Optional redemption prior to their maturity;
- ◆ Defeasances;
- ◆ Rating changes; and
- ◆ Release, substitution or sale of property, if any, securing repayment of the Bonds.

The District's obligations to provide annual financial information and notices of material events shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. Such undertaking, or any provision thereof, shall be null and void if the District (1) obtains an opinion of nationally recognized bond counsel to the effect that those portions of the Rule which require this undertaking, or any such provision, are invalid, have been repealed retroactively or otherwise do not apply to the Bonds; and (2) notifies the MSRB of such opinion and the cancellation of such undertaking.

Notwithstanding any other provision of the Bond Resolution, the District may amend this undertaking and any part of this undertaking may be waived with an approving legal opinion of bond counsel. In the event of any amendment or waiver of a provision of this undertaking, 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 will be given in the same manner as for a material event, and (ii) the annual report for the year in which the change is made should 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.

A Bondowner's or Beneficial Owner's right to enforce the provisions of the District's undertaking described in this section shall be limited to a right to obtain specific enforcement of the District's obligations, and any failure by the District to comply with the provisions of this undertaking shall not be an Event of Default with respect to the Bonds. For purposes of this section, "Beneficial Owner" means any person who has the power, directly or indirectly, to vote

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APPENDIX A

SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION

The following summary is a brief outline of certain provisions of the Bond Resolution and is not to be considered a full statement thereof and is qualified by reference to the complete Bond Resolution. Capitalized words or phrases that are not defined in this summary or conventionally capitalized have the meanings given such words or phrases in the Bond Resolution.

Certain Definitions

“Annual Debt Service” for any Fiscal Year means the sum of the amounts required in such Fiscal Year to pay: (a) the interest due in such Fiscal Year on all Parity Bonds then outstanding, excluding interest to be paid from the proceeds of sale of Parity Bonds; (b) the principal of all outstanding Serial Bonds due in such Fiscal Year; and (c) the Sinking Fund Requirement, if any, for any Term Bonds for such Fiscal Year reduced by certain credits made for Term Bonds.

“Bonds” means the Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series A, Series B, Series L and Series Z, authorized by the Bond Resolution.

“Coverage Requirement” means (a) 1.15 times the Annual Debt Service in a Fiscal Year plus (b) any money required by the Bond Resolution to be deposited into the Reserve Account in the Bond Fund or paid to providers of Qualified Insurance obtained for the Reserve Account, less (c) any amounts transferred into the Bond Fund as surplus money as of the end of the preceding Fiscal Year pursuant to the Bond Resolution.

“Derivative Payment Date” means any date specified in the Derivative Product on which a District Payment is due and payable under the Derivative Product.

“Derivative Product” means a written contract or agreement between the District and a Reciprocal Payor that has (or whose obligations are unconditionally guaranteed by a party that has) as of the date of the Derivative Product at least an investment grade rating from a rating agency, which provides that the District’s obligations thereunder will be conditioned on the performance by the Reciprocal Payor of its obligations under the agreement, and

(a) under which the District is obligated to pay, on one or more scheduled and specified Derivative Payment Dates, the District Payments in exchange for the Reciprocal Payor’s obligation to pay or to cause to be paid to the District, on scheduled and specified Derivative Payment Dates, the Reciprocal Payments;

(b) for which the District’s obligations to make District Payments may be secured by a pledge of and lien on the Net Revenues on an equal and ratable basis with the outstanding Bonds;

(c) under which Reciprocal Payments are to be made directly into the Bond Fund;

(d) for which the District Payments are either specified to be one or more fixed amounts or are determined as provided by the Derivative Product; and

(e) for which the Reciprocal Payments are either specified to be one or more fixed amounts or are determined as set forth in the Derivative Product.

“District Payment” means any regularly scheduled payment (designated as such by resolution) required to be made by or on behalf of the District under a Derivative Product and which is determined according to a formula set forth in the Derivative Product.

“Electric System” means the electric utility and telecommunications properties, rights and assets, real and personal, tangible and intangible, now owned and operated by the District and used or useful in the generation, transmission, distribution and sale of electric energy, telecommunications services, and the business incidental thereto, and all

properties, rights and assets, real and personal, tangible and intangible, hereafter constructed or acquired by the District as additions, betterments, improvements or extensions to said electric utility and telecommunications properties, rights and assets, including, but not limited to, the contract interest of the District in the P.E.C. Headworks Powerplant Project and in the Quincy Chute Project, but shall not include the Priest Rapids Project, or any additions thereto (the "Hydro Systems"), or any other generating, transmission and distribution facilities which heretofore have been or hereafter may be acquired or constructed by the District as a utility system that is declared by the Commission, at the time of financing thereof, to be separate from the Electric System, the revenues of which are pledged to the payment of bonds issued to purchase, construct or otherwise acquire or expand such separate utility system or are otherwise pledged to the payment of the bonds of another such separate utility system of the District. The Electric System does not include any interest of the District in the Power Sales Contracts, but does include the right of the District to receive power and energy from the Priest Rapids Project.

"Fiscal Year" means the fiscal year used by the District at any time. At the time of adoption of the Bond Resolution, the Fiscal Year is the 12 month period beginning January 1 of each year.

"Future Parity Bonds" means any bonds of the District issued in accordance with the Bond Resolution after the date of issuance of the Bonds and that are secured by a lien and charge as described in the Bond Resolution equal to the lien and charge securing the payment of the principal of and interest on the Outstanding Parity Bonds and the Bonds.

"Government Obligations" means those obligations defined in chapter 39.53 RCW, as amended.

"Gross Revenues" means all income, revenues, receipts and profits derived by the District through the ownership and operation of the Priest Rapids Project, together with the proceeds received by the District directly or indirectly from the sale, lease or other disposition of any of the properties, rights or facilities of the Priest Rapids Project, and together with the investment income earned on money held in any fund or account of the District, including any bond redemption funds and the accounts therein and federal credit payments for interest on bonds, in connection with the ownership and operation of the Priest Rapids Project, exclusive of insurance proceeds and income derived from investments irrevocably pledged to the payment of any specific revenue bonds of the District, such as bonds heretofore or hereafter refunded, or any Parity Bonds defeased pursuant to the Bond Resolution or other bonds defeased, or the payment of which is provided for, under any similar provision of any other bond resolutions of the District, and exclusive of investment income earned on money in any arbitrage rebate fund established for any Parity Bonds.

"Net Revenues" means, for any period, the excess of Gross Revenues over Operating Expenses for such period, excluding from the computation of Gross Revenues any profit or loss derived from the sale or other disposition, not in the ordinary course of business, of properties, rights or facilities of the Priest Rapids Project, or resulting from the early extinguishment of debt.

"New Power Sales Contracts" means the contracts entered into in December 2001, between the District and other electric utilities for the sale of power and energy from the Priest Rapids Project, as such contracts may be supplemented and amended from time to time.

"Operating Expenses" means the District's expenses for operation and maintenance of the Priest Rapids Project, and ordinary repairs, renewals of and replacements to the Priest Rapids Project, including payments into working capital reserves in the Revenue Fund for items of Operating Expenses the payment of which is not immediately required, and shall include, without limiting the generality of the foregoing, operation and maintenance expenses; rents; administrative and general expenses; engineering expenses; legal and financial advisory expenses; required payments to pension, retirement, health and hospitalization funds; insurance premiums; and any taxes, assessments, payments in lieu of taxes or other lawful governmental charges, all to the extent properly allocable to the Priest Rapids Project; and the fees and expenses of the Paying Agent and Registrar. Operating Expenses shall not include any costs or expenses for new construction, interest, amortization or any allowance for depreciation.

"Outstanding" when used with respect to Parity Bonds means, as of any date, Parity Bonds theretofore or thereupon issued pursuant to a resolution of the Board except (i) any Parity Bonds canceled by the Registrar or paid at or prior to such date, (ii) Parity Bonds in lieu of or in substitution for which Parity Bonds have been delivered, and (iii) Parity Bonds deemed no longer outstanding under the resolution authorizing their issuance.

“Outstanding Parity Bonds” means the Outstanding Priest Rapids Bonds and the Outstanding Wanapum Bonds.

“Outstanding Priest Rapids Bonds” means the currently Outstanding 2001 Priest Rapids Bonds, 2003 Priest Rapids Bonds, 2005 Priest Rapids Bonds and 2006 Priest Rapids Bonds.

“Outstanding Wanapum Bonds” means the currently Outstanding 1999 Wanapum D Bonds, 2001 Wanapum Bonds, 2003 Wanapum Bonds, 2005 Wanapum Bonds and 2006 Wanapum Bonds.

“Parity Bonds” means the Outstanding Parity Bonds, the Bonds and all Future Parity Bonds.

“Paying Agent” means the designated fiscal agent of the State of Washington or any bank or banks designated a Paying Agent by the District.

“Permitted Investments” means the following to the extent the same are legal for investments of funds of the District: (a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed by, the United States, including obligations of any of the federal agencies set forth in clause (b) below to the extent unconditionally guaranteed by the United States; (b) obligations of the Export-Import Bank of the United States, the Government National Mortgage Association, the Federal National Mortgage Association to the extent guaranteed by the Government National Mortgage Association, the Farmers Home Administration, or any agency or instrumentality of the Federal Government which shall be established for the purposes of acquiring the obligations of any of the foregoing or otherwise providing financing therefor; (c) new housing authority bonds issued by the public agencies or municipalities and fully secured as to the payment of both principal and interest by a pledge of annual contributions under an annual contributions contract or contracts with the United States, or project notes issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States; (d) direct and general obligations of any State within the territorial United States, to the payment of the principal of and interest on which the full faith and credit of such State is pledged, provided, that at the time of their purchase, such obligations are rated in one of the two highest rating categories by either Moody’s Investors Service or Standard & Poor’s Rating Services or their comparably recognized business successors or both Moody’s Investors Service and Standard & Poor’s Rating Services or their comparably recognized business successors if such obligations are rated by both; (e) certificates of deposit, whether negotiable or nonnegotiable, issued by any bank, savings and loan association or trust company provided that such certificates of deposit shall be (i) continuously and fully insured by the Federal Deposit Insurance Corporation, or (ii) issued by a recognized qualified public depository of the State of Washington under chapter 39.58 RCW, as amended, or (iii) continuously and fully secured by such securities as are described above in clauses (a) or (b), which shall have a market value (exclusive of accrued interest) at all times at least equal to the principal amount of such certificates of deposit; (f) any repurchase agreement with any bank or trust company organized under the laws of any State of the United States or any national banking association, which is secured by such securities as described in clauses (a) or (b) above in the possession or custody of the District or its agent and in which the District or its agent has a first perfected security interest free and clear of all rights of third parties, which matures within 270 days and which has a market value determined monthly equal to 100% of the face amount of the repurchase agreement; (g) Refunded Municipals (as defined in the Bond Resolution); and (h) any other investments or investment agreements permitted under the laws of the State of Washington, as amended from time to time.

“Power Sales Contracts” means the New Power Sales Contracts and any other contracts entered into by the District for the sale of power and energy from the Priest Rapids Project, and as such contracts may be amended and supplemented from time to time.

“Project Account” means the account of the District authorized to be created to pay costs of improvements to the Priest Rapids Project financed with proceeds of the Bonds.

“Qualified Insurance” means any municipal bond insurance policy or surety bond issued by any insurance company licensed to conduct an insurance business in any state of the United States (or by a service corporation acting on behalf of one or more such insurance companies), which insurance company or companies, as of the time of issuance of such policy or surety bond, are currently rated in the highest rating category (one of the two highest categories if the conditions set forth in the Bond Resolution are met) by Moody’s Investors Service or Standard &

Poor's or their comparably recognized business successors or both Moody's Investors Service and Standard & Poor's or their comparably recognized business successors if such institution is rated by both.

"Qualified Letter of Credit" means any letter of credit issued by a financial institution for the account of the District on behalf of the owners of a series of the Bonds, which institution maintains an office, agency or branch in the United States and as of the time of issuance of such letter of credit, is currently rated in the highest rating category (one of the two highest categories if the conditions set forth in Bond Resolution are met) by Moody's Investors Service or Standard & Poor's or their comparably recognized business successors or both Moody's Investors Service and Standard & Poor's or their comparably recognized business successors if such institution is rated by both.

"RR&C Fund" means the Priest Rapids Project Repair, Renewal and Contingency Fund created by the Bond Resolution.

"Reciprocal Payment" means any payment (designated as such by a resolution) to be made to, or for the benefit of, the District under a Derivative Product by the Reciprocal Payor.

"Reciprocal Payor" means a party to a Derivative Product that is obligated to make one or more Reciprocal Payments thereunder.

"Registrar" means the registrar and authenticating agent appointed pursuant to the Bond Resolution, its successor or successors and any other entity which may at any time be substituted in its place pursuant to the Bond Resolution.

"Reserve Account Requirement" means (a) with respect to the Bonds and each issue of Outstanding Parity Bonds, the maximum amount of interest due in any Fiscal Year on such Parity Bonds computed as of the date of Closing of such issue, (b) with respect to all Bonds and Outstanding Parity Bonds then Outstanding, the sum of all amounts computed under (a) above and (c) with respect to an issue of Future Parity Bonds, the amount set forth the resolution authorizing such Future Parity Bonds; provided, however, that so long as any 2001 Priest Rapids Bonds or 2001 Wanapum Bonds are insured under a policy issued by Financial Security Assurance Inc. and such insurer is not in default thereunder, or so long as any 2005 Priest Rapids Bonds or 2005 Wanapum Bonds are insured under a policy issued by FGIC and such insurer is not in default thereunder, the Reserve Account Requirement with respect to any Future Parity Bonds secured by the Reserve Account shall be an amount equal to the maximum amount of interest due in any Fiscal Year on such Future Parity Bonds. The resolution authorizing Future Parity Bonds may establish a separate reserve account for any such Future Parity Bonds or provide that some or all of such Future Parity Bonds be secured by a common reserve account. In the case of Variable Interest Rate Bonds, the interest rate thereon shall be calculated on the assumption that such Bonds will bear interest at a rate equal to the rate most recently reported by The Bond Buyer as The Bond Buyer's index for long-term revenue bonds; provided that if on such date of calculation the interest rate on such Parity Bonds shall then be fixed to maturity, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate.

"Serial Bonds" means Parity Bonds other than Term Bonds.

"Sinking Fund Requirement" means, for any Fiscal Year, the principal amount and premium, if any, of Term Bonds required to be purchased, redeemed or paid at maturity for such Fiscal Year as established by the resolution of the District authorizing the issuance of such Term Bonds.

"Term Bonds" means Parity Bonds of any principal maturity that are subject to mandatory redemption or for which mandatory sinking fund payments are required.

"Trustee" means The Bank of New York Mellon Trust Company, N.A., Seattle, Washington, or such other Trustee as shall be appointed by the District.

"2006 Priest Rapids Bonds" means the \$66,610,000 principal amount of Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z authorized by Resolution No. 8056.

“2005 Priest Rapids Bonds” means the \$139,515,000 principal amount of Priest Rapids Hydroelectric Development Revenue Bonds, 2005 Series A, B and Z authorized by Resolution No. 7901.

“2003 Priest Rapids Bonds” means the \$31,290,000 principal amount of Priest Rapids Hydroelectric Development Second Series Revenue Bonds, 2003 Series A and Z authorized by Resolution No. 7603.

“2001 Priest Rapids Bonds” means the \$23,315,000 principal amount of Priest Rapids Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series A, B and C authorized by Resolution No. 7486.

“1999 Priest Rapids Bonds” means the \$28,315,000 principal amount of Priest Rapids Hydroelectric Development Second Series Revenue Refunding Bonds, 1999 Series A, B and C authorized by Resolution No. 7255.

“2006 Wanapum Bonds” means the \$186,430,000 principal amount of Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z, authorized by Resolution No. 8057.

“2005 Wanapum Bonds” means the \$127,780,000 principal amount of Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z, authorized by Resolution No. 7777.

“2003 Wanapum Bonds” means the \$57,280,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Bonds, 2003 Series A, B and Z, authorized by Resolution No. 7604.

“2001 Wanapum Bonds” means the \$17,165,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series B and Series C authorized by Resolution No. 7487.

“1999 Wanapum A, B and C Bonds” means the \$17,837,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 1999 Series A, Series B and Series C authorized by Resolution No. 7254.

“1999 Wanapum D Bonds” means the \$20,000,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 1999 Series D, authorized by Resolution No. 7268 and reoffered pursuant to Resolution No. 7496.

“1998 Wanapum Bonds” means the \$31,620,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 1998 Series A, authorized by Resolution No. 7254.

Revenue Fund

The District shall pay into the Priest Rapids Project Revenue Fund all Gross Revenues, exclusive of earnings on money in the RR&C Fund, Project Fund and the Bond Fund. The District shall pay from the Revenue Fund, after paying or making provision for the payment of Operating Expenses, the Coverage Requirement. On or prior to the 25th day of each month, the Coverage Requirement shall be disbursed as follows:

- (A) The payments into the Bond Fund required by the Bond Resolution.
- (B) The deposits into the Reserve Account or payments to a provider of Qualified Insurance obtained to satisfy the Reserve Account Requirement required by the Bond Resolution.
- (C) An amount equal to .0125 of Annual Debt Service shall be deposited into the RR&C Fund and applied to the purposes set forth in the Bond Resolution.

The amounts in the Revenue Fund shall be used only for the following purposes and in the following order of priority:

- (1) to pay or provide for Operating Expenses;

(2) to make all payments required to be made into the Interest Account and to make any District Payments;

(3) to make all payments required to be made into the Principal and Bond Retirement Account;

(4) to make all payments required to be made into the Reserve Account and to make all payments required to be made pursuant to a reimbursement agreement or agreements (or other equivalent documents) in connection with Qualified Insurance or a Qualified Letter of Credit obtained for the Reserve Account; provided that if there is not sufficient money to make all payments under such reimbursement agreements, the payments will be made on a pro rata basis;

(5) to make all payments required to be made into the RR&C Fund; and

(6) to make all payments required to be made into any special fund or account created to pay or secure the payment of junior lien obligations.

After all of the above payments and credits have been made, amounts remaining in the Revenue Fund may be used for any other lawful purpose of the District relating to the Priest Rapids Project.

Bond Fund

The Priest Rapids Project Bond Fund (the "Bond Fund") shall be held in trust and administered by the District and consists of three accounts: the Interest Account, the Principal and Bond Retirement Account and the Reserve Account. The Bond Fund shall be used to pay the principal of, premium, if any, and interest on the Parity Bonds, and for purchasing such bonds prior to maturity. District Payments shall be made from, and Reciprocal Payments shall be made into, the Interest Account. The Bank of New York Mellon Trust Company, N.A., Seattle, Washington is appointed to act as Trustee and hold the Interest Account and the Principal and Bond Retirement Account. The District may elect to hold the Interest Account and the Principal and Bond Retirement Account in lieu of having the Trustee hold the fund at any time. The District will hold the Reserve Account. The District obligates and binds itself irrevocably to pay into the following accounts in the Bond Fund out of Gross Revenues certain fixed amounts in the following order of priority:

(1) Interest Account: On or prior to each date interest on the Parity Bonds becomes due, the amount, which (together with funds available in such account) shall equal the installment of interest next falling due on all Parity Bonds then Outstanding;

(2) Principal and Bond Retirement Account: On or prior to each date principal or a Sinking Fund Requirement is due, the amount which (together with funds available in such account) shall equal the installment of principal next falling due on all Parity Bonds then Outstanding or the Sinking Fund Requirement next falling due. The Trustee or District, as applicable, shall apply the money in the Principal and Bond Retirement Account to the redemption or purchase of Term Bonds on the next ensuing Sinking Fund Requirement due date; and

(3) Reserve Account: On or before the 25th day of each of the six months next succeeding each date of valuation of the amount in the Reserve Account, 1/6th of the amount necessary to make the valuation of the amount in the Reserve Account equal to the Reserve Account Requirement, if the valuation of the amount in the Reserve Account is less than the Reserve Account Requirement. Such amounts will be withdrawn from the Revenue Fund, the RR&C Fund or the construction funds. The District may obtain Qualified Insurance or a Qualified Letter of Credit for specific amounts required to be paid out of the Reserve Account.

The valuation of the amount in the Reserve Account must be made by the District on each December 31 and after certain withdrawals and may be made on each June 30. If the valuation of the amount in the Reserve Account is greater than the Reserve Account Requirement, then and only then may the District withdraw at any time prior to the next date of valuation from the Reserve Account the difference between the amount of the valuation and the Reserve Account Requirement.

Money in the Bond Fund may, at the option of the District, be invested and reinvested as permitted by law in Permitted Investments maturing, or which are retireable, prior to the final installment of principal of the Parity Bonds.

The Trustee or the District, as applicable, shall make up any deficiency in the Interest Account or the Principal and Bond Retirement Account from the funds available in the Reserve Account. See "SECURITY FOR THE PARITY BONDS—Reserve Account—Reserve Account Surety Bonds."

Project Account

The Bond Resolution creates a Project Account. A portion of the proceeds of the Bonds will be deposited into the Project Account and applied to pay costs of improvements to the Priest Rapids Project and to pay costs of issuance of the Bonds.

Supplemental Repair and Renewal Fund

The 1986 Bond Resolutions created the Priest Rapids Development Supplemental Repair and Renewal Fund and the Wanapum Supplemental Renewal and Contingency Fund. The Bond Resolution combines such funds into the RR&C Fund. The amount in such Fund shall initially be \$12,000,000 (the "Supplemental Fund Cap"). The amount in such Fund shall not exceed the Supplemental Fund Cap as of the last day of any Fiscal Year. The District may increase or decrease the amount of the Supplemental Fund Cap by resolution of the Commission. Earnings on investments in the RR&C Fund shall be transferred to the Revenue Fund to the extent not required to maintain the Supplemental Fund Cap. If money in the RR&C Fund at the end of any Fiscal Year, after making transfers into the Revenue Fund as provided in the preceding sentence, exceeds the Supplemental Fund Cap, such excess shall be transferred to the Bond Fund.

Money in the RR&C Fund must be used to make up any deficiency in the Bond Fund. To the extent not required to make up any deficiency in the Bond Fund, money in the RR&C Fund may be applied to any one or more of the following purposes: (1) to pay the cost of any project of repair, renewal, replacement, extraordinary maintenance, and safety improvement for the Priest Rapids Project; (2) to pay the cost of other improvements to and extensions of the Priest Rapids Project, including planning and design and feasibility studies for such improvements and extensions; and (3) to pay extraordinary operation costs.

Additional Parity Bonds

Future Parity Bonds may be issued for any lawful purpose of the District relating to the Priest Rapids Project, including, but not limited to, acquiring, constructing and installing additions, betterments and improvements to and extensions of, acquiring necessary equipment for, or making necessary renewals, replacements or repairs and capital improvements to the Priest Rapids Project, refunding any outstanding indebtedness, and funding the RR&C Fund. The District must comply with the following conditions before issuing additional Parity Bonds:

(1) At the times of the issuance of such Future Parity Bonds there is no deficiency in the Bond Fund or in any accounts therein.

(2) If such additional Parity Bonds are being issued to pay costs other than refunding Parity Bonds, there shall have been delivered to the District a report of a Professional Utility Consultant to the effect that (a) the plan pursuant to which proceeds of such Parity Bonds are to be expended is consistent with prudent utility practice and will not materially adversely interfere with operation of the Priest Rapids Project, and (b) in the opinion of the Professional Utility Consultant, based upon such assumptions as he believes to be reasonable, such plan will not result in a reduction of the Net Revenues below the amounts covenanted in the rate covenant in the Bond Resolution to be maintained; provided, however, that once the 2001 Priest Rapids and Wanapum Bonds are no longer Outstanding, no such report of a Professional Utility Consultant will be required where contracts with the Electric System (which may include a resolution of the District with respect to such obligation of the Electric System) and/or other purchasers are in effect for a term at least as long as the term of the proposed Future Parity Bonds and require

the Electric System and/or other purchasers to purchase 100% of the power from and to pay 100% of the costs of the Priest Rapids Project, including the cost of maintaining the rate coverage requirements of the Bond Resolution.

(3) The resolution authorizing the issuance of the additional Parity Bonds shall require that there shall be paid into the Reserve Account in the Bond Fund (a) from the proceeds of such Future Parity Bonds an amount such that the amount on deposit in the Reserve Account is equal to the Reserve Account Requirement, or (b) from Gross Revenues (i) in not more than five equal annual installments commencing one year from the date of issuance of such Future Parity Bonds or (ii) on the date of issuance of such Future Parity Bonds, so long as any 2001 Priest Rapids and Wanapum Bonds are insured under a policy issued by FSA and such insurer is not in default thereunder, or so long as any 2005 Priest Rapids and Wanapum Bonds are insured under a policy issued by Financial Guaranty and such insurer is not in default thereunder, an amount such that the amount on deposit in the Reserve Account is equal to the applicable Reserve Account Requirement, or (c) by the deposit of a Qualified Letter of Credit or Qualified Insurance the face amount of which, together with other funds on deposit in the Reserve Account, is equal to the Reserve Account Requirement. Upon the issuance of any Future Parity Bonds, the District shall recalculate the Reserve Account Requirement.

If any Future Parity Bonds are issued for refunding purposes and the issuance of such refunding Parity Bonds results in a present value monetary saving to the District and such refunding Parity Bonds will not require a greater amount (exclusive of issuance costs, any call premiums, and except as necessary to round out maturities to the nearest \$5,000) to be paid in any Fiscal Year thereafter than would have been required to be paid in the same Fiscal Year for Annual Debt Service on the bonds being refunded, then subsection 2 above need not be complied with.

Junior Lien Bonds

The District may issue bonds, notes, warrants or other obligations payable from and secured by a lien and charge junior to the lien and charge of the Parity Bonds.

Derivative Products

To the extent permitted by state law the District may enter into Derivative Products on a parity with the Bonds and any Parity Bonds subject to the conditions set forth in the Bond Resolution and summarized below.

The following shall be conditions precedent to the use of any Derivative Product on a parity with any Bonds under the Bond Resolution:

(1) General Parity Tests. The Derivative Product and the obligations to which it relates must satisfy the requirements for Future Parity Bonds described in the Bond Resolution taking into consideration District Payments and Reciprocal Payments under the Derivative Product. District Payments shall be made from the Bond Account, and Annual Debt Service shall include any regularly scheduled District Payments adjusted by any regularly scheduled Reciprocal Payments. Reciprocal Payments shall be deposited into the Bond Account. Termination payments owed pursuant to a Derivative Product shall not be on a parity with the Parity Bonds.

(2) Opinion of Bond Counsel. The District shall obtain an opinion of bond counsel on the due authorization and execution of such Derivative Product, the validity and enforceability thereof and opining that the action proposed to be taken is authorized or permitted by the Bond Resolution and will not adversely affect the excludability for federal income tax purposes of the interest on any Parity Bonds then Outstanding.

(3) Payments. Each Derivative Product shall set forth the manner in which the District Payments and Reciprocal Payments are to be calculated and a schedule of Derivative Payment Dates.

(4) Supplemental Resolutions to Govern Derivative Products. Prior to entering into a Derivative Product, the District shall adopt a resolution, which shall:

(a) establish general provisions for the rights of providers of Derivative Products or Derivative Facilities; and

(b) set forth such other matters as the District deems necessary or desirable in connection with the management of Derivative Products as are not clearly inconsistent with the provisions of the Bond Resolution.

Covenants

Rate Covenant—General

The District shall establish, maintain and collect rates or charges in connection with the ownership and operation of the Priest Rapids Project that shall be fair and nondiscriminatory and adequate to provide Gross Revenues sufficient for the payment of the principal of and interest on all Outstanding Parity Bonds, all amounts which the District is obligated to set aside in the Bond Fund, the payment of all Operating Expenses of the Priest Rapids Project, and for the payment of any and all amounts that the District may now or hereafter become obligated to pay from said Gross Revenues. See “SECURITY FOR THE PARITY BONDS – Rate Covenants.”

Rate Covenant—Debt Service Coverage

The District shall establish, maintain and collect rates or charges in connection with the ownership and operation of the Priest Rapids Project sufficient to provide Net Revenues in any Fiscal Year hereafter in an amount at least equal to the Coverage Requirement, and any amounts required to pay the principal of and interest on any junior lien obligations, excluding any capitalized interest. See “SECURITY FOR THE PARITY BONDS – Rate Covenants.”

Tax Covenant

The District has covenanted to undertake all actions required to maintain the tax-exempt status of interest on the 2010A Bonds and 2010B Bonds under Section 103 of the Code, including the payment of arbitrage rebate, if necessary, as set forth in the Tax Certificate.

FERC License

The District will use its best efforts to retain the FERC license for the Priest Rapids Project and renew such FERC license when it expires.

Enforcement of Power Sales Contracts

The District has covenanted to enforce its rights and the obligations of power purchasers under the Power Sales Contracts.

Additional Covenants

Obligation of the Electric System

Payments made by the Electric System for the costs of purchased power and energy shall be an operating expense of the Electric System. See “SECURITY FOR THE PARITY BONDS—Obligations of the Electric System” for a description of the Electric System’s obligations.

Maintenance of Developments in Good Condition

The District will maintain, preserve and keep the Priest Rapids Project in good repair, working order and condition, and will make all necessary and proper repairs, renewals, replacements, extensions and betterments thereto so that at all times the business carried on in connection therewith shall be properly and advantageously conducted, and the District will operate such properties and the business in connection therewith in an efficient manner and at reasonable cost.

Disposal of Properties

The District will not sell or otherwise dispose of the Priest Rapids Project in its entirety unless simultaneously with such sale or other disposition, provision is made for the payment into the Bond Fund sufficient to pay the principal of and interest on all Parity Bonds then Outstanding and any premium upon the retirement thereof in full, nor will it sell or otherwise dispose of any part of the useful operating properties of the Priest Rapids Project if such sale or disposition would result in a reduction of Net Revenues below the amounts required in the Bond Resolution.

The District may sell or otherwise dispose of any of the properties of the Priest Rapids Project which shall have become unserviceable, inadequate, obsolete or unfit to be used in the operation of the Priest Rapids Project or no longer necessary, material to or useful in such operation.

Insurance

The District will keep the Priest Rapids Project insured, and will carry such other insurance with responsible insurers against risks, accidents or casualties, at least to the extent that insurance is usually carried by municipal corporations operating like properties; provided the District may, if deemed necessary and advisable by the Commission, institute or continue a self insurance program with respect to such risks. In the event of any loss or damage, the District will promptly deposit the insurance proceeds into any construction funds, and use such funds to repair or replace the damaged portion of the insured property; or in the event the District should determine not to repair or reconstruct such damaged portion, the proceeds of such insurance or self insurance funding shall be transferred to the Reserve Account to the extent necessary to make up any deficiency in the Reserve Account and the balance, if any, shall, at the option of the District, be used for repairs, renewals, replacements, or additions to or extensions of the Priest Rapids Project or be used in the retirement of Parity Bonds prior to maturity, either by purchase or by call for redemption.

Books of Account

The District shall keep proper books of account, showing as a separate utility system the accounts of the Priest Rapids Project, in accordance with the rules prescribed by the Division of Municipal Corporations of the Washington State Auditor's office, or other State agency succeeding to such duties, and if no such rules are prescribed, then in substantial accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission or other federal agency having jurisdiction. The District shall cause its books of account to be audited annually by the State Auditor's office or other State agency authorized by law to make such audits, or if such an audit shall not be made for 12 months after the close of any Fiscal Year, by independent certified public accountants. Any owner of any Bond may obtain at the office of the District copies of the balance sheet and statement of income and retained earnings showing in reasonable detail the financial condition of the Priest Rapids Project as of the close of each Fiscal Year, and the income and expenses of such year, including the amounts paid into the funds created pursuant to the Bond Resolution, and the amounts expended for maintenance, renewals, replacements, and gross capital additions to the Priest Rapids Project.

Make Only Economically Sound Improvements

The District will not expend any revenues from the Priest Rapids Project or proceeds of Parity Bonds or other obligations for any extensions, betterments and improvements to the Priest Rapids Project which will not properly and advantageously contribute to the business of the Priest Rapids Project.

Merger or Consolidation

The District shall use its best efforts to avoid dissolution, termination of its existence or consolidation with another entity, without paying or providing for the payment of all Parity Bonds then Outstanding.

Rebates To Purchasers

If required by contract with the purchasers of power and energy from the Priest Rapids Project, the District may rebate money on hand in any fund, except the Bond Fund, relating to the Priest Rapids Project to such purchasers. Such a rebate may be paid to the Electric System on the same basis as to the other purchasers.

Events Of Default, Bondowners' Trustee, Remedies

Events of Default

The following constitute "Events of Default" under the Bond Resolution:

- (1) Default in the due and punctual payment of the principal of any of the Parity Bonds when the same shall become due, either at maturity or following notice of redemption;
- (2) Default in the due and punctual payment of interest on any Parity Bond when the same shall become due and payable;
- (3) Failure to purchase or redeem Term Bonds in an aggregate principal amount at least equal to the Sinking Fund Requirement for the applicable Fiscal Year;
- (4) Defaults in the performance of any other of the covenants, conditions and agreements in the Bond Resolution and such default continues for 90 days after the District receives from the Trustee or from the owners of not less than 66% in principal amount of any series of Parity Bonds then Outstanding, a written notice demanding the cure of such default; or
- (5) If the District: (a) admits in writing its inability to pay its debts generally as they become due; (b) files a petition in bankruptcy or seeking a composition of indebtedness under any state or federal law; (c) makes an assignment for the benefit of its creditors; (d) consents to the appointment of a receiver of the whole or any substantial part of the Priest Rapids Project; or (e) consents to the assumption by any court of competent jurisdiction under any other law for the relief or aid of debtors of custody or control of the District or of the whole or any substantial part of the Priest Rapids Project.

Bondowners' Trustee

If an Event of Default has occurred, is continuing, and has not been remedied, the owners of 25% in principal amount of Parity Bonds then outstanding, may appoint a bondowners' trustee (the "Bondowners' Trustee") by an instrument or concurrent instruments in writing signed and acknowledged by such registered owners of the Parity Bonds duly authorized and delivered to such Bondowners' Trustee, notification thereof being given to the District. Any Bondowners' Trustee so appointed must be a bank or trust company organized under the laws of the State of New York or a national banking association. That appointment shall become effective immediately upon acceptance thereof by the Bondowners' Trustee. The bank or trust company acting as Bondowners' Trustee may be removed at any time, and a successor Bondowners' Trustee may be appointed, by the registered owners of a majority in principal amount of Parity Bonds then Outstanding.

The Bondowners' Trustee may require such security and indemnity as may be reasonable against the costs, expenses and liabilities that may be incurred in the performance of its duties. The Bondowners' Trustee appointed in the manner provided in the Bond Resolution, and each successor thereto, will be a trustee for the owners of all Parity Bonds outstanding and is empowered to exercise all the rights and powers conferred on the Bondowners' Trustee. The Bondowners' Trustee may resign upon 60 days' notice and a new Bondowners' Trustee appointed by the owners of at least 25% in principal amount of Parity Bonds then Outstanding; provided, however, that no such resignation or removal can be effective until the successor Bondowners' Trustee has been appointed.

Any money collected by the Bondowners' Trustee at any time shall be applied in the following order of priority:

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

Second, to the payment to the persons entitled thereto, first of required interest and then, of unpaid principal amounts on any Parity Bonds which shall have become due (other than Parity Bonds previously called for redemption for the payment of which money is held pursuant to the provisions of the Bond Resolution), whether at maturity or by proceedings for redemption or otherwise, in the order of their due dates and, if the amount available shall not be sufficient to pay in full the principal amounts due on the same date, then to the payment thereof ratably, according to the principal amounts due thereon to the persons entitled thereto, without any discrimination or preference.

Neither the registered owner nor the beneficial owner of any one or more of Parity Bonds shall have any right to institute any action, suit or proceeding at law or in equity for the enforcement of same unless: (i) an Event of Default has happened and is continuing; and (ii) a Bondowners' Trustee has been appointed; and (iii) such owner previously shall 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 (iv) the owners of 25% in principal amount of the Parity Bonds outstanding, after the occurrence of such Event of Default, has made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; and (v) 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 (vi) the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time.

No registered owner or beneficial owner of any Parity Bond shall have any right in any manner whatever by his action to affect or impair the obligation of the District to pay from the Net Revenue the principal of and interest on such Parity Bonds to the respective owners thereof when due.

Amendments

Without the consent of the owners of Parity Bonds, the District may adopt supplemental resolutions to add to the covenants of the District contained in, or to surrender any right reserved to or conferred upon it by, the Bond Resolution, or to cure any ambiguity or correct any defect in the Bond Resolution or to change or add any provision to the Bond Resolution which will not materially adversely affect the bondowners in the opinion of nationally recognized bond counsel.

Any amendments or supplements to the Bond Resolution may be made by the District with the consent of 66% in aggregate principal amount of the Parity Bonds then outstanding; provided that without the consent of the owner of each Parity Bond that would be affected, no supplemental resolution shall (1) change the fixed maturity date for the payment of the principal of any Parity Bond or the date for the payment of interest thereon or the terms of the redemption thereof, or reduce the principal amount of any Parity Bond or the rate of interest thereon or the redemption price (or the redemption premium) payable upon the redemption or prepayment thereof; (2) reduce the aforesaid percentage of Parity Bonds the owners of which are required to consent to any supplemental resolution; (3) give to any Parity Bond any preference over any other Parity Bond; (4) create any pledge of the Gross Revenues and other money pledged superior or equal to the pledge of and lien and charge for the payment of the Parity Bonds; or (5) deprive any owner of the Bonds of the security afforded by the Bond Resolution.

After the owners of the required percentage of Parity Bonds have filed their consents to an amending or supplementing resolution, the District may thereafter adopt such amending or supplementing resolution. Notice of any such amendment or supplement must be given to each registered owner of Parity Bonds then Outstanding. Any action or proceeding to set aside or invalidate any such amending or supplementing resolution or any of the proceedings for its adoption must be commenced within 60 days after the mailing of such notice.

Rights of Insurers

For all purposes of governing events of default and remedies, except the giving of notice of default to registered owners of the Outstanding Parity Bonds, the insurer of Parity Bonds shall be deemed to be the sole holder of the bonds it has insured for so long as it has not failed to comply with its payment obligations under the policy. Any amendment or supplement to the Bond Resolution shall be subject to the prior written consent of certain Insurers.

APPENDIX B

SUMMARY OF CERTAIN PROVISIONS OF THE POWER CONTRACTS

In 2001, the District executed power sales contracts with all of the purchasers of power under the Priest Rapids and Wanapum Development power sales contracts as well as with ten Idaho cooperatives, and a few additional amendments have since been made (as amended, the “New Power Sales Contracts”). The New Power Sales Contracts went into effect on November 1, 2005, with respect to power from the Priest Rapids Development, and on November 1, 2009, with respect to power from the Wanapum Development.

The New Power Sales Contracts consist of a series of agreements signed with each of the Power Purchasers. The term of the New Power Sales Contracts is for the term of the new license received by the District for the Priest Rapids and Wanapum Developments (44 years).

Summaries of certain provisions of the New Power Sales Contracts are set forth below. Reference is made to the complete text of the New Power Sales Contracts for all of the provisions thereof. The major provisions of each of the New Power Sales Contracts are substantially similar except as to the percentages of Project Output to be taken by each of the Power Purchasers.

Term: Effective November 1, 2005 for the Priest Rapids Development and November 1, 2009 for the Wanapum Development, the District has available for its own use and for sale to others 100% of the output of the Priest Rapids Development and Wanapum Development. Each Power Purchaser has the right of first refusal to purchase its proportionate part of the Priest Rapids Project output which is in excess of the actual and prospective needs of the District at that time for service to ultimate consumers within the service area of the District.

Priest Rapids Project Output is defined as the amount of power and energy produced by, or received for the account of, the Priest Rapids Project during the term of the New Power Sales Contracts under the operating conditions which exist during said term, including periods when the Priest Rapids Project may be inoperable, after corrections for encroachment, station and Priest Rapids Project use, and depletions required by the FERC License.

Product Agreements (as amended). The Product Agreements address the 70% of output from the Priest Rapids Project that is not reserved by the FERC for sale to power customers in the region, as required by PL-544. Of that 70% of output from the Priest Rapids Project, each of the Power Purchasers receives, at cost, its participating share of the output (firm and non-firm) that remains after the District has satisfied its requirements. As the District’s requirements increase, the amount of power available to the Power Purchasers under the Product Agreements will decrease. The District will provide the Power Purchasers with an annual forecast of its requirements. If the District eventually requires 62% of the output from the Developments, the Power Purchasers will receive only the 8% slice resulting from elimination of the “Additional Product Sales Contract” under the Product Agreements

Reasonable Portion Agreements. The Reasonable Portion Agreements address the 30% of output from the Developments (the “reasonable portion”) that is reserved by the FERC for sale to other power customers in the region, as required by PL-544. The FERC order requires that this power be sold at market prices, and the Reasonable Portion Agreements provide that such sales will be made pursuant to a marketing plan approved by the Power Purchasers. The net revenue from sales of this “reasonable portion” of the output from the Priest Rapids Project will be distributed to the Power Purchasers in proportion to their participating shares under the Product Agreements. Once the District has taken the maximum amount of power allowed under the Product Agreements, it has rights to net revenues under the Reasonable Portion Agreements to provide for its firm energy requirements beyond that provided from the 62% allocation.

Continuity of Payments for Projects and Payments by Power Purchasers. Monthly payments for Priest Rapids Project Output shall be made by the Power Purchasers (and by the District through its Electric System) to the extent the Priest Rapids Project produces or is capable of producing power and energy in a Fiscal Year during the term of the New Power Sales Contracts sufficient in aggregate amount to pay all costs of the District resulting from the ownership, operation, maintenance of and improvements to the Priest Rapids Project, including 115% of debt service on Parity Bonds whether or not the Priest Rapids Project is operable; provided, however, that the amounts

required to be paid with respect to the Parity Bonds shall include only the amounts required to be paid during the term of the Power Contracts in accordance with the amortization of the Parity Bonds. See “SECURITY FOR THE PARITY BONDS—Obligations of the Electric System.”

The Power Purchasers agree to pay the District their respective percentage shares of all of the District’s costs related to the Priest Rapids Project, including, but not limited to:

(1) All costs of producing and delivering power and energy (excluding depreciation) that are properly chargeable to the Priest Rapids Project in accordance with the Uniform System of Accounts, less any credits against such costs by reason of net revenues from other sources than the direct sale of power, and also less any credits for interest charged during construction, all as provided for in the Uniform System of Accounts;

(2) Amounts required to pay for the prevention or correction of any loss or damage and for major replacements to keep the Priest Rapids Project in good operating condition to the extent that such costs are not covered by insurance and by the RR&C Fund;

(3) Amounts needed to pay debt service on bonds or other obligations financing improvements to the Priest Rapids Project, plus an additional 15% of the amount of debt service for Parity Bonds;

(4) Costs of creating and replenishing any reserve or contingency fund required to be maintained by any bond resolutions and working capital funds;

(5) Liabilities, including settlements and judgments, resulting from ownership, operation or maintenance of the Priest Rapids Project and not covered by insurance;

(6) Costs incurred by the District in applying for a new FERC license for the Priest Rapids Project (most of which costs will be amortized over a 15-year period);

(7) Obligations entered into by the District in obtaining a new FERC license for the Priest Rapids Project, including but not limited to the cost of replacing products that may be committed in such obligations;

(8) Certain costs incurred by the District to fulfill obligations, if any, to parties to the 1959 Power Sales Contracts that do not sign a New Power Sales Contract; and

(9) An amount equal to 15% of debt service in that contract year or such higher amount as may be required by a bond resolution to satisfy the Coverage Requirement.

In addition to the credits described in (1) and (2) above, Power Purchasers will receive credits for the following:

(A) Revenue, if any, received from obligations entered into by the District as part of its relicensing efforts;

(B) Revenue, if any, received as a result of the District’s fulfilling obligation to parties to the 1959 Power Sales Contracts that do not sign a New Power Sales Contract;

(C) The 15% Coverage Requirement amount, to the extent that it is not spent for capital or other costs of the Developments; and

(D) Interest earnings on funds of the Priest Rapids Project that are not required to be retained by such funds pursuant to any of the bond resolutions.

Debt. Regardless of how the District structures debt to pay costs of improvements to the Priest Rapids Project, the Power Purchasers will pay their share of such debt as if it were structured with level debt service amortized over a period equal to the estimated weighted average economic service life of the improvements financed or refinanced by such debt; provided that the amortization period shall not exceed 30 years.

Billing. At least 30 days before each contract year beginning in 2005, the District must give each Power Purchaser a pro forma statement showing estimated annual power costs, estimated cost to the District of selling the Displacement Product, risk premium allocable to the Power Purchaser, the Power Purchaser's estimated cost, and monthly payments for the following contract year. A final accounting shall be rendered to the Power Purchasers by the District by June 1 of each year, and any charge or credit adjustment required shall be made promptly by the District and the Power Purchasers.

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APPENDIX C

**CONSOLIDATED AUDITED FINANCIAL STATEMENTS OF THE DISTRICT
AS OF DECEMBER 31, 2008 AND 2007**

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Public Utility District No. 2 of
Grant County, Washington
Consolidated Financial Statements
December 31, 2008 and 2007



Public Utility District No. 2 of Grant County

Report of Independent Auditors

To the Board of Commissioners of
Public Utility District No. 2 of
Grant County, Washington

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of revenues and expenses and changes in net assets and of cash flows of the Public Utility District No. 2 of Grant County, Washington (the "District"), present fairly, in all material respects, the consolidated financial position of the District at December 31, 2008 and 2007, and its consolidated changes in financial position and its consolidated 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 audit. We conducted our audit of these financial 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, 2008 on pages 2 through 9 is not a required part of the financial statements as of and for the year then ended but is 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 purposes of forming an opinion on the financial statements taken as a whole. The Schedules of Changes in Working Capital, and Schedules of Power Costs and Allocation to Power Purchasers, as well as Note 13: Supplemental Disclosure of Telecommunication Activities, are presented for the purpose of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

PricewaterhouseCoopers LLP

April 24, 2009

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

Public Utility District No. 2 of Grant County, Washington (the "District") comprises three operating systems: the Electric System, the Columbia River-Priest Rapids Hydroelectric Production System ("Priest Rapids") and the Wanapum Development ("Wanapum"). Priest Rapids and Wanapum (collectively, the "Priest Rapids Project") are operated under Federal Energy Regulatory Commission ("FERC") License, Project No. 2114.

Presented below is a discussion and analysis of the financial activities for the years ended December 31, 2008, 2007 and 2006. Please read it in conjunction with the financial statements, which follow this section.

OVERVIEW OF DISTRICT'S FINANCIAL STATEMENTS

This annual financial report consists of a series of financial statements and reflects the self-supporting, proprietary activities of the District funded primarily by the sale of electrical power and energy and wholesale telecommunication services. The District reports the business-type activities in a manner similar to private business enterprises. The District's financial statements presented in this report consist of the Consolidated Balance Sheets, Consolidated Statements of Revenues and Expenses and Changes in Net Assets, Consolidated Statements of Cash Flows and the Notes to the Consolidated Financial Statements.

The Consolidated Balance Sheets includes all of the District's assets and liabilities and net assets, and provides information about the nature and amounts of investments in assets and the obligations of the District.

All of the revenues and expenses of the District are accounted for in the Consolidated Statements of Revenues and Expenses and Changes in Net Assets. These statements measure the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all of its costs through rates and other charges.

The primary purpose of the Consolidated Statements of Cash Flows is to provide information about the District's cash receipts and cash disbursements during the year. These statements report cash receipts, cash payments and net changes in cash resulting from operations, investing and financing activities.

The Notes to the Consolidated Financial Statements provide additional information that is essential for a full understanding of the information provided in the three statements described above.

FINANCIAL HIGHLIGHTS

On April 17, 2008, the Federal Energy Regulatory Commission issued the District a New 44-year License to operate the Priest Rapids Project effective April 1, 2008. Issuance of the new license represents both the culmination of over a decade of work to obtain that authorization, and the beginning of several decades of significant new license implementation activities. The original license to operate the Priest Rapids Project expired October 31, 2005 with annual licenses in effect until the new license was issued.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

The District has constructed a new fish passage facility through the center slot of future Unit 11 at Wanapum Dam. This fish bypass facility was designed to improve downstream passage of migrating smolts and improve water quality by reducing the amount of spill, total dissolved gas entrainment, fish injury and erosion at the Wanapum Dam. Construction began in 2005 and was completed in April, 2008. The District began operating the bypass in late April 2008. The bypass will be operated from April through August annually.

The financial stability of the Electric System has allowed it to revenue finance capital improvements. With the large industrial loads such as Microsoft and Yahoo! entering the service area and REC Solar Grade Silicon's expansion, the Electric System is required to add transmission and distribution infrastructure. As a result of the large capital projects underway, the Contributions in Aid of Construction have been over \$9 million for each year from 2006 to 2008. With industrial and commercial growth has also come residential growth, adding to the build out of the Electric System. Management and the Commission are evaluating the continued expansion of the electric distribution system and the foreseeable increase in power costs from the Priest Rapids Project and the effects they may have on rates and exploring the possible merits of bond financing capital improvements in the Electric System.

During 2007, the District reached an historic agreement with the Yakama Nation regarding various issues. Among them, the Yakama Nation agreed to drop pending legal claims against the District, grant the District the right of first refusal to participate in the development of new generation resources, and to represent itself on committees, subcommittees and groups associated with implementation of the various agreements associated with the Priest Rapids Project and the new license requirements. The Yakama Nation in turn will receive direct benefit from the Priest Rapids Project and pay the associated power costs. See Note 8.

The District has installed a fiber optic distribution system (the "Fiber Optic Network") in its service area for use by the Electric System. This fiber optic distribution system is connected to the Northwest Open Access Network ("NoaNet"), a fiber optic communication system. The District has made excess capacity on this system available to providers of high speed internet services and telephone services, among others. The Commission approved up to \$10 million per year to continue the system built out from 2007 - 2011.

In December of 2001, the District signed the Priest Rapids Power Sales Contracts with the original power purchasers and 10 purchasers in Idaho for the purchase and sale of output from Priest Rapids (after October 31, 2005) and output from Wanapum (after October 31, 2009). The Priest Rapids Power Sales Contracts consist of contracts with terms that will extend throughout the New License term. The contract provisions relating to Priest Rapids took effect on November 1, 2005 and those relating to Wanapum will take effect on November 1, 2009. In accordance with the Federal Energy Regulatory Commission ("FERC") Order in the Public Law 83-544 proceeding, the District will dedicate 30% of the combined output of the Priest Rapids Project for sales based on market principles. The power purchasers will be entitled to receive the net revenues from the sale of the 30% portion to the extent the District does not need the revenues to purchase power to meet the Electric System's firm loads.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

The Priest Rapids Power Sales Contracts provide that each power purchaser will be obligated to make payments equal to annual power costs, which include all operating expenses and debt service on the Parity Bonds and debt service coverage less any interest earnings, for the life of the new contracts, multiplied by the percentage of output or revenue, as applicable, that the purchaser is entitled to that year. Since November 1, 2005, the start of the term of the new power sales contracts, the District has been able to meet all of its firm load requirements with Priest Rapids and Wanapum generation and other benefits derived from the hydro facilities.

The District is in the process of a long-term turbine upgrade project at Wanapum Dam. In August 2008, the installation of the fourth advanced turbine was complete and began generating power. The fifth turbine replacement is underway and is scheduled to begin generating in July, 2009. The District anticipates replacing the remaining units at a rate of one every nine months, until all ten have been replaced, with projected scheduled for completion in May 2013. As of December 31, 2008, the cost of the remaining turbines to be replaced is estimated at \$80 million.

In 2008 the District determined the final scope and design of a long term capital improvement project for the Wanapum facilities. A contract was awarded January 5, 2009, to Alstom Hydro US, Inc. for approximately \$150 million to upgrade all ten generators at Wanapum Dam. The on-site construction is scheduled for May 2010 through January 2018. The turbine and generator schedules will match up on the seventh turbine. The existing generators are currently rated at 109.25 megavolt-amperes ("MVA"). The new generators will have a name plate rating of 128.6 MVA, an increase of 17.7%. Since the contracts were not binding until executed in January 2009, these contractual commitments are not included in the District's summary of commitments in Note 9.

Priest Rapids consists of a dam and hydroelectric generating station having a nameplate rating of 955,600 kilowatts ("KW"). Priest Rapids is located on the Columbia River in Grant and Yakima Counties about 150 air miles northeast of the City of Portland, 130 air miles southeast of the City of Seattle and 18 miles downstream of Wanapum.

During the year ended December 31, 2008, Priest Rapids provided 4,332,185 megawatt hours ("MWh") of electric energy at an average cost of \$12.50 per MWh. During the year ended December 31, 2007, Priest Rapids provided 4,677,541 MWh of electric energy at an average cost of \$9.99 per MWh. During the year ended December 31, 2006, Priest Rapids provided 4,548,031 MWh of electric energy at an average cost of \$8.84 per MWh.

Wanapum consists of a dam and hydroelectric generating station having a nameplate rating of 1,038,000 KW. Wanapum is located on the Columbia River in Grant and Kittitas Counties about 160 air miles northeast of the City of Portland, 129 air miles southeast of the City of Seattle and 18 miles upstream of Priest Rapids.

During the year ended December 31, 2008, Wanapum provided 4,050,691 MWh of electric energy at an average cost of \$16.21 per MWh. During the year ended December 31, 2007, Wanapum provided 4,573,711 MWh of electric energy at an average cost of \$11.95 per MWh. During the year ended December 31, 2006, Wanapum provided 4,411,859 MWh of electric energy at an average cost of \$9.68 per MWh.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

The increases in average cost per MWh in 2008 from 2007 at both Priest Rapids and Wanapum were attributable to lower generation output and an increase in operating costs in compliance with the new license.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

CONDENSED COMPARATIVE FINANCIAL INFORMATION

Balance Sheet	2008	2007	2006
Assets			
Current	\$ 471,409,148	\$ 473,565,189	\$ 415,073,492
Net utility plant	1,115,614,217	945,085,788	867,815,210
Noncurrent	23,429,478	83,652,072	191,332,911
Total assets	\$ 1,610,452,843	\$ 1,502,303,049	\$ 1,474,221,613
Liabilities			
Current	\$ 135,780,938	\$ 120,385,373	\$ 165,768,461
Noncurrent	833,288,908	821,371,899	849,546,618
Total liabilities	969,069,846	941,757,272	1,015,315,079
Net assets			
Invested in capital assets, net of related debt	399,831,412	344,510,152	248,523,636
Restricted	31,600,096	29,720,193	17,090,000
Unrestricted	209,951,489	186,315,432	193,292,898
Total net assets	641,382,997	560,545,777	458,906,534
Total liabilities and net assets	\$ 1,610,452,843	\$ 1,502,303,049	\$ 1,474,221,613
Revenues and Expenses and Changes in Net Assets			
Operating revenues	\$ 286,425,672	\$ 271,736,581	\$ 259,268,939
Operating expenses	187,095,925	162,937,302	187,583,840
Net operating income	99,329,747	108,799,279	71,685,099
Other revenues (expenses)	(27,339,585)	(21,283,520)	(22,358,907)
Contribution in aid of construction	9,103,456	10,287,593	10,700,539
Net extraordinary (loss) gain	(256,398)	3,835,891	(4,658,198)
Change in net assets	\$ 80,837,220	\$ 101,639,243	\$ 55,368,533

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS

DECEMBER 31, 2008 AND 2007

FINANCIAL ANALYSIS

The following discussion provides comparative financial information for the years ended December 31, 2008, 2007, and 2006.

ASSETS

Current Assets remained virtually unchanged from 2007 to 2008. This reflects the stable environment the District has operated in over the past years. The District has enjoyed good water volume to generate at the Priest Rapids Project and steady increase in loads in the Electric System. Current Assets had an increase of \$58 million from 2006 to 2007 in large part because of significant increase in net assets of over \$101 million and the subsequent capital produced.

Net Utility Plant has increased by over \$170 million from 2007 to 2008. The new license to operate the Priest Rapids Project was a major contributor to this large increase. A \$42 million liability and offsetting asset were booked effective April 1, 2008, related to commitments and obligations the District has incurred to comply with specific license requirements over the next 44 years. With the new license in hand, the District also transferred over \$60 million in relicensing costs that have accumulated in Noncurrent Assets to Net Utility Plant. These costs will be amortized over the life of the new license. The remaining increase of over \$68 million from 2007 to 2008 is similar to the increase of \$77 million from 2006 to 2007. From 2006 to 2008, significant expenditures were incurred to replace turbines and to install a fish bypass at Wanapum Dam as well as capital improvements to the Electric System and Priest Rapids Dam.

The decrease in other Noncurrent Assets from 2007 to 2008 is due in large part to the \$60 million transfer of relicensing costs to Net Utility Plant mentioned above. During 2008, the District also received a settlement of \$11.5 million from the California Independent System Operator Corporation (ISO) on a dispute dating back to 2001. Noncurrent Assets decreased by approximately \$108 million from 2006 to 2007 in large part due to a bond call. In November 2006, the District's Commissioners approved the call of the Electric System term bond, due January 1, 2022, for \$57,305,000. The bond call occurred January 2, 2007. The remaining decrease is due in large part to the construction of capital assets mentioned above.

LIABILITIES

The District has not issued debt since December of 2006. With the \$57 million bond call mentioned above and the retirement of debt over the normal course of debt service offset by the recognition of \$44 million in relicensing obligations associated with the new license issued in 2008, the liability position of the District has moved down \$75 million from 2006 to 2007 and back up \$29 million from 2007 to 2008.

The upheaval in the financial markets that has dominated financial headlines over the past year has to date had little effect on the District. While the District has over \$818 million in bonded debt, all of that debt is at fixed rates. In December of 2008, the Electric System's bonds received an upgrade from Standard & Poor's to 'AA-/stable' from 'A+'. At the same time, Standard & Poor's also

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

affirmed the 'AA-/Stable' rating for the Priest Rapids and Wanapum bonds. Cited as rational for the upgrade were the Electric System's strengthened financial performance, including very strong coverage of both debt service and fixed charges, and very strong liquidity. The debt service coverage for the Electric System was 5.80x, 3.81x, and 6.51x for 2008, 2007, and 2006, respectively. The debt service coverage for Priest Rapid and Wanapum is at a constant 1.15x per the power sales contracts.

NET ASSETS

Net Assets increased approximately \$81 million and \$102 million in 2008 and 2007, respectively. Both years are reflective of good river flows for generation, a strong market price for surplus generation, and a growing load in the Electric System.

STATEMENT OF REVENUES AND EXPENSES

The revenues of Priest Rapids and Wanapum are directly tied to their respective power costs (operating expenses – noncash items + debt service – interest earnings). Additional expenses related to compliance with the new license and other fish and operational costs have added to the revenues required to cover the cost of production.

The Electric System's revenues, on the other hand, are reflective of the individual ebbs and flows of the economy through power consumption and market forces on wholesale power prices. The retail power sales for 2008 reflected a modest increase in all categories with the commercial and industrial category showing the largest increase of 14%. Operating Revenues from 2006 to 2007 increased by \$6 million in Sales to Power Purchasers at Cost and \$5 million in Sales to Other Utilities. This increase in commercial and industrial consumption was anticipated. Over the past few years, large server farms from Yahoo! and Microsoft have been ramping up their operations in Grant County. Other industrial loads are increasing significantly such as REC Solar Grade Silicon which is making a major expansion to their operations. Sales to Other Utilities in 2008 were down only 3% from 2007 reflective of less surplus generation available for resale due to the increased load. It is important to note that the District has not had a rate increase since 2003. The Commission is in the process of assessing the adequacy of rates.

The increase in Operating Expenses from 2007 to 2008 was attributable to the increase in purchased power expense for the Electric System of over \$18 million due to the load growth mentioned above as well as a \$9 million increase in generation expense at Priest Rapids and Wanapum and the \$4 million increase in the net payments to the Yakama Nation in accordance to the agreement reached in 2007. Operating Expenses decreased from 2006 to 2007 largely because of the decrease in purchased power expense of \$13 million due in large part to the new power sales contracts and a decrease in impaired capital assets expense for the \$12 million write down of the liquidated diesel generators in 2006.

The decrease in Other Revenues (Expenses) from 2007 to 2008 is largely due to the collapse in 2008 of interest rates on reserve funds.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2008 AND 2007

The Extraordinary Loss in 2006 related to two events at Wanapum Dam; a tainter gate malfunction and a fire in its powerhouse. The Extraordinary Gain recognized in 2007 represented insurance recoveries from both events.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This report is designed to provide the District's ratepayers, bondholders, creditors and other interested parties with a general overview of the District's finances. If you have questions about this report or need additional information, contact the District's Treasurer/Controller at the Public Utility District No. 2 of Grant County, P.O. Box 878, Ephrata, Washington, 98823.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2008 AND 2007

ASSETS	2008	2007
CURRENT ASSETS		
Cash	\$ 10,184,998	\$ 6,508,098
Restricted cash and investments - Habitat funds	6,154,082	3,854,649
Bond principal and interest funds - restricted		
Cash	5,229,111	4,890,460
Investments and other	47,088,034	46,716,735
Short-term U.S. government and agency securities and investments	94,241,710	101,483,282
Customer accounts receivable, net of allowance for uncollectible accounts \$353,193 and \$665,326	29,344,587	23,648,959
Materials and supplies	18,195,780	18,650,515
Due from power purchasers	-	1,762,803
Other current assets	3,051,545	6,807,300
Special funds		
Cash in special funds	5,996,340	6,703,040
Noncash special funds	251,922,961	252,539,348
	<hr/>	<hr/>
Total current assets	471,409,148	473,565,189
	<hr/>	<hr/>
NONCURRENT ASSETS		
Long-term noncash special funds	7,912,406	-
Relicensing costs	-	58,059,925
Unamortized debt expense	7,268,746	8,163,266
Conservation loans	421,072	595,035
Long-term receivables, net of allowance for uncollectible accounts	644,180	10,401,194
Demand-side management	6,615,592	6,409,124
Deferred preliminary expenses	567,482	23,528
	<hr/>	<hr/>
Total other noncurrent assets	23,429,478	83,652,072
	<hr/>	<hr/>
Utility plant, net of accumulated depreciation and amortization	1,115,614,217	945,085,788
	<hr/>	<hr/>
Total noncurrent assets	1,139,043,695	1,028,737,860
	<hr/>	<hr/>
TOTAL ASSETS	\$ 1,610,452,843	\$ 1,502,303,049
	<hr/> <hr/>	<hr/> <hr/>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2008 AND 2007

LIABILITIES AND NET ASSETS	2008	2007
CURRENT LIABILITIES		
Accounts payable		
Trade	\$ 53,260,172	\$ 40,327,643
Wages payable	11,124,249	11,904,990
Power purchasers	1,899,514	1,368,492
Accrued taxes	4,843,464	4,734,951
Customer deposits	3,406,247	3,557,697
Accrued bond interest	20,580,787	21,232,806
Unearned revenue	289,636	3,769,923
Habitat PRCC liability	6,087,681	3,768,678
Other current liabilities	35,096	55,193
Current portion of long-term obligations	2,689,092	-
Current portion of long-term debt	31,565,000	29,665,000
	<u>135,780,938</u>	<u>120,385,373</u>
Total current liabilities		
	<u>135,780,938</u>	<u>120,385,373</u>
NONCURRENT LIABILITIES		
Accrued other postemployment benefits	340,672	199,322
Federal arbitrage tax liability	730,914	757,320
Long-term unearned revenue	1,821,440	-
Licensing obligations, less current portion	41,430,904	-
Revenue bonds, less current portion	786,830,000	818,395,000
Unamortized premium	14,046,554	15,793,243
Unamortized discount	(903,281)	(986,574)
Unamortized refunding loss	(11,008,295)	(12,786,412)
	<u>833,288,908</u>	<u>821,371,899</u>
Total noncurrent liabilities		
	<u>833,288,908</u>	<u>821,371,899</u>
Total liabilities	<u>969,069,846</u>	<u>941,757,272</u>
	<u>969,069,846</u>	<u>941,757,272</u>
COMMITMENTS AND CONTINGENCIES (NOTES 8, 9, 10, 11, 12 and 13)		
NET ASSETS		
Invested in capital assets, net of related debt	399,831,412	344,510,152
Restricted	31,600,096	29,720,193
Unrestricted	209,951,489	186,315,432
	<u>641,382,997</u>	<u>560,545,777</u>
Total net assets		
	<u>641,382,997</u>	<u>560,545,777</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,610,452,843</u>	<u>\$ 1,502,303,049</u>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

CONSOLIDATED STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
OPERATING REVENUES		
Sales to power purchasers at cost	\$ 53,598,558	\$ 46,480,883
Retail energy sales		
Residential	31,926,286	30,323,220
Irrigation	16,555,562	15,881,126
Commercial and industrial	61,773,063	54,026,068
Governmental and others	931,072	904,948
Sales to other utilities	115,636,467	119,195,047
Fiber optic network sales	2,025,299	1,679,793
Other	3,979,365	3,245,496
	<u>286,425,672</u>	<u>271,736,581</u>
OPERATING EXPENSES		
Purchased power	36,046,358	29,635,802
Generation	38,301,363	29,173,906
Transmission	9,146,854	10,012,768
Distribution	9,461,035	9,530,993
Customer and information services	4,385,547	4,194,906
Fiber optic network operations	1,132,614	1,239,247
Administrative and general	41,700,409	36,258,583
Impaired capital assets	-	165,209
Depreciation and amortization	36,747,081	32,875,695
Taxes	10,174,664	9,850,193
	<u>187,095,925</u>	<u>162,937,302</u>
Total operating expenses	<u>187,095,925</u>	<u>162,937,302</u>
NET OPERATING INCOME	<u>99,329,747</u>	<u>108,799,279</u>
OTHER REVENUES (EXPENSES)		
Interest and other income	11,503,116	19,763,062
Interest on revenue bonds and other, net of capitalized interest of \$5,141,635 and \$4,606,500	(37,833,462)	(39,311,313)
Amortization of debt expense, discount, and premium	(1,009,239)	(1,735,269)
	<u>(27,339,585)</u>	<u>(21,283,520)</u>
Total other revenues (expenses)	<u>(27,339,585)</u>	<u>(21,283,520)</u>
CONTRIBUTION IN AID OF CONSTRUCTION	<u>9,103,456</u>	<u>10,287,593</u>
EXTRAORDINARY (LOSS) GAIN		
Loss related to powerhouse fire and gate malfunction	(176,482)	(42,529)
(Loss) gain on insurance settlements	(79,916)	3,878,420
	<u>(256,398)</u>	<u>3,835,891</u>
Net extraordinary (loss) gain	<u>(256,398)</u>	<u>3,835,891</u>
CHANGE IN NET ASSETS	<u>80,837,220</u>	<u>101,639,243</u>
NET ASSETS		
Beginning of year	<u>560,545,777</u>	<u>458,906,534</u>
End of year	<u>\$ 641,382,997</u>	<u>\$ 560,545,777</u>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retail energy sales	\$ 109,773,701	\$ 101,146,470
Cash received from sales to power purchasers at cost	55,403,046	44,041,175
Cash received from sales to other utilities	107,622,004	118,235,571
Other cash receipts	6,188,963	4,490,513
Cash (paid for) received from customer deposits	(245,546)	29,981
Cash received from conservation loans	-	119,786
Cash paid for demand side management	(1,133,311)	(788,040)
Cash paid for purchase of power	(28,994,240)	(27,203,279)
Cash paid to contractors, suppliers, and employees	(92,686,751)	(79,842,957)
Cash paid for materials and supplies	-	(2,423,367)
Cash received from (paid for) long-term receivables	11,500,000	(647,883)
Cash received from long-term contracts	1,821,440	-
Taxes paid	(10,070,276)	(9,682,072)
	<u>159,179,030</u>	<u>147,475,898</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on revenue bonds	(29,665,000)	(74,395,000)
Interest paid on revenue bonds	(41,813,899)	(38,485,184)
Payment on refunded debt	-	(905,000)
Bond issuance costs	-	(129,249)
Relicensing costs	(76,070)	(570,984)
Cash received from contribution in aid of construction	5,623,169	11,957,516
Insurance proceeds	3,798,505	-
Extraordinary loss - Powerhouse fire and gate malfunction	(256,398)	(42,529)
Acquisition and construction of plant assets	(101,911,854)	(111,086,714)
Proceeds on sale of plant assets	1,320,157	8,733,910
	<u>(162,981,390)</u>	<u>(204,923,234)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(724,919,992)	(540,453,898)
Sale proceeds of investment securities	724,403,332	536,671,428
Investment income proceeds	9,693,915	20,435,040
Net repurchase agreement	(1,320,285)	55,389,270
Cash received from conservation loans	173,963	-
	<u>8,030,933</u>	<u>72,041,840</u>
NET INCREASE IN CASH	<u>\$ 4,228,573</u>	<u>\$ 14,594,504</u>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
CASH AT END OF YEAR		
Special funds	\$ 5,996,340	\$ 6,703,040
Bond funds	5,229,111	4,890,460
Restricted funds	2,228,774	1,309,052
Working capital	10,184,998	6,508,098
	<u>23,639,223</u>	<u>19,410,650</u>
CASH AT BEGINNING OF YEAR		
Special funds	6,703,040	401,688
Bond funds	4,890,460	176,578
Restricted funds	1,309,052	1,309,052
Working capital	6,508,098	2,928,828
	<u>19,410,650</u>	<u>4,816,146</u>
NET INCREASE IN CASH	<u>\$ 4,228,573</u>	<u>\$ 14,594,504</u>
OPERATING ACTIVITIES		
Net operating income	\$ 99,329,747	\$ 108,799,279
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	36,747,081	32,875,695
Provision for uncollectible accounts	312,133	(134,381)
Cash provided by (used in) changes in operating assets and liabilities:		
Change in Habitat funds held in trust	919,722	-
Customer accounts receivable	(8,551,378)	(2,565,244)
Materials and supplies	454,735	(2,564,354)
Other current assets	(189,417)	2,468,542
Conservation loans	-	119,786
Long-term receivables	11,500,000	(647,883)
Unearned revenue	1,821,440	-
Demand-side management	(1,133,311)	(788,040)
Trade payables	15,690,233	3,142,885
Payable to (receivable from) power purchasers, net	2,293,825	(504,995)
Payable to other District systems, net	-	6,816,885
Accrued taxes	108,513	173,227
Customer deposits	(245,546)	29,981
Other current liabilities	(20,097)	55,193
Accrued other postemployment benefits	141,350	199,322
	<u>\$ 159,179,030</u>	<u>\$ 147,475,898</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 159,179,030</u>	<u>\$ 147,475,898</u>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

1. ORGANIZATION AND ACCOUNTING POLICIES

Public Utility District No. 2 of Grant County, Washington (the "District") is comprised of three operating systems: the Electric System, the Columbia River-Priest Rapids Hydroelectric Production System ("Priest Rapids"), and the Wanapum Development ("Wanapum"). Priest Rapids and Wanapum (collectively, the "Priest Rapids Project") are operated under Federal Energy Regulatory Commission ("FERC") License, Project No. 2114. The District also maintains a Service System, to provide administrative services to the operating systems. Internal transactions including revenues and expenses between the District's reporting segments and the Service System have been eliminated in the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. The District is required by its financing arrangements to maintain separate accounts and to report separately on each operating system. See Note 15. The financing arrangements require maintenance of certain funds and application of accounting procedures prescribed by the State of Washington, which generally conform to those prescribed by FERC and accounting principles generally accepted in the United States of America. The accompanying financial statements are those of the District, which transmits and distributes electric energy and wholesale telecommunication services within Grant County, Washington.

The District maintains its accounts in accordance with accounting principles generally accepted in the United States of America for proprietary funds as prescribed by the Governmental Accounting Standards Board ("GASB"), and where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board ("FASB"). The District's accounting records generally follow the Uniform System of Accounts for public utilities and licensees prescribed by FERC except as it relates to the accounting for contributions in aid of construction ("CIAC"). FERC would account for CIAC's as a reduction to plant.

New Accounting Standards - In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 157, *Fair Value Measurements*, which is effective for fiscal years beginning after November 15, 2007. On January 1, 2008, the District adopted SFAS No. 157 for financial assets and liabilities, which clarifies the meaning of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The effective date of the provisions of FAS 157 for non-financial assets and liabilities, except for items recognized at fair value on a recurring basis, was deferred by FASB Staff Position FAS 157-2 ("FSP FAS 157-2") and are effective for the fiscal year beginning January 1, 2009. The District is currently evaluating the impact of the provisions for non-financial assets and liabilities. The adoption of FAS 157 for financial assets and liabilities did not have an impact on the District's financial condition, results of operations or cash flows. See Note 7.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*, which provides guidance and additional flexibility around the measurement of eligible items at fair value at specified election dates. SFAS No. 159 is effective for fiscal years beginning after

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

November 15, 2007. The District has adopted SFAS No. 159 with no significant impact upon the District's financial condition, results of operations or cash flows.

In June 2007, the GASB issued Statement No. 51 *Accounting and Financial Reporting for Intangible Assets*. The objective of this statement is to establish accounting and financial reporting requirements for intangible assets and is expected to enhance the comparability of the accounting and reporting of such assets among state and local governments. GASB Statement No. 51 is required for financial statements for periods beginning after June 15, 2009. The District is currently evaluating the impacts of adopting this statement for the District's financial statements.

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures*, an amendment of GASB Statements No. 25 and No. 27. Statement No. 50 more closely aligns current pension disclosure requirements for governments with those requirements that governments are beginning to implement for retiree health insurance and other post-employment benefits. GASB Statement No. 50 became effective for the District as of January 1, 2008. The disclosures required by GASB Statement No. 50 are included in Note 10 of the financial statements.

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which establishes financial reporting standards for pollution remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution. If any of five specified obligation events occurs, a government is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability. GASB Statement No. 49 became effective for the District as of January 1, 2008. The District had no accrued pollution remediation obligations as of December 31, 2008.

Revenue Recognition – The District recognizes revenues associated with power sales to its retail and wholesale customers when delivered, which includes an estimate of revenue earned but not billed to customers as of year-end.

Revenues associated with power sales from the Priest Rapids Project under the Power Sales Contracts described in Note 8 are recorded based on a cost-based formula specified in the contracts which include operation and maintenance costs, 115% of debt service and adjustments related to other factors. Depreciation and amortization, extraordinary maintenance, and charges paid by the Reserve and Contingency Fund, Supplemental Repair and Renewal Fund, Supplemental Renewal and Contingency Fund, and Construction Funds and are not considered costs of producing and delivering power for this purpose.

Allowance for Uncollectible Accounts – Management reviews accounts receivable on a regular basis to determine if any receivables will potentially be uncollectible. The allowance for uncollectible accounts includes amounts of specific customers that may be unable to meet their financial obligations and an estimate based on historical experience.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

Contributions in Aid of Construction – A portion of the District’s utility plant is financed through contributions from customers in accordance with the District’s line extension policy. Additionally, a portion of utility plant is financed through contributions from external sources. The District recognizes capital contributions from external sources as nonoperating revenue at the point at which it becomes nonrefundable. The District recognized \$9,103,456 and \$10,287,593 of contributions in aid of construction for the years ended December 31, 2008 and 2007, respectively.

Allowance for Funds Used During Construction – Interest costs incurred to finance major construction projects are capitalized as part of the cost of the project. The composite interest rate for calculating capitalized interest was 4.98% and 5.10% for 2008 and 2007, respectively. Total capitalized interest was \$5,141,635 and \$4,606,500 during 2008 and 2007, respectively.

Utility Plant – Utility plant assets are recorded at cost including an allocation of administrative and general costs. Depreciation is determined by the straight-line method over the estimated life of the asset. The District’s asset lives used for computing depreciation range from seven to 100 years, with a composite rate of 2.33% and 2.32% for 2008 and 2007, respectively. When utility plant assets are retired, their original cost, together with removal costs, less salvage, are charged to accumulated depreciation. The District does not collect costs of disposal through rates. Such costs are charged to accumulated depreciation.

The District periodically reviews the impact of any legal obligations associated with the retirement of the District’s tangible long-lived assets. Any significant legal obligations which resulted in an asset retirement obligation would be recorded in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*. In the District’s judgment, it does not have any material legal obligations associated with the retirement of its tangible long-lived assets.

The costs of maintenance and repairs are charged to operations as incurred. Renewals, replacements and betterments are capitalized. On a periodic basis, the District identifies impaired assets and strives to minimize the financial loss through liquidation of these assets. Once an asset has been identified as impaired and selected for liquidation, it is written down to its net realizable value, based on fair market value less settlement costs.

Energy Conservation and Demand-Side Management (“DSM”) Programs – The District’s expenditures for regional conservation programs and other DSM programs benefit future periods by reducing energy supply requirements. These costs are amortized over the expected useful lives of the programs.

Cash and Cash Equivalents – For purposes of the statements of cash flows, the District classifies only amounts held in demand deposit accounts as cash. The cash balances in the Statements of Cash Flows include cash as identified on the Balance Sheet.

Investments – Investments to be held for more than twelve months are presented at fair value. Fair values are based on quoted market prices for those investments. All other investments are presented at amortized cost in accordance with GASB No. 31, *Accounting and Financial*

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Reporting for Certain Investments and for External Investment Pools. Discounts and premiums on investments are amortized as adjustments to interest income over the remaining term of the investments using the constant yield method.

All investment instruments, which are held in demand deposit accounts, are classified as investments. Short-term investments are defined as an investment with a maturity of less than one year. The purchase and maturity of investment instruments are reported on a gross basis in the Statement of Cash Flows from investing activities, with the exception of repurchase agreements, which are reported on the net basis. Repurchase agreements are an overnight sweep account, which represents the primary difference between the repurchase agreements and other investments.

Realized gains and losses on investments that had been held for more than one fiscal year and sold in the current year have been recognized as an increase or decrease in the fair value of investments reported in the prior year on an accrual basis. These realized gains and losses are reflected as interest and other income on the Statement of Revenues and Expenses and Changes in Net Assets.

Materials and Supplies – Materials and supplies consist of hydroelectric generation, transmission, and distribution assets as well as fiber optic cable and fiber-related supplies. All inventory amounts are recorded at average cost.

Due from (to) Power Purchasers – Balance represents actual power costs in excess (deficit) of estimated power costs received by Priest Rapids and Wanapum from power purchasers to be collected from the power purchasers.

Relicensing Costs - Costs associated with the relicensing efforts were treated as a deferred charge pending issuance of the New License. With the issuance of the New License effective April 1, 2008, these costs have been reclassified to Utility Plant and the District is amortizing these costs over the term of the New 44 year License.

Debt Discounts, Premiums and Issuance Costs – Debt discounts and premiums relating to the sale of bonds are amortized over the lives of the related bonds using the constant yield method. Debt issuance costs are amortized over the lives of the related bonds using the effective interest method.

Refunds of Debt – The gain or loss on refunding of debt is amortized over the remaining life of the refunded or newly issued bond, whichever is shorter. If debt is extinguished using the District's own resources, any resulting gain or loss will be recognized during the current period.

Unearned Revenue – Unearned revenue consists of contributions in aid of construction that were refundable as of year-end in accordance to the District's facilities cost contribution agreements.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Additionally, during 2008, the District entered into three exchange contracts that resulted in unearned revenue. Two of the contracts relate to exchanges and expire January 1, 2027. For each hour of the counterparty's contracted Grand Coulee Project output delivered to the District, the District will deliver power to the counterparties. Both counterparties have made a one-time prepayment of \$1,000,000 during 2008. The District recognizes the revenue monthly on a straight line basis over the life of these agreements. The third contract is an energy/capacity agreement. The payments are due monthly in advance of the exchange transactions. This contract expires during 2009.

Revenue Taxes – Utility revenue-based taxes assessed by governmental entities are accounted for as a separate cost collected from customers for remittance to those governmental entities. Therefore, revenue taxes paid to the taxing authorities are accounted for as an operating expense on the Statements of Revenues and Expenses and Changes in Net Assets. Taxes collected from customers on behalf of other governmental entities are included in retail energy sales in the Statements of Revenues and Expenses and Changes in Net Assets.

Net Assets – The District classifies its net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in capital assets, net of related debt* – This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses, and related unspent project and debt service funds.
- *Restricted* – This component consists of net assets with constraints placed on their use. Constraints include those imposed by debt trust indentures, grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation.
- *Unrestricted* – This component of net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Significant Risk and Uncertainties – The District is subject to certain business risks that could have a material impact on future operations and financial performance. See Note 12. These risks include weather and natural-disaster-related disruptions, collective bargaining labor disputes, fish and other Endangered Species Act (“ESA”) issues, Environmental Protection Agency regulations, federal government regulations or orders concerning the operation, maintenance and/or licensing of hydroelectric facilities, and the deregulation of the electrical utility industry.

The District has elected self-insurance for general liability up to \$500,000 per incident. The District has not historically had significant claims, and estimates claims incurred but not reported are not significant as of December 31, 2008. There are no significant claims outstanding under this program at December 31, 2008.

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Personal Leave Benefit – Employees of the District accrue a personal leave benefit based upon a years of service schedule. Personal leave may be used for vacation, sick leave or other employee absences. The District records personal leave as an expense and a liability as earned. Unused personal leave may be accumulated up to a maximum of 1,200 hours. At the time of resignation, termination, or death of the employee all accrued personal leave is cashed out to the employee or surviving beneficiary. For bargaining unit employees only, upon retirement 90% of accumulated personal leave is deposited into a personal HRA-Voluntary Employees' Beneficiary Association (VEBA) account. The remaining 10% of accumulated personal leave is cashed out to the employee on the last paycheck.

Use of 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 amounts 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 these estimates. The District has used significant estimates in determination of useful lives of DSM, unbilled revenue, licensing obligations, allowance for uncollectible accounts, accrued other postemployment benefits and in the determination of depreciable lives of utility plant.

2. CASH AND INVESTMENTS

The District's cash deposits at December 31, 2008 and 2007 were either entirely covered by federal depository insurance or protected against loss by being on deposit with financial institutions recognized as qualified public depositories of the State of Washington under the Revised Code of Washington ("RCW") Chapter 39. Subject to specific bond resolution limitations, management is permitted to invest as provided under the laws of the State of Washington.

Interest Rate Risk – The District has no formal investment policy limitations on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk – The District has no formal investment policy that specifies credit ratings of potential investment issuers as a means of managing the District's exposure to credit risk.

Concentration of Credit Risk – The District places no limit on the amount the District may invest in any one issuer. All repurchase agreements are brokered by one financial institution. The investments underlying these repurchase agreements are United States Treasury debt securities and, as such, credit ratings are not reported.

The District's investments at December 31, 2008 and 2007, as identified on both the Balance Sheets and in Note 5, are shown below by investment type. All investments are either issued or registered in the name of the District or are held by the District or by the District's agent in the District's name. The amounts shown below do not include accrued interest.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

During 2008 and 2007, the District realized \$10,896,545 and \$18,747,422, respectively, of interest earnings and realized gains from investments. The unrealized gain on investments held at December 31, 2008 and 2007 was \$240,859 and \$590,412, respectively.

Investments are made in investment types authorized by the RCW. The types are 1) Obligations of the U.S. Government and its agencies, 2) Money market funds that have holdings of or are backed by U.S. Government obligations, 3) Repurchase agreements collateralized by U.S. Government obligations, and 4) Certificate of deposit.

	2008	2007
U.S. agencies	\$ 176,882,045	\$ 265,874,696
U.S. treasuries	148,632,775	61,610,221
Money market funds	37,940,354	37,314,033
Repurchase agreements	35,100,000	32,400,000
Certificate of deposit	4,100,000	-
	<u>4,100,000</u>	<u>-</u>
Total investments	<u>\$ 402,655,174</u>	<u>\$ 397,198,950</u>

The District places no limit on the amounts invested in any one issuer for federal agency securities. The following are the concentrations of risk greater than 5%, in either year. The credit ratings listed are from Standard and Poor's as of December 31, 2008. TSY refers to U.S. Treasury securities and N/R means not rated.

	Credit Rating	2008	2007
U.S. treasuries	TSY	37%	16%
Federal Home Loan Bank	AAA	26%	19%
Federal National Mortgage and Discount Note	AAA	12%	15%
Money market funds	N/R	9%	9%
Repurchase agreements	N/R	9%	8%
FNMA Discount Notes	AAA	less than 5%	19%
Federal Home Loan Mortgage Corporation	AAA	less than 5%	7%
Federal Farm Credit	AAA	less than 5%	7%

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

3. UTILITY PLANT

Utility plant of the District as of December 31 is summarized as follows:

	Balance 2007	Additions	Retirements/ Transfers	Balance 2008
Distribution facilities				
Electric System	\$ 316,190,684	\$ 34,295,351	\$ (1,442,053)	\$ 349,043,982
Telecommunications	80,899,122	3,513,689	-	84,412,811
Transmission facilities	133,521,140	9,136,927	-	142,658,067
Hydro facilities				
Power plant structures	68,268,676	4,420,762	(29,698,125)	42,991,313
Reservoirs, dams, waterways	346,044,237	22,682,608	-	368,726,845
Power plant equipment	240,104,947	26,657,421	26,147,025	292,909,393
General facilities				
Quincy Chute (Note 8)	17,643,370	-	-	17,643,370
Potholes East Canal (Note 8)	16,380,006	-	-	16,380,006
Other generation	29,656	-	-	29,656
General plant	130,529,322	4,177,486	(1,168,601)	133,538,207
FERC License	-	99,548,303	-	99,548,303
Total	1,349,611,160	204,432,547	(6,161,754)	1,547,881,953
Accumulated depreciation and amortization	(518,680,325)	(38,001,184)	6,161,754	(550,519,755)
Subtotal	830,930,835	166,431,363	-	997,362,198
Land and land rights	22,302,261	1,063,718	-	23,365,979
Construction in progress	91,852,692	103,203,045	(100,169,697)	94,886,040
Total net utility plant	\$ 945,085,788	\$ 270,698,126	\$ (100,169,697)	\$ 1,115,614,217

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	Balance 2006	Additions	Retirements/ Transfers	Balance 2007
Distribution facilities				
Electric System	\$ 288,320,875	\$ 28,325,649	\$ (455,840)	\$ 316,190,684
Telecommunications	79,710,173	2,340,901	(1,151,952)	80,899,122
Transmission facilities	132,260,363	1,260,777		133,521,140
Hydro facilities				
Power plant structures	37,856,323	32,187,853	(1,775,500)	68,268,676
Reservoirs, dams, waterways	282,534,728	63,509,509	-	346,044,237
Power plant equipment	233,005,234	7,335,756	(236,043)	240,104,947
General facilities				
Quincy Chute (Note 8)	17,614,427	28,943	-	17,643,370
Potholes East Canal (Note 8)	16,547,375	-	(167,369)	16,380,006
Other generation	29,656	-	-	29,656
General plant	<u>121,795,772</u>	<u>8,738,885</u>	<u>(5,335)</u>	<u>130,529,322</u>
Total	1,209,674,926	143,728,273	(3,792,039)	1,349,611,160
Accumulated depreciation and amortization	<u>(488,960,528)</u>	<u>(32,764,848)</u>	<u>3,045,051</u>	<u>(518,680,325)</u>
Subtotal	720,714,398	110,963,425	(746,988)	830,930,835
Land and land rights	21,754,562	547,699	-	22,302,261
Construction in progress	<u>125,346,250</u>	<u>105,803,720</u>	<u>(139,297,278)</u>	<u>91,852,692</u>
Total net utility plant	<u>\$ 867,815,210</u>	<u>\$ 217,314,844</u>	<u>\$ (140,044,266)</u>	<u>\$ 945,085,788</u>

4. LICENSING

On April 17, 2008, the FERC issued the District a New 44-year License for the continued operation of the Priest Rapids Project effective April 1, 2008. Issuance of the new license represented both the culmination of over a decade of work to obtain that authorization, and the beginning of several decades of significant new license implementation activities. The original license to operate the Priest Rapids Project expired October 31, 2005 with annual licenses in effect until the new license was issued.

Costs associated with the relicensing efforts of approximately \$57.1 million were treated as a deferred charge pending issuance of the New License. Upon issuance of the new license, these costs were reclassified as an intangible asset to Utility Plant and the District is amortizing these costs over the term of the new license.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Certain of the FERC license conditions require payments to other organizations using funds provided by the District. The present value of the obligations for which the District will provide funding total \$42.4 million as of December 31, 2008, of which approximately \$2.7 million is expected to be paid within one year. These amounts are included in the FERC license balance and are reflected as liabilities in the balance sheet. The elements of these obligating payments, comprised of the Salmon and Steelhead Agreement, Part A (Hatchery Renovation) and Part B (Resident Fish Monitoring and Trout Purchase), which are further discussed in Note 9 of these financial statements.

5. SPECIAL FUNDS AND RESTRICTED FUNDS

Special Funds

In accordance with bond resolutions and certain related agreements, certain special fund accounts are established and maintained. The assets held in these accounts are restricted for specific uses, including construction, debt service and other special reserve requirements. There are a number of covenants and requirements contained in the various bond indentures. See Note 6.

The net assets of the District's special funds are as follows:

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

December 31, 2008

	Investments	Accrued Interest Receivable	Total Noncash in Special Funds	Cash	Total Special Funds
Future Generation Development Fund	\$ 7,463,662	\$ 44,913	\$ 7,508,575	\$ 792,827	\$ 8,301,402
Construction Funds	129,690,499	1,212,343	130,902,842	1,104,553	132,007,395
Quincy Chute Renewal and Replacement Fund	1,085,377	-	1,085,377	616,273	1,701,650
Excess Earnings Fund	51,922	-	51,922	29,481	81,403
Reserve and Contingency Funds	96,734,791	961,510	97,696,301	2,738,500	100,434,801
Supplemental Repair and Renewal Fund	10,106,341	103,124	10,209,465	42,353	10,251,818
Supplemental Renewal and Contingency Fund	11,499,854	113,222	11,613,076	236,394	11,849,470
Self-Insurance Fund	767,809	-	767,809	435,959	1,203,768
Total Special Funds	<u>\$ 257,400,255</u>	<u>\$ 2,435,112</u>	<u>\$ 259,835,367</u>	<u>\$ 5,996,340</u>	<u>\$ 265,831,707</u>

December 31, 2007

	Investments	Accrued Interest Receivable	Total Noncash in Special Funds	Cash	Total Special Funds
Future Generation Development Fund	\$ 8,303,045	\$ 18,985	\$ 8,322,030	\$ 197,484	\$ 8,519,514
Relicensing Funds	1,467,577	-	1,467,577	754,690	2,222,267
Construction Funds	170,894,407	1,863,688	172,758,095	519,354	173,277,449
Quincy Chute Renewal and Replacement Fund	1,506,720	3,704	1,510,424	163,108	1,673,532
Excess Earnings Fund	52,975	-	52,975	27,242	80,217
Reserve and Contingency Funds	49,087,050	617,290	49,704,340	789,872	50,494,212
Supplemental Repair and Renewal Fund	8,314,836	34,630	8,349,466	1,734,940	10,084,406
Supplemental Renewal and Contingency Fund	9,543,406	28,397	9,571,803	2,103,600	11,675,403
Self-Insurance Fund	802,638	-	802,638	412,750	1,215,388
Total Special Funds	<u>\$ 249,972,654</u>	<u>\$ 2,566,694</u>	<u>\$ 252,539,348</u>	<u>\$ 6,703,040</u>	<u>\$ 259,242,388</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

In 2007, the Commission established the Future Generation Development Fund with the sale proceeds from the diesel generators totaling \$8,261,000. This fund is to be used specifically for the development and acquisition of new generation resources.

Restricted Funds

The District maintains restricted funds for debt service as required by bond indentures. In addition, the District maintains restricted funds for habitat mitigation as described in Note 9. All of the District's investments maintained in these accounts have maturities of one year or less.

The net assets of the District's restricted funds are as follows:

December 31, 2008

	Cash	Investments and other	Total Restricted Funds
Bond Sinking Funds	\$ 3,813,592	\$ 27,890,482	\$ 31,704,074
Bond Interest Funds	1,415,519	19,197,552	20,613,071
Habitat Funds	2,228,774	3,925,308	6,154,082
	\$ 7,457,885	\$ 51,013,342	\$ 58,471,227
Total Restricted Funds	\$ 7,457,885	\$ 51,013,342	\$ 58,471,227

December 31, 2007

	Cash	Investments and other	Total Restricted Funds
Bond Sinking Funds	\$ 3,470,728	\$ 26,679,192	\$ 30,149,920
Bond Interest Funds	1,419,732	20,037,543	21,457,275
Habitat Funds	1,309,052	2,545,597	3,854,649
	\$ 6,199,512	\$ 49,262,332	\$ 55,461,844
Total Restricted Funds	\$ 6,199,512	\$ 49,262,332	\$ 55,461,844

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

6. REVENUE BONDS

On March 1, 2007, in exchange for ownership of Telecommunication assets, the District's Electric System defeased \$495,000 of the Series 2005A Priest Rapids 5.00% 2033 Term Bond due January 1, 2033 and \$410,000 of the Series 2005A Wanapum 5.00% 2034 Term Bond due January 1, 2034. The defeasance was authorized by the District's Commission on November 30, 2006. The District did not issue any new debt in 2008 and 2007.

All the outstanding issues, which are on parity with each other, are secured by a pledge of the gross revenues of the District.

The District's outstanding revenue bonds at December 31 are as follows:

Electric System	2008	2007
Electric System revenue refunding bonds, Series 2001H 5.0% to 5.375% serial maturities, due January 1, 2008 – 2019	<u>\$ 148,485,000</u>	<u>\$ 158,380,000</u>
Priest Rapids	2008	2007
Priest Rapids second series revenue refunding bonds, Series 1997B 5.5% to 5.6% serial maturities, due January 1, 2008 – 2009	\$ 480,000	\$ 930,000
Priest Rapids second series revenue refunding bonds, Series 1997D 6.0% term maturities, due January 1, 2008 – 2009	250,000	485,000
Priest Rapids second series revenue refunding bonds, Series 1999B 5.0% to 5.375% serial and term maturities, due January 1, 2008 – 2018	7,815,000	8,400,000
Priest Rapids second series revenue refunding bonds, Series 2001A 3.5% to 4.25% serial maturities, due January 1, 2008 – 2012	4,510,000	5,535,000
Priest Rapids second series revenue refunding bonds, Series 2001B 4.0% to 5.0% serial and term maturities, due January 1, 2008 – 2023	10,300,000	10,770,000
Priest Rapids second series revenue bonds, Series 2003A 2.75% to 4.75% serial maturities, due January 1, 2008 – 2021	<u>10,880,000</u>	<u>11,525,000</u>
Balance	<u>\$ 34,235,000</u>	<u>\$ 37,645,000</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Balance	<u>\$ 34,235,000</u>	<u>\$ 37,645,000</u>
Priest Rapids second series revenue bonds, Series 2003Z		
3.61% to 5.48% serial and term maturities, due January 1, 2008 – 2021	16,645,000	17,560,000
Priest Rapids second series revenue bonds, Series 2005A		
4.0% to 5.0% serial and term maturities, due January 1, 2008 – 2033	64,235,000	66,515,000
Priest Rapids second series revenue bonds, Series 2005B		
4.0% to 5.25% serial and term maturities, due January 1, 2008 – 2033	25,700,000	26,285,000
Priest Rapids second series revenue bonds, Series 2005Z		
4.81% to 5.5% serial and term maturities, due January 1, 2008 – 2033	41,330,000	42,590,000
Priest Rapids second series revenue bonds, Series 2006A		
3.5% to 5.0% serial maturities, due January 1, 2008 – 2036	24,365,000	24,770,000
Priest Rapids second series revenue bonds, Series 2006B		
3.625% to 4.0% serial maturities, due January 1, 2010 – 2017	5,470,000	5,470,000
Priest Rapids second series revenue bonds, Series 2006Z		
5.15% to 5.33% term maturities, due January 1, 2017 – 2036	<u>35,900,000</u>	<u>36,370,000</u>
Total Priest Rapids revenue bonds outstanding	<u>\$ 247,880,000</u>	<u>\$ 257,205,000</u>
Wanapum	2008	2007
Wanapum second series revenue bonds, Series 1996B		
5.5% to 5.6% serial maturities, due January 1, 2008 – 2009	\$ 240,000	\$ 470,000
Wanapum second series revenue refunding bonds, Series 1997A		
5.3% to 5.4% serial maturities, due January 1, 2008 – 2009	450,000	875,000
Wanapum second series revenue refunding bonds, Series 1997B		
5.5% to 5.6% serial maturities, due January 1, 2008 – 2009	<u>795,000</u>	<u>1,550,000</u>
Balance	<u>\$ 1,485,000</u>	<u>\$ 2,895,000</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Balance	<u>\$ 1,485,000</u>	<u>\$ 2,895,000</u>
Wanapum second series revenue refunding bonds, Series 1997C 6.0% term maturities, due January 1, 2009	175,000	340,000
Wanapum second series revenue refunding bonds, Series 1997D 6.0% term maturities, due January 1, 2009	300,000	580,000
Wanapum second series revenue refunding bonds, Series 1998A 4.375% to 5.2% serial and term maturities, due January 1, 2008 – 2023	25,100,000	26,235,000
Wanapum second series revenue refunding bonds, Series 1999A 5.0% serial maturities, due January 1, 2008 – 2009	435,000	850,000
Wanapum second series revenue refunding bonds, Series 1999B 5.0% to 5.375% serial and term maturities, due January 1, 2008 – 2018	6,250,000	6,720,000
Wanapum second series revenue refunding bonds, Series 1999D 4.375% to 5.2% serial and term maturities, due January 1, 2008 – 2023	15,085,000	15,760,000
Wanapum second series revenue refunding bonds, Series 2001B 4.0% to 5.0% serial and term maturities, due January 1, 2008 – 2023	13,760,000	14,390,000
Wanapum second series revenue bonds, Series 2003A 2.75% to 5.0% serial and term maturities, due January 1, 2008 – 2035	18,520,000	19,275,000
Wanapum second series revenue bonds, Series 2003B 3.0% to 5.0% serial and term maturities, due January 1, 2008 – 2012	15,330,000	15,620,000
Wanapum second series revenue bonds, Series 2003Z 3.61% to 5.48% serial and term maturities, due January 1, 2008 – 2021	18,165,000	19,165,000
Wanapum second series revenue bonds, Series 2005A 2.5% to 5.0% serial and term maturities, due January 1, 2008 – 2038	50,015,000	50,680,000
Wanapum second series revenue bonds, Series 2005B 3.0% to 5.25% serial and term maturities, due January 1, 2008 – 2038	<u>68,200,000</u>	<u>69,200,000</u>
Balance	<u>\$ 232,820,000</u>	<u>\$ 241,710,000</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Balance	<u>\$ 232,820,000</u>	<u>\$ 241,710,000</u>
Wanapum second series revenue bonds, Series 2005Z 3.91% to 5.29% serial maturities, due January 1, 2008 – 2018	4,010,000	4,335,000
Wanapum second series revenue bonds, Series 2006A 4.0% to 5.5% serial and term maturities, due January 1, 2008 – 2043	70,865,000	71,395,000
Wanapum second series revenue bonds, Series 2006B 3.75% to 5.0% serial and term maturities, due January 1, 2009 – 2031	18,190,000	18,190,000
Wanapum second series revenue bonds, Series 2006Z 5.15% to 5.42% term maturities, due January 1, 2008 – 2043	<u>96,145,000</u>	<u>96,845,000</u>
Total Wanapum revenue bonds outstanding	<u>\$ 422,030,000</u>	<u>\$ 432,475,000</u>
Total consolidated revenue bonds outstanding	<u><u>\$ 818,395,000</u></u>	<u><u>\$ 848,060,000</u></u>

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Scheduled debt service requirements for the District's bonds are as follows:

	Principal	Interest	Total
2009	\$ 31,565,000	\$ 40,653,001	\$ 72,218,001
2010	33,105,000	39,172,167	72,277,167
2011	34,605,000	37,630,891	72,235,891
2012	36,215,000	35,939,145	72,154,145
2013	38,040,000	34,124,714	72,164,714
2014 – 2018	204,790,000	140,236,484	345,026,484
2019 – 2023	138,020,000	94,927,790	232,947,790
2024 – 2028	85,775,000	68,418,323	154,193,323
2029 – 2033	96,575,000	44,929,985	141,504,985
2034 – 2038	77,275,000	22,412,019	99,687,019
2039 – 2043	<u>42,430,000</u>	<u>6,917,287</u>	<u>49,347,287</u>
Total	<u>\$ 818,395,000</u>	<u>\$ 565,361,806</u>	<u>\$ 1,383,756,806</u>

The fair market value of the District's long-term debt is based on quoted market prices. At December 31, 2008 and 2007, the fair market value of long-term debt was \$776,678,329 and \$890,931,225.

The District is in compliance with all debt covenants related to the outstanding bonds, which includes debt service coverage, at December 31, 2008 and 2007.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

During the years ended December 31 the following changes occurred in the District's long-term debt:

	Balance 2007	Additions	Reductions	Balance 2008	Due Within One Year
Revenue bonds payable	\$ 848,060,000	\$ -	\$ (29,665,000)	\$ 818,395,000	\$ 31,565,000
Unamortized premium	15,793,243	-	(1,746,689)	14,046,554	-
Unamortized discounts	(986,574)	-	83,293	(903,281)	-
Unamortized refunding loss	(12,786,412)	-	1,778,117	(11,008,295)	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	<u>\$ 850,080,257</u>	<u>\$ -</u>	<u>\$ (29,550,279)</u>	<u>\$ 820,529,978</u>	<u>\$ 31,565,000</u>

	Balance 2006	Additions	Reductions	Balance 2007	Due Within One Year
Revenue bonds payable	\$ 923,360,000	\$ -	\$ (75,300,000)	\$ 848,060,000	\$ 29,665,000
Unamortized premium	17,667,845	-	(1,874,602)	15,793,243	-
Unamortized discounts	(1,874,655)	-	888,081	(986,574)	-
Unamortized refunding loss	(15,211,572)	-	2,425,160	(12,786,412)	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	<u>\$ 923,941,618</u>	<u>\$ -</u>	<u>\$ (73,861,361)</u>	<u>\$ 850,080,257</u>	<u>\$ 29,665,000</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

7. FAIR VALUE MEASUREMENTS

As defined in SFAS No.157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 sets a fair value hierarchy to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy prioritizes inputs to valuation techniques used to measure fair value to three broad levels. The three levels of the fair value hierarchy defined by SFAS No. 157 are as follows:

- *Level 1* – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.
- *Level 2* – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- *Level 3* – Inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent the observable inputs are not available thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The District uses the market approach to measure the fair value of its energy derivatives. All assets and liabilities are valued as stand alone contracts. Fair values are based on quoted prices from an independent external pricing service as of December 31, 2008. All derivative instruments are forward energy contracts, which expire within the next year and have published market prices for the contracted measurements dates.

The following table sets for the value the District’s energy derivative instruments for the year ended December 31, 2008. All instruments are reported at Level 2. The District does not have instruments to report at Level 1 and Level 3.

Fair Value Measures	Value as of December 31, 2008	
	Level 2	
Assets:		
Energy derivative instruments	\$	<u>2,109,072</u>
Liabilities:		
Energy derivative instruments	\$	<u>3,615,836</u>

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8. POWER PURCHASER COMMITMENTS

During the year ending December 31, the following resources were used to meet the District's load:

	2008	2007
BPA	46%	50%
Priest Rapids Project	27%	33%
Market and other	<u>27%</u>	<u>17%</u>
	<u>100%</u>	<u>100%</u>

Priest Rapids Project

The District met approximately 27% and 33% of its electric power loads for 2008 and 2007, respectively, through generation from its Priest Rapids Project. The balance of the load is met primarily through purchases from the Bonneville Power Administration ("BPA") and from other resources or suppliers. In connection with the original financing of the Priest Rapids Project, the District entered into power sales contracts expiring October 31, 2005 for Priest Rapids, and October 31, 2009 for Wanapum, with certain public and private utilities for the sale of 63.5% of the output of the Priest Rapids Project.

As of November 1, 2005, the new set of Priest Rapids Power Sales Contracts went into effect. The amount of net power costs incurred by the District in serving its load changes on an annual basis in relation to its firm power requirements. For 2008, the District incurred 78% of Priest Rapids power costs with power purchasers funding of 22%. For 2007, the District incurred 75% of Priest Rapids power costs with power purchasers funding of 25%.

The District is committed to cover a minimum annual debt service requirement of approximately \$38 million over the next five years associated with the power costs at Priest Rapids and Wanapum. Debt service requirements for Priest Rapids and Wanapum currently extend to year 2043.

In connection with these Power Sales Contracts, the District received proceeds of \$49,839,797 and \$33,071,852 in 2008 and 2007, respectively, to offset purchase power costs associated with the District buying power in the open market to cover its load not met by power from Priest Rapids and Wanapum. These proceeds are recorded as an offset to purchased power expense in the Statements of Revenues and Expenses and Changes in Net Assets.

Under the provisions in the new Power Sales Contracts, the District sells a portion of the Priest Rapids generation to displace the costs of purchasing BPA power. The net effect to the District is that the BPA portion of the District's load is served at Priest Rapids power cost.

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Each purchaser is obligated to pay its share of the cost (excluding depreciation, amortization, and certain maintenance costs) of producing and delivering power, plus 115% of its share of the amounts required for debt service payments.

BPA

The District is a statutory preference customer of BPA. The District purchases power from BPA under contracts which expire September 30, 2011. BPA and the District agreed to a Shaped Block Purchase under which the District received 188 average megawatt hours for the years ended December 31, 2008 and 2007. Block deliveries are fixed at a flat rate within each month, but predetermined at different levels each month so as to more closely follow anticipated seasonal load requirements. The District signed a follow up contract during 2008 for a small contract to serve its Grand Coulee load of approximately 5 average megawatts that expires September 30, 2028.

District management estimates the District's minimum commitments to BPA for the next five years are as follows:

2009	\$	51,015,000
2010		51,626,000
2011		42,693,000
2012		1,471,000
2013		1,486,000

Nine Canyon Wind Power Purchase Agreement

The District participates in a power purchase agreement with Energy Northwest for Phase I of the Nine Canyon Wind Project (the "Project") which consists of 37 wind turbines with an aggregate generating capacity of approximately 48 megawatts ("MW"). Energy Northwest is a municipal corporation and a joint operating agency of the State of Washington (formerly known as the Washington Public Power Supply System). The District does not participate in the two other phases of the Project which comprise additional generation capacity of approximately 48 MW. The phases are operated together as a single project under an amended power purchase agreement.

The District is one of nine public agencies participating in the original project power purchase agreement for Phase I of the Project. The District's purchaser share of Phase I of the project output was 25% of output up to a maximum of 12 MW. Since the District did not participate in either Phase II or Phase III of the Project, its share of the combined Project is 12.54%. In exchange for the output, the District pays its proportionate share of certain Project costs after the Project commenced commercial operation and its 25% share of Phase I debt service.

In 2001, Energy Northwest issued \$70,110,000 in revenue bonds for the purpose of financing the acquisition, development and construction of the Nine Canyon Wind Project, Phase I. The

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bonds were issued in two separate series: Series 2001A at \$49,875,000 and Series 2001B at \$20,235,000. The District is a 25% share purchaser of Phase I and, therefore, is responsible for 25% of these bonds.

In 2005, Energy Northwest issued \$62,325,000 of revenue refunding bonds for the purpose of refunding a portion of the Wind Project Revenue Bonds Series 2001A and Series 2001B. The Electric System continues its 25% purchaser responsibility for these bonds.

Scheduled debt service requirements, inclusive of principal and interest, for the District's 25% share of the bonds related to Phase I are as follows:

	2001 Bonds	2005 Bonds	Total
2009	\$ 631,502	\$ 979,650	\$ 1,611,152
2010	-	1,412,025	1,412,025
2011	-	1,412,119	1,412,119
2012	-	1,410,400	1,410,400
2013	-	1,411,744	1,411,744
2014 - 2018	-	7,058,397	7,058,397
2019 - 2024	-	8,470,969	8,470,969
	<hr/>	<hr/>	<hr/>
Total	\$ 631,502	\$ 22,155,304	\$ 22,786,806
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Yakama Nation Agreement

In 2007, the District entered into an agreement with the Yakama Nation to settle several issues including previous lawsuits, claims, allegations, filings, and other actions by the Yakama Nation against the District. The agreement expires at the end of the New License term. A primary consideration for settlement is an allocation of the benefit from the Priest Rapids Project to the Yakama Nation. The benefit to the Yakama Nation will be the financial equivalent of 20 aMW for 2007-2009, 15 aMW for 2010-2015 and 10 aMW throughout the term of the agreement. After 2015, the Yakama Nation can request to have actual physical power delivered. The Yakama Nation is responsible to pay the costs associated with producing the benefit received (either financial or physical delivery).

Other consideration to be provided by the Yakama Nation throughout the life of the agreement include providing the District with right of first refusal to participate in the development of new generation resources, to cooperatively develop with the District Pacific Lamprey and White Sturgeon Management Plans, and to represent itself on committees, subcommittees and groups involved with implementation of the various agreements associated with the Priest Rapids Project and the new license requirements.

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The agreement went into effect on July 1, 2007. The net payments to the Yakama Nation totaled \$8,512,384 during 2008 and \$4,158,092 for the last six months during 2007. These costs were charged to administrative and general expense.

The District's commitment to this agreement extends through the New License term. The estimated annual costs during the next five years for this agreement are as follows:

2009	\$	6,661,000
2010		4,815,000
2011		4,605,000
2012		4,674,000
2013		4,646,000

Other Sources

Pursuant to agreements with three irrigation districts, the District constructed and will operate and maintain both the Quincy Chute and Potholes East Canal hydroelectric generation facilities in return for the right to all output from the projects. In accordance with the Quincy Chute agreement, the Quincy Chute Renewal and Replacement Fund was established on October 1, 1995. The Electric System is required to deposit \$150,000 annually into the Quincy Chute Renewal and Replacement Fund for the remaining term of the agreement whenever the total amount of the Quincy Chute Renewal and Replacement Fund is less than \$1,500,000. The construction costs of the projects are being amortized over the terms of the agreements, which expire October 1, 2025, and September 1, 2030, respectively. The irrigation districts hold title to the project facilities.

9. NONPOWER COMMITMENTS

Capital Projects

The District has contractual commitments relating to several Electric System capital improvement projects including electrical system upgrades, multiple transformer purchases, and substation construction projects over the next few years totaling approximately \$16 million.

The District has undertaken certain improvement programs at Priest Rapids funded by second series revenue bonds. The improvement programs include powerhouse crane rehab, new transformers and other capital projects. The District intends to, or has committed by contract to, fulfill these programs, which are projected to be substantially complete by late 2009. At December 31, 2008, the contractually committed amount on future Priest Rapids work to be performed on these major capital programs is approximately \$4 million.

The District has undertaken certain improvement programs at Wanapum funded by second series revenue bonds. The improvement programs include restoration or replacement of

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generators and turbines, turbine runner blade replacements, deleading and painting of six turbines. The District intends to, or has committed by contract to, fulfill these programs, which are projected to be substantially complete by early 2018. As of December 31, 2008, the contractually committed amount on future Wanapum work to be performed on these major capital programs is approximately \$57 million.

Other Commitments

In 2006, the District entered into a Salmon and Steelhead Agreement with the United States Department of Interior, U.S. Fish and Wildlife Service, the National Marine Fisheries Service of the National Oceanic and Atmospheric Administration, the Washington Department of Fish and Wildlife, the Yakama Nation, and the Confederated Tribes of the Colville Reservation, for the purpose of resolving all issues between the District and the other signatories related to anadromous salmonid fish species in connection with the District's New License for the Priest Rapids Project. This agreement is intended to constitute a comprehensive and long-term adaptive management program for the protection, mitigation, and enhancement of fish species which pass or may be affected by the Priest Rapids Project.

In order to implement the Salmon and Steelhead Agreement, the District is obligated to establish separate restricted funds (the "Habitat funds") into which the District will deposit payments for further distribution in accordance with the requirements of the Salmon and Steelhead Agreement and the Biological Opinion. The Priest Rapids Coordinating Committee (PRCC) oversees the distribution of the Habitat funds created through the Salmon and Steelhead Agreement. The voting members of the PRCC include the District, the U.S. Fish and Wildlife Service, NOAA Fisheries, Washington Department of Fish and Wildlife, the Confederated Colville Tribes, and the Yakama Nation. The Habitat funds cannot be spent without the unanimous consent of all voting members. All interest earned by the Habitat funds increase the balance of these funds and is not recognized as income by the District. Expenditures of these funds will be made in accordance with the Salmon and Steelhead Agreement and the Biological Opinion for the protection and restoration of habitats along the mainstem and tributaries within the Upper Columbia River watershed including the Okanogan, Methow, Entiat, and Wenatchee River watersheds. These funds are intended to compensate for 2% of the unavoidable mortality to salmonids due to the operation of the hydroelectric project. The District anticipates funding these accounts up to and through the New License term. The District's required contributions to the Habitat funds are comprised of a fixed portion and a portion which is variable based on annual salmonid mortality within the Priest Rapids Project.

In October 2006, The District filed a request for a 401 Water Quality Certification ("WQC") from the Washington State Department of Ecology ("Ecology"), pursuant to the provisions of section 401 of the Clean Water Act. A 401 WQC for the operation of the Priest Rapids Project was issued by Ecology on April 3, 2007, and amended on March 6, 2008.

In order to fulfill requirements of the 401 WQC related to native resident fish, the District is required to provide funds to track native resident fish species diversity and provide mitigation

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for impacts to and loss of resident fish and harvest opportunities by compliance with Parts A and B as described below.

To remain in compliance under Part A (“Hatchery Renovation”), the District is required to provide funds (not to exceed \$1,500,000) to renovate the existing Columbia Basin Hatchery facility to ensure stable operations at current capacity for the term of license. Current capacity is 60,000-70,000 pounds of trout annually, which shall be credited to the District as mitigation for reduced recreational fishing opportunities occurring on native resident fish species. Under Part B (“Resident Fish Monitoring and Trout Purchase”), the District is obligated to establish and administer a fund for resident fish monitoring and fish purchase. Funds from Part B are specifically directed towards the monitoring of native resident fish species within the Priest Rapids Project area. The District is required to make contributions to the fund annually on or before February 15 of each year in the amount of \$100,000 per year, based upon 2003 dollars and annually adjusted for inflation.

The District’s total contributions to the Habitat funds for the years ended December 31, 2008 and December 31, 2007 equaled \$2,485,770 and \$2,409,287, respectively. This cost was charged to administrative and general expense. The following table shows the District's projected remaining fixed contributions to the Habitat funds as of December 31, 2008 representing required contributions through the New License term.

Projected Fixed Habitat Funding Commitments

2009	\$	2,689,000
2010		3,525,000
2011		2,234,000
2012		1,532,000
2013		1,581,000
2014 and thereafter		123,147,000
		<hr/>
Total	\$	134,708,000
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Participation In Northwest Open Access Network, Inc. D.B.A. NoaNet - The District, along with 11 other Washington State Public Utility Districts and Energy Northwest, 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 BPA, throughout the State of Washington to assist its members in the efficient management of load, conservation and acquisition of electric energy as well as other purposes. 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 mature through December 2016, with

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interest due semi-annually at rates ranging from 6.34% to 7.09%. Each member of NoaNet has entered into a Repayment Agreement to guarantee the bonds of NoaNet. The District's guarantee is limited to a maximum of 17.57% of the bonds. In January 2003, NoaNet established a \$5 million nonrevolving line of credit with a commercial lender in order to finance capital expenditures and network upgrades. In 2006, NoaNet established a second line of credit for that same purpose in the amount of \$4.5 million which will be repaid over the next five years. In August 2008, NoaNet established a third line of credit for the same purpose in the amount of \$1.5 million which will be repaid over the next five years. At the end of 2008, the amount remaining to be paid on the 2008, 2006, and 2003 lines of credit were \$1,500,000, \$2,629,495 and \$76,923, respectively. NoaNet pledged future assessments, if necessary, to repay the lines of credit, of which the District will pay its ownership share.

The management of NoaNet anticipates meeting its cost of operations through revenues but it has been necessary for NoaNet to assess members a fee to cover its debt obligations during the initial years of operation. The obligation paid in 2008 and 2007 by the District was \$361,583 and \$432,109, respectively.

10. PENSION / RETIREMENT PLAN

Substantially all 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. The CAFR is the responsibility of the State of Washington and is not a component of the District's financial statements. PricewaterhouseCoopers LLP (PwC), independent accountant for the District, has not audited or examined any information in the CAFR, and accordingly, does not express an opinion or any other form of assurance with respect thereto. 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*.

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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; 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 participants 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 participants 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 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statute 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 annual benefit is two percent of the average final compensation (AFC) per year of service, capped at 60 percent. (The AFC is based on the greatest compensation during any 24 eligible consecutive compensation months.) Plan 1 members who retire from inactive status prior to the age of 65 may receive actuarially reduced benefits. The benefit is actuarially reduced to reflect the choice of a survivor option. A cost-of living allowance (COLA) is granted at age 66 based upon years of service times the COLA amount, increased by 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 2 members are vested after the completion of five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service with an allowance of two

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percent of the AFC per year of service. (The AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 2 members who retire prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a three percent per year reduction applies; otherwise an actuarial reduction will apply. The benefit is also actuarially reduced 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.

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 benefit calculated at 1 percent of the AFC per year of service. (The AFC is based on the greatest compensation during any eligible consecutive 60-month period.) 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 of service, if twelve 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 to retire with full benefits at age 65, or they may retire at age 55 with 10 years of service. Plan 3 members who retire prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a three percent per year reduction applies; otherwise an actuarial reduction will apply. The benefit is also actuarially reduced to reflect the choice 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.

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 Employee Retirement Benefits Board.

There are 1,190 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2007:

Retirees and Beneficiaries Receiving Benefits	71,244
Terminated Plan Members Entitled to but not yet Receiving Benefits	26,583
Active Plan Members Vested	105,447
Active Plan Members Non-vested	52,575
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Total	255,849
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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 six percent for state agencies and local government unit employees, and at 7.5 percent for state government

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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 Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 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, 2008, were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	8.31%**	8.31%**	8.31%***
Employee	6.00%****	5.45%****	*****

* The employer rates include the employer administrative expense fee currently set at 0.16%.

** The employer rate for state elected officials is 12.39% for Plan 1 and 8.31% for Plan 2 and Plan 3.

*** Plan 3 defined benefit portion only.

**** The employee rate for state elected officials is 7.50% for Plan 1 and 5.45% for Plan 2.

***** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the District and the employees made the required contributions. The District's required contributions for the years ended December 31 were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2008	\$ 464,009	\$ 4,879,826	\$ 1,389,794
2007	225,320	2,108,927	538,053
2006	138,063	1,073,911	260,011

Deferred Compensation Plan – The District has an Internal Revenue Code Section 457 (b) deferred compensation program covering eligible employees as defined in the plan document. Participants may contribute and defer, up to defined limits, a portion of their current year's salary. The deferred compensation is held in trust and is not available to employees until

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termination, retirement, death, or unforeseeable emergency. In October 2008, the District established a loan provision in accordance with IRS guidelines. All plan assets are held in trust for the exclusive benefit of participants and their beneficiaries and therefore are not included in the District's financial statements.

Additionally, the District administers the Public Utility District No. 2 of Grant County's 401(a) Governmental Money Purchase Plan and Trust (fixed and variable plan) and makes matching contributions to either the Section 457 deferred compensation plan or the 401(a) defined contribution plan (employee's choice) for eligible employees. The match provides 50 cents per one dollar of employee contributions and the District's match is capped at 2% of straight-time employee wages for the pay period. The District's matching employer contributions are solely deposited in the 401(a) plan.

The District made matching contributions of \$781,908 in 2008, and \$712,357 in 2007.

11. POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS ("OPEB")

Plan Description

The District administers a single-employer defined benefit premium program ("the retiree subsidy plan"). The plan provides a subsidy that covers a portion of healthcare insurance for retirees ages 60 to 65 and their spouses. The retiree subsidy plan may be amended through collective bargaining (for bargaining unit employees) and ratified by the District's Commission, or changed without bargaining for nonunit employees. The retiree subsidy plan does not issue a publicly available financial report.

Funding Policy

The District pays a percentage of the medical premiums based upon years of service of the retirees. Starting on their 60th year, the retiree is eligible for a subsidy of 3% of their premium cost for each year of service (including any partial year during the year of retirement) up to 30 years (years x 3% x retiree premium). The subsidy cannot be more than the premium amount paid for active employees and is effective until the retiree turns 65. For the years ended December 31, 2008 and 2007, the District paid \$256,945 and \$192,647 in retiree subsidies, respectively.

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Annual OPEB Cost and Net Obligation

The District's annual OPEB cost (expense) is calculated based on the annual required contribution ("ARC") of the employer. The District's ARC and related information is based upon an actuarial valuation as required by GASB Statement No. 45. As of year end, the ARC represents the normal cost for the year and the total unfunded accrued liability. The following table shows the components of the District's annual OPEB cost for the years ending December 31, 2008 and 2007:

Actuarial Accrued Liability (AAL)

	2008	2007
Normal cost with interest	\$ 116,252	\$ 112,866
Amortization amount with interest	<u>285,043</u>	<u>279,103</u>
Annual required contribution	<u>\$ 401,295</u>	<u>\$ 391,969</u>
Annual OPEB cost	\$ 401,295	\$ 391,969
Less: benefit payments	<u>(256,945)</u>	<u>(192,647)</u>
Increase in net OPEB obligation	144,350	199,322
Net OPEB obligation at beginning of year	<u>199,322</u>	<u>-</u>
Net OPEB obligation at end of year	<u>\$ 343,672</u>	<u>\$ 199,322</u>

Funded Status and Funding Progress

As of December 31, 2008 and 2007, the District's AAL was \$4,381,803 and \$4,290,498, respectively, all of which was unfunded. The District has no plans at this time to fund the obligation using an irrevocable trust. The AAL will be amortized over a 30-year period and the increase in net OPEB obligation will be accrued each year and will be split between the District systems, based on current labor allocations. For 2008 and 2007, the covered payroll (annual payroll of active employees covered by the plan) was \$47,621,867 and \$45,134,752, respectively, and the ratio of the unfunded obligation to the covered payroll was 9.2% and 9.5%, respectively.

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

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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.

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 which was December 31, 2007. The actuarial results were calculated based on the Projected Unit Credit actuarial funding method. The methods and assumptions used include techniques that are designed to reduce the effect 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 are the significant assumptions related to the plan's actuarial liability:

Retirement age for active employees – Based on assumptions used by Washington Public Employees' Retirement System ("PERS") but adjusted to reflect expected future rates of retirement based on current experience of the District.

Mortality – Life expectancies were based on the RP 2000 combined active/retiree healthy mortality table for males and females.

Medical Trends – Premium increases of 7.0% in 2009 and declining percentages in future years. It is assumed that the monthly premium and maximum employer subsidy amounts will increase at a slower rate than future claims in the immediate future.

Discount Rate – The discount rate of 5.0% that was used in the valuation represents the expected long-term return on short-term U.S. Treasury securities and similar investments as of January 1, 2008. This rate is used because the Plan is "unfunded" and the District's assets would be used to pay benefits.

12. CONTINGENCIES

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.

13. SUPPLEMENTAL DISCLOSURE OF TELECOMMUNICATION ACTIVITIES

As described in Note 9, the District, along with 11 other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network ("NoaNet"), a Washington nonprofit mutual corporation established in 2000. The network began commercial operation in January 2001. NoaNet leases a fiber optic network from Bonneville Power Administration and was created to assist in the development of a communications

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network to facilitate the utilities in the management of load, conservation, and acquisition of electrical energy. The network assists utilities in adapting high speed information technology systems to meet future customer needs.

The District is installing a fiber optic distribution system in its service area. This fiber optic distribution system is connected to NoaNet's fiber optic communication system. The District has made capacity on this system available to providers of high speed Internet services, and telephone services, among others.

A summary of the financial position and results of operations of the Telecommunication activities as of and for the year ended December 31 are as follows:

	2008	2007
Operating revenues		
Wholesale fiber services	\$ 1,924,139	\$ 1,679,793
Dark fiber revenue	71,160	-
	<u>1,995,299</u>	<u>1,679,793</u>
Wholesale fiber services	\$ 1,995,299	\$ 1,679,793
Operating expenses		
Administrative and general	\$ 1,132,614	\$ 1,239,247
Repair and maintenance	412,379	499,920
Impaired capital assets	-	165,209
Depreciation	5,072,002	2,881,665
	<u>6,616,995</u>	<u>4,786,041</u>
Total operating expenses	\$ 6,616,995	\$ 4,786,041
Nonoperating revenues		
Contribution in aid of construction	\$ 214,799	\$ 15,528
Utility plant		
Additions to construction in progress	\$ 11,091,061	\$ 2,426,251
Utility plant, net of accumulated depreciation	\$ 60,683,099	\$ 54,664,040

14. EXTRAORDINARY ITEMS

In February 2006, a fire broke out in the Wanapum powerhouse. The cause of the fire remains undetermined. The powerhouse remained functional despite extensive smoke damage to the building. The repair and cleanup costs totaled \$2,431,845 related to the event. In addition, there were other assets destroyed that had a net book value of \$857,046. In

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September 2008, the District received insurance proceeds of \$2,609,156, net of the District's deductible of \$250,000, in connection with the powerhouse fire.

A malfunction of the opening mechanism of tainter gate number 12 at Wanapum caused significant damage to the gate. The damage to the gate has been repaired at a cost of \$2,362,980. In February 2008, the District received insurance proceeds of \$1,189,349, net of the District's deductible of \$250,000, in connection with the gate malfunction.

In 2007, the District recognized receivables and extraordinary gains associated with the above events based on agreements reached with the insurance company which resulted in substantive realization of the insurance proceeds in advance of actual collections. In 2008, the net extraordinary gains were adjusted primarily as a result of the District's final accounting for its costs associated with these events.

15. CONSOLIDATING SEGMENTS

The District has outstanding revenue bonds used to finance the Electric System, as well as the Priest Rapids and Wanapum hydroelectric production facilities. As described in Note 6, all the outstanding bond issues, which are on parity with each other, are secured by a pledge of the gross revenues only of the individual project or system that issued the bonds.

Each project has an external requirement to be accounted for separately. The following consolidating financial schedules of the operating segments of the District include these three segments, Electric System, Priest Rapids and Wanapum, along with the Service System. The Service System is presented in order to reconcile to the consolidated results as it is not considered a segment of the District.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS DECEMBER 31, 2008

CONSOLIDATING SCHEDULE OF ASSETS

ASSETS	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
CURRENT ASSETS						
Cash	\$ 7,225,719	\$ 839,510	\$ 2,119,769	\$ -	\$ -	\$ 10,184,998
Restricted cash and investments - Habitat funds	-	3,043,841	3,043,840	-	66,401	6,154,082
Bond principal and interest funds - restricted						
Cash	5,194,015	-	35,096	-	-	5,229,111
Investments and other	9,081,516	19,320,708	26,732,125	-	(8,046,315)	47,088,034
U.S. government and agency securities and short-term investments	73,762,699	14,558,935	5,723,996	196,080	-	94,241,710
Advances to Service System	992,275	1,196,136	1,196,136	-	(3,384,547)	-
Customer accounts receivable, net of allowance for uncollectible accounts of \$353,193	29,260,491	-	-	84,096	-	29,344,587
Materials and supplies	16,029,762	-	-	2,166,018	-	18,195,780
Due from special funds and bond funds	148,471	1,736,317	2,308,974	46,370,874	(50,564,636)	-
Other current assets	1,739,617	631,350	680,578	-	-	3,051,545
Special funds						
Cash in special funds	3,441,195	484,223	1,634,963	435,959	-	5,996,340
Noncash special funds	92,967,331	51,776,090	87,901,675	767,809	18,510,056	251,922,961
Total current assets	<u>239,843,091</u>	<u>93,587,110</u>	<u>131,377,152</u>	<u>50,020,836</u>	<u>(43,419,041)</u>	<u>471,409,148</u>
NONCURRENT ASSETS						
Long-term noncash special funds	7,912,406	-	-	-	-	7,912,406
Unamortized debt expense	828,386	2,323,976	4,116,384	-	-	7,268,746
Conservation loans	421,072	-	-	-	-	421,072
Long-term receivables, net of allowance for uncollectible accounts	644,180	-	-	-	-	644,180
Demand-Side Management	6,615,592	-	-	-	-	6,615,592
Deferred preliminary expenses	-	266,310	301,172	-	-	567,482
Total other noncurrent assets	<u>16,421,636</u>	<u>2,590,286</u>	<u>4,417,556</u>	<u>-</u>	<u>-</u>	<u>23,429,478</u>
Utility plant, net of accumulated depreciation and amortization	<u>429,703,257</u>	<u>247,315,471</u>	<u>438,595,489</u>	<u>-</u>	<u>-</u>	<u>1,115,614,217</u>
Total noncurrent assets	<u>446,124,893</u>	<u>249,905,757</u>	<u>443,013,045</u>	<u>-</u>	<u>-</u>	<u>1,139,043,695</u>
TOTAL ASSETS	<u>\$ 685,967,984</u>	<u>\$ 343,492,867</u>	<u>\$ 574,390,197</u>	<u>\$ 50,020,836</u>	<u>\$ (43,419,041)</u>	<u>\$ 1,610,452,843</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS

DECEMBER 31, 2008

CONSOLIDATING SCHEDULE OF LIABILITIES AND NET ASSETS

LIABILITIES AND NET ASSETS	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
CURRENT LIABILITIES						
Accounts payable						
Trade	\$ 10,873,508	\$ 1,114,815	\$ 686,764	\$ 35,445,555	\$ 5,139,530	\$ 53,260,172
Wages payable	-	-	-	11,124,249	-	11,124,249
Power purchasers	-	5,779,389	1,259,655	-	(5,139,530)	1,899,514
Due to other district systems and funds, net	24,874,417	7,817,039	7,323,817	3,403,768	(43,419,041)	-
Accrued taxes	3,016,891	918,235	861,074	47,264	-	4,843,464
Customer deposits	3,406,247	-	-	-	-	3,406,247
Accrued bond interest	3,900,531	6,130,929	10,549,327	-	-	20,580,787
Unearned revenue	289,636	-	-	-	-	289,636
Habitat PRCC liability	-	3,043,841	3,043,840	-	-	6,087,681
Other current liabilities	-	-	35,096	-	-	35,096
Current portion of long-term obligations	-	1,344,546	1,344,546	-	-	2,689,092
Current portion of long-term debt	10,375,000	9,870,000	11,320,000	-	-	31,565,000
	<u>56,736,230</u>	<u>36,018,794</u>	<u>36,424,119</u>	<u>50,020,836</u>	<u>(43,419,041)</u>	<u>135,780,938</u>
Total current liabilities						
NONCURRENT LIABILITIES						
Accrued other postemployment benefits	140,016	82,102	118,554	-	-	340,672
Federal arbitrage tax liability	-	332,771	398,143	-	-	730,914
Long-term unearned revenue	1,821,440	-	-	-	-	1,821,440
Licensing obligations, less current portion	-	20,715,452	20,715,452	-	-	41,430,904
Revenue bonds, less current portion	138,110,000	238,010,000	410,710,000	-	-	786,830,000
Unamortized premium	4,200,384	3,323,681	6,522,489	-	-	14,046,554
Unamortized discount	-	(256,011)	(647,270)	-	-	(903,281)
Unamortized refunding loss	(767,653)	(6,145,030)	(4,095,612)	-	-	(11,008,295)
	<u>143,504,187</u>	<u>256,062,965</u>	<u>433,721,756</u>	<u>-</u>	<u>-</u>	<u>833,288,908</u>
Total noncurrent liabilities						
Total liabilities	<u>200,240,417</u>	<u>292,081,759</u>	<u>470,145,875</u>	<u>50,020,836</u>	<u>(43,419,041)</u>	<u>969,069,846</u>
NET ASSETS						
Invested in capital assets, net of related debt	278,613,912	34,970,661	86,246,839	-	-	399,831,412
Net restricted assets	10,375,000	9,870,000	11,355,096	-	-	31,600,096
Unrestricted	196,738,655	6,570,447	6,642,387	-	-	209,951,489
	<u>485,727,567</u>	<u>51,411,108</u>	<u>104,244,322</u>	<u>-</u>	<u>-</u>	<u>641,382,997</u>
Total net assets						
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 685,967,984</u>	<u>\$ 343,492,867</u>	<u>\$ 574,390,197</u>	<u>\$ 50,020,836</u>	<u>\$ (43,419,041)</u>	<u>\$ 1,610,452,843</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2008

CONSOLIDATING SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
OPERATING REVENUES						
Sales to power purchasers at cost	\$ -	\$ 54,150,258	\$ 65,664,345	\$ -	\$ (66,216,045)	\$ 53,598,558
Retail energy sales						
Residential	31,926,286	-	-	-	-	31,926,286
Irrigation	16,555,562	-	-	-	-	16,555,562
Commercial and industrial	61,773,063	-	-	-	-	61,773,063
Governmental and others	931,072	-	-	-	-	931,072
Sales to other utilities	115,636,467	-	-	-	-	115,636,467
Fiber optic network sales	2,025,299	-	-	-	-	2,025,299
Other	3,979,365	-	-	-	-	3,979,365
Total operating revenues	232,827,114	54,150,258	65,664,345	-	(66,216,045)	286,425,672
OPERATING EXPENSES						
Purchased power	102,262,403	-	-	-	(66,216,045)	36,046,358
Generation	378,920	18,211,713	19,710,730	-	-	38,301,363
Transmission	7,166,830	932,069	1,047,955	-	-	9,146,854
Distribution	9,461,035	-	-	-	-	9,461,035
Customer and information services	4,385,547	-	-	-	-	4,385,547
Fiber optic network operations	1,132,614	-	-	-	-	1,132,614
Administrative and general	11,635,258	14,365,843	15,699,308	-	-	41,700,409
Depreciation and amortization	23,459,726	5,081,327	8,206,028	-	-	36,747,081
Taxes	8,395,355	918,235	861,074	-	-	10,174,664
Total operating expenses	168,277,688	39,509,187	45,525,095	-	(66,216,045)	187,095,925
NET OPERATING INCOME	64,549,426	14,641,071	20,139,250	-	-	99,329,747
OTHER REVENUES (EXPENSES)						
Interest and other income	5,435,576	2,264,701	3,802,839	-	-	11,503,116
Interest on revenue bonds and other, net of capitalized interest of \$5,141,635	(7,895,769)	(12,192,982)	(17,744,711)	-	-	(37,833,462)
Amortization of debt expense, discount, and premium	482,950	(916,190)	(575,999)	-	-	(1,009,239)
Total other revenues (expenses)	(1,977,243)	(10,844,471)	(14,517,871)	-	-	(27,339,585)
CONTRIBUTION IN AID OF CONSTRUCTION	9,058,551	-	44,905	-	-	9,103,456
EXTRAORDINARY LOSS						
Loss related to powerhouse fire and gate malfunction	-	-	(176,482)	-	-	(176,482)
Loss on insurance settlements	-	-	(79,916)	-	-	(79,916)
Net extraordinary loss	-	-	(256,398)	-	-	(256,398)
CHANGE IN NET ASSETS	71,630,734	3,796,600	5,409,886	-	-	80,837,220
NET ASSETS						
Beginning of year	414,096,833	47,614,508	98,834,436	-	-	560,545,777
End of year	\$ 485,727,567	\$ 51,411,108	\$ 104,244,322	\$ -	\$ -	\$ 641,382,997

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2008

CONSOLIDATING SCHEDULE OF CASH FLOWS

	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
CASH FLOWS FROM OPERATING ACTIVITIES						
Cash received from retail energy sales	\$ 109,773,701	\$ -	\$ -	\$ -	\$ -	\$ 109,773,701
Cash received from sales to power purchasers at cost	-	54,389,570	69,700,093	-	(68,686,617)	55,403,046
Cash received from sales to other utilities	107,622,004	-	-	-	-	107,622,004
Other cash receipts	6,188,963	-	-	-	-	6,188,963
Cash paid from customer deposits	(245,546)	-	-	-	-	(245,546)
Cash paid for demand side management	(1,133,311)	-	-	-	-	(1,133,311)
Cash paid for purchase of power	(97,680,857)	-	-	-	68,686,617	(28,994,240)
Cash paid to contractors, suppliers, and employees	(27,641,780)	(31,257,204)	(37,491,408)	3,703,641	-	(92,686,751)
Cash received from other long-term receivables	11,500,000	-	-	-	-	11,500,000
Cash received from long-term contracts	1,821,440	-	-	-	-	1,821,440
Taxes paid	(8,106,709)	(991,863)	(971,704)	-	-	(10,070,276)
Net cash provided by operating activities	102,097,905	22,140,503	31,236,981	3,703,641	-	159,179,030
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Principal paid on revenue bonds	(9,895,000)	(9,325,000)	(10,445,000)	-	-	(29,665,000)
Interest paid on revenue bonds	(8,042,143)	(12,456,436)	(21,315,320)	-	-	(41,813,899)
Relicensing costs	-	(38,035)	(38,035)	-	-	(76,070)
Cash received from contribution in aid of construction	5,578,264	-	44,905	-	-	5,623,169
Insurance proceeds	-	-	3,798,505	-	-	3,798,505
Extraordinary loss - Powerhouse fire and gate malfunction	-	-	(256,398)	-	-	(256,398)
Acquisition and construction of plant assets	(59,677,269)	(11,996,995)	(30,237,590)	-	-	(101,911,854)
Proceeds on sale of plant assets	1,071,471	124,343	124,343	-	-	1,320,157
Net cash used in capital and related financing activities	(70,964,677)	(33,692,123)	(58,324,590)	-	-	(162,981,390)
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchase of investment securities	(368,817,512)	(150,878,655)	(201,123,825)	(4,100,000)	-	(724,919,992)
Sale proceeds of investment securities	346,109,748	154,505,213	223,788,371	-	-	724,403,332
Investment income proceeds	3,457,549	2,340,610	3,895,756	-	-	9,693,915
Net repurchase agreement	(6,686,679)	4,074,303	872,523	419,568	-	(1,320,285)
Cash received from conservation loans	173,963	-	-	-	-	173,963
Net cash provided by (used in) investing activities	(25,762,931)	10,041,471	27,432,825	(3,680,432)	-	8,030,933
NET INCREASE (DECREASE) IN CASH	\$ 5,370,297	\$ (1,510,149)	\$ 345,216	\$ 23,209	\$ -	\$ 4,228,573

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

**NOTE 15 - CONSOLIDATING SEGMENTS
FOR THE YEAR ENDED DECEMBER 31, 2008**

CONSOLIDATING SCHEDULE OF CASH FLOWS, CONTINUED

	Electric System	Priest Rapids	Wanapum	Service System	Total
CASH AT END OF YEAR					
Special funds	\$ 3,441,195	\$ 484,223	\$ 1,634,963	\$ 435,959	\$ 5,996,340
Bond funds	5,194,015	-	35,096	-	5,229,111
Restricted funds	-	1,114,387	1,114,387	-	2,228,774
Working capital	7,225,719	839,510	2,119,769	-	10,184,998
Total cash at end of year	<u>15,860,929</u>	<u>2,438,120</u>	<u>4,904,215</u>	<u>435,959</u>	<u>23,639,223</u>
CASH AT BEGINNING OF YEAR					
Special funds	570,260	2,355,447	3,364,583	412,750	6,703,040
Bond fund debt service	4,835,267	-	55,193	-	4,890,460
Restricted funds	-	654,526	654,526	-	1,309,052
Working capital	5,085,105	938,296	484,697	-	6,508,098
Total cash at beginning of year	<u>10,490,632</u>	<u>3,948,269</u>	<u>4,558,999</u>	<u>412,750</u>	<u>19,410,650</u>
NET INCREASE (DECREASE) IN CASH	<u>\$ 5,370,297</u>	<u>\$ (1,510,149)</u>	<u>\$ 345,216</u>	<u>\$ 23,209</u>	<u>\$ 4,228,573</u>
OPERATING ACTIVITIES					
Net operating income	\$ 64,549,426	\$ 14,641,071	\$ 20,139,250	\$ -	\$ 99,329,747
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:					
Depreciation and amortization	23,459,726	5,081,327	8,206,028	-	36,747,081
Provision for uncollectible accounts	312,133	-	-	-	312,133
Cash provided by (used in) changes in operating assets and liabilities:					
Advances to Service System	805	403	403	(1,611)	-
Change in Habitat funds held in trust	-	459,861	459,861	-	919,722
Customer accounts receivable	(8,551,378)	-	-	-	(8,551,378)
Materials and supplies	826,740	-	-	(372,005)	454,735
Other current assets	(589,703)	211,390	10,376	178,520	(189,417)
Other long-term receivables	11,500,000	-	-	-	11,500,000
Unearned revenue	1,821,440	-	-	-	1,821,440
Demand-Side Management	(1,133,311)	-	-	-	(1,133,311)
Trade payables	5,116,868	(131,522)	(27,630)	10,732,517	15,690,233
Payable to (receivable from) power purchasers	(1,981,235)	239,312	4,035,748	-	2,293,825
Payable to (receivable from) other District systems, net	6,665,199	1,678,224	(1,505,518)	(6,837,905)	-
Accrued taxes	288,646	(73,628)	(110,630)	4,125	108,513
Customer deposits	(245,546)	-	-	-	(245,546)
Other current liabilities	-	-	(20,097)	-	(20,097)
Accrued other postemployment benefits	58,095	34,065	49,190	-	141,350
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 102,097,905</u>	<u>\$ 22,140,503</u>	<u>\$ 31,236,981</u>	<u>\$ 3,703,641</u>	<u>\$ 159,179,030</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS DECEMBER 31, 2007

CONSOLIDATING SCHEDULE OF ASSETS

ASSETS	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
CURRENT ASSETS						
Cash	\$ 5,085,105	\$ 938,296	\$ 484,697	\$ -	\$ -	\$ 6,508,098
Restricted cash and investments - Habitat funds	-	1,884,339	1,884,339	-	85,971	3,854,649
Bond principal and interest funds - restricted						
Cash	4,835,267	-	55,193	-	-	4,890,460
Investments and other	9,201,039	18,971,223	26,079,445	-	(7,534,972)	46,716,735
U.S. government and agency securities and short-term investments	88,835,586	11,705,149	942,547	-	-	101,483,282
Advances to Service System	993,080	1,196,539	1,196,539	-	(3,386,158)	-
Customer accounts receivable, net of allowance for uncollectible accounts of \$665,326	23,386,345	-	-	262,614	-	23,648,959
Materials and supplies	16,856,502	-	-	1,794,013	-	18,650,515
Due from power purchasers	-	-	2,776,093	-	(1,013,290)	1,762,803
Due from special funds and bond funds	410,966	2,831,581	13,920,041	39,562,549	(56,725,137)	-
Other current assets	1,509,694	801,258	4,496,348	-	-	6,807,300
Special funds						
Cash in special funds	570,260	2,355,447	3,364,583	412,750	-	6,703,040
Noncash special funds	101,692,583	61,815,554	116,534,831	802,638	(28,306,258)	252,539,348
Total current assets	253,376,427	102,499,386	171,734,656	42,834,564	(96,879,844)	473,565,189
NONCURRENT ASSETS						
Relicensing costs	-	29,001,622	29,058,303	-	-	58,059,925
Unamortized debt expense	1,008,108	2,643,930	4,511,228	-	-	8,163,266
Conservation loans	595,035	-	-	-	-	595,035
Long-term receivables, net of allowance for uncollectible accounts	10,401,194	-	-	-	-	10,401,194
Demand-Side Management	6,409,124	-	-	-	-	6,409,124
Deferred preliminary expenses	-	11,764	11,764	-	-	23,528
Total other noncurrent assets	18,413,461	31,657,316	33,581,295	-	-	83,652,072
Utility plant, net of accumulated depreciation	393,008,228	189,610,161	362,467,399	-	-	945,085,788
Total noncurrent assets	411,421,689	221,267,477	396,048,694	-	-	1,028,737,860
TOTAL ASSETS	\$ 664,798,116	\$ 323,766,863	\$ 567,783,350	\$ 42,834,564	\$ (96,879,844)	\$ 1,502,303,049

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS DECEMBER 31, 2007

CONSOLIDATING SCHEDULE OF LIABILITIES AND NET ASSETS

LIABILITIES & NET ASSETS	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
CURRENT LIABILITIES						
Accounts payable						
Trade	\$ 7,737,570	\$ 1,246,337	\$ 714,394	\$ 27,471,047	\$ 3,158,295	\$ 40,327,643
Wages payable	-	-	-	11,904,990	-	11,904,990
Power purchasers	-	5,540,077	-	-	(4,171,585)	1,368,492
Due to other district systems and funds, net	66,209,218	6,367,815	19,874,133	3,415,388	(95,866,554)	-
Accrued taxes	2,728,245	991,863	971,704	43,139	-	4,734,951
Customer deposits	3,557,697	-	-	-	-	3,557,697
Accrued bond interest	4,141,306	6,325,507	10,765,993	-	-	21,232,806
Unearned revenue	3,769,923	-	-	-	-	3,769,923
Habitat PRCC liability	-	1,884,339	1,884,339	-	-	3,768,678
Other current liabilities	-	-	55,193	-	-	55,193
Current portion of long-term debt	9,895,000	9,325,000	10,445,000	-	-	29,665,000
Total current liabilities	<u>98,038,959</u>	<u>31,680,938</u>	<u>44,710,756</u>	<u>42,834,564</u>	<u>(96,879,844)</u>	<u>120,385,373</u>
NONCURRENT LIABILITIES						
Accrued other postemployment benefits	81,921	48,037	69,364	-	-	199,322
Federal arbitrage tax liability	-	216,977	540,343	-	-	757,320
Revenue bonds, less current portion	148,485,000	247,880,000	422,030,000	-	-	818,395,000
Unamortized premium	5,050,767	3,688,784	7,053,692	-	-	15,793,243
Unamortized discount	-	(288,731)	(697,843)	-	-	(986,574)
Unamortized refunding loss	(955,364)	(7,073,650)	(4,757,398)	-	-	(12,786,412)
Total noncurrent liabilities	<u>152,662,324</u>	<u>244,471,417</u>	<u>424,238,158</u>	<u>-</u>	<u>-</u>	<u>821,371,899</u>
Total liabilities	<u>250,701,283</u>	<u>276,152,355</u>	<u>468,948,914</u>	<u>42,834,564</u>	<u>(96,879,844)</u>	<u>941,757,272</u>
NET ASSETS						
Invested in capital assets, net of related debt	231,540,933	31,690,098	81,279,121	-	-	344,510,152
Net restricted assets	9,895,000	9,325,000	10,500,193	-	-	29,720,193
Unrestricted	172,660,900	6,599,410	7,055,122	-	-	186,315,432
Total net assets	<u>414,096,833</u>	<u>47,614,508</u>	<u>98,834,436</u>	<u>-</u>	<u>-</u>	<u>560,545,777</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 664,798,116</u>	<u>\$ 323,766,863</u>	<u>\$ 567,783,350</u>	<u>\$ 42,834,564</u>	<u>\$ (96,879,844)</u>	<u>\$ 1,502,303,049</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2007

CONSOLIDATING SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
OPERATING REVENUES						
Sales to power purchasers at cost	\$ -	\$ 46,712,241	\$ 54,637,861	\$ -	\$ (54,869,219)	\$ 46,480,883
Retail energy sales						
Residential	30,323,220	-	-	-	-	30,323,220
Irrigation	15,881,126	-	-	-	-	15,881,126
Commercial and industrial	54,026,068	-	-	-	-	54,026,068
Governmental and others	904,948	-	-	-	-	904,948
Sales to other utilities	119,195,047	-	-	-	-	119,195,047
Fiber optic network sales	1,679,793	-	-	-	-	1,679,793
Other	3,245,496	-	-	-	-	3,245,496
Total operating revenues	<u>225,255,698</u>	<u>46,712,241</u>	<u>54,637,861</u>	<u>-</u>	<u>(54,869,219)</u>	<u>271,736,581</u>
OPERATING EXPENSES						
Purchased power	84,505,021	-	-	-	(54,869,219)	29,635,802
Generation	833,414	14,484,358	13,856,134	-	-	29,173,906
Transmission	7,988,601	955,609	1,068,558	-	-	10,012,768
Distribution	9,530,993	-	-	-	-	9,530,993
Customer and information services	4,194,906	-	-	-	-	4,194,906
Fiber optic network operations	1,239,247	-	-	-	-	1,239,247
Administrative and general	11,074,835	12,288,306	12,895,442	-	-	36,258,583
Impaired capital assets	165,209	-	-	-	-	165,209
Depreciation	22,023,229	4,494,085	6,358,381	-	-	32,875,695
Taxes	7,886,626	991,863	971,704	-	-	9,850,193
Total operating expenses	<u>149,442,081</u>	<u>33,214,221</u>	<u>35,150,219</u>	<u>-</u>	<u>(54,869,219)</u>	<u>162,937,302</u>
NET OPERATING INCOME	<u>75,813,617</u>	<u>13,498,020</u>	<u>19,487,642</u>	<u>-</u>	<u>-</u>	<u>108,799,279</u>
OTHER REVENUES (EXPENSES)						
Interest and other income	7,169,558	4,653,266	7,940,238	-	-	19,763,062
Interest on revenue bonds and other, net of capitalized interest of \$4,606,500	(9,734,815)	(11,806,973)	(17,769,525)	-	-	(39,311,313)
Amortization of debt expense, discount, and premium	-	(1,070,590)	(664,679)	-	-	(1,735,269)
Total other revenues (expenses)	<u>(2,565,257)</u>	<u>(8,224,297)</u>	<u>(10,493,966)</u>	<u>-</u>	<u>-</u>	<u>(21,283,520)</u>
CONTRIBUTION IN AID OF CONSTRUCTION	<u>10,173,455</u>	<u>-</u>	<u>114,138</u>	<u>-</u>	<u>-</u>	<u>10,287,593</u>
EXTRAORDINARY GAIN (LOSS)						
Loss related to powerhouse fire and gate malfunction	-	-	(42,529)	-	-	(42,529)
Gain on insurance settlements	-	-	3,878,420	-	-	3,878,420
Net extraordinary gain (loss)	<u>-</u>	<u>-</u>	<u>3,835,891</u>	<u>-</u>	<u>-</u>	<u>3,835,891</u>
CHANGE IN NET ASSETS	<u>83,421,815</u>	<u>5,273,723</u>	<u>12,943,705</u>	<u>-</u>	<u>-</u>	<u>101,639,243</u>
NET ASSETS						
Beginning of year	<u>330,675,018</u>	<u>42,340,785</u>	<u>85,890,731</u>	<u>-</u>	<u>-</u>	<u>458,906,534</u>
End of year	<u>\$ 414,096,833</u>	<u>\$ 47,614,508</u>	<u>\$ 98,834,436</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 560,545,777</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2007

CONSOLIDATING SCHEDULE OF CASH FLOWS

	Electric System	Priest Rapids	Wanapum	Service System	Internal Transactions	Total
CASH FLOWS FROM OPERATING ACTIVITIES						
Cash received from retail energy sales	\$ 101,146,470	\$ -	\$ -	\$ -	\$ -	\$ 101,146,470
Cash received from sales to power purchasers at cost	-	50,675,619	50,169,488	-	(56,803,932)	44,041,175
Cash received from sales to other utilities	118,235,571	-	-	-	-	118,235,571
Other cash receipts	4,490,513	-	-	-	-	4,490,513
Cash received from customer deposits	29,981	-	-	-	-	29,981
Cash received from conservation loans	119,786	-	-	-	-	119,786
Cash paid for demand side management	(788,040)	-	-	-	-	(788,040)
Cash paid for purchase of power	(84,007,211)	-	-	-	56,803,932	(27,203,279)
Cash paid to contractors, suppliers, and employees	(30,509,038)	(26,202,351)	(23,701,293)	569,725	-	(79,842,957)
Cash paid for materials and supplies	(2,098,665)	-	-	(324,702)	-	(2,423,367)
Cash received from other long-term receivables	(647,883)	-	-	-	-	(647,883)
Taxes paid	(7,781,655)	(963,642)	(936,775)	-	-	(9,682,072)
Net cash provided by operating activities	98,189,829	23,509,626	25,531,420	245,023	-	147,475,898
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Principal paid on revenue bonds	(57,730,000)	(7,795,000)	(8,870,000)	-	-	(74,395,000)
Interest paid on revenue bonds	(9,722,569)	(11,360,078)	(17,402,537)	-	-	(38,485,184)
Payment on refunded debt	-	(495,000)	(410,000)	-	-	(905,000)
Bond issuance costs	-	(131,478)	2,229	-	-	(129,249)
Relicensing costs	-	(285,492)	(285,492)	-	-	(570,984)
Cash received from contribution in aid of construction	11,843,378	-	114,138	-	-	11,957,516
Extraordinary loss - Powerhouse fire and gate malfunction	-	-	(42,529)	-	-	(42,529)
Acquisition and construction of plant assets	(48,494,265)	(13,284,591)	(49,307,858)	-	-	(111,086,714)
Proceeds on sale of plant assets	8,733,910	-	-	-	-	8,733,910
Net cash used in capital and related financing activities	(95,369,546)	(33,351,639)	(76,202,049)	-	-	(204,923,234)
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchase of investment securities	(263,816,823)	(130,583,246)	(146,053,829)	-	-	(540,453,898)
Sale proceeds of investment securities	205,683,055	140,262,220	190,726,153	-	-	536,671,428
Investment income proceeds	6,986,682	4,965,262	8,483,096	-	-	20,435,040
Net repurchase agreement	55,747,961	(1,653,389)	1,160,914	133,784	-	55,389,270
Net cash provided by investing activities	4,600,875	12,990,847	54,316,334	133,784	-	72,041,840
NET INCREASE IN CASH	\$ 7,421,158	\$ 3,148,834	\$ 3,645,705	\$ 378,807	\$ -	\$ 14,594,504

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 15 - CONSOLIDATING SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2007

CONSOLIDATING SCHEDULE OF CASH FLOWS, CONTINUED

	Electric System	Priest Rapids	Wanapum	Service System	Total
CASH AT END OF YEAR					
Special funds					
Bond funds	\$ 570,260	\$ 2,355,447	\$ 3,364,583	\$ 412,750	\$ 6,703,040
Restricted funds	4,835,267	-	55,193	-	4,890,460
Working capital	-	654,526	654,526	-	1,309,052
	<u>5,085,105</u>	<u>938,296</u>	<u>484,697</u>	<u>-</u>	<u>6,508,098</u>
Total cash at end of year	<u>10,490,632</u>	<u>3,948,269</u>	<u>4,558,999</u>	<u>412,750</u>	<u>19,410,650</u>
CASH AT BEGINNING OF YEAR					
Special funds					
Bond fund debt service	42,252	122,197	203,296	33,943	401,688
Restricted funds	176,578	-	-	-	176,578
Working capital	-	654,526	654,526	-	1,309,052
	<u>2,850,644</u>	<u>22,712</u>	<u>55,472</u>	<u>-</u>	<u>2,928,828</u>
Total cash at beginning of year	<u>3,069,474</u>	<u>799,435</u>	<u>913,294</u>	<u>33,943</u>	<u>4,816,146</u>
NET INCREASE IN CASH	<u>\$ 7,421,158</u>	<u>\$ 3,148,834</u>	<u>\$ 3,645,705</u>	<u>\$ 378,807</u>	<u>\$ 14,594,504</u>
OPERATING ACTIVITIES					
Net operating income					
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:	\$ 75,813,617	\$ 13,498,020	\$ 19,487,642	\$ -	\$ 108,799,279
Depreciation					
Provision for uncollectible accounts	22,023,229	4,494,085	6,358,381	-	32,875,695
Cash provided by (used in) changes in operating assets and liabilities:	(134,381)	-	-	-	(134,381)
Advances to Service System					
Customer accounts receivable	(12,481)	(6,240)	(6,241)	24,962	-
Materials and supplies	(2,565,244)	-	-	-	(2,565,244)
Other current assets	(2,239,652)	-	-	(324,702)	(2,564,354)
Conservation loans	(25,474)	(181,512)	2,829,782	(154,254)	2,468,542
Other long-term receivables	119,786	-	-	-	119,786
Demand-Side Management	(647,883)	-	-	-	(647,883)
Trade payables	(788,040)	-	-	-	(788,040)
(Receivable from) payable to power purchasers	1,948,213	562,751	(2,690,136)	3,322,057	3,142,885
Payable to (receivable from) other District systems, net	-	3,963,378	(4,468,373)	-	(504,995)
Accrued taxes	4,481,266	1,102,886	3,860,879	(2,628,146)	6,816,885
Customer deposits	104,971	28,221	34,929	5,106	173,227
Other current liabilities	29,981	-	-	-	29,981
Accrued other postemployment benefits	-	-	55,193	-	55,193
	<u>81,921</u>	<u>48,037</u>	<u>69,364</u>	<u>-</u>	<u>199,322</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 98,189,829</u>	<u>\$ 23,509,626</u>	<u>\$ 25,531,420</u>	<u>\$ 245,023</u>	<u>\$ 147,475,898</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

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Supplementary Information

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
COLUMBIA RIVER-PRIEST RAPIDS HYDROELECTRIC PRODUCTION SYSTEM

SCHEDULE OF CHANGES IN WORKING CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	Revenue Fund	Construction Fund	Relicensing Fund	Supp R&R Fund	Bond Interest Funds	Bond Sinking Funds	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
Ending Working Capital	\$ 1,988,224	\$ 46,260,313	\$ -	\$ 6,000,000	\$ 3,319,779	\$ -	\$ 57,568,316	\$ 70,818,448
Beginning Working Capital	3,326,731	57,060,834	1,110,167	6,000,000	3,320,716	-	70,818,448	47,684,748
NET CHANGE IN WORKING CAPITAL	<u>\$ (1,338,507)</u>	<u>\$ (10,800,521)</u>	<u>\$ (1,110,167)</u>	<u>\$ -</u>	<u>\$ (937)</u>	<u>\$ -</u>	<u>\$ (13,250,132)</u>	<u>\$ 23,133,700</u>
POWER COST PROFORMA DEPOSITS:								
Operations and maintenance	\$ 38,288,064	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 38,288,064	\$ 30,203,430
Principal						9,870,000	9,870,000	9,325,000
Interest					8,941,142		8,941,142	9,923,499
15% of debt service				3,319,779			3,319,779	3,320,716
Proforma deposits sub-total	38,288,064	-	-	3,319,779	8,941,142	9,870,000	60,418,985	52,772,645
Year-end power cost adjustment	(6,268,727)						(6,268,727)	(6,060,404)
Total power cost proforma deposit	<u>32,019,337</u>	<u>-</u>	<u>-</u>	<u>3,319,779</u>	<u>8,941,142</u>	<u>9,870,000</u>	<u>54,150,258</u>	<u>46,712,241</u>
Less								
15% of debt service transferred as an offset to interest expense				(3,319,779)	3,319,779		-	-
Plant/capital additions		(11,474,259)	(1,072,132)				(12,546,391)	(14,121,278)
Capitalized interest on CWIP		928,284					928,284	844,040
Current portion of long-term obligations	(1,344,546)						(1,344,546)	-
Normal operations and maintenance	(34,393,793)						(34,393,793)	(28,623,662)
Extraordinary operations and maintenance							-	(48,438)
Interest/misc income	2,206,106			168,349			2,374,455	4,480,636
Excess fund balance transfer	168,349			(168,349)			-	-
Change in federal arbitrage tax liability	115,794						115,794	216,977
Change in current year sinking fund requirements						(545,000)	(545,000)	(1,530,000)
Face amount of debt retired						(9,325,000)	(9,325,000)	(7,795,000)
Bond interest expense					(12,261,858)		(12,261,858)	(12,651,012)
Preliminary surveys		(254,546)					(254,546)	(11,764)
Relicensing costs			(38,035)				(38,035)	(285,491)
Transfer from long-term noncash special funds							-	35,739,593
Unrealized (gain)/loss on investments	(109,754)						(109,754)	206,858
NET CHANGE IN WORKING CAPITAL	<u>\$ (1,338,507)</u>	<u>\$ (10,800,521)</u>	<u>\$ (1,110,167)</u>	<u>\$ -</u>	<u>\$ (937)</u>	<u>\$ -</u>	<u>\$ (13,250,132)</u>	<u>\$ 23,133,700</u>

**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
COLUMBIA RIVER-PRIEST RAPIDS HYDROELECTRIC PRODUCTION SYSTEM**

**SCHEDULES OF POWER COSTS AND ALLOCATION TO POWER PURCHASERS
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007**

	2008	2007
OPERATING EXPENSES	\$ 39,509,187	\$ 33,214,221
Less:		
Depreciation and amortization	5,081,327	4,494,085
Other noncash expenses	34,065	48,037
Extraordinary maintenance and other charges paid by Renewal and Replacement Fund and Construction Fund	-	48,438
	34,393,795	28,623,661
Add:		
Interest on revenue bonds and other district systems, including capitalized interest of \$928,284 and \$844,040	12,261,858	12,651,013
Principal and sinking fund installments on debt	9,870,000	9,325,000
15% of interest and sinking fund installments	3,319,779	3,320,716
	59,845,432	53,920,390
Less:		
Interest and other income, excluding gains (losses) of certain special funds of \$109,754 and (\$206,858)	2,374,458	4,480,636
15% of prior year second series debt service installments	3,320,716	2,727,513
NET COSTS CHARGEABLE TO POWER PURCHASERS	\$ 54,150,258	\$ 46,712,241
ALLOCATION TO POWER PURCHASERS		
Billed to power purchasers as follows:		
PacifiCorp Electric Operations	\$ 2,316,072	\$ 2,360,495
Portland General Electric	2,316,072	2,360,495
Puget Sound Energy, Inc.	1,333,480	1,359,187
Tacoma Power	1,266,074	1,283,251
City of Seattle, City Light Department	1,244,539	1,264,698
Avista Corporation	1,014,514	1,034,162
Public Utility District No. 1 of Cowlitz County	818,316	705,035
Eugene Water and Electricity Board	285,195	290,221
City of Forest Grove, Oregon	188,428	162,344
City of McMinnville, Oregon	188,428	162,344
City of Milton-Freewater, Oregon	188,428	162,344
Public Utility District No. 1 of Kittitas County	150,743	129,875
Snake River Power Association	312,134	269,901
Clearwater Power Company	60,237	52,087
Idaho County Light and Power Company	21,905	18,941
Kootenai Electric Cooperative, Inc.	104,040	89,962
Northern Lights, Inc.	93,095	80,499
Public Utility District No. 2 of Grant County	42,248,558	34,926,400
	\$ 54,150,258	\$ 46,712,241

**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
WANAPUM DEVELOPMENT**

**SCHEDULE OF CHANGES IN WORKING CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007**

	Revenue Fund	Construction Fund	Relicensing Fund	R&C Fund	Supp R&C Fund	Bond Interest Funds	Bond Sinking Funds	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
Ending Working Capital	\$ 553,597	\$ 77,536,638	\$ -	\$ 6,000,000	\$ 6,000,000	\$ 4,862,798	\$ -	\$ 94,953,033	\$ 127,023,900
Beginning Working Capital	2,256,035	106,845,928	1,053,485	6,000,000	6,000,000	4,868,452	-	127,023,900	93,857,512
NET CHANGE IN WORKING CAPITAL	<u>\$ (1,702,438)</u>	<u>\$ (29,309,290)</u>	<u>\$ (1,053,485)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (5,654)</u>	<u>\$ -</u>	<u>\$ (32,070,867)</u>	<u>\$ 33,166,388</u>
POWER COST PROFORMA DEPOSITS:									
Operations and maintenance	\$ 34,511,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 34,511,000	\$ 18,416,687
Principal							11,320,000	11,320,000	10,445,000
Interest						16,230,202		16,230,202	18,131,629
15% of debt service					4,862,798			4,862,798	4,868,452
Proforma deposits sub-total	34,511,000	-	-	-	4,862,798	16,230,202	11,320,000	66,924,000	51,861,768
Year-end power cost adjustment	(1,259,655)							(1,259,655)	2,776,093
Total power cost proforma deposit	33,251,345	-	-	-	4,862,798	16,230,202	11,320,000	65,664,345	54,637,861
Less:									
15% of debt service transferred as an offset to interest expense					(4,862,798)	4,862,798		-	-
Plant/capital additions		(33,021,740)	(1,015,450)					(34,037,190)	(47,158,760)
Capitalized interest on CWIP		4,213,351						4,213,351	3,762,460
Current portion of long-term obligations	(1,344,546)							(1,344,546)	-
Normal operations and maintenance	(37,269,876)							(37,269,876)	(28,761,698)
Extraordinary operations and maintenance		(176,424)						(176,424)	(3,305)
(Loss)/gain on insurance proceeds on extraordinary loss		(79,974)						(79,974)	3,878,421
Interest/misc income	3,722,791			116,018	179,722			4,018,531	7,568,919
Excess fund balance transfer	295,740			(116,018)	(179,722)			-	-
Change in federal arbitrage tax liability	(142,200)							(142,200)	540,342
Change in current year sinking fund requirements							(875,000)	(875,000)	(1,575,000)
Face amount of debt retired							(10,445,000)	(10,445,000)	(8,870,000)
Bond interest expense						(21,098,654)		(21,098,654)	(21,531,985)
Preliminary expenses		(289,408)						(289,408)	(11,764)
Relicensing costs			(38,035)					(38,035)	(285,493)
Transfer from long-term noncash special funds								-	70,478,698
Unrealized (gain)/loss on investments	(215,692)							(215,692)	383,554
CIAC Puget Sound Energy / Dept of Energy		44,905						44,905	114,138
NET CHANGE IN WORKING CAPITAL	<u>\$ (1,702,438)</u>	<u>\$ (29,309,290)</u>	<u>\$ (1,053,485)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (5,654)</u>	<u>\$ -</u>	<u>\$ (32,070,867)</u>	<u>\$ 33,166,388</u>

**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
WANAPUM DEVELOPMENT**

**SCHEDULES OF POWER COSTS AND ALLOCATION TO POWER PURCHASERS
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007**

	2008	2007
OPERATING EXPENSES	\$ 45,525,095	\$ 35,150,219
Less:		
Depreciation and amortization	8,206,028	6,358,381
Other noncash expenses	49,190	30,139
	37,269,877	28,761,699
Add:		
Interest on revenue bonds and other district systems, including capitalized interest of \$4,213,351 and \$3,762,460	21,098,654	21,531,985
Principal and sinking fund installments on debt	11,320,000	10,445,000
15% of interest and sinking fund installments	4,862,798	4,868,452
	74,551,329	65,607,136
Less:		
Interest and other income, excluding gains (losses) of certain special funds of \$215,692 and (\$383,554)	4,018,532	7,568,919
15% of prior year second series debt service installments	4,868,452	3,400,356
NET COSTS CHARGEABLE TO POWER PURCHASERS	\$ 65,664,345	\$ 54,637,861
ALLOCATION TO POWER PURCHASERS		
Billed to power purchasers as follows:		
PacifiCorp Electric Operations	18.70 % \$ 12,279,233	\$ 10,217,280
Portland General Electric	18.70 12,279,233	10,217,280
Puget Sound Energy, Inc.	10.80 7,091,749	5,900,889
Avista Corporation	8.20 5,384,476	4,480,305
Public Utility District No. 1 of Cowlitz County	2.70 1,772,937	1,475,222
Eugene Water and Electricity Board	2.30 1,510,280	1,256,671
City of Forest Grove, Oregon	0.70 459,650	382,465
City of McMinnville, Oregon	0.70 459,650	382,465
City of Milton-Freewater, Oregon	0.70 459,650	382,465
Public Utility District No. 2 of Grant County	36.50 23,967,487	19,942,819
	<u>100.00 % \$ 65,664,345</u>	<u>\$ 54,637,861</u>

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APPENDIX D

PROPOSED FORM OF OPINION OF BOND COUNSEL

Public Utility District No. 2
of Grant County, Washington

Re: Public Utility District No. 2 of Grant County, Washington
Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010
Series A (Not Subject to AMT) — \$40,265,000
Series B (Subject to AMT) — \$10,665,000
Series L (Taxable Build America Bonds – Direct Payment) — \$173,915,000
Series M (New Clean Renewable Energy Bonds – Direct Payment) — \$90,000,000
Series Z (Taxable) — \$34,585,000

Ladies and Gentlemen:

We have served as bond counsel to Public Utility District No. 2 of Grant County, Washington (the “District”), and have examined a certified transcript of the proceedings taken in the matter of the issuance by the District of its Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series A (Not Subject to AMT), in the aggregate principal amount of \$40,265,000 (the “2010A Bonds”), Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2010 Series B (Subject to AMT), in the aggregate principal amount of \$10,665,000 (the “2010B Bonds”), Priest Rapids Hydroelectric Project Revenue Bonds, 2010 Series L (Taxable Build America Bonds – Direct Payment), in the aggregate principal amount of \$173,915,000 (the “2010L Bonds”), Priest Rapids Hydroelectric Project Revenue Bonds, 2010 Series M (New Clean Renewable Energy Bonds – Direct Payment), in the aggregate principal amount of \$90,000,000 (the “2010M Bonds”) and Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series Z, in the aggregate principal amount of \$34,585,000 (the “2010Z Bonds” and, collectively with the 2010A Bonds, the 2010B Bonds, the 2010L Bonds and the 2010M Bonds, the “Bonds”), and in that capacity have examined such law and such certified proceedings and other documents as we have deemed necessary to render this opinion. As to matters of fact material to this opinion, we have relied upon representations contained in the certified proceedings and other certifications of public officials furnished to us, without undertaking to verify the same by independent investigation.

The Bonds are issued by the District pursuant to Resolution No. 8475 of the District’s Board of Commissioners (the “Bond Resolution”) to finance improvements to the Priest Rapids Project, to refund certain outstanding Priest Rapids Development and Wanapum Development revenue bonds, to fund the Reserve Account and to pay costs of issuance of the Bonds.

The District has irrevocably bound itself to set aside and pay into the Bond Fund and the Reserve Account therein out of Gross Revenue (defined below), amounts necessary to pay the principal of and interest on the Bonds as the same becomes due.

The District has pledged that the payments to be made into the Bond Fund and the Reserve Account out of the Gross Revenue shall be a lien and charge thereon equal in rank to the lien and charge upon the revenue of the amounts required to pay and secure the payment of the Outstanding Parity Bonds, and superior to all other liens and charges, except the Operating Expenses. The District has reserved the right to issue Future Parity Bonds on the terms set forth in the Bond Resolution.

Reference is made to the Bonds and the Bond Resolution for the definitions of capitalized terms used and not otherwise defined herein.

We express no opinion herein concerning the completeness or accuracy of any official statement, offering circular or other sales or disclosure material relating to the issuance of the Bonds or otherwise used in connection with the Bonds.

Under the Internal Revenue Code of 1986, as amended (the “Code”), the District is required to comply with certain requirements after the date of issuance of the 2010A Bonds and 2010B Bonds in order to maintain the exclusion of the interest on the 2010A Bonds and 2010B Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2010A Bonds and 2010B Bond proceeds and the facilities financed or refinanced with 2010A Bonds and 2010B Bond proceeds, limitations on investing gross proceeds of the 2010A Bonds and 2010B Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the 2010A Bonds and 2010B Bonds. The District has covenanted in the Bond Resolution to comply with those requirements, but if the District fails to comply with those requirements, interest on the 2010A Bonds and 2010B Bonds could become taxable retroactive to the date of issuance of the 2010A Bonds and 2010B Bonds. We have not undertaken and do not undertake to monitor the District’s compliance with such requirements.

Based upon the foregoing, as of the date of initial delivery of the Bonds to the purchasers thereof and full payment therefor, it is our opinion that under existing law:

1. The District has the right and power under Title 54 of the Revised Code of Washington (the “Act”) to adopt the Bond Resolution. The Bond Resolution has been duly and lawfully adopted by the District, is in full force and effect, is valid and binding upon the District and is enforceable in accordance with its terms.

2. The Bond Resolution creates the valid pledges under the Act which it purports to create of (i) the money and assets, if any, credited to the Revenue Fund, the Bond Fund, the Project Account and the RR&C Fund, and the income therefrom, and (ii) the Gross Revenues, subject to prior application to pay Operating Expenses (as such terms are defined in the Bond Resolution).

3. The District is duly authorized and entitled to issue the Bonds, and the Bonds have been duly and validly authorized and issued by the District in accordance with the laws of the State of Washington, including the Act. The Bonds constitute the valid and binding obligations of the District as provided in the Bond Resolution, are enforceable in accordance with their terms and the terms of the Bond Resolution and are entitled to the benefits of the Act and the Bond Resolution. The Bonds are special limited obligations of the District and neither the State of Washington nor any political subdivision thereof, other than the District, is obligated to pay the principal of and interest on the Bonds, except to the extent that the enforcement of the rights and remedies of such owner of the Bonds may be limited by laws relating to bankruptcy, insolvency, moratorium, reorganization or other similar laws of general application affecting the rights of creditors, by the application of equitable principles and the exercise of judicial discretion.

4. Assuming compliance by the District after the date of issuance of the 2010A Bonds with applicable requirements of the Code, the interest on the 2010A Bonds is excluded from gross income for federal income tax purposes; however, interest on the 2010A Bonds received by certain S corporations may be subject to tax, and interest on the 2010A Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax; and such exclusion is not available with respect to interest on any 2010A Bond for any period during which such 2010A Bond is held by a “substantial user” of the Priest Rapids Project or by a “related person” within the meaning of Section 147(a) of the Code. We express no opinion as to whether some or all interest on the 2010A Bonds is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income or regarding any other federal tax consequences of receipt of interest on the 2010A Bonds.

5. Assuming compliance by the District after the date of issuance of the 2010B Bonds with applicable requirements of the Code, under existing federal law, the interest on the 2010B Bonds is excluded from gross income for federal income tax purposes, however such exclusion is not available with respect to interest on any 2010B Bond for any period during which such 2010B Bond is held by a “substantial user” of the Priest Rapids Project or by a “related person” within the meaning of Section 147(a) of the Code; interest received by individuals and corporations will constitute an item of tax preference for purposes of the federal alternative minimum tax applicable to individuals and corporations; interest on the 2010B Bonds received by certain S corporations may be subject to tax, and interest on the 2010B Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. We express no opinion regarding any other federal tax consequences of receipt of interest on the 2010B Bonds.

6. Interest on the 2010L Bonds, 2010M Bonds and 2010Z Bonds is not excludable from gross income for federal tax purposes.

We have not been engaged nor have we undertaken to review the accuracy, completeness or sufficiency of the official statement or other offering material related to the Bonds (except to the extent, if any, stated in the official statement). We express no opinion relating to the undertaking by the District to provide ongoing disclosure pursuant to SEC Rule 15c2 12.

This opinion is given as of the date hereof, and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law that may hereafter occur.

We bring to your attention the fact that the foregoing opinions are expressions of our professional judgment on the matters expressly addressed and do not constitute guarantees of result.

Respectfully submitted,

FOSTER PEPPER PLLC

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APPENDIX E

BOOK-ENTRY SYSTEM

The following information has been provided by the Depository Trust Company, New York, New York (“DTC”). The District makes no representation regarding the accuracy or completeness thereof. Beneficial Owners (as hereinafter defined) should therefore confirm the following with DTC or the Participants (as hereinafter defined).

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-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 maturity of the Bonds in the principal amount of such maturity and will be deposited with DTC.

DTC, the world’s largest 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, and 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 highest rating: AAA. 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 and www.dtc.org.

Purchases of the Bonds under the DTC system, in denominations of \$5,000 or any integral multiple thereof, must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“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 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 the Bonds, except in the event that use of the book-entry entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by 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 Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such 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.

When notices are given, they shall be sent by the Bond Registrar to DTC only. 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 Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the District 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 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the 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 Bond Registrar, on 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 DTC, the Bond Registrar, 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 any other nominee as may be requested by an authorized representative of DTC) is the responsibility of the District or the Bond Registrar, 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 securities depository with respect to the Bonds at any time by giving reasonable notice to the District and the Bond Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

The District may decide to discontinue use of the system of the book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

With respect to Bonds registered on the Bond Register in the name of Cede & Co., as nominee of DTC, the District and the Bond Registrar shall have no responsibility or obligation to any Participant or to any person on behalf of whom a Participant holds an interest in the Bonds with respect to (i) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any ownership interest in the Bonds; (ii) the delivery to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any notice with respect to the Bonds, including any notice of redemption; (iii) the payment to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any amount with respect to principal of, premium, if any, or interest on the Bonds; (iv) the selection by DTC or any Participant of any person to receive payment in the event of a partial redemption of the Bonds; (v) any consent given action taken by DTC as registered owner; or (vi) any other matter. The District and the Bond Registrar may treat and consider Cede & Co., in whose name each Bond is registered on the Bond Register, as the holder and absolute owner of such Bond for the purpose of payment of principal and interest with respect to such Bond, for the purpose of giving notices of redemption and other matters with respect to such Bond, for the purpose of registering transfers with respect to such Bond, and for all other purposes whatsoever. For the purposes of this Official Statement, the term "Beneficial Owner" shall include the person for whom the Participant acquires an interest in the Bonds.

APPENDIX F

INFORMATION CONCERNING OFFERING RESTRICTIONS IN CERTAIN JURISDICTIONS OUTSIDE THE UNITED STATES AND GLOBAL CLEARANCE PROCEDURES

THE UNDERWRITERS HAVE PROVIDED THE FOLLOWING INFORMATION. THE DISTRICT HAS NOT VERIFIED THIS INFORMATION AND MAKES NO REPRESENTATION AS TO THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION.

MINIMUM UNIT SALES

THE BONDS WILL TRADE AND SETTLE ON A UNIT BASIS (ONE UNIT EQUALING ONE BOND OF \$5,000 PRINCIPAL AMOUNT). GLOBAL CLEARANCE PROCEDURE PRACTICE IS THAT FOR ANY SALES MADE OUTSIDE THE UNITED STATES, THE MINIMUM PURCHASE AND TRADING AMOUNT IS 20 UNITS (BEING 20 BONDS IN AN AGGREGATE PRINCIPAL AMOUNT OF \$100,000).

NOTICE TO RESIDENTS OF THE EUROPEAN ECONOMIC AREA

NO ACTION HAS BEEN OR WILL BE TAKEN IN ANY JURISDICTION THAT WOULD PERMIT A PUBLIC OFFERING OF ANY OF THE BONDS, OR POSSESSION OR DISTRIBUTION OF THIS OFFICIAL STATEMENT OR ANY OTHER OFFERING MATERIAL, IN ANY COUNTRY OR JURISDICTION WHERE ACTION FOR THAT PURPOSE IS REQUIRED. EACH UNDERWRITER SHALL COMPLY WITH ALL RELEVANT LAWS, REGULATIONS AND DIRECTIVES IN EACH JURISDICTION IN WHICH IT PURCHASES, OFFERS, SELLS OR DELIVERS BONDS OR HAS IN ITS POSSESSION OR DISTRIBUTES THIS OFFICIAL STATEMENT OR ANY OTHER OFFERING MATERIAL, IN ALL CASES AT ITS OWN EXPENSE.

IN RELATION TO EACH MEMBER STATE OF THE EUROPEAN ECONOMIC AREA WHICH HAS IMPLEMENTED THE PROSPECTUS DIRECTIVE (EACH, A "RELEVANT MEMBER STATE"), EACH UNDERWRITER HAS SEVERALLY REPRESENTED AND AGREED THAT WITH EFFECT FROM AND INCLUDING THE DATE ON WHICH THE PROSPECTUS DIRECTIVE IS IMPLEMENTED IN THAT RELEVANT MEMBER STATE (THE "RELEVANT IMPLEMENTATION DATE") IT HAS NOT MADE AND WILL NOT MAKE AN OFFER OF THE BONDS WHICH ARE THE SUBJECT OF THE OFFERING CONTEMPLATED BY THIS OFFICIAL STATEMENT TO THE PUBLIC IN THAT RELEVANT MEMBER STATE OR, WHERE APPROPRIATE, APPROVED IN ANOTHER RELEVANT MEMBER STATE AND PUBLISHED AND NOTIFIED TO THE COMPETENT AUTHORITY IN THAT RELEVANT MEMBER STATE, ALL IN ACCORDANCE WITH THE PROSPECTUS DIRECTIVE AS IMPLEMENTED IN THAT RELEVANT MEMBER STATE, UNTIL THE END DATE SPECIFIED IN SUCH PROSPECTUS, EXCEPT THAT IT MAY, WITH EFFECT FROM AND INCLUDING THE RELEVANT IMPLEMENTATION DATE, MAKE AN OFFER OF SUCH BONDS TO THE PUBLIC IN THAT RELEVANT MEMBER STATE:

(A) TO LEGAL ENTITIES WHICH ARE AUTHORIZED OR REGULATED TO OPERATE IN THE FINANCIAL MARKETS OR, IF NOT SO AUTHORIZED OR REGULATED, WHOSE CORPORATE PURPOSE IS SOLELY TO INVEST IN SECURITIES;

(B) TO ANY LEGAL ENTITY WHICH HAS TWO OR MORE OF (1) AN AVERAGE OF AT LEAST 250 EMPLOYEES DURING THE LAST FINANCIAL YEAR; (2) A TOTAL BALANCE SHEET OF MORE THAN €43,000,000; AND (3) AN ANNUAL NET TURNOVER OF MORE THAN €50,000,000, AS SHOWN IN ITS LAST ANNUAL OR CONSOLIDATED ACCOUNTS;

(C) TO FEWER THAN 100 NATURAL OR LEGAL PERSONS (OTHER THAN QUALIFIED INVESTORS AS DEFINED IN THE PROSPECTUS DIRECTIVE) SUBJECT TO OBTAINING THE PRIOR CONSENT OF THE RELEVANT UNDERWRITER OR UNDERWRITERS NOMINATED BY THE ISSUER FOR ANY SUCH OFFER; OR

(D) IN ANY OTHER CIRCUMSTANCES FALLING WITHIN ARTICLE 3(2) OF THE PROSPECTUS DIRECTIVE,

PROVIDED THAT NO SUCH OFFER OF THE BONDS REFERRED TO ABOVE SHALL REQUIRE THE DISTRICT OR ANY UNDERWRITER TO PUBLISH A PROSPECTUS PURSUANT TO ARTICLE 3 OF THE PROSPECTUS DIRECTIVE OR SUPPLEMENT A PROSPECTUS PURSUANT TO ARTICLE 16 OF THE PROSPECTUS DIRECTIVE.

FOR PURPOSES OF THIS PROVISION, THE EXPRESSION AN “OFFER OF THE BONDS TO THE PUBLIC” IN RELATION TO ANY BONDS IN ANY RELEVANT MEMBER STATE MEANS THE COMMUNICATION IN ANY FORM AND BY ANY MEANS OF SUFFICIENT INFORMATION ON THE TERMS OF THE OFFER AND THE BONDS TO BE OFFERED SO AS TO ENABLE AN INVESTOR TO DECIDE TO PURCHASE OR SUBSCRIBE FOR THE BONDS, AS THE SAME MAY BE VARIED IN THAT MEMBER STATE BY ANY MEASURE IMPLEMENTING THE PROSPECTUS DIRECTIVE IN THAT MEMBER STATE, AND THE EXPRESSION “PROSPECTUS DIRECTIVE” MEANS DIRECTIVE 2003/71/EC AND INCLUDES ANY RELEVANT IMPLEMENTING MEASURE IN EACH RELEVANT MEMBER STATE.

NOTICE TO RESIDENTS OF AUSTRALIA

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IN CONNECTION WITH THE DISTRIBUTION OF THE BONDS, IT:

(A) WILL NOT MAKE ANY OFFER OR DISTRIBUTION IN AUSTRALIA OR ANY OFFER OR INVITATION WHICH IS RECEIVED IN AUSTRALIA IN RELATION TO THE ISSUE, SALE OR PURCHASE OF THE BONDS UNLESS THE OFFEREE IS REQUIRED TO PAY AT LEAST A\$500,000 FOR THE BONDS OR ITS FOREIGN CURRENCY EQUIVALENT (IN EITHER CASE DISREGARDING AMOUNTS, IF ANY, LENT BY THE DISTRICT OR OTHER PERSON OFFERING THE BONDS OR ITS ASSOCIATES (WITHIN THE MEANING OF THOSE EXPRESSIONS IN PART 6D.2 OF THE CORPORATIONS ACT 2001 OF AUSTRALIA (THE “CORPORATIONS ACT”))), OR IT IS OTHERWISE AN OFFER OR INVITATION FOR WHICH BY VIRTUE OF SECTION 708 OF THE CORPORATIONS ACT DISCLOSURE IS REQUIRED TO BE MADE UNDER PART 6D.2 OF THE CORPORATIONS ACT AND IS NOT MADE TO A RETAIL CLIENT (AS DEFINED IN SECTION 761G OF THE CORPORATIONS ACT); AND

(B) HAS NOT CIRCULATED OR ISSUED AND WILL NOT CIRCULATE OR ISSUE A DISCLOSURE DOCUMENT RELATING TO THE BONDS IN AUSTRALIA OR RECEIVED IN AUSTRALIA WHICH LODGING UNDER DIVISION 5 OF PART 6D.2 OR UNDER PART 7 OF THE CORPORATIONS ACT.

NOTICE TO RESIDENTS OF BELGIUM

THIS OFFICIAL STATEMENT IS NOT INTENDED TO CONSTITUTE A PUBLIC OFFER IN BELGIUM AND MAY NOT BE DISTRIBUTED TO THE BELGIAN PUBLIC. THE BELGIAN COMMISSION FOR BANKING, FINANCE AND INSURANCE (COMMISSION BANCAIRE, FINANCIÈRE ET DES ASSURANCES) HAS NOT BEEN NOTIFIED OF THE OFFER UNDER THIS OFFICIAL STATEMENT PURSUANT TO ARTICLE 32 OF THE LAW OF 16 JUNE 2006 ON THE PUBLIC OFFERING OF SECURITIES AND THE ADMISSION OF SECURITIES TO TRADE ON REGULATED MARKETS (THE “PROSPECTUS LAW”) NOR HAS THIS OFFICIAL STATEMENT BEEN, OR WILL IT BE, APPROVED BY THE BELGIAN BANKING, FINANCE AND INSURANCE COMMISSION PURSUANT TO ARTICLE 23 OF THE PROSPECTUS LAW. ACCORDINGLY, EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT WILL NOT OFFER OR SELL THE BONDS OR DISTRIBUTE THIS OFFICIAL STATEMENT OR ANY OTHER INFORMATION, DOCUMENT, BROCHURE OR SIMILAR DOCUMENT, DIRECTLY OR INDIRECTLY, TO ANY PERSON IN BELGIUM OTHER THAN TO (I) QUALIFIED INVESTORS REFERRED TO IN ARTICLE 3, §2 A) OF THE PROSPECTUS LAW, ACTING FOR THEIR OWN ACCOUNT OR (II) INVESTORS WISHING TO ACQUIRE BONDS FOR AN AMOUNT OF AT LEAST €50,000 (OR ITS EQUIVALENT IN FOREIGN CURRENCIES) PER TRANSACTION, AS SPECIFIED IN ARTICLE 3, §2 C) OF THE PROSPECTUS LAW.

NOTICE TO RESIDENTS OF BRAZIL

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT OFFERED OR SOLD, AND WILL NOT OFFER OR SELL, ANY BONDS IN BRAZIL, EXCEPT IN CIRCUMSTANCES WHICH DO NOT CONSTITUTE A PUBLIC OFFERING OR DISTRIBUTION UNDER BRAZILIAN LAWS AND REGULATIONS. THE BONDS WILL NOT BE REGISTERED WITH THE BRAZILIAN SECURITIES COMMISSION (COMISSÃO DE VALORES MOBILIÁRIOS, OR “CVM”).

NOTICE TO RESIDENTS OF CANADA

THE BONDS WILL NOT BE QUALIFIED FOR SALE UNDER THE SECURITIES LAWS OF ANY PROVINCE OR TERRITORY OF CANADA. EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT OFFERED, SOLD OR DISTRIBUTED AND WILL NOT OFFER, SELL OR DISTRIBUTE ANY BONDS, DIRECTLY OR INDIRECTLY, IN CANADA OR TO OR FOR THE BENEFIT OF ANY RESIDENT IN CANADA, OTHER THAN IN COMPLIANCE WITH APPLICABLE SECURITIES LAWS. EACH UNDERWRITER HAS ALSO REPRESENTED AND AGREED THAT IT HAS NOT AND WILL NOT DISTRIBUTE OR DELIVER THE OFFICIAL STATEMENT, OR ANY OTHER OFFERING MATERIAL IN CONNECTION WITH ANY OFFERING OF BONDS IN CANADA, OTHER THAN IN COMPLIANCE WITH APPLICABLE SECURITIES LAWS.

NOTICE TO RESIDENTS OF DENMARK

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT THE BONDS HAVE NOT BEEN OFFERED OR SOLD AND WILL NOT BE OFFERED, SOLD OR DELIVERED DIRECTLY OR INDIRECTLY IN THE KINGDOM OF DENMARK BY WAY OF PUBLIC OFFERING, UNLESS IN COMPLIANCE WITH THE DANISH SECURITIES TRADING ACT, CONSOLIDATION ACT NO. 795 OF 20 AUGUST 2009 AS AMENDED FROM TIME TO TIME AND ANY ORDERS ISSUED THEREUNDER.

NOTICE TO RESIDENTS OF FRANCE

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT OFFERED OR SOLD, AND WILL NOT OFFER OR SELL, DIRECTLY, OR INDIRECTLY, THE BONDS TO THE PUBLIC IN THE REPUBLIC OF FRANCE WITHIN THE MEANING OF ARTICLE L.411-1 OF THE FRENCH CODE MONÉTAIRE ET FINANCIER AND THAT OFFERS AND SALES OF THE BONDS IN FRANCE WILL EITHER (1) RELATE TO BONDS THE NOMINAL VALUE PER UNIT OF WHICH AMOUNTS AT LEAST TO €50,000 OR (2) BE MADE ONLY TO QUALIFIED INVESTORS (INVESTISSEURS QUALIFIÉS) LISTED UNDER ARTICLE D.411-1 OF THE FRENCH CODE MONÉTAIRE ET FINANCIER OR TO A RESTRICTED CIRCLE OF INVESTORS (CERCLE RESTREINT D’INVESTISSEURS) OF LESS THAN 100 INVESTORS PURSUANT TO ARTICLE D.411-2 OF THE FRENCH CODE MONÉTAIRE ET FINANCIER, OR TO PERSONS PROVIDING PORTFOLIO MANAGEMENT FINANCIAL SERVICES FOR THE ACCOUNT OF THIRD PARTIES (PERSONNES FOURNISSANT LE SERVICE D’INVESTISSEMENT DE GESTION DE PORTEFEUILLE POUR COMPTE DE TIERS), ALL ACTING FOR THEIR OWN ACCOUNT AS DEFINED IN AND IN ACCORDANCE WITH ARTICLES L.411-2, D.411-1, D.411-2, D.754-1 AND D.764-1 OF THE FRENCH CODE MONÉTAIRE ET FINANCIER.

IN ADDITION, EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT DISTRIBUTED OR CAUSED TO BE DISTRIBUTED AND WILL NOT DISTRIBUTE OR CAUSE TO BE DISTRIBUTED IN THE REPUBLIC OF FRANCE THIS OFFICIAL STATEMENT OR ANY OTHER OFFERING MATERIAL RELATING TO THE BONDS OTHER THAN IN ACCORDANCE WITH L.411-1, L.411-2, L.412-1 AND L.621-8 TO L.621-8-3 OF THE FRENCH CODE MONÉTAIRE ET FINANCIER TO INVESTORS TO WHOM OFFERS AND SALES OF THE BONDS IN FRANCE MAY BE MADE AS DESCRIBED ABOVE AND THAT THIS OFFICIAL STATEMENT HAS NOT BEEN SUBMITTED FOR APPROVAL (VISA) BY THE AUTORITÉ DES MARCHÉS FINANCIERS UNDER THE CONDITIONS SET OUT INTER ALIA BY ARTICLES 212-1 ET SEQ. OF THE GENERAL REGULATIONS (RÈGLEMENT GÉNÉRAL) OF THE AUTORITÉ DES MARCHÉS FINANCIERS AND DOES NOT CONSTITUTE AN OFFER FOR SALE OR SUBSCRIPTION OF BONDS.

NOTICE TO RESIDENTS OF GERMANY

EACH OF THE UNDERWRITERS HAS AGREED AND REPRESENTED TO COMPLY WITH THE FOLLOWING OFFERING AND SELLING RESTRICTIONS APPLICABLE IN THE FEDERAL REPUBLIC OF GERMANY.

EACH OF THE UNDERWRITERS HAS AGREED THAT IT SHALL NOT OFFER OR SELL THE BONDS IN THE FEDERAL REPUBLIC OF GERMANY OTHER THAN IN COMPLIANCE WITH THE GERMAN SECURITIES PROSPECTUS ACT (WERTPAPIERPROSPEKTGESETZ), THE GERMAN SECURITIES SALES PROSPECTUS ACT (WERTPAPIER-VERKAUFSPROSPEKTGESETZ), AND THE GERMAN INVESTMENT ACT (INVESTMENTGESETZ), RESPECTIVELY, AND ANY OTHER LAWS AND REGULATIONS APPLICABLE IN THE FEDERAL REPUBLIC OF GERMANY GOVERNING THE ISSUE, THE OFFERING AND THE SALE OF THE BONDS.

THE BONDS MAY NEITHER BE NOR ARE INTENDED TO BE DISTRIBUTED BY WAY OF PUBLIC OFFERING, PUBLIC ADVERTISEMENT OR IN A SIMILAR MANNER WITHIN THE MEANING OF SECTIONS 2 NO. 4 AND SECTION 3 PARA. 1 OF THE GERMAN SECURITIES PROSPECTUS ACT (WERTPAPIERPROSPEKTGESETZ), SECTION 8F(1) OF THE GERMAN SECURITIES SALES PROSPECTUS ACT (WERTPAPIER-VERKAUFSPROSPEKTGESETZ) AND SECTIONS 1 AND 2(11) OF THE GERMAN INVESTMENT ACT (INVESTMENTGESETZ) NOR SHALL THE DISTRIBUTION OF THIS OFFICIAL STATEMENT OR ANY OTHER DOCUMENT RELATING TO THE BONDS CONSTITUTE SUCH PUBLIC OFFER.

THE DISTRIBUTION OF THE BONDS HAS NOT BEEN NOTIFIED, AND THE BONDS ARE NOT REGISTERED OR AUTHORIZED FOR PUBLIC DISTRIBUTION, IN THE FEDERAL REPUBLIC OF GERMANY UNDER THE GERMAN SECURITIES PROSPECTUS ACT (WERTPAPIERPROSPEKTGESETZ) OR THE GERMAN INVESTMENT ACT (INVESTMENTGESETZ). ACCORDINGLY, THIS OFFICIAL STATEMENT HAS NOT BEEN FILED OR DEPOSITED WITH THE GERMAN FEDERAL FINANCIAL SUPERVISORY AUTHORITY (BUNDESANSTALT FÜR FINANZDIENSTLEISTUNGSAUFSICHT - BAFIN).

NOTICE TO RESIDENTS OF HONG KONG

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT ISSUED, OR HAD IN ITS POSSESSION FOR THE PURPOSE OF ISSUE, AND WILL NOT ISSUE OR HAVE IN ITS POSSESSION FOR THE PURPOSES OF ISSUE, WHETHER IN HONG KONG OR ELSEWHERE, ANY ADVERTISEMENT, INVITATION, OR DOCUMENT RELATING TO THE BONDS WHICH IS DIRECTED AT, OR THE CONTENTS OF WHICH ARE LIKELY TO BE ACCESSED OR READ BY, THE PUBLIC IN HONG KONG (EXCEPT IF PERMITTED TO DO SO UNDER THE LAWS OF HONG KONG) OTHER THAN WITH RESPECT TO BONDS WHICH ARE OR ARE INTENDED TO BE DISPOSED OF ONLY TO PERSONS OUTSIDE HONG KONG OR ONLY TO "PROFESSIONAL INVESTORS" AS DEFINED IN THE SECURITIES AND FUTURES ORDINANCE (CAP. 571 OF THE LAWS OF HONG KONG) AND ANY RULES MADE UNDER THAT ORDINANCE.

THE CONTENTS OF THIS DOCUMENT HAVE NOT BEEN REVIEWED BY ANY REGULATORY AUTHORITY IN HONG KONG. YOU ARE ADVISED TO EXERCISE CAUTION IN RELATION TO THE OFFER OF THE BONDS. IF YOU ARE IN ANY DOUBT ABOUT ANY OF THE CONTENTS OF THIS DOCUMENT, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.

NOTICE TO RESIDENTS OF IRELAND

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT:

(A) TO THE EXTENT APPLICABLE, IT HAS COMPLIED AND WILL COMPLY WITH ALL APPLICABLE PROVISIONS OF THE EUROPEAN COMMUNITIES (MARKETS IN FINANCIAL INSTRUMENTS) REGULATIONS 2007 OF IRELAND, AS AMENDED, WITH RESPECT TO ANYTHING DONE BY IT IN RELATION TO THE BONDS OR OPERATING IN, OR OTHERWISE INVOLVING, IRELAND.

(B) IT WILL NOT UNDERWRITE THE ISSUE OF, PLACE, OR DO ANYTHING IN IRELAND IN RESPECT OF THE BONDS OTHERWISE THAN IN CONFORMITY WITH THE PROVISIONS OF THE IRISH PROSPECTUS (DIRECTIVE 2003/71/EC) REGULATIONS 2005 AND ANY RULES ISSUED UNDER SECTION 51 OF THE IRISH INVESTMENT FUNDS, COMPANIES AND MISCELLANEOUS PROVISIONS ACT 2005, BY THE IRISH CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY (“IFSRA”); AND

(C) IT WILL NOT UNDERWRITE THE ISSUE OF, PLACE, OR OTHERWISE ACT IN IRELAND IN RESPECT OF THE BONDS, OTHERWISE THAN IN CONFORMITY WITH THE PROVISIONS OF THE IRISH MARKET ABUSE (DIRECTIVE 2003/6/EC) REGULATIONS 2005 AND ANY RULES ISSUED UNDER SECTION 34 OF THE IRISH INVESTMENT FUNDS, COMPANIES AND MISCELLANEOUS PROVISIONS ACT 2005 BY IFSRA.

NOTICE TO RESIDENTS OF ITALY

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT OFFERED, SOLD OR DELIVERED, WILL NOT OFFER, SELL OR DELIVER, HAS NOT DISTRIBUTED AND WILL NOT DISTRIBUTE AND HAS NOT MADE AND WILL NOT MAKE AVAILABLE IN ITALY ANY BONDS, THE OFFICIAL STATEMENT NOR ANY OTHER OFFERING MATERIAL RELATING TO THE BONDS OTHER THAN:

(A) TO PROFESSIONAL INVESTORS (“CLIENTI PROFESSIONALI”), AS DEFINED IN CONSOB REGULATION ON INTERMEDIARIES NO. 16190 OF OCTOBER 29, 2007, PURSUANT TO ARTICLES 100 AND 100 BIS OF THE LEGISLATIVE DECREE NO. 58 OF FEBRUARY 1998 (THE “FINANCIAL SERVICES ACT”) AS AMENDED FROM TIME TO TIME; OR

(B) IN CIRCUMSTANCES WHICH ARE EXEMPTED FROM THE RULES ON PUBLIC OFFERINGS PURSUANT TO ARTICLE 100 OF THE FINANCIAL SERVICES ACT AND CONSOB REGULATION ON ISSUERS AS AMENDED FROM TIME TO TIME. ANY OFFER, SALE OR DELIVERY OF THE BONDS OR DISTRIBUTION OF COPIES OF THE OFFICIAL STATEMENT OR ANY OTHER DOCUMENT RELATING TO THE BONDS IN ITALY UNDER (A) OR (B) ABOVE MUST BE:

(I) MADE BY AN INVESTMENT FIRM, BANK OR FINANCIAL INTERMEDIARY PERMITTED TO CONDUCT SUCH ACTIVITIES IN ITALY IN ACCORDANCE WITH THE FINANCIAL SERVICES ACT, THE LEGISLATIVE DECREE NO. 385 OF SEPTEMBER 1, 1993, AS AMENDED FROM TIME TO TIME (THE BANKING ACT), AND CONSOB REGULATION ON INTERMEDIARIES NO. 16190 OF OCTOBER 29, 2007;

(II) IN ACCORDANCE WITH ANY OTHER APPLICABLE LAWS AND REGULATIONS.

NOTICE TO RESIDENTS OF JAPAN

THE BONDS HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE FINANCIAL INSTRUMENTS AND EXCHANGE ACT OF JAPAN (LAW NO. 25 OF 1948, AS AMENDED (THE "FIEL")) AND, ACCORDINGLY, EACH UNDERWRITER HAS REPRESENTED, WARRANTED AND AGREED THAT IT WILL NOT OFFER OR SELL ANY BONDS, DIRECTLY OR INDIRECTLY, IN JAPAN OR TO, OR FOR THE BENEFIT OF, ANY JAPANESE PERSON OR TO OTHERS FOR REOFFERING OR RESALE, DIRECTLY OR INDIRECTLY, IN JAPAN OR TO ANY JAPANESE PERSON EXCEPT PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF, AND OTHERWISE IN COMPLIANCE WITH THE FIEL AND ANY OTHER APPLICABLE LAWS AND REGULATIONS OF JAPAN. FOR THE PURPOSES OF THIS PARAGRAPH, "JAPANESE PERSON" SHALL MEAN ANY PERSON RESIDENT IN JAPAN, INCLUDING ANY CORPORATION OR OTHER ENTITY ORGANISED UNDER THE LAWS AND REGULATIONS OF JAPAN.

NOTICE TO RESIDENTS OF KUWAIT

THE BONDS HAVE NOT BEEN AUTHORIZED OR LICENSED FOR OFFERING, MARKETING OR SALE IN THE STATE OF KUWAIT. THE DISTRIBUTION OF THIS OFFICIAL STATEMENT AND THE OFFERING AND SALE OF THE BONDS IN THE STATE OF KUWAIT IS RESTRICTED BY LAW UNLESS A LICENSE IS OBTAINED FROM THE KUWAIT MINISTRY OF COMMERCE AND INDUSTRY IN ACCORDANCE WITH LAW 31 OF 1990. PERSONS INTO WHOSE POSSESSION THIS OFFICIAL STATEMENT COMES ARE REQUIRED BY THE UNDERWRITERS TO INFORM THEMSELVES ABOUT AND TO OBSERVE SUCH RESTRICTIONS. INVESTORS IN THE STATE OF KUWAIT WHO APPROACH ANY OF THE UNDERWRITERS TO OBTAIN COPIES OF THIS OFFICIAL STATEMENT ARE REQUIRED BY THE UNDERWRITERS TO KEEP SUCH OFFICIAL STATEMENT CONFIDENTIAL AND NOT TO MAKE COPIES THEREOF OR DISTRIBUTE THE SAME TO ANY OTHER PERSON AND ARE ALSO REQUIRED TO OBSERVE THE RESTRICTIONS PROVIDED FOR IN ALL JURISDICTIONS WITH RESPECT TO OFFERING, MARKETING AND THE SALE OF THE BONDS.

NOTICE TO RESIDENTS OF LUXEMBOURG

EACH UNDERWRITER HAS UNDERTAKEN THAT IN RELATION TO THE ISSUE OF THE BONDS IT HAS NOT AND WILL NOT, DIRECTLY OR INDIRECTLY, OFFER, SELL, TRANSFER OR DELIVER ANY BONDS AS PART OF THEIR INITIAL DISTRIBUTION OR AT ANY TIME THEREAFTER (INCLUDING RIGHTS REPRESENTING AN INTEREST IN A GLOBAL NOTE) TO THE PUBLIC IN THE GRAND DUCHY OF LUXEMBOURG OTHER THAN (I) TO LEGAL ENTITIES WHICH ARE AUTHORIZED OR REGULATED TO OPERATE IN THE FINANCIAL MARKETS OR, IF NOT SO AUTHORIZED OR REGULATED, WHOSE CORPORATE PURPOSE IS SOLELY TO INVEST IN SECURITIES, (II) TO ANY LEGAL ENTITY WHICH HAS TWO OR MORE OF (1) AN AVERAGE OF AT LEAST 250 EMPLOYEES DURING THE LAST FINANCIAL YEAR, (2) TOTAL NET ASSETS REFLECTED ON THE BALANCE SHEET OF MORE THAN €43,000,000, AND (3) AN ANNUAL NET TURNOVER OF MORE THAN €50,000,000, AS SHOWN IN ITS LAST ANNUAL OR CONSOLIDATED ACCOUNTS, (III) TO FEWER THAN 100 NATURAL OR LEGAL PERSONS (OTHER THAN QUALIFIED INVESTORS AS DEFINED IN THE LUXEMBOURG ACT OF 10 JULY 2005 ON PROSPECTUSES FOR SECURITIES (THE "PROSPECTUS ACT")) OR (IV) IN ANY OTHER CIRCUMSTANCES FALLING WITHIN ARTICLE 5 (2) AND 5 (3) OF THE PROSPECTUS ACT.

THIS OFFICIAL STATEMENT MAY NOT BE REPRODUCED OR USED FOR ANY OTHER PURPOSE AND NEITHER THIS OFFICIAL STATEMENT NOR ANY SUBSCRIPTION FORM, CIRCULAR OR ANY OTHER DOCUMENT ISSUED IN RELATION TO THE BONDS SHALL BE PROVIDED TO ANY OTHER PERSONS OR DISTRIBUTED IN CIRCUMSTANCES OTHER THAN THOSE AS DESCRIBED ABOVE.

NOTICE TO RESIDENTS OF THE NETHERLANDS

EACH UNDERWRITER HAS UNDERTAKEN THAT IN RELATION TO THE ISSUE OF THE BONDS IT HAS NOT AND WILL NOT, DIRECTLY OR INDIRECTLY, OFFER, SELL, TRANSFER OR DELIVER ANY BOND AS PART OF THEIR INITIAL DISTRIBUTION OR AT ANY TIME THEREAFTER (INCLUDING RIGHTS REPRESENTING AN INTEREST IN A GLOBAL BOND) TO INDIVIDUALS OR LEGAL ENTITIES WHO OR WHICH ARE ESTABLISHED, DOMICILED OR HAVE THEIR RESIDENCE IN THE NETHERLANDS IF SUCH A BOND DOES NOT HAVE A DENOMINATION OF AT LEAST €50,000 OR, IF SUCH A BOND IS DENOMINATED IN OTHER CURRENCY THAN EURO, AT LEAST A VALUE OF €50,000.

NOTICE TO RESIDENTS OF NEW ZEALAND

(A) THE DISTRICT DOES NOT INTEND THAT THE BONDS SHOULD BE OFFERED FOR SALE OR SUBSCRIPTION TO THE PUBLIC IN NEW ZEALAND IN TERMS OF THE SECURITIES ACT 1978.

(B) EACH UNDERWRITER SHALL:

(I) OBSERVE ALL APPLICABLE LAWS AND REGULATIONS IN ANY JURISDICTION IN WHICH IT MAY SUBSCRIBE, OFFER, SELL OR DELIVER BONDS; AND

(II) NOT SUBSCRIBE, OFFER, SELL OR DELIVER BONDS OR DISTRIBUTE THE OFFICIAL STATEMENT OR ANY OTHER OFFERING MATERIAL RELATING TO THE BONDS IN ANY JURISDICTION EXCEPT UNDER THE CIRCUMSTANCES THAT WILL RESULT IN COMPLIANCE WITH ALL APPLICABLE LAWS AND REGULATIONS.

(C) WITHOUT LIMITING PARAGRAPH (B):

(I) EACH UNDERWRITER REPRESENTS THAT IT IS A PERSON WHOSE PRINCIPAL BUSINESS IS THE INVESTMENT OF MONEY OR WHO, IN THE COURSE OF AND FOR THE PURPOSE OF ITS BUSINESS, HABITUALLY INVESTS MONEY; AND

(II) NO UNDERWRITER MAY OFFER, SELL OR DELIVER BONDS OR DISTRIBUTE ANY ADVERTISEMENT OR OFFERING MATERIAL RELATING TO THE BONDS, IN BREACH OF ANY PROVISION OF THE SECURITIES ACT 1978.

NOTICE TO RESIDENTS OF PEOPLE'S REPUBLIC OF CHINA

EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT NEITHER IT NOR ANY OF ITS AFFILIATES HAS OFFERED OR SOLD OR WILL OFFER OR SELL ANY OF THE BONDS IN THE PEOPLE'S REPUBLIC OF CHINA (EXCLUDING HONG KONG, MACAU AND TAIWAN) AS PART OF THE INITIAL DISTRIBUTION OF THE BONDS.

THIS OFFICIAL STATEMENT DOES NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES IN THE PEOPLE'S REPUBLIC OF CHINA (EXCLUDING HONG KONG, MACAU AND TAIWAN, THE "PRC") TO ANY PERSON TO WHOM IT IS UNLAWFUL TO MAKE THE OFFER OR SOLICITATION IN THE PRC.

THE DISTRICT DOES NOT REPRESENT THAT THIS OFFICIAL STATEMENT MAY BE LAWFULLY DISTRIBUTED, OR THAT ANY BONDS MAY BE LAWFULLY OFFERED, IN COMPLIANCE OF ANY APPLICABLE REGISTRATION OR OTHER REQUIREMENTS IN THE PRC, OR PURSUANT TO AN EXEMPTION AVAILABLE THEREUNDER, OR ASSUME ANY RESPONSIBILITY FOR FACILITATING ANY SUCH DISTRIBUTION OR OFFERING. IN PARTICULAR, NO ACTION HAS BEEN TAKEN BY THE DISTRICT WHICH WOULD PERMIT A PUBLIC OFFERING OF ANY BONDS OR THE DISTRIBUTION OF THIS OFFICIAL STATEMENT IN THE PRC. ACCORDINGLY, THE BONDS ARE NOT BEING OFFERED OR SOLD WITHIN THE PRC BY MEANS OF THIS OFFICIAL STATEMENT OR ANY OTHER DOCUMENT.

NEITHER THIS OFFICIAL STATEMENT NOR ANY ADVERTISEMENT OR OTHER OFFERING MATERIAL MAY BE DISTRIBUTED OR PUBLISHED IN THE PRC, EXCEPT UNDER CIRCUMSTANCES THAT WILL RESULT IN COMPLIANCE WITH ANY APPLICABLE LAWS AND REGULATIONS.

NOTICE TO RESIDENTS OF PORTUGAL

NO OFFER OF THE BONDS MAY BE MADE IN PORTUGAL EXCEPT UNDER CIRCUMSTANCES THAT WILL RESULT IN COMPLIANCE WITH THE RULES CONCERNING THE MARKETING OF SUCH BONDS AND WITH THE LAWS OF PORTUGAL GENERALLY.

IN RELATION TO PORTUGAL, EACH UNDERWRITER HAS REPRESENTED AND AGREED THAT IT HAS NOT MADE AND WILL NOT MAKE AN OFFER OF THE BONDS TO THE PUBLIC IN PORTUGAL, EXCEPT THAT IT MAY MAKE AN OFFER OF THE BONDS TO THE PUBLIC IN PORTUGAL:

(I) IN THE PERIOD BEGINNING ON THE DATE OF PUBLICATION OF AN OFFICIAL STATEMENT IN RELATION TO THE BONDS WHICH HAS BEEN APPROVED BY THE PORTUGUESE SECURITIES EXCHANGE COMMISSION (COMISSÃO DO MERCADO DE VALORES MOBILIÁRIOS, OR THE “CMVM”) IN ACCORDANCE WITH THE PROSPECTUS DIRECTIVE OR, WHERE APPROPRIATE, PUBLISHED IN ANOTHER MEMBER STATE AND NOTIFIED TO THE CMVM ALL IN ACCORDANCE WITH ARTICLE 18 OF THE PROSPECTUS DIRECTIVE AND ENDING ON THE DATE WHICH IS 12 MONTHS AFTER THE DATE OF SUCH PUBLICATION;

(II) AT ANY TIME TO ANY ENTITIES WHO ARE CONSIDERED AS QUALIFIED INVESTORS ACCORDING TO ARTICLE 30 OF THE PORTUGUESE SECURITIES CODE (CÓDIGO DOS VALORES MOBILIÁRIOS); AND

(III) AT ANY TIME IN ANY OTHER CIRCUMSTANCES WHICH DO NOT REQUIRE THE PUBLICATION BY THE ISSUER OF A PROSPECTUS PURSUANT TO ARTICLE 3 OF THE PROSPECTUS DIRECTIVE

FOR THE PURPOSE OF THIS PROVISION, THE EXPRESSION AN “OFFER OF THE BONDS TO THE PUBLIC” IN RELATION TO ANY BONDS IN PORTUGAL MEANS THE COMMUNICATION IN ANY FORM AND BY ANY MEANS OF SUFFICIENT INFORMATION ON THE TERMS OF THE OFFER AND THE BONDS TO BE OFFERED SO AS TO ENABLE AN INVESTOR TO DECIDE TO PURCHASE OR SUBSCRIBE FOR THE BONDS AND THE EXPRESSION PROSPECTUS DIRECTIVE MEANS DIRECTIVE 2003/71/EC AND INCLUDES ANY RELEVANT IMPLEMENTING MEASURE IN PORTUGAL.

NOTICE TO RESIDENTS OF SAUDI ARABIA

NO ACTION HAS BEEN OR WILL BE TAKEN IN THE KINGDOM OF SAUDI ARABIA THAT WOULD PERMIT A PUBLIC OFFERING OR PRIVATE PLACEMENT OF THE BONDS IN THE KINGDOM OF SAUDI ARABIA, OR POSSESSION OR DISTRIBUTION OF ANY OFFERING MATERIALS IN RELATION THERETO. THE BONDS MAY ONLY BE OFFERED AND SOLD IN THE KINGDOM OF SAUDI ARABIA IN ACCORDANCE WITH PART 5 (EXEMPT OFFERS) OF THE OFFERS OF SECURITIES REGULATIONS DATED 20/8/1425 AH CORRESPONDING TO 4/10/2004 (THE “REGULATIONS”) AND, IN ACCORDANCE WITH PART 5 (EXEMPT OFFERS) ARTICLE 17(A)(3) OF THE REGULATIONS, THE BONDS WILL BE OFFERED TO NO MORE THAN 60 OFFEREEES IN THE KINGDOM OF SAUDI ARABIA WITH EACH SUCH OFFEREE PAYING AN AMOUNT NOT LESS THAN SAUDI RIYALS ONE MILLION OR ITS EQUIVALENT. INVESTORS ARE INFORMED THAT ARTICLE 20 OF THE REGULATIONS PLACES RESTRICTIONS ON SECONDARY MARKET ACTIVITY WITH RESPECT TO THE BONDS. ANY RESALE OR OTHER TRANSFER, OR ATTEMPTED RESALE OR OTHER TRANSFER, MADE OTHER THAN IN COMPLIANCE WITH THE ABOVE-STATED RESTRICTIONS SHALL NOT BE RECOGNIZED.

NOTICE TO RESIDENTS OF SINGAPORE

THIS OFFICIAL STATEMENT HAS NOT BEEN REGISTERED AS A PROSPECTUS WITH THE MONETARY AUTHORITY OF SINGAPORE, AND THE BONDS WILL BE OFFERED PURSUANT TO EXEMPTIONS UNDER THE SECURITIES AND FUTURES ACT, CHAPTER 289 OF SINGAPORE (THE "SECURITIES AND FUTURES ACT"). ACCORDINGLY, THE BONDS MAY NOT BE OFFERED OR SOLD OR MADE THE SUBJECT OF AN INVITATION FOR SUBSCRIPTION OR PURCHASE NOR MAY THIS OFFICIAL STATEMENT OR ANY OTHER DOCUMENT OR MATERIAL IN CONNECTION WITH THE OFFER OR SALE, OR INVITATION FOR SUBSCRIPTION OR PURCHASE, OF BONDS BE CIRCULATED OR DISTRIBUTED WHETHER DIRECTLY OR INDIRECTLY TO ANY PERSON IN SINGAPORE OTHER THAN (I) TO AN INSTITUTIONAL INVESTOR UNDER SECTION 274 OF THE SECURITIES AND FUTURES ACT, (II) TO A RELEVANT PERSON PURSUANT TO SECTION 275(1) OF THE SECURITIES AND FUTURES ACT, OR ANY PERSON PURSUANT TO SECTION 275(1A) OF THE SECURITIES AND FUTURES ACT, AND IN ACCORDANCE WITH THE CONDITIONS, SPECIFIED IN SECTION 275 OF THE SECURITIES AND FUTURES ACT, OR (III) OTHERWISE PURSUANT TO, AND IN ACCORDANCE WITH THE CONDITIONS OF, ANY OTHER APPLICABLE PROVISION OF THE SECURITIES AND FUTURES ACT.

EACH OF THE FOLLOWING PERSONS SPECIFIED IN 275 OF THE SECURITIES AND FUTURES ACT WHICH HAS SUBSCRIBED OR PURCHASED THE BONDS, NAMELY A PERSON WHO IS:

(A) A CORPORATION (WHICH IS NOT AN ACCREDITED INVESTOR (AS DEFINED IN SECTION 4A OF THE OF THE SECURITIES AND FUTURES ACT)) THE SOLE BUSINESS OF WHICH IS TO HOLD INVESTMENTS AND THE ENTIRE SHARE CAPITAL OF WHICH IS OWNED BY ONE OR MORE INDIVIDUALS, EACH OF WHOM IS AN ACCREDITED INVESTOR; OR

(B) A TRUST (WHERE THE TRUSTEE IS NOT AN ACCREDITED INVESTOR) WHOSE SOLE PURPOSE IS TO HOLD INVESTMENTS AND EACH BENEFICIARY OF THE TRUST IS AN INDIVIDUAL WHO IS AN ACCREDITED INVESTOR, SHOULD NOTE THAT SHARES, DEBENTURES AND UNITS OF SHARES AND DEBENTURES OF THAT CORPORATION OR THE BENEFICIARIES' RIGHTS AND INTERESTS (HOWSOEVER DESCRIBED) IN THAT TRUST SHALL NOT BE TRANSFERRED WITHIN SIX MONTHS AFTER THAT CORPORATION OR THAT TRUST HAS ACQUIRED THE BONDS UNDER SECTION 275 OF THE SFA EXCEPT:

(1) TO AN INSTITUTIONAL INVESTOR (FOR CORPORATIONS, UNDER SECTION 274 OF THE SECURITIES AND FUTURES ACT) OR TO A RELEVANT PERSON DEFINED IN SECTION 275(1) AND SECTION 275(1A) OF THE SECURITIES AND FUTURES ACT, RESPECTIVELY AND IN ACCORDANCE WITH THE CONDITIONS SPECIFIED IN SECTION 275 OF THE SECURITIES AND FUTURES ACT;

(2) WHERE NO CONSIDERATION IS OR WILL BE GIVEN FOR THE TRANSFER;

(3) WHERE THE TRANSFER IS BY OPERATION OF LAW; OR

(4) PURSUANT TO SECTION 276(7) OF THE SECURITIES AND FUTURES ACT.

NOTICE TO RESIDENTS OF SPAIN

THE BONDS MAY NOT BE OFFERED, SOLD OR DISTRIBUTED IN THE KINGDOM OF SPAIN SAVE IN ACCORDANCE WITH THE REQUIREMENTS OF LAW 24/1988, OF 28 JULY, ON THE SECURITIES MARKET (LEY 24/1988, DE 28 DE JULIO, DEL MERCADO DE VALORES) AS AMENDED AND RESTATED, AND ROYAL DECREE 1310/2005, OF 4 NOVEMBER 2005, PARTIALLY DEVELOPING LAW 24/1988, OF 28 JULY, ON THE SECURITIES MARKET IN CONNECTION WITH LISTING OF SECURITIES IN SECONDARY OFFICIAL MARKETS, INITIAL PURCHASE OFFERS, RIGHTS ISSUES AND THE PROSPECTUS REQUIRED IN THESE CASES (REAL DECRETO 1310/2005, DE 4 DE NOVIEMBRE, POR EL QUE SE DEARROLLA PARCIALMENTE LA LEY 24/1988, DE 28 DE JULIO, DEL MERCADO DE

VALORES, EN MATERIA DE ADMISIÓN A NEGOCIACIÓN DE VALORES EN MERCADOS SECUNDARIOS OFICIALES, DE OFERTAS PÚBLICAS DE VENTA O SUSCRIPCIÓN Y DEL FOLLETO EXIGIBLE A TALES EFECTOS) AND THE DECREES AND REGULATIONS MADE THEREUNDER. NEITHER THE BONDS NOR THIS OFFICIAL STATEMENT HAVE BEEN VERIFIED OR REGISTERED IN THE ADMINISTRATIVE REGISTRIES OF THE NATIONAL STOCK EXCHANGE COMMISSION (COMISIÓN NACIONAL DE MERCADO DE VALORES), AND THEREFORE THIS OFFICIAL STATEMENT IS NOT INTENDED FOR ANY PUBLIC OFFER OF THE BONDS IN SPAIN.

NOTICE TO RESIDENTS OF SWEDEN

EACH UNDERWRITER HAS CONFIRMED AND AGREED THAT IT WILL NOT OFFER FOR SUBSCRIPTION OR PURCHASE OR ISSUE INVITATIONS TO SUBSCRIBE FOR OR BUY BONDS OR DISTRIBUTE ANY DRAFT OR FINAL DOCUMENT IN RELATION TO SUCH OFFER, INVITATION OR SALE EXCEPT IN CIRCUMSTANCES THAT WILL NOT RESULT IN A REQUIREMENT TO PREPARE A PROSPECTUS PURSUANT TO THE PROVISIONS OF THE SWEDISH FINANCIAL INSTRUMENTS TRADING ACT (LAG (1991:980) OM HANDL MED FINANSIELLA INSTRUMENT).

NOTICE TO RESIDENTS OF SWITZERLAND

THIS OFFICIAL STATEMENT IS BEING COMMUNICATED IN SWITZERLAND TO A SMALL NUMBER OF SELECTED INVESTORS ONLY. EACH COPY OF THIS DOCUMENT IS ADDRESSED TO A SPECIFICALLY NAMED RECIPIENT AND MAY NOT BE PASSED ON TO THIRD PARTIES. THE BONDS ARE NOT BEING OFFERED TO THE PUBLIC IN SWITZERLAND, AND NEITHER THIS OFFICIAL STATEMENT, NOR ANY OTHER OFFERING MATERIALS RELATING TO THE BONDS, MAY BE DISTRIBUTED IN CONNECTION WITH ANY SUCH PUBLIC OFFERING.

NOTICE TO RESIDENTS OF TAIWAN

THE BONDS MAY NOT BE OFFERED, SOLD OR DISTRIBUTED IN TAIWAN TO TAIWANESE RESIDENTS OR ENTITIES INCORPORATED IN TAIWAN OTHER THAN IN ACCORDANCE WITH THE LAWS AND REGULATIONS OF TAIWAN. EACH PURCHASER OF BONDS CONFIRMS THAT IT WILL NOT ON-SELL OR DISTRIBUTE THE BONDS IN TAIWAN TO TAIWANESE RESIDENTS OR ENTITIES INCORPORATED IN TAIWAN OTHER THAN IN ACCORDANCE WITH THE LAWS AND REGULATIONS OF TAIWAN.

NOTICE TO RESIDENTS OF THAILAND

THIS OFFICIAL STATEMENT HAS NOT BEEN APPROVED OR FILED WITH THE SECURITIES AND EXCHANGE COMMISSION OR ANY OTHER REGULATORY AUTHORITY IN THE KINGDOM OF THAILAND. ACCORDINGLY, THE BONDS MAY NOT BE OFFERED OR SOLD, OR THIS OFFICIAL STATEMENT DISTRIBUTED DIRECTLY OR INDIRECTLY, TO ANY PERSON IN THAILAND EXCEPT UNDER CIRCUMSTANCES WHICH WILL RESULT IN COMPLIANCE WITH ALL APPLICABLE LAWS, REGULATIONS AND GUIDELINES PROMULGATED BY THE THAI GOVERNMENT AND REGULATORY AUTHORITIES IN EFFECT AT THE RELEVANT TIME.

NOTICE TO RESIDENTS OF THE UNITED ARAB EMIRATES

EACH UNDERWRITER HAS ACKNOWLEDGED AND AGREED THAT:

(A) THE BONDS TO BE ISSUED HAVE NOT BEEN AND WILL NOT BE OFFERED, SOLD OR PUBLICLY PROMOTED OR ADVERTISED BY IT IN THE UNITED ARAB EMIRATES OTHER THAN IN COMPLIANCE WITH ANY LAWS APPLICABLE IN THE UNITED ARAB EMIRATES GOVERNING THE ISSUE, OFFERING AND SALE OF SECURITIES; AND

(B) THE INFORMATION CONTAINED IN THIS OFFICIAL STATEMENT DOES NOT CONSTITUTE AN OFFER OF SECURITIES IN THE UNITED ARAB EMIRATES IN ACCORDANCE WITH THE COMMERCIAL COMPANIES LAW (FEDERAL LAW NO.8 OF 1986 (AS AMENDED)) OR OTHERWISE AND IS NOT INTENDED TO BE A PUBLIC OFFER AND THE INFORMATION CONTAINED IN THIS OFFICIAL STATEMENT IS NOT INTENDED TO LEAD TO THE CONCLUSIONS OF ANY CONTRACT WITHIN THE TERRITORY OF THE UNITED ARAB EMIRATES.

NOTICE TO RESIDENTS OF THE UNITED KINGDOM

EACH UNDERWRITER HAS SEVERALLY REPRESENTED AND AGREED THAT (I) IT HAS ONLY COMMUNICATED OR CAUSED TO BE COMMUNICATED AND WILL ONLY COMMUNICATE OR CAUSE TO BE COMMUNICATED AN INVITATION OR INDUCEMENT TO ENGAGE IN INVESTMENT ACTIVITY (WITHIN THE MEANING OF SECTION 21 OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (THE "FSMA")) RECEIVED BY IT IN CONNECTION WITH THE ISSUE OR SALE OF THE BONDS IN CIRCUMSTANCES IN WHICH SECTION 21(1) OF THE FSMA DOES NOT APPLY TO THE DISTRICT; AND (II) IT HAS COMPLIED AND WILL COMPLY WITH ALL APPLICABLE PROVISIONS OF THE FSMA WITH RESPECT TO ANYTHING DONE BY IT IN RELATION TO THE BONDS IN, FROM OR OTHERWISE INVOLVING THE UNITED KINGDOM.

GLOBAL CLEARANCE PROCEDURES

The information set out below has been provided by the Underwriters, but prospective investors are advised to make their own inquiries as to such procedures. In particular, such information is subject to any change in or interpretation of the rules, regulations and procedures of Euroclear or Clearstream, Luxembourg (together, the "Clearing Systems") currently in effect and investors wishing to use the facilities of any of the Clearing Systems are therefore advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. Neither the District nor the Underwriters will have any responsibility for the performance by the Clearing Systems, the Clearstream Participants or the Euroclear Operator or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or for the sufficiency for any purpose of the arrangements described below. No representation is made as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.

CLEARSTREAM

Clearstream Banking, société anonyme, 42 Avenue J.F. Kennedy, L-1855 Luxembourg ("Clearstream, Luxembourg"), was incorporated in 1970 as "Cedel S.A.," a company with limited liability under Luxembourg law (a société anonyme). Cedel S.A. subsequently changed its name to Cedelbank. On January 10, 2000, Cedelbank's parent company, Cedel International, société anonyme ("CI") merged its clearing, settlement and custody business with that of Deutsche Börse AG ("DBAG"). The merger involved the transfer by CI of substantially all of its assets and liabilities (including its shares in Cedelbank), and the transfer by DBAG of its shares in Deutsche Börse Clearing ("DBC"), to a new Luxembourg company, which with effect January 14, 2000 was renamed Clearstream International, société anonyme, and was then 50% owned by CI and 50% owned by DBAG. Following this merger, the subsidiaries of Clearstream International were also renamed to give them a cohesive brand name. On January 18, 2000, Cedelbank was renamed "Clearstream Banking, société anonyme," and Cedel Global Services was renamed "Clearstream Services, société anonyme." On January 17, 2000, Deutsche Börse Clearing AG was renamed "Clearstream Banking AG." Today Clearstream International is 100% owned by DBAG. The shareholders of DBAG are comprised of mainly banks, securities dealers and financial institutions.

Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions between Clearstream, Luxembourg customers through electronic book-entry changes in accounts of Clearstream, Luxembourg customers, thereby eliminating the need for physical movement of certificates. Transactions may be settled by Clearstream, Luxembourg in any of 36 currencies, including United States Dollars. Clearstream, Luxembourg provides to its customers, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream, Luxembourg also deals with domestic securities markets in many countries through established depository and custodial relationships. Clearstream, Luxembourg is registered as a bank in Luxembourg, and as such is subject to regulation by the Commission de Surveillance du Secteur Financier, "CSSF," and the Banque Centrale du Luxembourg ("BCL") which supervise and oversee the activities of Luxembourg banks. Clearstream, Luxembourg's customers are world-wide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations.

Clearstream, Luxembourg's U.S. customers are limited to securities brokers and dealers and banks. Currently, Clearstream, Luxembourg has approximately 2,500 customers located in over 110 countries, including all major European countries, Canada, and the United States. Indirect access to Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of Clearstream, Luxembourg. Clearstream, Luxembourg has established an electronic bridge with Euroclear Bank S.A./N.V. as the Operator of the Euroclear System (the "Euroclear Operator") in Brussels to facilitate settlement of trades between Clearstream, Luxembourg and the Euroclear Operator.

EUROCLEAR BANK

Euroclear Bank S.A./N.V. ("Euroclear Bank") holds securities and book-entry interests in securities for participating organizations and facilitates the clearance and settlement of securities transactions between Euroclear Participants,

and between Euroclear Participants and Participants of certain other securities intermediaries through electronic book-entry changes in accounts of such Participants or other securities intermediaries.

Euroclear Bank provides Euroclear Participants, among other things, with safekeeping, administration, clearance and settlement, securities lending and borrowing, and related services. Euroclear Participants are investment banks, securities brokers and dealers, banks, central banks, supranationals, custodians, investment managers, corporations, trust companies and certain other organizations. Certain of the managers or underwriters for this offering, or other financial entities involved in this offering, may be Euroclear Participants. Non-Participants in the Euroclear System may hold and transfer book-entry interests in the Securities through accounts with a Participant in the Euroclear System or any other securities intermediary that holds a book-entry interest in the securities through one or more securities intermediaries standing between such other securities intermediary and Euroclear Bank.

Clearance and Settlement. Although Euroclear Bank has agreed to the procedures provided below in order to facilitate transfers of securities among Participants in the Euroclear System, and between Euroclear Participants and Participants of other intermediaries, it is under no obligation to perform or continue to perform such procedures and such procedures may be modified or discontinued at any time.

Initial Distribution. Investors electing to acquire securities through an account with Euroclear Bank or some other securities intermediary must follow the settlement procedures of such an intermediary with respect to the settlement of new issues of securities. Securities to be acquired against payment through an account with Euroclear Bank will be credited to the securities clearance accounts of the respective Euroclear Participants in the securities processing cycle for the business day following the settlement date for value as of the settlement date, if against payment.

Secondary Market. Investors electing to acquire, hold or transfer securities through an account with Euroclear Bank or some other securities intermediary must follow the settlement procedures of such an intermediary with respect to the settlement of secondary market transactions in securities. Please be aware that Euroclear Bank will not monitor or enforce any transfer restrictions with respect to the securities offered herein.

Custody. Investors who are Participants in the Euroclear System may acquire, hold or transfer interests in the securities by book-entry to accounts with Euroclear Bank. Investors who are not Participants in the Euroclear System may acquire, hold or transfer interests in the securities by book-entry to accounts with a securities intermediary who holds a book-entry interest in the securities through accounts with Euroclear Bank.

Custody Risk. Investors that acquire, hold and transfer interests in the securities by book-entry through accounts with Euroclear Bank or any other securities intermediary are subject to the laws and contractual provisions governing their relationship with their intermediary, as well as the laws and contractual provisions governing the relationship between such an intermediary and each other intermediary, if any, standing between themselves and the individual securities.

Euroclear Bank has advised as follows:

Under Belgian law, investors that are credited with securities on the records of Euroclear Bank have a co-property right in the fungible pool of interests in securities on deposit with Euroclear Bank in an amount equal to the amount of interests in securities credited to their accounts. In the event of the insolvency of Euroclear Bank, Euroclear Participants would have a right under Belgian law to the return of the amount and type of interests in securities credited to their accounts with Euroclear Bank. If Euroclear Bank did not have a sufficient amount of interests in securities on deposit of a particular type to cover the claims of all Participants credited with such interests in securities on Euroclear Bank's records, all Participants having an amount of interests in securities of such type credited to their accounts with Euroclear Bank would have the right under Belgian law to the return of their pro-rata share of the amount of interests in securities actually on deposit.

Under Belgian law, Euroclear Bank is required to pass on the benefits of ownership in any interests in securities on deposit with it (such as dividends, voting rights and other entitlements) to any person credited with such interests in securities on its records.

Initial Settlement; Distributions; Actions Upon Behalf of Owners

All of the Bonds will initially be registered in the name of Cede & Co., the nominee of DTC. Clearstream and Euroclear may hold omnibus positions on behalf of their participants through customers' securities accounts in Clearstream's and/or Euroclear's names on the books of their respective U.S. Depository, which, in turn, holds such positions in customers' securities accounts in its U.S. Depository's name on the books of DTC. Citibank, N.A. acts as depository for Clearstream and JPMorgan Chase Bank acts as depository for Euroclear (the "U.S. Depositories"). Holders of the Bonds may hold their Bonds through DTC (in the United States) or Clearstream or Euroclear (in Europe) if they are participants of such systems, or directly through organizations that are participants in such systems. Investors electing to hold their Bonds through Euroclear or Clearstream accounts will follow the settlement procedures applicable to conventional EuroBonds in registered form. Securities will be credited to the securities custody accounts of Euroclear and Clearstream holders on the business day following the settlement date against payment for value on the settlement date.

Distributions with respect to the Bonds held beneficially through Clearstream will be credited to the cash accounts of Clearstream customers in accordance with its rules and procedures, to the extent received by its U.S. Depository. Distributions with respect to the Bonds held beneficially through Euroclear will be credited to the cash accounts of Euroclear Participants in accordance with the Terms and Conditions, to the extent received by its U.S. Depository. Such distributions will be subject to tax reporting in accordance with relevant United States tax laws and regulations. Clearstream or the Euroclear Operator, as the case may be, will take any other action permitted to be taken by an owner of the Bonds on behalf of a Clearstream customer or Euroclear Participant only in accordance with the relevant rules and procedures and subject to the U.S. Depository's ability to effect such actions on its behalf through DTC.

Secondary Market Trading

Secondary market trading between Participants (other than U.S. Depositories) will be settled using the procedures applicable to U.S. corporate debt obligations in same-day funds. Secondary market trading between Euroclear Participants and/or Clearstream customers will be settled using the procedures applicable to conventional EuroBonds in same-day funds. When securities are to be transferred from the account of a Participant (other than U.S. Depositories) to the account of a Euroclear Participant or a Clearstream customer, the purchaser must send instructions to the applicable U.S. Depository one business day before the settlement date. Euroclear or Clearstream, as the case may be, will instruct its U.S. Depository to receive the securities against payment. Its U.S. Depository will then make payment to the Participant's account against delivery of the securities. After settlement has been completed, the securities will be credited to the respective clearing system and by the clearing system, in accordance with its usual procedures, to the Euroclear participant's or Clearstream customers' accounts. Credit for the securities will appear on the next day (European time) and cash debit will be back-valued to, and the interest on the Bonds will accrue from the value date (which would be the preceding day when settlement occurs in New York). If settlement is not completed on the intended value date (i.e., the trade fails), the Euroclear or Clearstream cash debit will be valued instead as of the actual settlement date.

Euroclear Participants and Clearstream customers will need to make available to the respective clearing systems the funds necessary to process same-day funds settlement. The most direct means of doing so is to pre-position funds for settlement, either from cash on hand or existing lines of credit, as they would for any settlement occurring within Euroclear or Clearstream. Under this approach, they may take on credit exposure to Euroclear or Clearstream until the securities are credited to their accounts one day later. As an alternative, if Euroclear or Clearstream has extended a line of credit to them, participants/customers can elect not to pre-position funds and allow that credit line to be drawn upon to finance settlement. Under this procedure, Euroclear Participants or Clearstream customers purchasing securities would incur overdraft charges for one day, assuming they cleared the overdraft when the securities were credited to their accounts. However, interest on the securities would accrue from the value date. Therefore, in many cases, the investment income on securities earned during that one day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each participant's/customer's particular cost of funds. Because the settlement is taking place during New York business hours, Participants can employ their usual procedures for sending securities to the applicable U.S. Depository for the benefit of Euroclear Participants or Clearstream customers. The sale proceeds will be available to the DTC seller on

the settlement date. Thus, to the Participant, a cross-market transaction will settle no differently from a trade between two Participants.

Due to time zone differences in their favor, Euroclear Participants and Clearstream customers may employ their customary procedure for transactions in which securities are to be transferred by the respective clearing system, through the applicable U.S. Depository to another Participant's. In these cases, Euroclear will instruct its U.S. Depository to credit the securities to the Participant's account against payment. The payment will then be reflected in the account of the Euroclear Participant or Clearstream customer the following business day, and receipt of the cash proceeds in the Euroclear Participants' or Clearstream customers' accounts will be backvalued to the value date (which would be the preceding day, when settlement occurs in New York). If the Euroclear Participant or Clearstream customer has a line of credit with its respective clearing system and elects to draw on such line of credit in anticipation of receipt of the sale proceeds in its account, the back-valuation may substantially reduce or offset any overdraft charges incurred over that one-day period. If settlement is not completed on the intended value date (i.e., the trade fails), receipt of the cash proceeds in the Euroclear Participant's or Clearstream customer's accounts would instead be valued as of the actual settlement date.

Procedures May Change

Although DTC, Clearstream and Euroclear have agreed to these procedures in order to facilitate transfers of securities among DTC and its Participants, Clearstream and Euroclear, they are under no obligation to perform or continue to perform these procedures and these procedures may be discontinued and may be changed at any time by any of them.

General Statement

THE DISTRICT CANNOT AND DOES NOT GIVE ANY ASSURANCES THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS WILL DISTRIBUTE TO THE BENEFICIAL OWNERS OF THE BONDS (1) PAYMENTS OF PRINCIPAL OF OR INTEREST OR REDEMPTION PREMIUM ON THE BONDS (2) CONFIRMATIONS OF THEIR OWNERSHIP INTERESTS IN THE BONDS OR (3) OTHER NOTICES SENT TO DTC OR CEDE & CO., ITS PARTNERSHIP NOMINEE, AS THE REGISTERED OWNER OF THE BONDS, OR THAT THEY WILL DO SO ON A TIMELY BASIS, OR THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS WILL SERVE AND ACT IN THE MANNER DESCRIBED IN THIS OFFICIAL STATEMENT.

THE DISTRICT WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO DTC, THE DIRECT PARTICIPANTS, THE INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR, EUROCLEAR PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS; (2) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OF OR INTEREST OR REDEMPTION PREMIUM ON THE BONDS; (3) THE DELIVERY BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS OF ANY NOTICE TO ANY BENEFICIAL OWNER THAT IS REQUIRED OR PERMITTED TO BE GIVEN TO OWNERS UNDER THE TERMS OF THE INDENTURE; OR (4) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS OWNER OF THE BONDS.

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