

*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 Bonds, interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals. However, while interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by certain S corporations may be subject to tax, and interest on the Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the Bonds may have other federal tax consequences for certain taxpayers. See the caption “TAX EXEMPTION.”*



**\$156,070,000**

**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON  
ELECTRIC SYSTEM REVENUE AND REFUNDING BONDS, SERIES 2011-I**

**Bonds Dated: Date of Delivery**

**Due: January 1, as shown on the inside cover page**

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.

Interest on the Bonds, first payable on January 1, 2012, 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 D—“BOOK-ENTRY SYSTEM.”

The principal of and interest on the Bonds are payable solely from and secured by the Gross Revenue of the Electric System and other funds pledged therefor by the Bond Resolution, subject to prior application for payment of Operating Expenses. Additional bonds payable on a parity with the Bonds may be issued subject to certain requirements. The Electric System Revenue and Refunding Bonds, Series 2001-H were outstanding in the principal amount of \$115,795,000, of which \$53,005,000 have been defeased with District funds, and \$62,790,000 will be refunded with proceeds of the Bonds. See “SECURITY FOR THE PARITY BONDS.”

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**MATURITY SCHEDULE — See Inside Cover**

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The Bonds will be subject to redemption prior to maturity as described herein under “DESCRIPTION OF THE BONDS—Redemption Provisions.”

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 NOR THE REVENUES OF ANY UTILITY SYSTEMS OF THE DISTRICT OTHER THAN THE NET REVENUE OF THE ELECTRIC SYSTEM, ARE PLEDGED TO THE PAYMENT OF THE BONDS.

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 October 5, 2011, through the facilities of DTC in New York, New York, by Fast Automated Securities Transfer.

**Citigroup**

**J.P. Morgan**

Dated: September 21, 2011

**MATURITY SCHEDULES, INTEREST RATES, YIELDS AND CUSIP NUMBERS**

**\$156,070,000**

**Electric System Revenue and Refunding Bonds, Series 2011-I**

<b>Maturity (January 1)</b>	<b>Amount</b>	<b>Interest Rate</b>	<b>Initial Reoffering Yield</b>	<b>CUSIP No.*</b>
2012	\$ 4,335,000	1.50%	0.24%	387874VT4
2013	11,255,000	3.00	0.57	387874VU1
2014	3,195,000	3.00	0.73	387874VV9
2014	8,400,000	5.00	0.73	387874WN6
2015	950,000	3.00	0.98	387874VW7
2015	11,160,000	5.00	0.98	387874WP1
2016	10,025,000	3.00	1.37	387874VX5
2016	2,670,000	5.00	1.37	387874WQ9
2017	300,000	3.00	1.68	387874WF3
2017	12,830,000	5.00	1.68	387874VY3
2018	3,675,000	3.50	1.98	387874WG1
2018	10,105,000	5.00	1.98	387874VZ0
2019	500,000	4.00	2.29	387874WH9
2019	13,915,000	5.00	2.29	387874WA4
2020	1,300,000	4.00	2.53	387874WJ5
2020	13,830,000	5.00	2.53	387874WB2
2021	2,025,000	4.00	2.70	387874WK2
2021	13,845,000	5.00	2.70	387874WC0
2022	2,345,000	4.00	2.89**	387874WL0
2022	14,300,000	5.00	2.89**	387874WD8
2023	1,825,000	3.125	3.10**	387874WM8
2023	13,285,000	5.00	3.10**	387874WE6

\* 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 January 1, 2021 par call date.

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 the 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 purpose 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.

Assured Guaranty Municipal Corp. ("AGM") makes no representation regarding the Bonds or the advisability of investing in the Bonds. In addition, AGM has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom.

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

**Commissioners**

Randall Allred ..... President  
Thomas Flint..... Vice President  
Terry Brewer ..... Secretary  
Bob Bernd..... Commissioner  
Dale Walker..... Commissioner

**Senior Management**

Tim Culbertson ..... General Manager  
Joe Lukas ..... Interim Controller and Senior Policy Advisor  
Chuck Berrie..... Assistant General Manager  
Anthony Webb..... Assistant General Manager  
Mitch Delabarre..... General Counsel  
Kim Justice ..... Auditor  
Andrew Munro ..... Director of External Affairs  
Kevin Nordt..... Director of Power Management  
Dawn Woodward..... Director of Hydro  
Debbie Lowe ..... Director of Support Services  
Jeff Grizzel ..... Director of Natural Resources  
Mary Kunkle..... Treasurer

**Bond and Disclosure Counsel**

Foster Pepper PLLC  
Seattle, Washington

**Paying Agent and Registrar**

The Bank of New York Mellon  
New York, New York

**Financial Advisor**

A. Dashen & Associates  
Bellevue, Washington

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**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

**OFFICIAL STATEMENT**

**RELATING TO**

**\$156,070,000**

**ELECTRIC SYSTEM REVENUE AND REFUNDING BONDS, SERIES 2011-I**

**INTRODUCTION**

The purpose of this Official Statement, which includes the cover page, inside cover page and appendices, is to set forth information concerning Public Utility District No. 2 of Grant County, Washington (the "District"), the District's electric transmission, distribution, telecommunications and generating system (the "Electric System"), the District's Priest Rapids Hydroelectric Project (the "Priest Rapids Project"), which consists of the Priest Rapids Development and the Wanapum Development, and the District's \$156,070,000 principal amount of Electric System Revenue and Refunding Bonds, Series 2011-I (the "Bonds").

The Bonds are to be issued pursuant to Title 54 of the Revised Code of Washington ("RCW") (the "Enabling Act") and Chapters 39.46 and 39.53 RCW. The Bonds are authorized by Resolution No. 8572 of the District, adopted on September 12, 2011 (the "Bond Resolution").

The District's Electric System Revenue and Refunding Bonds, Series 2001-H (the "2001 Bonds"), were outstanding in the amount of \$115,795,000, of which \$53,005,000 have been defeased with District funds and the remainder will be refunded with Bond proceeds. The Bonds and bonds issued on a parity therewith pursuant to the Bond Resolution ("Future Parity Bonds") are hereinafter referred to as the "Parity Bonds."

Certain capitalized words and phrases used in this Official Statement have the meanings as defined in the Bond Resolution, unless the context shall clearly indicate that another meaning is intended. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Certain Definitions."

**PURPOSE AND APPLICATION OF BOND PROCEEDS**

**Purpose of the Bonds**

The Bonds are being issued to fund certain Electric System capital improvements, including various transmission, distribution and general plant projects, to refund a portion of the 2001 Bonds (the "Refunded Bonds"), to fund a portion of the Reserve Fund, and to pay costs of issuance of the Bonds.

## Refunding Plan

In order to effect debt service savings and to change covenants for the benefit the ratepayers of the District, a portion of the proceeds of the Bonds will be used to refund a portion of the 2001 Bonds maturing on or after January 1, 2012 (the "Refunded Bonds"), in the following amounts at a price of par on their maturity date or on the January 1, 2012, call date.

### Refunded Bonds

<u>Bond</u>	<u>Maturity Date</u>	<u>Par Amount (\$)</u>	<u>Interest Rate (%)</u>	<u>Maturity/ Redemption Date</u>	<u>Redemption Price (%)</u>	<u>CUSIP Numbers</u>
<i>Electric System Revenue and Refunding Bonds, 2001-H</i>						
Serials	1/1/2012	\$ 7,260,000	5.375%	1/1/2012	N/A	387874VN7
	1/1/2013	5,240,000	5.375	1/1/2012	100%	387874VP2
	1/1/2014	5,520,000	5.375	1/1/2012	100	387874VQ0
	1/1/2015	5,820,000	5.375	1/1/2012	100	387874VK3
	1/1/2016	8,980,000	5.375	1/1/2012	100	387874VR8
	1/1/2017	9,470,000	5.375	1/1/2012	100	387874VS6
	1/1/2018	9,975,000	5.375	1/1/2012	100	387874VL1
	1/1/2019	10,525,000	5.375	1/1/2012	100	387874VM9
Total		\$62,790,000				

A portion of the net proceeds from the sale of the Bonds will be irrevocably deposited in the Refunding Account (the "Refunding Account") and used to purchase direct, non-callable obligations of the United States of America (the "Escrow Obligations") to be held by The Bank of New York Mellon Trust Company, N.A. (the "Escrow Agent") under an escrow deposit agreement (the "Escrow Agreement"), dated the date of delivery of the Bonds, between the District and the Escrow Agent. The Escrow Obligations will mature at such times and pay interest in such amounts that will provide, with other available funds held by the Escrow Agent under the Escrow Agreement, sufficient money to pay the interest on the Refunded Bonds coming due on and prior to the redemption date set forth above and to redeem and retire the Refunded Bonds on the redemption date set forth above at a price of 100% of the principal amount to be redeemed. 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 of the Refunded Bonds will terminate and be discharged and released.

An independent verification shall be obtained from The Arbitrage Group, 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 date fixed for redemption. The verification will also confirm the correctness of the mathematical computations supporting the conclusion of Bond Counsel that the Bonds are not "arbitrage bonds" as defined by Section 148 of the Internal Revenue Code of 1986, as amended.

In addition, the District defeased the remaining \$53,005,000 of the outstanding 2001 Bonds maturing on and after January 1, 2012 with District funds on September 15, 2011. Such bonds are defeased to the call date of January 1, 2012.

## Application of the Bond Proceeds

The proceeds of the Bonds are expected to be applied as follows:

### Sources and Uses

#### Sources of Funds

Principal Amount of the Bonds	\$ 156,070,000
Original Issue Premium	<u>20,801,703</u>
Total Sources of Funds	\$ 176,871,703

#### Uses of Funds

Deposit to Construction Account	\$ 100,000,000
Deposit to Reserve Fund	11,195,444
Deposit to Refunding Account	64,477,481
Underwriter's Discount and Issuance Costs(1)	<u>1,198,778</u>
Total Uses of Funds	\$ 176,871,703

(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 Bonds will be issued in the aggregate principal amount of \$156,070,000 and will be dated the date of their delivery. The Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2012, and semiannually thereafter on each July 1 and January 1, and will mature on January 1 in each year as set forth on the inside cover page hereof.

The Bonds will be issuable in registered form, in the denomination of \$5,000 or any integral multiple thereof within a single 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 D—"BOOK-ENTRY SYSTEM."

### 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 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 at the owner's 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**

The Bonds maturing in the years 2012 through 2021, inclusive, shall be issued without the right or option of the District to redeem those Bonds prior to their stated maturity dates. The District reserves the right and option to redeem the Bonds maturing on or after January 1, 2022, prior to their stated maturity dates at any time on or after January 1, 2021, as a whole or in part (within one or more maturities selected by the District), at par plus accrued interest to the date fixed for redemption.

### **Partial Redemption**

If less than all of the Bonds are to be redeemed, the District may select the maturity or maturities to be redeemed. If less than all of the Bonds 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, randomly, 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.

### **Notice of Redemption**

So long as the Bonds are held by DTC in book-entry only form, any notice of redemption will be given at the time, to the entity and in the manner required by the Blanket Issuer Letter of Representations between the District and DTC ("Letter of Representations"). During any period in which the Bonds are not in book-entry only form, unless waived by any registered owner of the Bonds to be redeemed, official notice of any redemption of Bonds will be given by the Bond Registrar on behalf of the District by mailing a copy of an official redemption notice by first-class mail, postage prepaid, at least 20 days and not more than 60 days prior to the date fixed for redemption, to the registered owners of the Bonds to be redeemed at the address appearing on the bond register at the time the Bond Registrar prepares the notice.

In the case of an optional redemption, the District reserves the right to rescind any redemption notice and the related optional redemption of Bonds by giving a notice of rescission to the affected registered owners at any time prior to the scheduled optional redemption date. Any notice of optional redemption that is so rescinded will be of no effect, and the Bonds for which the notice of optional redemption has been rescinded will remain outstanding.

Interest on the Bonds called for redemption will cease to accrue on the date fixed for redemption, except in the case of a rescinded optional redemption as described above or unless payment of that Bond is not made or provided for in full on the date fixed for 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.

## **SECURITY FOR THE PARITY BONDS**

### **Pledge of Revenues**

The Bonds and the interest thereon are payable solely from the Electric System Revenue Bond Fund (the "Bond Fund") created by Resolution No. 4744 of the District. The District has covenanted: (i) to pay into the Revenue Fund created by Resolution No. 75 all Gross Revenue, except for certain investment income, and (ii) to pay into the Bond Fund amounts sufficient to pay the principal of, premium, if any, and interest on all Parity Bonds outstanding as the same become due and payable and to provide the required payments into the Reserve Fund. The pledge of the Gross Revenue is subject to its prior application for payment of Operating Expenses and costs associated with Resource Obligations for any month in which any power and energy or other goods and services from such resources were made available to the Electric System. The District has covenanted in the Bond Resolution not to issue any obligations subsequent to the issuance of the Bonds with a lien or charge on the Gross Revenue of the Electric System prior to the lien and charge of the Parity Bonds. See "SECURITY FOR THE PARITY BONDS—Electric System Obligation."

The rights of the owners of the Bonds under the Bonds and the Bond Resolution, and the enforceability thereof, may be subject to judicial discretion and valid exercise of sovereign police powers of the State of Washington, and of the Constitutional powers of the United States of America, and valid bankruptcy, insolvency, receivership, reorganization, moratorium, and other laws affecting creditors' rights.

### **Limited Obligations**

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 nor the taxing power of

the District nor the revenues of any utility systems of the District other than the Gross Revenue of the Electric System are pledged to the payment of the Bonds.

### **Rate Covenant**

The District has covenanted to establish, maintain and collect rates or charges for electric energy and other services, commodities and facilities sold, furnished or supplied by the District in connection with the operation of the Electric System which shall be fair and non-discriminatory and sufficient to provide Net Revenue in any Fiscal Year hereafter equal to at least 1.25 times the Annual Debt Service in such Fiscal Year on outstanding Parity Bonds, excluding any capitalized interest thereon in such Fiscal Year. For purposes of calculating the coverage requirement, there must be added to the Net Revenue in any year any amount withdrawn from the Rate Stabilization Account in such calendar year and deposited in the Revenue Fund, and there must be subtracted from Net Revenue in any year any amount withdrawn from the Revenue Fund and deposited in the Rate Stabilization Account. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Rate Stabilization Account."

### **Additional Bonds**

The District has covenanted not to issue any obligations subsequent to the issuance of the Bonds with a lien or charge on the Gross Revenue of the Electric System prior to the lien and charge of the Bonds. The Bond Resolution permits the issuance of junior lien debt. The District, subject to the limitations set forth in the Bond Resolution, may for any lawful purpose of the District issue bonds having a lien upon the Gross Revenue of the Electric System (subject to prior application for the payment of Operating Expenses and, in certain circumstances, Resource Obligations) equal to the lien of the Parity Bonds if, among other things a certificate of the District sets forth that the Net Revenues for any 12 consecutive months of the 24 months prior to the date of issuance of such Bonds, divided by the maximum Annual Debt Service in any future fiscal year for all Parity Bonds then outstanding and Additional Bonds then to be issued, results in a percentage that is not less than 125%. For the purpose of this certificate, Net Revenue may be adjusted to include a full 12 months of net revenue from any customers added during the 12-month period being considered; the annual estimated net revenue to be received as a result of any additions, betterments and improvements to and extensions of the Electric System to be acquired, constructed or installed by the District from the proceeds of the Future Parity Bonds to be issued or under construction at the time of such certificate; and the additional net revenue which would have been received by the District if any rate change adopted prior to the delivery of the Future Parity Bonds, but subsequent to the beginning of the 12-month period being considered, had been in force during the full 12-month period. In the alternative, the District may obtain a certificate from a Professional Utility Consultant stating that the projected annual Net Revenue for the Fiscal Years in which the Parity Bonds, including the Future Parity Bonds being issued, will be outstanding are expected to at least equal 1.25 times the Annual Debt Service required to be paid in any Fiscal Year thereafter. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Additional Bonds."

### **Flow of Funds Under the Bond Resolution**

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 Revenue exclusive of earnings on money in any arbitrage rebate account, the Reserve and Contingency Fund or the Reserve Fund, which may be retained in such funds and account.

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

- (1) to pay Operating Expenses and costs associated with Resource Obligations (to the extent payable as Operating Expenses);
- (2) to make all payments required to be made into the Bond Fund for the payment of accrued interest on the next interest payment date and to make any District Payments (See APPENDIX A—

“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Derivative Products”);

- (3) to make all payments required to be made into the Bond Fund for the payment of the principal amount of Serial Bonds next coming due, and into the Bond Fund for the optional or mandatory redemption of Term Bonds;
- (4) to make all payments required to be made into the Reserve Fund, or to meet a reimbursement obligation with respect to any Qualified Insurance or Qualified Letter of Credit or other credit enhancement device, if so required by resolution of the Commission; and
- (5) to make all payments required to be made into any special fund or account created to pay or secure the payment of the principal of and interest on any revenue bonds, warrants or other revenue obligations of the District having a lien upon Gross Revenue and money in the Revenue Fund and Bond Fund and accounts therein junior and inferior to the lien thereon for the payment of the principal of and interest on the Bonds.

Costs associated with Resource Obligations not payable as Operating Expenses shall be paid on a parity with outstanding Parity Bonds as provided in Sections (2) and (3) above.

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.

### **Electric System Obligation**

As of June 30, 2011, the District had outstanding \$924,550,000 principal amount of bonds for 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 Priest Rapids Project 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.

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 Parity 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. See “THE PRIEST RAPIDS PROJECT.” For a summary of outstanding debt of the District, see Table 8.

### **Reserve Fund**

The Reserve Fund Requirement with respect to the Bonds and any Future Parity Bonds secured by the Reserve Fund shall be an amount equal to the lesser of (a) 125% of average Annual Debt Service or (b) maximum Annual Debt Service, and that at the time of issuance of any series of bonds, the Reserve Fund Requirement allocable to a series of Parity Bonds shall not exceed 10% of the initial principal amount of that series of Parity Bonds. Such Reserve Fund Requirement may be recalculated and determined from time to time.

The resolution authorizing Future Parity Bonds may establish a separate Reserve Fund for such Future Parity Bonds or provide that such Future Parity Bonds be secured by a common Reserve Fund. The reserve fund requirement may be recalculated as of the date of the defeasance of any Parity Bonds. If the interest rate on any such Parity Bonds is other than a fixed rate, interest on such Parity Bonds is calculated as provided in the Bond Resolution. The valuation of the amount in the Reserve Fund must be made by the District on each December 31 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 Reserve Fund 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 Bonds are insured by Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. (“AGM”), the Reserve Fund 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 Fund 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 Fund Requirement through the deposit of a letter of credit or insurance policy. To meet the Reserve Fund Requirement for the 2001 Bonds, the District obtained a reserve account surety policy in the original aggregate amount of \$12,625,472 with AGM, of which \$6,491,726.39 will be available upon the refunding of the 2001 Bonds. Moody’s Investors Service (“Moody’s”) and Standard & Poor’s Ratings Services (“S&P”) currently rate AGM “Aa3” and “AA+,” respectively. The surety policy terminates when the portion of the Bonds that refund the 2001 Bonds are no longer outstanding, which is expected to be on January 1, 2019. See “Reserve Fund Surety for 2001 Bonds” below. There is currently no cash in the Reserve Fund.

The District has covenanted to make up any deficiency in the Bond Fund from the funds available in the Reserve Fund. The District will replenish such withdrawals from money in the Revenue Fund first available after making current specified payments into the Bond Fund, and after paying and making provision for the payment of Operating Expenses. Once the surety policy is terminated (expected to be in 2019), and if the Bonds are the only Parity Bonds secured by the Reserve Fund, the District shall not be required to replenish any deficiency in the Reserve Fund as the result of such termination.

The District will fund the Reserve Fund Requirement for the Bonds on the date of issuance of the Bonds with Bond proceeds and the AGM reserve account surety policy. The Reserve Fund is held by the District.

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 or S&P or their comparable recognized business successors or both Moody’s or S&P 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 Fund shall first be applied to remedy any deficiency in such account.

#### ***Reserve Fund Surety for 2001 Bonds***

The surety bond issued by AGM provides that upon the later of (i) one business day after the receipt by the surety of a notice of nonpayment 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 notice for nonpayment submitted to the surety, the 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.

Pursuant to the terms of the surety bond, the policy limit is automatically reduced to the extent of each payment made by the surety under the terms of the surety bond, and the District is required to reimburse the surety for any draws under the surety bond with interest as provided in the surety. Upon such reimbursement, the surety bond is reinstated to the extent of each reimbursement up to but not exceeding the policy limit. The reimbursement obligation of the District under the surety bond 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 Fund exceeds the amount of the surety bond, any draw on the surety bond shall be made only after all the funds in the Reserve Fund have been expended. In the event that the amount on deposit in, or credited to, the Reserve Fund, in addition to the amount available under the surety bond, includes amounts available under a letter of credit, insurance policy, surety bond or other such funding instrument, draws on the surety bond and additional funding instruments shall be made on a pro rata basis to fund the insufficiency. The Bond Resolution provides that the Reserve Fund shall be replenished by payments of principal of and interest on the surety bond and on the additional funding instruments from first-available Gross Revenues on a pro rata basis. The surety bond does not insure against nonpayment caused by the insolvency or negligence of the Paying Agent.

AGM is 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 AGM are available on the company’s website, [www.assuredguaranty.com](http://www.assuredguaranty.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.”

### **Reserve and Contingency Fund**

The District has established an Electric System Reserve and Contingency Fund (the “R&C Fund”) for the purposes of paying the costs of extraordinary, unexpected or catastrophic expenses not otherwise provided for, additional power and energy purchases, and defeasing outstanding debt. The Commission determines the amount, if any, to deposit in such fund as part of the annual budget. The R&C Fund is pledged to the payment of the Bonds to the extent, if any, of money in such fund. There was approximately \$96 million in the R&C Fund as of June 30, 2011, of which approximately \$45 million will be used for the defeasance of a portion of the outstanding 2001 Bonds. Continued maintenance of the R&C Fund is within the discretion of the Commission. The Rate Stabilization Account is an account within the R&C Fund. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Rate Stabilization Account” for a discussion of the use of the Rate Stabilization Account for rate stabilization purposes.

### **Resource Obligations; Take or Pay Contracts**

Upon compliance with certain requirements in the Bond Resolution (See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Separate System Bonds; Resource Obligations”), the District may (1) enter into contracts for the purchase of energy, capacity, capability, reserves, conservation or services or (2) construct or acquire as a separate system, facilities or resources for the generation of power and energy or for the conservation, transformation, transmission or distribution of power and energy and may declare costs associated with such contract or separate system (including debt service on bonds) to be a resource obligation (“Resource Obligation”) of the Electric System to be paid as an Operating Expense of the Electric System for any month in which power and energy or other goods and services from such resource were made available to the Electric System during such month (regardless of whether or not the Electric System actually scheduled or received energy from such resource during such month). At all other times a Resource Obligation is an indebtedness of the Electric System payable from Gross Revenue on a parity of lien with the Bonds. The District has not entered into Resource Obligations. The District’s share of the Priest Rapids Project is not a Resource Obligation, but the District’s costs associated with the Priest Rapids Project are Operating Expenses as long as power or energy is provided or capable of being provided.

The District has covenanted in the Bond Resolution not to enter into any agreement which obligates the District to pay from Gross Revenue for (a) generating or transmission capacity or energy or the use or lease of generating or transmission facilities (under which agreement payment is not conditioned on the availability of such capacity, energy or facility) or (b) the installment purchase or lease of property which otherwise transfers to the District the burdens and benefits of ownership, unless such agreement specifically provides that the payment obligation of the District thereunder is junior to the obligation of the District to make payments from the Revenue Fund into the Bond Fund. This restriction does not apply to Resource Obligations or any agreement relating to the Priest Rapids Project or to any other hydroelectric facility owned and operated by the District.

## **Other Covenants**

The District has, among other covenants, made covenants in the Bond Resolution with respect to maintenance of District properties, sale or disposition of the Electric System, insurance and the keeping of proper books of account of the Electric System. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Additional Covenants.”

## **Derivative Products**

To the extent permitted by State law, the District may enter into Derivative Products secured by a pledge and lien on Gross Revenue on a parity with the 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.” See “THE ELECTRIC SYSTEM—Power Supply Management and Power Marketing” for a description of two power supply 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 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 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 any 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 bonds issued for the Priest Rapids Project also are not subject to acceleration. The District has never defaulted in the payment of principal or interest on any of its bonds.

## Debt Service Requirements for the Electric System

The District's debt service requirements on the Bonds are as follows. The District's debt service requirements for the outstanding Priest Rapids Project bonds are shown in Table 18.

**Table 1**  
**DEBT SERVICE REQUIREMENTS OF THE ELECTRIC SYSTEM**

Year (1)	The Bonds		
	Principal	Interest	Total Debt Service
2011	\$ 4,335,000	\$ 1,668,933	\$ 6,003,933
2012	11,255,000	6,921,206	18,176,206
2013	11,595,000	6,583,556	18,178,556
2014	12,110,000	6,067,706	18,177,706
2015	12,695,000	5,481,206	18,176,206
2016	13,130,000	5,046,956	18,176,956
2017	13,780,000	4,396,456	18,176,456
2018	14,415,000	3,762,581	18,177,581
2019	15,130,000	3,046,831	18,176,831
2020	15,870,000	2,303,331	18,173,331
2021	16,645,000	1,530,081	18,175,081
2022	15,110,000	721,281	15,831,281
	<u>\$156,070,000</u>	<u>\$47,530,127</u>	<u>\$203,600,127</u>

(1) Includes January 1 payment of succeeding year.  
Certain columns may not add due to rounding.

## Future Electric System Borrowings

The District currently does not expect to issue additional Parity Bonds in the next 12 months.

## 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.

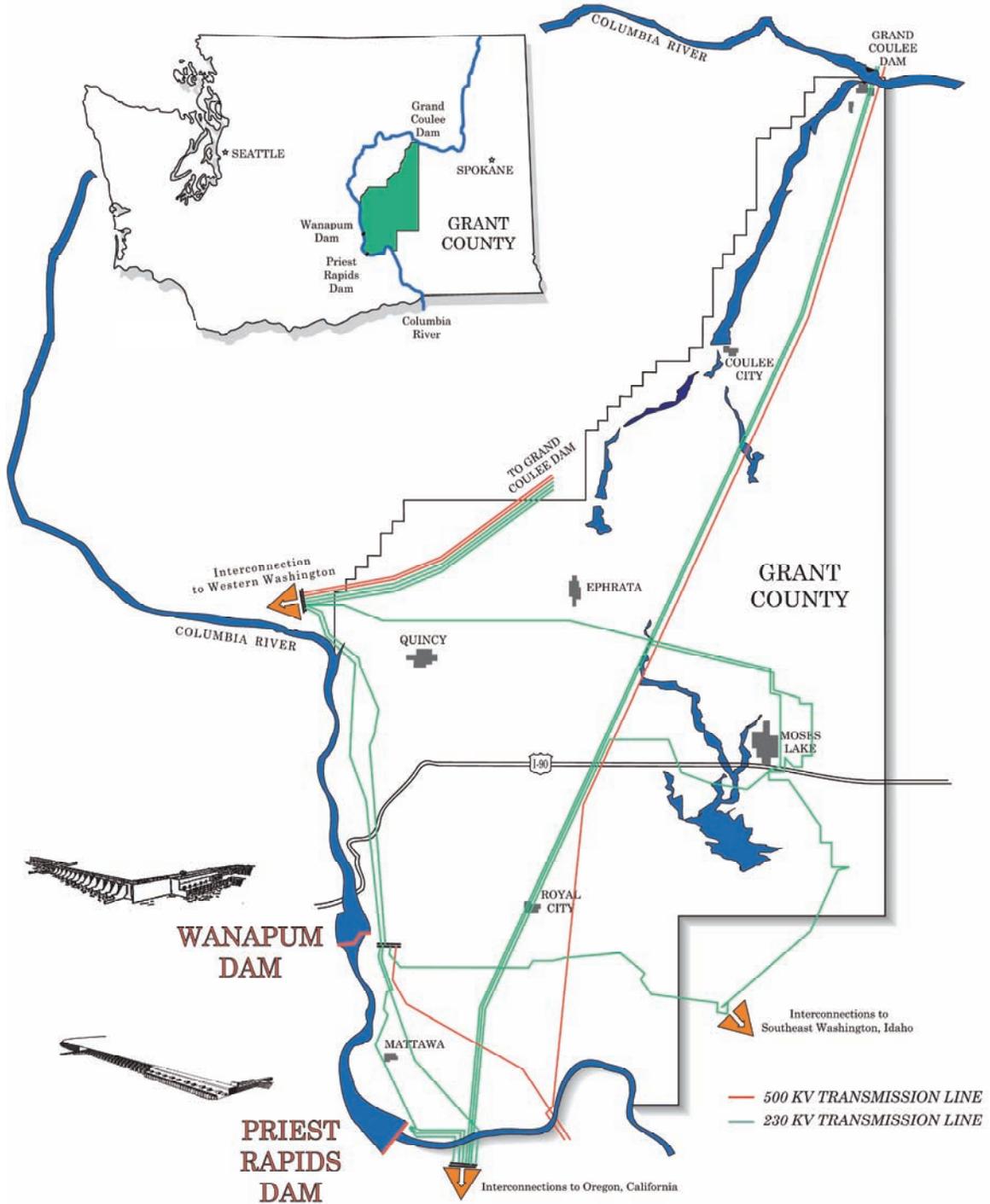
The District's electric utility properties and operations consist of two operating systems, each of which is accounted for and financed separately. The systems are the Electric System and the Priest Rapids Project, which consists of the Priest Rapids Development and the Wanapum Development. The present 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 Electric System.

**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.

<u>Name</u>	<u>Title</u>	<u>Expiration of Term of Office (12/31)</u>
Randall Allred	President	2014
Thomas Flint	Vice President	2012
Terry Brewer	Secretary	2012
Bob Bernd	Commissioner	2016
Dale Walker	Commissioner	2016

*Randall Allred, President.* Commissioner Allred, elected to the Commission in 2002, has been a resident of Grant County for 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 long-serving member of the Quincy Columbia Basin Irrigation District Board of Directors.

*Thomas Flint, Vice President.* Commissioner Flint joined the Commission after being elected in the fall of 2000. He is a fifth generation farmer actively farming in Grant County. As founder and director for AgFARMation, he is a grassroots activist and Director of the Black Sands Irrigation District and the Columbia Basin Development League. Commissioner Flint has a Bachelor of Arts in industrial technology from Central Washington University.

*Terry Brewer, Secretary.* Commissioner Brewer was elected to the Commission in 2006. He has over 30 years of experience in the electric utility industry. Commissioner Brewer 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. Commissioner Brewer 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.

*Bob Bernd, Commissioner.* Commissioner Bernd joined the Commission in January 2007. A Grant County native, he is retired from a career in moving and storage, waste disposal and recycling. Commissioner Bernd 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.

*Dale Walker, Commissioner.* Commissioner Walker was elected to the commission in the fall of 2010. He is a 57-year resident of Grant County having been actively involved in agriculture and agriculture research. His family was involved in the development of the Columbia Basin Project. Commissioner Walker has served local, state and national organizations representing the agricultural industry. He is currently a member of the Grant County Planning Commission.

The senior management team of the District is as follows:

*Tim Culbertson, General Manager,* has been with the District since 2000. He has more than 41 years of executive management, power management and overall utility operations experience in west coast utilities. An active player in the nation's energy industry, Mr. Culbertson has testified before many Western State Commissions as well as Senate and Congressional subcommittees on energy issues. He serves on the executive committee for the Large Public Power Council, Pacific Northwest Utilities Conference Committee and the Public Generating Pool. In addition to national efforts, Mr. Culbertson is heavily involved in Northwest energy issues. He serves as a member of the executive and energy committees at the Washington Public Utility Districts Association and participates in the region's wind integration committee, and holds an executive committee position with ColumbiaGrid.

*Joe Lukas, Interim Controller and Senior Policy Advisor*, has worked for the District since 1995. He has more than 16 years of experience working on natural resource, relicensing and various strategic issues including financial planning and prior bond issues. He served as Assistant General Manager from 2004 through 2008 and was instrumental in the District receiving a new FERC License for the Priest Rapids Project in 2008. His current work focuses on representing the General Manager on strategic issues of importance including negotiation of a new collective bargaining agreement with the IBEW and financial planning for the District. Mr. Lukas has a Bachelor of Science degree from the University of Idaho and a Master of Science degree from Virginia Tech.

*Chuck Berrie, Assistant General Manager*, joined the District in 2007. Mr. Berrie is a Grant County native and has more than 21 years of utility experience at three eastern Washington public utility districts. Prior to joining the District, he served as general manager of Okanogan Public Utility District. At the District, Mr. Berrie manages the hydro, natural resources and power management divisions. He has a Bachelor of Science degree from Washington State University.

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

*Mitch Delabarre, General Counsel*, joined the District in 2009. He has more than 24 years of legal experience, including 18 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.

*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.

*Debbie Lowe, Director of Support Services*, has been with the District since 1984. She manages the support services and information technology divisions and previously served as the Customer Service Manager.

*Jeff Grizzel, Director of Natural Resources*, joined the District in 2010 after 16 years with the Washington State Department of Natural Resources. His work with the State included land use policy development and watershed analysis implementation aimed at protecting salmon habitat. His Master of Science degree in Hydrology/Forest Engineering is from Oregon State University.

*Mary Kunkle, Treasurer*, joined the District in 2003 after 19 years as Treasurer/Controller at Samaritan Healthcare in Moses Lake. She has been the District's Deputy Treasurer since 2007, became the District's Treasury Operations Manager in 2009, was appointed as Interim Treasurer in July 2011 and Treasurer in September 2011. She has a Bachelor of Science degree with a major in Accounting from the University of Idaho.

## 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. 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. The financial statements of the District for the fiscal year ended December 31, 2010, which have been audited by PricewaterhouseCoopers LLP, are included as a part of this Official Statement as Appendix B. Financial information for 2010 is included in various tables throughout this Official Statement. The information in the body of this Official Statement has not been audited by PricewaterhouseCoopers.

## District Employees and Retirement Plans and Other Post-Employment Benefits

Following are the number of District employees by function as of June 2, 2011.

Function	Number of Regular Employees (FTE)
Manager’s Division	9
Power Management	37
HR/Safety	11
Accounting, Finance and Strategic Planning	22
Hydro Generation	248
Natural Resources	37
Support Services	96
Customer Service	183
Total	643

The District also has approximately 20 full-time equivalent part-time and temporary employees. 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 and generator rehabilitation, and environmental and other projects.

Of the 643 regular employees, as of June 2, 2011, 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, 2014. 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. These plans are administered by the State. The Washington State Investment Board invests the funds in the plans. PERS Plan 1 and Plan 2 are defined benefit plans. PERS Plan 3 is both a defined benefit plan (employer share) and defined contribution plan (employee share). The Electric System’s and Priest Rapids Project’s shares of these costs are in proportion to their share of direct payroll costs. The following shows employer and employee contribution rates.

### PERS Contribution Rates Expressed as a Percentage of Covered Payroll (As of September 1, 2011)

	Plan 1	Plan 2	Plan 3
<b>Employer</b> <sup>(1)</sup>	7.25%	7.25%	7.25%
<b>Employee</b>	6.00%	4.64%	Variable <sup>(2)</sup>

(1) Includes a 0.16% administration fee.

(2) Rates vary from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

While the District's 2010 contribution of \$3,153,000, on a covered payroll of \$52,800,000, 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 8 to the Audited Financial Statements for the Years Ended December 31, 2010 and 2009, attached hereto as APPENDIX B.

According to the Office of the State Actuary, as of June 30, 2010, PERS Plans 2 and 3 had no unfunded actuarial accrued liability. However, during the years 2001 through 2010 the rates adopted by the Legislature were lower than those that would have been required to produce actuarially required contributions to PERS Plan 1, a closed plan with a large proportion of the retirees. According to a report issued by the Office of the State Actuary, the total unfunded actuarial accrued liability of PERS Plan 1 was \$3.238 billion as of June 30, 2010. The assumptions used by the State Actuary in calculating the unfunded liability were an 8% annual rate of investment return, 4% general salary increases and 3.5% consumer price index increase.

Assets from one plan may not be used to fund benefits for another plan; however, all employers in PERS are required to make contributions at a rate (percentage of payroll) determined by the Office of the State Actuary every two years for the sole purpose of amortizing the PERS Plan 1 unfunded actuarial accrued liability within a rolling 10-year period. The Legislature has established certain maximum contribution rates that began in 2009 and will continue until 2015 and certain minimum contribution rates that are to become effective in 2015 and remain in effect until the actuarial value of assets in PERS Plan 1 equals 100% of the actuarial accrued liability of PERS Plan 1. These rates are subject to change by future legislation enacted by the State Legislature to address future changes in actuarial and economic assumptions and investment performance. In 2011, the Legislature ended the future automatic annual increase, which is a fixed dollar amount multiplied by the member's total years of service, for most retirees in the PERS Plan 1 plan, which is forecast to reduce the unfunded accrued actuarial liability in PERS Plan 1.

The District administers a single-employer defined benefit premium program that covers a portion of healthcare insurance for retirees ages 59 1/2 to 65 and their spouses. For the years ended December 31, 2010 and 2009, the District paid \$206,000 and \$198,000 in retiree subsidies. The District's net accrued other post-employment benefit obligation at the year ended December 31, 2010 was \$919,000. See Note 9 to the Audited Financial Statements for the Years Ended December 31, 2010 and 2009, attached hereto as APPENDIX B.

## **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 marine liability, foreign travel and non-owned aviation liability to protect the District from losses associated with these 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 \$1.175 million at 2010 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 Electric System, the Priest Rapids Project, 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 May 2011 that will be reviewed 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 2.0 times debt service coverage, a retail operating ratio of 100%, working capital minimum of \$35 million (excluding special funds), increasing the R&C Fund balance to \$120 million, and on average a minimum of 50% funding of capital expenditures from revenues. 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 Priest Rapids Project bond resolutions.

**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 or volatile financial products such as “inverse floaters” or structured notes. The Bond Resolution provides that money in the Bond Fund, Reserve Fund, Revenue Fund, R&C Fund and project accounts be invested in any investments permitted under State law and the Bond Resolution.

The following summarizes the par value of the District’s investments as of May 31, 2011.

**District’s Investments**

Federal Home Loan Bank	\$ 21,500,000
Federal Farm Credit Bank	11,000,000
Fed. Nat. Mortgage Assoc.	67,500,000
Freddie Mac Discount Notes	29,000,000
Treasuries	229,366,000
Repurchase Agreements	71,100,000
Municipal Bonds	2,770,000
Money Market	<u>33,243,015</u>
	\$465,479,015

For information relating to the District’s investments, see Note 2 to the Audited Financial Statements for the Years Ended December 31, 2010 and 2009, attached hereto as APPENDIX B.

**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.

## 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 project. The Electric System is owned and operated by the District and serves all of Grant County. During 2010, the Electric System operated approximately 4,211 miles of lines and served approximately 45,998 retail customers. As of December 31, 2010, the District’s gross investment in the Electric System was \$812.5 million and its net investment was \$474.6 million. The District’s Priest Rapids Project is the primary source of power for the Electric System.

### Retail Energy Sales and Customers

The Electric System’s gross operating revenues for 2010 totaled approximately \$213.7 million. Of this total, approximately \$122.9 million (58%) was derived from retail energy sales to an average of 45,998 customers. Sales to other utilities provided approximately \$86.4 million of revenues (40% of the total). See “Power Supply Management and Power Marketing.” Of the retail customers, 76% were residential customers, providing 25.4% of all retail energy revenues. The number of retail customers, energy sales and revenues for the year ended December 31, 2010, for each major retail customer class are listed below.

**Table 2**  
**ELECTRIC SYSTEM**  
**2010 RETAIL CUSTOMERS, ENERGY SALES AND REVENUES**

Customer Class (1)	Average Number of Customers		Energy Sold		Revenue (2)	
	Number	%	GWh (3)	%	\$000	%
Residential	35,215	76.56	729.7	18.82	\$ 31,252	25.43
Commercial	5,999	13.04	440.0	11.35	15,507	12.62
Irrigation	4,553	9.90	503.7	12.99	16,295	13.26
Industrial	113	0.24	2,198.7	56.70	58,865	47.90
Other	118	0.26	6.0	0.14	981	0.79
<b>Total</b>	<b>45,998</b>	<b>100.00</b>	<b>3,878.1</b>	<b>100.00</b>	<b>\$ 122,900</b>	<b>100.00</b>

- (1) Statistics reported by class of service classification.  
(2) Includes municipal taxes.  
(3) Gigawatt hour equal to 1,000 megawatt hours (“MWh”).

The ten largest customers, based on retail revenue of the Electric System for the 12 months ended December 31, 2010, are shown in the following table.

**Table 3**  
**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
EKA Chemicals, Inc.	Moses Lake	Crystal sodium chlorate and liquid sodium chlorate
J.R. Simplot	Quincy	Vegetables processor
Lamb-Weston, Inc.	Quincy	French fried potatoes
Microsoft Corp.	Quincy	Data center
Moses Lake Industries, Inc.	Moses Lake	Manufacture highly purified raw chemical components
Norco, Inc.	Moses Lake	Liquid nitrogen, oxygen and argon
REC Solar Grade Silicon LLC	Moses Lake	Polycrystalline silicon and silane gas
Yahoo!	Quincy	Data center

The Electric System's ten largest customers used approximately 47% of total retail energy sold and provided approximately 41% of retail revenues in 2010. The District's rate structure for industrial customers is designed to include the marginal cost of additional power purchases.

The District continues to see large industrial and manufacturing customers locate or enlarge operations in the County. REC Solar Grade Silicon LLC has constructed a large expansion to its facilities and has increased its electrical load substantially since 2009. By the end of 2011, carbon manufacturer SGL Group will be finished with Phase I of its plant that will make carbon fiber based products for BMW with plans to finish Phases II and III by 2016. Several internet server farms, including Microsoft, Yahoo!, Intuit, Dell and Sabey Data Centers, have been built or are planned to be built, 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 10% to 15% is expected over the next five to seven 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 District's power sales contracts for the Priest Rapids Project.

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 4**  
**ELECTRIC SYSTEM**  
**RETAIL CUSTOMERS, ENERGY SALES, AND REVENUES**

	2006	2007	2008	2009	2010
Number of Customers					
(Average) (1)					
Residential	32,523	33,457	34,326	34,901	35,215
Commercial	5,523	5,628	5,782	5,899	5,999
Irrigation	4,414	4,446	4,493	4,541	4,553
Industrial	95	103	115	117	113
Other (1)	119	120	121	118	118
Total Customers	42,674	43,754	44,837	45,576	45,998
Energy Sales (MWh) (1)					
Residential	691,436	721,885	750,149	819,448	729,695
Commercial	411,738	424,166	444,447	467,134	439,988
Irrigation	476,558	521,363	555,748	541,930	503,706
Industrial	1,539,856	1,574,663	1,773,930	1,881,258	2,198,721
Other (2)	5,297	5,459	5,648	5,896	6,044
Total Energy Sales	3,124,885	3,247,536	3,529,922	3,715,666	3,878,154
System Peak (MW)					
Winter	550	523	589	660	643
Summer	579	572	623	640	662
Revenues from Energy					
Sales (\$000) (1)					
Residential	\$ 29,536	\$ 30,323	\$ 31,926	\$ 33,211	\$ 31,252
Commercial	14,305	14,568	15,346	15,658	15,507
Irrigation	15,049	15,881	16,556	16,422	16,295
Industrial	38,303	39,458	46,427	48,602	58,865
Other (2)	886	905	931	971	981
Total Revenues	\$ 98,079	\$ 101,135	\$ 111,186	\$ 114,864	\$ 122,900

(1) Statistics reported by class of service classification.

(2) "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 the cities of 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. For example, in 2009 there was a colder than normal winter and hotter than normal summer. The MWh usage in industrial accounts from 2006 to 2010 grew 53%.

#### **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 Priest Rapids and Wanapum Development's reservoirs, and the Developments are considered "run of the river" operations. 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." Columbia River flow is coordinated to meet a number of constraints, including optimizing generation, providing minimum flows for fish, and meeting other operational 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 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 are included in this planning. Market purchases are made in periods that are forecast to generate a deficit, and sales are made in 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 these variable resource and system requirements, the District enters into a number of wholesale energy transactions. These include purchases and sales in the daily and real-time markets. The District also is 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 and optimizing the value of the Priest Rapids Project 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 value.

The District's firm energy resource requirements are fully satisfied by the District's entitlements under the Priest Rapids Project power sales contracts. These entitlements result in surplus secondary energy available for resale in the wholesale markets on average. 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 will terminate on August 15, 2012. 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 outside 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 2006 through 2010.

**Table 5**  
**ELECTRIC SYSTEM**  
**WHOLESALE ENERGY SALES (1)**

	2006	2007	2008	2009 (2)	2010 (2)
Wholesale Energy Sales (\$000) (1)	\$ 114,541	\$ 119,195	\$ 115,636	\$ 87,908	\$ 86,385
Total MWh	3,209,775	3,317,929	3,360,177	3,111,968	2,777,244
Average Revenue (\$/MWh)	\$ 35.69	\$ 35.92	\$ 34.41	\$ 28.25	\$ 31.10

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

(2) 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 Commission 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 Commission. The Energy Risk Management Policy and Procedures outline the parameters for

transaction, trader and counterparty exposure. 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 projected 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; 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) traders are authorized to sell and purchase both physical and financial power (long and near term), options, ancillary services, renewable energy credits ("RECs") and REC options, which trades are made to hedge the District position, sell surplus power or purchase power where the District is in a deficit position; and (6) 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 these policies limit the risk of any substantial financial loss resulting from the District's power supply management activities.

The District has entered into hedging agreements in the form of International Swaps and Derivatives Association ("ISDA") agreements with two different entities. The agreements are designed to manage price risk associated with power transactions and, in all cases, will be used to hedge the risk of an underlying physical position. The District currently has two confirmations in place to fix the price of certain power sales with a notional value of \$1.5 million and which expire in late 2011. As of July 18, 2011, the marked-to-market value of the outstanding agreements was \$97,252 in favor of the District. The District does not, at this time, anticipate executing any further ISDA agreements.

The ISDA agreements require that the District post collateral in the form of a letter of credit to secure its obligation to pay under the contracts if certain predetermined thresholds are met or the counterparty has commercially reasonable grounds for insecurity regarding the District's performance. Thresholds on the two agreements in place are currently at 3.5 times the District's internally-allowed credit exposures. Credit exposures are monitored continuously and calculated weekly on notional and mark-to-market values. In the event that credit exposure approaches a predetermined threshold, the District would determine the most appropriate course of action including, but not limited to, trading out of the given transactions. If no other action was deemed to be in the best interest of the District, the District would proceed to provide a letter of credit or collateral within one to three business days depending on the triggering event. The collateral provisions are reciprocal, meaning that the District has the right to ask its counterparties to post collateral if the exposure of the forward transactions moves in the District's favor and the predetermined thresholds are met.

## **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. 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. The District’s electrical rates are among the lowest in the nation. The average annual residential power bill for the District in 2010 was \$887 and the average cost per kWh for residential service in the District was 4.28 cents.

**Table 6**  
**ELECTRIC SYSTEM**  
**MONTHLY ELECTRIC BILLS COMPARISON (1)**  
**As of June 2011**  
**(Winter Rates where applicable)**

	<b>Residential</b> <b>(1,500 kWh)</b>	<b>Commercial</b> <b>(30 kW</b> <b>9,000 kWh)</b>	<b>Industrial</b> <b>(400 kW</b> <b>150,000 kWh)</b>
<b>The District</b>	\$ 68	\$ 380	\$ 4,136
<b>Washington State Public Utility Districts</b>			
Benton County PUD No. 1	108	541	8,742
Chelan County PUD No. 1	44	240	4,594
Clark Public Utilities	130	710	9,735
Douglas County PUD No. 1	40	196	3,549
Franklin County PUD No. 1	121	641	8,831
Grays Harbor County PUD No. 1	124	701	10,161
Kittitas County PUD No. 1	134	698	8,290
Klickitat County PUD No. 2	114	448	8,512
Lewis County PUD No. 1	80	422	6,498
Mason County PUD No. 3	107	627	8,877
Snohomish County PUD No. 1	125	722	11,175
<b>Washington Cities</b>			
City of Ellensburg	100	564	8,299
City of Richland	96	403	7,099
City of Seattle	123	610	9,044
City of Tacoma	105	620	7,668
<b>Private Power Companies</b>			
Avista	121	963	12,229
Pacific Power (a PacifiCorp Company)(2)	125	650	9,830
Portland General Electric	165	799	11,920
Puget Sound Energy	151	805	12,802

(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.

(2) As of June 13, 2011.

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. The following table shows the District's rate increases since 1999.

**Table 7**  
**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
February 1, 2011	6

The forecast adopted by the Commission has future overall annual rate increases of 8% each year for the years 2012 through 2015, which are subject to final Commission action.

**The Electric System's Power Supply**

In 2010, the Electric System obtained approximately 76% of its firm energy requirements from the District's share of the Priest Rapids Project and the Bonneville Power Administration ("Bonneville") contract, and the remainder from the Quincy Chute Hydroelectric Project, P.E.C. Headworks Powerplant Project, Nine Canyon Wind Project, and market purchases. 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." Since 2005, the New Power Sales Contracts for the Priest Rapids Project have permitted the District to increase its share of power from the Priest Rapids Project, which has significantly reduced the District's reliance on power from Bonneville. After September 30, 2011, the District will purchase only a small amount of power from Bonneville to serve loads in the Grand Coulee area and the District will obtain most of its power from the Priest Rapids Project.

***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 32,056 MWh in 2010.

***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 22,739 MWh in 2010.

### ***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 10,756 annual average megawatts (“aMW”) under average water conditions and about 8,478 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. In 2010, the Electric System purchased about 42% of its power from Bonneville. The Electric System’s ability to meet more of its load requirements with power from the Priest Rapids Project has significantly reduced its reliance on power from Bonneville. Under the District’s current contract with Bonneville, which expires on September 30, 2011, the District purchases 161.8 aMW of a Shaped Block Product and a Full Requirements Product for the District’s Grand Coulee load. The cost of the District’s power from Bonneville currently is approximately 50% higher than the cost of the Priest Rapids Project’s power. The current Bonneville delivered power purchase price is approximately \$29.00/MWh. .

The District has 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 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 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. Under the new Bonneville contracts effective October 1, 2011, Bonneville will conduct a rate case every two or three years. The first rate case was 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. 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 offers 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 its conservation programs, but the District, recognizing the value of promoting cost-effective energy conservation, voluntarily continued to promote and finance programs without Bonneville's financial assistance.

In 2001, the District increased conservation activities based on the Bonneville Conservation and Renewables Discount ("C&RD") program, which over five-years provided approximately \$3,650,000 in benefits that enabled the District to spend less on wholesale energy purchases and use the savings to fund local conservation activities. In 2006, the District continued its conservation activities and implemented an early start option in the Bonneville Conservation Rate Credit ("CRC") program. Between 2006 and 2009, the District received approximately \$846,600 per year from the CRC program. Bonneville 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), which the District signed. The District's current conservation budget amount is \$6,312,000 for the 12-months ending September 30, 2011. For the Bonneville rate period 2012 and 2013, the ECA budget will be reduced to \$150,000 total. This reduction is due to the decrease in power purchases from Bonneville. District funds will be used for the majority of cost-effective conservation and energy efficiency projects in the future.

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 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 "Recent 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.

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 project costs, including repayment of debt service, are 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, 2010 was \$68.87 per MWh. The projected net cost for calendar year 2011 is expected to be \$60.90 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 2010, the District received approximately 29,963 MWh of wind generation output from the project and the District is projecting output from the project to be about 35,000 MWh in 2011.

### ***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 \$3.365 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 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.

### ***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 consists 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 was approximately 0.8 aMW in 2010 and is expected to be approximately 0.5 aMW in 2011. The output is seasonal and concurrent with the irrigation season that runs from March through October. The rated capacities of the Wapato Hydroelectric Project are 1.6 MW and 2.5 MW, respectively.

### **Future Resources**

The District has evaluated resource additions to minimize District exposure to variations in water supply and market prices in serving energy demand in excess of its existing resource entitlements. Under evaluation were 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. The preferred resource alternative was identified as a mix of short, medium and long term market purchases. 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.

## **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 eligible renewable resources by January 1, 2012, and each year thereafter through December 31, 2015; (b) 9% of their electricity from eligible renewable resources by January 1, 2016, and each year thereafter through December 31, 2019; and (c) 15% of their electricity from eligible renewable resources by January 1, 2020, and each year thereafter. I-937 also requires qualifying electric utilities to undertake all 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 the Wanapum Development Future Unit Fish Bypass, the Priest Rapids Development Fish Bypass and the 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.

The Washington Legislature 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. Proposed federal energy legislation 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.

## **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, 2010, the District’s Wholesale Fiber Optic Network was available to over 20,800 homes and businesses within Grant County. Over 5,690 users currently subscribe to services from the existing group of retail providers. The Wholesale Fiber Optic Network currently has about 16 internet service providers,

four telephone service providers, and one video service provider, all of which are small 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 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.

The Commission established financial goals for the Wholesale Fiber Optic Network and expectations for funding expansion over the next several years. In 2009 and 2010, the District spent \$14.98 million and \$10.50 million, respectively, for Wholesale Fiber Optic Network expansion and capital improvements. The approved capital budget for 2011 includes \$2 million and forecasts an additional \$10 million through 2013. The District experienced a 13.8% growth in wholesale fiber services revenue for December 2010 compared to December 2009.

The Wholesale Fiber Optic Network is operated and accounted for as part of the Electric System. Through the year ended December 31, 2010, the District had invested more than \$122.9 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 B—“AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF THE DISTRICT AS OF DECEMBER 31, 2010 AND 2009,” including in particular Note 11, 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. In June 2011, NoaNet issued \$13,165,000 to refund most of the NoaNet 2001 bonds. The Electric System has guaranteed the repayment of up to approximately \$2.67 million of NoaNet’s remaining 2001 bonds and the 2011 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 17.57% of the outstanding balance to the extent NoaNet’s revenues are insufficient to pay the loans. The District contributed \$220,855 and \$129,552 to NoaNet in 2009 and 2010, respectively.

## Outstanding Long-Term Debt of the District

The following table lists the outstanding long term debt of the District prior to the issuance of the Bonds.

**Table 8**  
**SUMMARY OF OUTSTANDING LONG TERM DEBT OF THE DISTRICT**  
**As of May 31, 2011**

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	\$ 115,795*	\$ 217,320	\$ 115,795*
Priest Rapids Development	2001-A	1/1/2012	10,480	1,195		
	2001-B	1/1/2023	12,335	8,775		
	2003-A	1/1/2021	12,840	8,840		
	2003-Z	1/1/2021	18,450	13,680		
	2005-A	1/1/2033	69,050	56,835		
	2005-B	1/1/2033	26,780	23,805		
	2005-Z	1/1/2033	43,685	37,165		
	2006-A	1/1/2036	24,770	22,880		
	2006-B	1/1/2017	5,470	3,790		
	2006-Z	1/1/2036	36,370	34,035	260,230	211,000
Wanapum Development	1999-D	1/1/2023	18,750	12,865		
	2001-B	1/1/2023	16,465	11,715		
	2003-A	1/1/2035	20,465	16,115		
	2003-B	1/1/2035	16,680	14,405		
	2003-Z	1/1/2021	20,135	14,930		
	2005-A	1/1/2038	52,325	47,900		
	2005-B	1/1/2038	71,050	64,955		
	2005-Z	1/1/2018	4,405	2,960		
	2006-A	1/1/2043	71,395	66,710		
	2006-B	1/1/2031	18,190	15,240		
2006-Z	1/1/2043	96,845	92,575	406,705	360,370	
Priest Rapids Project	2010-A	1/1/2023	40,265	37,560		
	2010-B	1/1/2018	10,665	9,875		
	2010-L	1/1/2040	173,915	173,915		
	2010-M	1/1/2027	90,000	90,000		
	2010-Z	1/1/2040	34,585	34,340	349,430	345,690
Total			<u>\$1,233,685</u>	<u>\$1,032,855</u>	<u>\$ 1,233,685</u>	<u>\$1,032,855</u>

\* Will be refunded with the Bonds or defeased with District funds.

## Electric System Operating Results

The following table shows the Electric System's historical operating results for fiscal years 2006 through 2010. This table is designed to show compliance with the debt service coverage requirements in the Bond Resolution. As a result, it differs from the financial statements in Appendix B, because it does not follow all of the accounting principles generally accepted in the United States.

**Table 9**  
**ELECTRIC SYSTEM HISTORICAL OPERATING RESULTS**  
**(\$000)**

	2006	2007	2008	2009	2010
<b>Revenues</b>					
Retail Energy Sales	\$ 98,079	\$ 101,135	\$ 111,186	\$ 114,864	\$ 122,900
Miscellaneous Electrical Revenues (1)	15,694	15,099	15,063	5,172	13,236
Sales to Other Utilities (2)	114,541	119,195	115,636	87,908	86,385
<b>Total Revenues</b>	<b>\$ 228,314</b>	<b>\$ 235,429</b>	<b>\$ 241,885</b>	<b>\$ 207,944</b>	<b>\$ 222,521</b>
<b>Expenses</b>					
Power Supply Costs (3)	\$ 97,393	\$ 93,327	\$ 109,808	\$ 127,015	\$ 148,349
Power Cost Deferral	7,480	0	0	0	0
Operation and Maintenance (4)	23,303	26,040	26,614	29,457	31,121
Taxes	7,920	7,887	8,395	8,800	8,983
<b>Total Expenses</b>	<b>\$ 136,096</b>	<b>\$ 127,254</b>	<b>\$ 144,817</b>	<b>\$ 165,272</b>	<b>\$ 188,453</b>
<b>Net Revenues</b>	<b>\$ 92,218</b>	<b>\$ 108,175</b>	<b>\$ 97,068</b>	<b>\$ 42,672</b>	<b>\$ 34,068</b>
<b>Interest and Other Income</b>	<b>\$ 6,194</b>	<b>\$ 7,170</b>	<b>\$ 5,436</b>	<b>\$ 1,644</b>	<b>\$ 577</b>
<b>Transfer to the Rate Stabilization Account (5)</b>	<b>(23,000)</b>	<b>(48,000)</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Revenues Available for Debt Service</b>	<b>75,412</b>	<b>67,345</b>	<b>102,504</b>	<b>44,316</b>	<b>34,645</b>
<b>Less Debt Service</b>	<b>(11,587)</b>	<b>(17,696)</b>	<b>(17,667)</b>	<b>(17,634)</b>	<b>(17,613)</b>
<b>Uncommitted Revenues</b>	<b>\$ 63,825</b>	<b>\$ 49,649</b>	<b>\$ 84,837</b>	<b>\$ 26,682</b>	<b>\$ 17,032</b>
<b>Beginning Working Capital</b>	<b>\$ 95,242</b>	<b>\$ 107,763</b>	<b>\$ 155,337</b>	<b>\$ 183,107</b>	<b>\$ 141,303</b>
<b>Bond Proceeds – Construction Fund</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Funds Available for Construction</b>	<b>159,067</b>	<b>157,412</b>	<b>240,174</b>	<b>209,789</b>	<b>158,335</b>
<b>Less Capital Construction</b>	<b>(10,223)</b>	<b>(36,651)</b>	<b>(46,849)</b>	<b>(61,570)</b>	<b>(36,611)</b>
<b>Change in Deferred Power Cost Asset</b>	<b>(7,480)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Change in Other Balance Sheet Accounts</b>	<b>(33,601)</b>	<b>34,576</b>	<b>(10,218)</b>	<b>(6,916)</b>	<b>(18,363)</b>
<b>Ending Working Capital</b>	<b>\$ 107,763</b>	<b>\$ 155,337</b>	<b>\$ 183,107</b>	<b>\$ 141,303</b>	<b>\$ 103,361</b>
<b>R&amp;C Fund (6)</b>	<b>\$ 42,164</b>	<b>\$ 92,199</b>	<b>\$ 94,319</b>	<b>\$ 95,072</b>	<b>\$ 96,118</b>
<b>Debt Service Coverage</b>	<b>6.51x</b>	<b>3.81x</b>	<b>5.80x</b>	<b>2.51x</b>	<b>1.97x</b>
<b>Retail Energy Sales (MWh)</b>	<b>3,124,885</b>	<b>3,247,536</b>	<b>3,529,922</b>	<b>3,715,666</b>	<b>3,878,154</b>
<b>Average Retail Energy Rate Increase (7)</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>4%</b>
<b>Average Retail Revenue Requirement (cents/kWh)</b>	<b>3.14¢</b>	<b>3.11¢</b>	<b>3.15¢</b>	<b>3.09¢</b>	<b>3.17¢</b>

(1) The District recognized earned contributions in aid of construction of \$8,871,577, \$993,576, \$9,058,551, \$10,173,455 and \$9,550,683 in 2010, 2009, 2008, 2007 and 2006, respectively.

(2) The decreases in 2010 and 2009 were related to depressed market prices and lower water flows.

(3) The increases in 2010 and 2009 were related to lower water flows for generation and increased power cost from the Priest Rapids Project.

(4) Excludes noncash items of depreciation and amortization.

(5) In 2007 and 2006, pursuant to Commission resolutions, \$48,000,000 and \$23,000,000, respectively, was transferred to the Rate Stabilization Account from the Revenue Fund.

(6) During 2010, pursuant to Commission resolutions, \$8,334,656 was transferred to the R&C Fund from the liquidation of the Future Generation Development Fund and \$7,500,000 was transferred from the R&C Fund into the Revenue Fund.

(7) During 2010, pursuant to Commission resolution, the District implemented rate increases ranging from 2.8% for residential customers to 6.6% for small industrial customers. The combined effect for all rate classes was a 4% increase in retail revenues.

The following table shows the Electric System's historical energy requirements, resources and power costs for fiscal years 2006 through 2010.

**Table 10**  
**ELECTRIC SYSTEM**  
**HISTORICAL ENERGY REQUIREMENTS, RESOURCES AND POWER COSTS**

	2006	2007	2008	2009	2010
Annual Energy Requirements (MWh)					
Retail Sales (1)	3,143,916	3,256,927	3,553,474	3,693,343	3,878,190
Electrical System Usage	11,987	12,719	11,067	11,892	11,336
Sales for Resale (2)	3,275,078	3,337,221	4,020,567	3,111,968	2,777,244
Distribution/Transmission Line Losses	127,022	183,009	164,848	175,698	148,431
Total Energy Requirements	6,558,003	6,789,876	7,749,956	6,992,901	6,815,201
Annual Resources (MWh)					
Priest Rapids Project (3)	4,329,192	4,447,749	4,000,144	3,651,136	4,036,382
Quincy Chute Project	30,297	29,742	35,570	32,805	32,336
PEC Headworks Project	21,751	19,373	23,533	20,700	22,746
Bonneville/CSPE	1,568,398	1,714,918	1,718,103	1,704,937	1,704,796
Other (4)	608,365	578,094	1,972,606	1,583,323	1,018,941
Total Energy Resources	6,558,003	6,789,876	7,749,956	6,992,901	6,815,201
Average Power Cost by Resource (cents/kWh)					
Priest Rapids Project (3)	0.98¢	1.23¢	1.66¢	1.68¢	1.97¢
Quincy Chute Project	3.71	3.25	2.53	2.35	2.72
PEC Headworks Project	3.12	3.66	2.89	2.94	3.24
Bonneville/CSPE	2.58	2.40	2.38	2.64	2.79
Other	2.44	(1.99)	(0.22)	0.78	1.18
Annual Power Cost by Resource (\$000)					
Priest Rapids Project (3)	\$ 42,368	\$ 54,869	\$ 66,216	\$ 61,199	\$ 79,698
Quincy Chute Project	1,123	968	899	771	879
PEC Headworks Project	679	709	681	609	736
Bonneville/CSPE	40,541	41,187	40,923	45,039	47,566
Other (5)	14,829	(11,508)	(4,334)	12,338	11,997
Wheeling	5,333	7,102	5,423	7,059	7,473
Total Power Costs (\$000)	\$ 104,873	\$ 93,327	\$ 109,808	\$ 127,015	\$ 148,349
Average Power Costs (cents/kWh) (6)	1.60¢	1.37¢	1.42¢	1.82¢	2.18¢

(1) Reflects total retail energy requirements.

(2) The increase in 2008 was attributable to additional utility, market and bookout sales. Decreases in 2010 were due to decreased water for generation and low wholesale prices.

(3) During 2010, pursuant to Commission resolution, the Priest Rapids Development and the Wanapum Development were combined into one system, the Priest Rapids Project. Prior year disclosures for the Priest Rapids Development and the Wanapum Development have been combined for comparative purposes.

(4) The increases in 2008 and 2009 were necessary to satisfy the increase in annual energy requirements combined with a reduction of power resources received from the Priest Rapids Project during 2008 and 2009 compared to 2007 as a result of less power generation. Low production in 2010 was offset by greater production from the Priest Rapids Project.

(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 2007 and 2008 were due to the Electric System having an increased share of the 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 strong financial results with high debt service coverage ratios and a substantial buildup in reserves. The operating results for 2006 to 2010 reflect the benefits of the New Power Sales Contracts 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 years 2009 and 2010, 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. Despite these challenges, the Electric System was able to produce net revenues of \$42 million and \$34 million in 2009 and 2010, respectively as shown in Table 9.

The District has always met its debt service coverage covenants. Once the power cost deferral, which was amortized from 2003 to 2006, was retired, the District began adding to its Rate Stabilization Account in 2006 and 2007. From 2007 to 2010, the Electric System's debt service coverage ranged from 5.8 times to 1.97 times, well in excess of the 1.25 times 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 on average a minimum of 50% revenue financing of capital expenditures for the Electric System.

The Commission approved a 6% rate increase effective February 1, 2011, following a 4% increase in 2010. In addition, the Commission adopted a forecast with annual overall rate increases of 8% for the years 2012 through 2015, effective January 1<sup>st</sup> of each year. These increases are designed to help the Electric System meet requirements for capital improvements, increasing costs 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. These future rate increases may be modified to reflect future financial conditions.

As of December 31, 2010, the District had \$131.4 million in unrestricted cash and investments. As described in the following section, the District anticipates using Revenues, Bond proceeds and cash to finance Electric System capital improvements. Total working capital and cash reserves are expected to be maintained at the Commission-approved level of \$155 million over the forecasted future timeframe.

## **Discussion of 2011 Results to Date**

The first six months of 2011 have seen an 18% increase in revenues for the Electric System compared to the first six months of 2010. Water for generation is projected to be 127% of average for 2011. Compared to the 81% of average water in 2010, this increase has provided the Electric System with significant additional power available for surplus power sales. The Electric System has seen over \$11 million in increased wholesale power transactions in the first six months of 2011. The Electric System has added over \$15 million to its net assets during the first six months of 2011. The debt service coverage ratio for the Electric System is projected at approximately 3.0x for 2011.

## **Capital Requirements**

As part of its planning process, the District has prepared its annual estimate of the capital requirements for the Electric System. 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 is constructing a 230kv transmission line that spans from Rocky Ford Substation to the Columbia intertie. The District expects the total cost of capital expenditures for 2011 through 2013 to be approximately \$141 million, as shown in Table 11. A portion of this capital plan will be

financed by Bond proceeds with the remainder being financed with revenues. See “THE ELECTRIC SYSTEM—Retail Energy Sales and Customers.”

**Table 11**  
**ELECTRIC SYSTEM PROJECTED**  
**CAPITAL IMPROVEMENTS PROGRAM 2011-2013**

Transmission System	\$ 56,164,773
Distribution System	55,193,914
Fiber Program	17,520,123*
Miscellaneous	12,048,975
	<u>\$ 140,927,785</u>

\* Bond proceeds will not be used for the fiber program capital improvements.

### **Various Factors Affecting the Electric Utility Industry**

The electric utility industry in general has been, or in the future may be, affected by a number of factors which could impact the financial condition and competitiveness of many electric utilities and the level of utilization of generating and transmission facilities. Such factors include, among others, (1) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (2) changes resulting from conservation and demand-side management programs on the timing and use of electric energy, (3) changes resulting from a national energy policy, (4) effects of competition from other electric utilities (including increased competition resulting from mergers, acquisitions, and “strategic alliances” of competing electric and natural gas utilities and from competitors transmitting less expensive electricity from much greater distances over an interconnected system) and new methods of, and new facilities for, producing low-cost electricity, (5) the repeal of certain federal statutes that would have the effect of increasing the competitiveness of many investor owned utilities, (6) increased competition from independent power producers and marketers, brokers and federal power marketing agencies, (7) “self-generation” or “distributed generation” (such as microturbines and fuel cells) by industrial and commercial customers and others, (8) effects of inflation on the operating and maintenance costs of an electric utility and its facilities, (9) changes from projected future load requirements, (10) increases in costs and uncertain availability of capital, (11) shifts in the availability and relative costs of different fuels (including the cost of natural gas), (12) increases in the price of energy purchased or sold on the open market that may occur in times of high peak demand or supply, (13) issues with transmission capacity and integrating wind power generation, (14) inadequate risk management procedures and practices with respect to, among other things, the purchase and sale of energy and transmission capacity, (15) other legislative changes, voter initiatives, referenda and statewide propositions, (16) effects of the changes in the economy, (17) effects of possible manipulation of the electric markets, (18) natural disasters or other physical calamities, including, but not limited to, earthquakes and floods and (19) changes to the climate. Any of these factors (as well as other factors) could have an adverse effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways.

The District is unable to predict what impact such factors will have on its business operations and financial condition. This Official Statement includes a brief discussion of certain of these factors. This discussion does not purport to be comprehensive or definitive, and these matters are subject to change subsequent to the date hereof. Extensive information on the electric utility industry is available from the legislative and regulatory bodies and other sources in the public domain, and potential purchasers of the Bonds should obtain and review such information.

### **THE PRIEST RAPIDS PROJECT**

#### **Description**

The Priest Rapids Project consists of the Priest Rapids Development and the Wanapum Development (the “Developments”). In 2010, the District 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 through 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. 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 Wanapum Development**

The Wanapum Development consists of a dam and hydroelectric generating station having a nameplate rating of 1,038 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.

### **Energy Production**

The following table shows the energy production for the Priest Rapids Project for the years 2006 to 2010. 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 12**  
**PRIEST RAPIDS PROJECT HISTORICAL ENERGY PRODUCTION**

	2006	2007	2008	2009	2010
Priest Rapids Project					
Net Peaking Production (MW)	1,794	1,790	1,799	1,782	1,767
Net Energy Production (000’s MWh)	8,829	9,145	8,297	7,569	7,061(1)
Annual Availability Factor (2)	89%	92%	93%	90%	90%
Plant Factor (3)	64%	66%	60%	56%	53%
Average Cost (\$/MWh)	\$9.39	\$11.08	\$14.44	\$14.58	\$18.97
Bonneville Power PF Rate (\$/MWh) (4)	\$28.30	\$27.00	\$27.10	\$26.60	\$28.77

(1) Water was 81% of average in 2010.

(2) The ratio of the actual hours that the generating units of the Priest Rapids Project are available for service during the period indicated to the total hours in the period.

(3) 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).

(4) 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 certain of the purchasers of the output of the Priest

Rapids Project other than the District (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 10 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.” 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. Sixty-two percent 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.

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 13**  
**2010 PARTICIPATION IN COSTS OF PRIEST RAPIDS PROJECT**

Power Purchaser	Percent Share	Priest Rapids Project Nameplate(1) Rating (MW)
PacifiCorp Electric Operations	10.09%	201.154
Portland General Electric	10.09	201.154
Puget Sound Energy, Inc.	5.81	115.828
Tacoma Power	2.34	46.650
Seattle City Light	2.32	46.252
Avista Corporation	4.43	88.316
Public Utility District No. 1 of Cowlitz County	1.75	34.888
Eugene Water and Electric Board	1.16	23.126
Other Power Purchasers (2)	2.51	50.039
The District’s Electric System	59.50	1,186.193
Total	100.00%	1,993.600

(1) Based on total installed nameplate rating of 1,993.6 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 may change annually since each power purchaser’s percentage of the total power costs can change as a result of provisions in the New Power Sales Contracts.

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

The New Power Sales Contracts include the following provisions:

- The District is mandated to offer the Reasonable Portion output for sale based on market principles. Under the Reasonable Portion Contract, the Power Purchasers receive the net revenues from the sale of the 30% Reasonable Portion. However, 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—Electric System Obligations.”

- Under the Product Sales Contract, the District has the ability to take up to 62% of the firm output of the Priest Rapids Project 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 example, in 2010 the Power Purchasers were 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 (3.8% in total) of output from the Priest Rapids Project for the term of the New Power Sales Contracts. A collection of other purchasers are entitled to a 4.2% share of the Priest Rapids Project for the term of the New Power Sales Contracts because of an amendment to the contracts that transferred the rights to 33.5% of the Priest Rapids Project non-firm energy from the purchasers to the District. Together, these two agreements account for 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 Priest Rapids Project Parity Bonds and debt service coverage (currently 15% of annual debt service for the Priest Rapids Project Parity Bonds) 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 the output in the last full year of operation.

## 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 14**  
**REASONABLE PORTION AUCTION WINNERS**

<b>Period Covered</b>	<b>Auction Winner</b>	<b>Slice of Priest Rapids Development</b>	<b>Auction Price Priest Rapids Development</b>	<b>Slice of Priest Rapids Project (1)</b>	<b>Auction Price Priest Rapids Project</b>	<b>Total Reasonable Portion Revenues Generated (2)</b>
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
12 mos. ending Dec. 2011	Powerex	–	–	10.14	26,587,218	–
12 mos. ending Dec. 2011	Shell	–	–	10.14	27,953,652	80,721,564

(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 and 2011, the Electric System did not use Reasonable Portion Revenues because it does not have EUDL due to the higher percentage of firm Wanapum Development generation that became available to the District on November 1, 2009 under the New Power Sales Contracts.

## Priest Rapids Project Output

The actual amounts of energy sold to the Power Purchasers for the fiscal years 2006 through 2010 are shown in the following table. During the years 2006 through 2010, the Priest Rapids Project delivered to the Power Purchasers and the District an average of 8,180,191 MWh of net energy annually. See “Coordination Agreements” and “FERC License” for a description of certain of the factors that result in the net energy figures.

**Table 15**  
**PRIEST RAPIDS PROJECT HISTORICAL ENERGY SALES**  
**(MWh)**

	2006	2007	2008	2009	2010
Gross Generation (1)	10,007,202	10,342,293	9,394,961	8,710,613	8,193,903
Plus: Pond Transfer (2)	102,753	7,220	76,764	(39,792)	41,451
Less: Rock Island Encroachment (3)	(653,795)	(612,604)	(608,844)	(601,733)	(571,821)
Coordination Exchange (4)	2,350	(482)	(925)	1,866	695
Less: Canadian Entitlements (5)	(498,620)	(485,174)	(479,080)	(494,308)	(514,055)
Spill Past Unloaded Units (6)	(131,074)	(106,333)	(85,699)	(7,178)	(89,599)
Net Energy to Purchasers	8,828,816	9,144,920	8,297,177	7,569,468	7,060,574
Max. One-Hour Production (MW)	1,794	1,790	1,799	1,782	1,767
Plant Factor (7)	64%	66%	60%	56%	53%
Annual Availability Factor (8)	89%	92%	93%	90%	90%
Disposition of Net Energy (9)					
District’s Electric System	4,329,192	4,447,749	4,000,144	3,651,136	4,036,382
PacifiCorp Electric Operations	1,197,847	1,273,885	1,135,283	732,664	629,567
Portland General Electric Co.	1,155,054	1,179,528	1,040,256	944,017	687,590
Puget Sound Energy, Inc.	667,577	653,710	664,964	374,752	78,153
City of Seattle	24,505	25,396	23,195	32,988	168,255
City of Tacoma	183,207	191,505	24,970	34,557	37,944
Avista Corporation	458,442	489,601	464,631	420,026	288,389
Cowlitz County PUD	189,896	195,201	175,134	156,109	129,527
Eugene Water & Electric Board	145,254	111,789	97,456	82,600	18,148
Other Power Purchasers (10)	477,842	576,556	671,144	1,140,619	986,619
Total	8,828,816	9,144,920	8,297,177	7,569,468	7,060,574

- (1) Excludes station service energy requirements. Variations from year to year are a result of changing fish spill requirements and Columbia River flows.
  - (2) Purchases of generating capability from neighboring hydroelectric projects.
  - (3) 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.
  - (4) Priest Rapids Project energy exchanged by the District with parties to the Mid-Columbia Hourly Coordination Agreement.
  - (5) 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) Gross generation divided by the maximum one-hour production divided by 8,760 (the hours in one year).
  - (8) Actual hours that the generating units of the Priest Rapids Project are available for service during the period divided by the total hours in the period.
  - (9) The Disposition of Net Energy between power purchasers changed in 2009 due to the New Power Sales Contracts that took effect November 1, 2009 for the Wanapum Development.
  - (10) 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.

## **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 transmission agreements with Bonneville effective October 1, 2001, which expire on September 30, 2011. 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. The ongoing Bonneville load service for the Grand Coulee area will be delivered via a new Bonneville network integration transmission contract that begins on October 1, 2011 and runs through the duration of the Bonneville power contract. In addition, the District has entered into a two-year 250 MW short term firm Bonneville point-to-point contract beginning October 1, 2011, has entered into a five-year long-term firm Bonneville point-to-point contract beginning January 1, 2011, and is currently pursuing the construction of a 230 kV transmission line from Bonneville’s Columbia substation to the District’s Rocky Ford substation, which when taken together should ensure adequate transmission service to meet its retail load requirements for the foreseeable future. See “THE ELECTRIC SYSTEM—The Electric System’s Power Supply.” The Bonneville transmission agreements are standard transmission agreements offered by Bonneville for similar requirements of other public and private utilities.

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, turbines 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 2011 to 2013 is estimated at \$135 million.

### ***Priest Rapids Fishway Modification***

The Priest Rapids Development and the Wanapum Development 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 lack of redundancy for the Priest Rapids fishways. If a failure were to occur upstream, passage of adult salmonids and steelhead could be impacted. During relicensing, the District proposed installation of new pumps in the empty pumping bays at an estimated cost of \$10.6 million. In the new license, FERC requested a plan for installing a pumping system at each fishway water supply. The District is currently exploring options for the fishways while proceeding with the addition of the pumps on the left bank fishway, which is currently scheduled to occur by 2014. The current estimated costs for this project from 2011 through 2014 is \$13.3 million.

### ***Priest Rapids Fish Bypass Modification***

The District currently operates a temporary fish passage facility, consisting of top spill bulkheads in two of the Priest Rapids Dam spillways (19 and 20) operating in conjunction gates 21 and 22 to provide a combined top and bottom spill of approximately 22,000 cubic feet per second (“cfs”) through the gates. 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 Priest Rapids Dam. A permanent bypass system is required to be constructed to meet license obligations. Construction of a permanent bypass that can pass up to 27,000 cfs through gates 20, 21, and 22 will be constructed in the 2011 through 2015 timeframe. The estimated cost in this timeframe is \$35.4 million. The spill reduction allowed from construction of the new bypass provides a measurable increase in spring and summer power generation at Priest Rapids Dam when compared with the approved spill without a new bypass.

### ***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 and a contribution of \$100,000 on an annual basis (adjusted for CPI) for operation and maintenance and native resident fish surveys within the Priest Rapids Project at five year intervals.

### ***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. Approximately \$46 million is currently budgeted for license-required recreation improvements between the years 2011 through 2020. In addition, the license required 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 was to file a plan for the future use of Crescent Bar Island after 2012. This plan was filed and identified new public recreation facilities (campground, marine facilities, day use areas, trails, wildlife areas, comfort stations, golf course, and others), a new wastewater treatment plant, and related roadway, parking, building and maintenance facilities and infrastructure on Crescent Bar Island. This plan was finalized and submitted to FERC in 2010, and it is anticipated that a license amendment will be submitted to FERC in 2011. The license amendment will detail specific public recreation and wildlife enhancement plans for Crescent Bar Island and will provide a proposed implementation schedule. In 2015, the District is required to update its Recreation Resource Management Plan. This update may result in additional and or modified recreation-related requirements. After FERC approval of the Shoreline Management Plan (anticipated in 2011), the District must conduct an update to the plan every six years.

### ***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. The HPMP was submitted to the FERC in April 2011 and is awaiting the FERC approval. Over \$5.2 million (capital only) is budgeted for the 2011 through 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 2013 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 through 2009, 15 aMW for 2010

through 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 approximately \$2.4 million for 2010 and approximately \$3.4 million for 2009. These costs were charged to Priest Rapids Project License compliance and related agreements 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 million per year.

### **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 Endangered Species Act (“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 measures taken to protect salmon, 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 the District, 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 through 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 2010 equaled approximately \$2.7 million and \$3.1 million respectively. The District expects to contribute approximately \$18.3 million during the period 2011 through 2015.

### **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, emergency gate and crane modernization, powerhouse improvements, generating unit auxiliary equipment improvements including control, protection, and communications upgrades. Other major site improvements include the construction of the Priest Rapids Fish bypass, Priest Rapids Hatchery Renovation, Priest Rapids water system improvements and the new Heritage Center.

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 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 seven of the ten Wanapum units with the most recent being placed in service in April 2011. The District anticipates replacing the remaining units at a rate of one every ten months and then conform the first two units completed, until all ten have been replaced, with projected completion in 2014. As of December 31, 2010, the cost of the remaining turbines to be replaced is estimated at \$44 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%. The first new generator was brought on line in April 2011. The current remaining budget for the generator replacement project is \$141 million for the 2011-2020 timeframe.

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 is working through the design and contracting process, with turbine upgrade installation at the Priest Rapids Development beginning in 2015 and completed by 2024. The current budget from 2011 to 2024 for turbines and generators combined is \$243 million.

The five generator step-up transformers at Wanapum Dam are the original transformers and are approaching the end of their useful life. A contract for replacement transformers, including a sixth spare transformer, is expected to be awarded in September 2011. These transformers are scheduled to be replaced in the 2012 through 2014 timeframe at a budgeted cost of \$20 million.

Main generating unit circuit breakers have been replaced at the Wanapum and Priest Rapids Developments. From 2005 through 2009 the five main step-up transformers were replaced at the Priest Rapids Development. 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. Most of the major plant cranes have been rebuilt with the last one scheduled for upgrade in 2012. The 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 was 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. These gates are 50 feet wide by 68 feet tall and the original paint system contains lead. Wanapum spillway gate painting will begin in 2013 and is expected to be completed in 2018.

Project seismicity has been under review for about the last eight years. In June 2011, staff engineers and consultants met with the FERC and presented the Probabilistic Seismic Hazards Analysis (“PSHA”). It is anticipated that the FERC will approve the report in 2011. Based on the results of the PSHA, it is anticipated that seismic remediation of portions of both the Priest Rapids and Wanapum Dams will be necessary. Specifically, the right embankment at Priest Rapids Dam, the embankment closure section at Wanapum Dam, and the tainter gates at

Wanapum Dam will require remediation. At the current time the best estimate of the seismic remediation costs from 2011 through 2019 will be \$134 million.

Facilities at the Priest Rapids Project, including fabrication shops, machine shops, painting/blasting facilities, warehousing, car and boat repair shops, hazardous material building, and offices are in the process of being upgraded or replaced. These projects are being done in several phases from 2011 through 2016 at an estimated cost of \$37 million.

**Estimated Capital and Financing Requirements**

The District projects that the total cost of the capital program at the Priest Rapids Project during the period 2011 through 2013 will be approximately \$370 million, as shown in Table 16, which will be financed by existing and future bond proceeds of the Priest Rapids Project.

**Table 16**  
**PRIEST RAPIDS HYDROELECTRIC PROJECT**  
**2011-2013 FORECAST CAPITAL PROGRAM EXPENDITURES**

Turbine/Generator Restoration	\$ 140,443,319
License Implementation	137,458,293
Powerhouse Improvements	48,734,840
Miscellaneous (1)	43,207,656
	\$ 369,844,108

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

**Future Priest Rapids Project Borrowings**

The District may issue additional New Clean Renewable Energy Bonds for the Priest Rapids Project in the next 14 months in the approximate amount of \$42 million to finance a portion of additional improvements to the Priest Rapids Project.

**Operating Results**

Table 17 shows actual operating results for the Priest Rapids Project for the fiscal years 2006 through 2010. Revenues from the Power Purchasers and the District’s Electric System are currently equal to the cost of power from the Priest Rapids Project. Such cost of power is a function of operating expenses, annual debt service and coverage requirements on the Priest Rapids Project Parity Bonds and reserve requirements imposed by the Priest Rapids Project Bond Resolution and the New Power Sales Contract (which went into effect on November 1, 2005 for the Priest Rapids Development and November 1, 2009 for the Wanapum Development) and the Wanapum Development 1959 Power Sales Contracts. The Power Sales Contracts established the costs to be included in the cost of power from the Priest Rapids Project. This table differs from the financial statements in Appendix B 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.”

**Table 17**  
**PRIEST RAPIDS PROJECT OPERATING RESULTS**  
**(\$000)**

	2006	2007	2008	2009	2010
Operating Revenues					
Sales of Power (1)	\$ 82,874	\$ 101,350	\$ 119,874	\$ 110,376	\$ 133,945
Interest and Other Income (2)	<u>5,134</u>	<u>12,003</u>	<u>6,393</u>	<u>3,484</u>	<u>5,955</u>
Total Revenues and Other Income	\$ 88,008	\$ 113,353	\$ 126,207	\$ 113,860	\$ 139,900
Operating Expenses					
Generation	\$ 24,926	\$ 28,340	\$ 37,923	\$ 26,799	\$ 21,966
Transmission	1,954	2,025	1,980	2,060	1,985
Administrative and General	16,993	25,183	30,065	16,308	15,435
License Compliance and Related Agreements (3)	0	0	0	18,362	25,260
Taxes	<u>1,901</u>	<u>1,964</u>	<u>1,779</u>	<u>1,735</u>	<u>1,398</u>
Total Operating Expenses	\$ <u>45,774</u>	\$ <u>57,512</u>	\$ <u>71,747</u>	\$ <u>65,264</u>	\$ <u>66,044</u>
Net Revenues	\$ <u>42,234</u>	\$ <u>55,841</u>	\$ <u>54,460</u>	\$ <u>48,596</u>	\$ <u>73,856</u>
Transfer Requirements (4)	273	48	0	6,000	0
Unused bond proceeds refunded	0	0	0	0	16
Excess Available in Supplemental R&R Fund	\$ <u>4,768</u>	\$ <u>6,128</u>	\$ <u>8,189</u>	\$ <u>8,183</u>	\$ <u>8,196</u>
Remaining Net Revenues Available for Debt Service on Parity Bonds	\$ <u>47,275</u>	\$ <u>62,017</u>	\$ <u>62,649</u>	\$ <u>62,779</u>	\$ <u>82,068</u>
Debt Service on Parity Bonds	\$ 41,146	\$ 53,953	\$ 54,551	\$ 54,642	\$ 71,842
Debt Service Coverage on Parity Bonds (5)	1.15x	1.15x	1.15x	1.15x	1.15x
Net Energy Output (MWh)	8,828,816	9,144,920	8,297,177	7,569,468	7,060,574
Average Cost (\$/MWh) (6)	\$9.39	\$11.08	\$14.45	\$14.58	\$18.97

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

(2) Interest on various funds of the Priest Rapids Project.

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

(4) Represents amounts transferred to the 1956 Renewal and Replacement Fund, 1963 Reserve and Contingency Fund and the 1963 Bond Reserve Account or to be credited to power costs. In 2006 and 2007, the money was used for payment of extraordinary items out of the construction funds. In 2009, the balances represent 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.

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

(6) 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, 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.

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 \$22 per MWh under average water conditions.

## Discussion of 2011 Priest Rapids Project Results to Date

Power costs in 2011 for the Priest Rapids Project are projected to be in line with the budgeted amounts. The projected 127% of average water is expected to increase generation by over 2.7 million MWh for 2011 as compared to 2010. This increase in water is projected to help decrease the millage rate of Priest Rapids Project power from \$18.97/MWh in 2010 to under \$16/MWh in 2011.

## Debt Service Requirements for the Priest Rapids Project

The following table gives debt service requirements for the Outstanding Priest Rapids Project Bonds.

**Table 18**  
**PRIEST RAPIDS PROJECT BONDS TOTAL DEBT SERVICE REQUIREMENTS**

Year (1)	Priest Rapids Development	Wanapum Development	Priest Rapids Project (2)	Aggregate Debt Service on Priest Rapids Project Bonds (3)
2011	\$ 21,170,162	\$ 29,152,231	\$ 24,225,900	\$ 74,548,293
2012	21,227,004	29,145,745	24,227,127	74,599,876
2013	21,217,563	29,161,730	24,220,651	74,599,944
2014	19,527,699	27,499,208	24,224,921	71,251,828
2015	19,537,491	27,517,402	24,229,771	71,284,664
2016	19,525,815	27,493,048	24,230,671	71,249,534
2017	18,484,879	26,746,571	24,239,286	69,470,736
2018	17,070,304	26,035,527	22,356,972	65,462,803
2019	17,066,494	26,032,519	22,305,476	65,404,489
2020	17,073,458	26,037,223	22,262,708	65,373,389
2021	14,089,438	23,018,141	22,200,187	59,307,766
2022	14,091,062	23,036,480	22,140,213	59,267,755
2023	10,604,456	20,239,919	19,778,139	50,622,514
2024	10,591,375	20,241,273	19,712,853	50,545,501
2025	10,587,437	20,243,714	19,643,968	50,475,119
2026	10,606,139	20,231,729	109,565,261(4)	140,403,129
2027	10,603,418	20,243,864	19,656,314	50,503,596
2028	10,593,090	20,238,989	19,485,033	50,317,112
2029	10,598,087	20,241,613	19,310,832	50,150,532
2030	10,106,671	19,832,832	19,127,565	49,067,068
2031	6,476,784	18,469,139	18,933,148	43,879,071
2032	6,480,036	18,467,746	18,731,912	43,679,694
2033	4,068,759	18,466,992	18,532,693	41,068,444
2034	4,061,963	18,470,359	18,308,740	40,841,062
2035	4,066,055	16,849,272	18,084,763	39,000,090
2036	--	16,849,962	17,854,013	34,703,975
2037	--	16,853,659	17,610,031	34,463,690
2038	--	9,869,629	17,361,653	27,231,282
2039	--	9,868,225	17,102,128	26,970,353
2040	--	9,870,771	--	9,870,771
2041	--	9,870,954	--	9,870,954
2042	--	9,867,711	--	9,867,711
Total (3)	<u>\$329,525,633</u>	<u>\$ 656,164,173</u>	<u>\$ 689,662,929</u>	<u>\$ 1,675,352,745</u>

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

(2) Before the federal credit payments.

(3) Columns may not add due to rounding.

(4) Including \$90 million of New Clean Renewable Energy Bonds to be paid annually from invested sinking fund deposits between 2011 to 2027.

## 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 2010 population of 20,366 and Ephrata, the County seat, is the second largest with a 2010 population of 7,664. The County’s total population has grown from 74,698 in 2000 to 89,120 in 2010, an increase of over 19%. Population density in the County in 2010 was 33.24 persons per square mile ranking it 21<sup>st</sup> of the 39 counties in the State. The total civilian labor force in the County in 2010 was 42,250.

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 19**  
**GRANT COUNTY**  
**SELECTED ECONOMIC INDICATORS**

	Population (1)	Per Capita Personal Income (2)	Taxable Retail Sales (\$000) (3)	Value of Building Permits (\$000) (4)	Personal Income (\$000) (2)
2010	89,120	—	\$ 1,215,315	\$ 72,488	—
2009	86,100	\$ 29,025	1,225,954	41,432	\$2,557,014
2008	84,600	29,464	1,551,866	76,211	2,522,614
2007	82,500	27,286	1,537,951	121,243	2,267,736
2006	80,600	24,907	1,107,853	78,601	2,027,185
2005	79,100	24,043	872,602	78,572	1,919,739
2004	78,300	24,033	800,596	66,819	1,898,176
2003	77,100	23,396	744,458	52,264	1,828,312
2002	76,400	22,380	727,045	49,151	1,726,147
2001	75,900	21,890	772,135	48,521	1,667,391
2000	74,698	20,741	714,116	42,587	1,554,727

(1) *Source:* Washington State Employment Security Department, Labor Market & Economical Analysis Branch; information for 2000 and 2010 are from the U.S. Bureau of the Census.

(2) *Source:* Washington State Bureau of Economic Analysis; 2009 is most recent data available.

(3) *Source:* Washington State Department of Revenue.

(4) *Source:* Grant County Building Department.

**Table 20**  
**GRANT COUNTY MAJOR PROPERTY TAXPAYERS (1)**

Taxpayer	Business	Assessed Valuation	% of County Assessed Valuation
REC Solar Grade Silicon, LLC	Chemical Manufacturing	\$1,608,090,420	17.44%
Microsoft Corporation	Data Center/Technology	395,031,300	4.28
Yahoo, Inc.	Data Center/Technology	163,549,580	1.77
Intuit Inc.	Data Center/Technology	160,000,895	1.73
J. R. Simplot	Potato Products	58,214,035	0.63
Inflation Systems	Air Bag Products	51,465,858	0.56
Moses Lake Industries	Chemical Manufacturing	47,323,255	0.51
Columbia Colstor, Inc.	Cold Storage	46,004,495	0.50
Conagra Lamb-Weston Inc.	Potato Products	38,509,805	0.42
Chemi-Con Materials Corp.	Chemical Manufacturing	34,402,665	0.37
BNSF Railway Company Tax Dept.	Railroads	32,862,093	0.36
EKA Chemicals, Inc.	Chemicals	28,157,860	0.31
National Frozen Foods Corp.	Frozen Foods	26,402,090	0.29
TAC Search & Media WA LLC	Data Center	23,930,520	0.26
REC Adv Silicon Materials Inc.	Chemical Manufacturing	23,653,860	0.26
Basic American Inc.	Potato Products	23,212,165	0.25
Lamb-Weston BSW, LLC	Potato Products	21,968,565	0.24
Guardian Fiberglass Inc.	Fiberglass	21,864,610	0.24
Quincy Foods, LLC	Frozen Vegetables	17,121,525	0.19
Oregon Potato Company	Potato Products	17,693,970	0.19
William G. and Jeannette Evans	Real Estate	16,309,155	0.18
Qwest Corporation Inc.	Telecommunications	15,019,147	0.16
		\$2,870,787,868	31.14%

(1) Total County assessed valuation for 2009 taxes is \$6,939,463,594.  
Source: Grant County Assessor for tax collection year 2009.

**Table 21**  
**GRANT COUNTY MAJOR EMPLOYERS**

Employer	Product/Service	Employees
Moses Lake School District	Education	974
Grant County Government	Government	675
REC Silicon	Polysilicon Manufacturing	650
Wal-Mart	General Retail & Grocery Retail	615
The District	Electric Utility	600
Genie Industries, Inc.	Construction & Industrial Material Lifts & Aerial Work Platforms	600
Quincy Foods, LLC	Frozen Vegetable Processing	550
Quincy School District	Education	450
Samaritan Healthcare	Health Care	400
ConAgra Foods, Inc.	Frozen Potato Processing	400
Big Bend Community College	Education	300
J.R. Simplot Co.	Frozen French Fries & Dehydrated Potato Products	330
Ephrata School District	Education	310
Lamb Weston BSW	Frozen Potato Processing	300
Moses Lake Clinic	Health Care	266
Moses Lake Community Health	Health Care	264
Columbia Foods, Inc.	Corn & Peas Processing	250
Inflation Systems, Inc.	Automotive Air Bags	250
Columbia Basin Hospital	Health Care	200
Washington Potato Co.	Dehydrated Potato Flake Processing	200
Northwest Stone & Brick, LLC	Stone and Brick Processing	150
Moses Lake Industries, Inc.	Corporate Headquarters & Industrial Chemical	150
D&L Foundry, Inc.	Manhole Cover Manufacturing	125
Home Depot	Home Building & Repair Retail	72
International Paper	Corrugated Box Manufacturing	68

*Source:* Grant County Economic Development Council as of August 2010.

**Table 22**  
**GRANT COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT**

	Annual Averages						
	2004	2005	2006	2007	2008	2009	2010
Total Labor Force	37,330	38,130	38,610	40,140	40,810	42,280	42,250
Employment	34,270	35,370	36,100	37,830	38,210	38,100	37,810
Unemployment	3,060	2,760	2,510	2,310	2,610	4,170	4,450
Unemployment Rate	8.2%	7.2%	6.5%	5.8%	6.4%	9.9%	10.5%

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

**Table 23**  
**GRANT COUNTY NONAGRICULTURAL EMPLOYMENT**

NAICS Industry Title	Annual Averages						
	2004	2005	2006	2007	2008	2009	2010
Total Nonfarm	24,410	24,980	26,060	26,960	26,870	25,690	25,410
Total Private	17,160	17,720	18,720	19,480	19,200	17,930	17,560
Goods Producing	4,930	5,100	5,480	5,860	6,230	5,430	5,190
Services Providing	19,490	19,870	20,580	21,110	20,640	20,250	20,210
Trade, Transport. & Utilities	4,880	5,030	5,060	5,260	5,390	5,390	5,390
Information & Financial Activities	880	890	990	1,020	1,020	960	1,000
Government	7,260	7,260	7,330	7,480	7,680	7,760	7,840

*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 the 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 pending litigation in United States District Court Eastern District of Washington Case No. CV-11-023-JLQ titled *Kelley v. Public Utility District No. 2 of Grant County, Washington*. The District leased property to the Port of Quincy on June 5, 1962. The lease terminates on May 31, 2012. Certain residents of Crescent Bar Island occupy property owned by the District under subleases and claim the right to continue possession of the property after termination of the lease. Any such claims conflict with the terms of the District's license issued by FERC, which does not permit residential uses on public lands. The District disputes the claims of the lessees and will vigorously defend the District's legal rights. 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 C.

## TAX MATTERS

*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 Bonds, interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals.

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

*Corporate Alternative Minimum Tax.* While interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, under Section 55 of the Code, tax exempt interest, including interest on the Bonds, received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations (as defined for federal income tax purposes). Under the Code, alternative minimum taxable income of a corporation will be increased by 75% of the excess of the corporation's adjusted current earnings (including any tax exempt interest) over the corporation's alternative minimum taxable income determined without regard to such increase. A corporation's alternative minimum taxable income, so computed, that is in excess of an exemption of \$40,000, which exemption will be reduced (but not below zero) by 25% of the amount by which the corporation's alternative minimum taxable income exceeds \$150,000, is then subject to a 20% minimum tax.

A small business corporation is exempt from the corporate alternative minimum tax for any taxable year beginning after December 31, 1997, if its average annual gross receipts during the three-taxable-year period beginning after December 31, 1993, did not exceed \$5,000,000, and its average annual gross receipts during each successive three-taxable-year period thereafter ending before the relevant taxable year did not exceed \$7,500,000.

*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 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 Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 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 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 Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the Bonds could adversely affect the market value and liquidity of the Bonds until the audit is concluded, regardless of its ultimate outcome.

*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 \$10,000,000 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 is a governmental unit that, together with all subordinate entities, reasonably anticipates issuing more than \$10,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) during the current calendar year and has not designated the Bonds as “qualified tax exempt obligations” for purposes of the 80% financial institution interest expense deduction. Therefore, no interest expense of a financial institution allocable to the Bonds is deductible for federal income tax purposes.

*Original Issue Premium.* The Bonds have been sold at prices reflecting original issue premium (“Premium Bonds”). An amount equal to the excess of the purchase price of a Premium Bond over its stated redemption price at maturity constitutes premium on such Premium Bond. A purchaser of a Premium Bond must amortize any premium over such 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 Premium Bond will offset a like amount of qualified stated interest on such 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 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 Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of 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 Premium Bonds.

*Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies.* Under Section 832 of the Code, interest on the 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 Bonds into account in determining gross income.

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

*Potential Future Federal Tax Law Changes.* From time to time, there are legislative proposals in Congress which, if enacted, could require changes in the description of federal tax matters relating to the Bonds set forth above or adversely affect the market value of the Bonds. For example, on September 12, 2011, the President submitted to Congress a legislative proposal entitled the “American Jobs Act of 2011” (the “Jobs Act”), certain provisions of which, if enacted as proposed, would result in federal income tax being imposed on a portion of the interest on tax-exempt bonds (including the Bonds) received in taxable years beginning on or after January 1, 2013, by taxpayers with incomes above certain thresholds specified in the Jobs Act. It cannot be predicted whether the Jobs Act will be enacted as proposed or other future legislation may be proposed or enacted that would affect the federal tax treatment of interest received on the Bonds. Prospective purchasers of the Bonds should consult with their own tax advisors regarding any proposed or pending legislation that would change the federal tax treatment of interest on the Bonds, including the provisions of the Jobs Act.

## **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 C. 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 underwriter’s 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 LLP will be rendered solely to the Underwriters, will be limited in scope, and cannot be relied upon by investors.

## **CONTINUING DISCLOSURE**

### **Basic Undertaking to Provide Annual Financial Information and Notice of Material Events**

To meet the requirements of United States Securities and Exchange Commission (“SEC”) Rule 15c2-12(b)(5) (the “Rule”), as applicable to a participating underwriter for the Bonds, the District will undertake (the “Undertaking”) for the benefit of holders of the Bonds to provide or cause to be provided, either directly or through a designated agent, to the Municipal Securities Rulemaking Board (“MSRB”), in an electronic format as prescribed by the MSRB, accompanied by identifying information as prescribed by the MSRB:

(1) Annual financial information and operating data of the type include in this Official Statement as generally described below (“annual financial information”); and

(2) Timely notice (not in excess of ten business days after the occurrence of the event) of the occurrence of any of the following events with respect to the Bonds:

- principal and interest payment delinquencies;
- non-payment related defaults, if material;
- unscheduled draws on debt service reserves reflecting financial difficulties;
- unscheduled draws on credit enhancements reflecting financial difficulties;
- substitution of credit or liquidity providers, or their failure to perform;
- adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701—TEB) or other material notices or determinations with respect to the tax status of the Bonds;

- modifications to rights of holders of the Bonds, if material;
- Bond calls (other than scheduled mandatory redemptions of Term Bonds), if material, and tender offers;
- defeasances;
- release, substitution, or sale of property securing repayment of the Bonds, if material;
- rating changes;
- bankruptcy, insolvency, receivership or similar event of the District (a “Bankruptcy Event”);
- the consummation of a merger, consolidation, or acquisition involving the District or the sale of all or substantially all of the assets of the District, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- appointment of a successor or additional trustee or the change of name of a trustee, if material.

A Bankruptcy Event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for the District in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the District, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

The District also will provide to the MSRB timely notice of a failure by the District to provide required annual financial information on or before the date specified below.

#### **Type of Annual Financial Information Undertaken to be Provided**

The annual financial information that the District undertakes to provide will consist of (1) the audited financial statements of the 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 Electric System’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; (2) the outstanding long term indebtedness of the Electric System, the Priest Rapids Project and any other system of the District which provides power or capacity to the Electric System; (3) Electric System retail customers, energy sales, peak loads and revenues; (4) Electric System operating results and debt service coverage on the outstanding Parity Bonds; (5) Electric System energy requirements, resources and power costs; (6) the aggregate amount and percentage of total energy sold and of retail revenues provided by the Electric System’s ten largest customers; and (7) gross generation, net energy, disposition of net energy, maximum one-hour production, average production costs, plant factor and annual availability for the Priest Rapids Project; and will be provided to the MSRB not later than the last day of the ninth month after the end of each fiscal year of the District (currently, a fiscal year ending December 31), as such fiscal year may be changed as required or permitted by State law, commencing with the District’s fiscal year ending December 31, 2011.

The annual financial information may be provided in a single or multiple documents, and may be incorporated by specific reference to documents available to the public on the Internet website of the MSRB or filed with the SEC.

## **Amendment of Undertaking**

The Undertaking is subject to amendment after the primary offering of the Bonds without the consent of any holder of any Bond, or of any broker, dealer, municipal securities dealer, participating underwriter, rating agency or the MSRB, under the circumstances and in the manner permitted by the Rule.

The District will give notice to the MSRB of the substance (or provide a copy) of any amendment to the Undertaking and a brief statement of the reasons for the amendment. If the amendment changes the type of annual financial information to be provided, the annual financial information containing the amended financial information will include a narrative explanation of the effect of that change on the type of information to be provided.

## **Termination of Undertaking**

The District's obligations under the Undertaking shall terminate upon the legal defeasance of all of the Bonds. In addition, the District's obligations under the Undertaking shall terminate if those provisions of the Rule which require the District to comply with the Undertaking become legally inapplicable in respect of the Bonds for any reason, as confirmed by an opinion of nationally recognized bond counsel or other counsel familiar with federal securities laws delivered to the District, and the District provides timely notice of such termination to the MSRB.

## **Remedy for Failure to Comply with Undertaking**

If the District or any other obligated person fails to comply with the Undertaking, the District will proceed with due diligence to cause such noncompliance to be corrected as soon as practicable after the District learns of that failure. No failure by the District or other obligated person to comply with the Undertaking will constitute a default in respect of the Bonds. The sole remedy of any holder of a Bond will be to take such actions as that holder deems necessary, including seeking an order of specific performance from an appropriate court, to compel the District or other obligated person to comply with the Undertaking.

## **Prior Compliance with Continuing Disclosure Undertakings**

The District has complied with its prior written undertakings under the Rule.

## **RATINGS**

Moody's Investors Service ("Moody's"), Standard & Poor's Ratings Services ("S&P") and Fitch Ratings ("Fitch") have assigned their ratings of "Aa3," "AA-," and "AA," respectively, to the Bonds. Such ratings reflect only the views of the respective rating agency and are not a recommendation to buy, sell or hold the Bonds. An explanation of the significance of such ratings may be obtained from the rating agencies. The District has furnished to each rating agency certain information and materials with respect to the Bonds. Generally, rating agencies base their ratings on such information and materials, and on investigations, studies and assumptions made by the rating agencies. There is no assurance that the ratings assigned to the Bonds will continue for any given period of time or that they will not be revised or withdrawn entirely by such rating agencies if, in the judgment of the rating agencies, circumstances so warrant. The District and the Underwriters undertake no responsibility either to bring to the attention of the owners of the Bonds any downward revision or withdrawal of any such rating or to oppose any such revision or withdrawal. A downward revision or withdrawal of the ratings may have an adverse effect on the market price of the Bonds.

## **UNDERWRITING**

The Underwriters have agreed, subject to certain conditions, to purchase the Bonds from the District at an Underwriters' discount of \$730,600. The Underwriters' obligations are subject to certain conditions precedent, and they will be obligated to purchase all Bonds, if any Bonds 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



## APPENDIX A

### SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION

The following summary is a brief outline of certain provisions of the Bond Resolution, 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 to be paid into the Bond Fund, in such Fiscal Year, to pay (a) the interest due in such Fiscal Year on all outstanding Parity Bonds, excluding interest to be paid from the proceeds of the sale of bonds, (b) the principal of all outstanding Serial Bonds due in such Fiscal Year, (c) the Sinking Fund Requirement, if any, for such Fiscal Year, and (d) any regularly scheduled District Payments, adjusted by any regularly scheduled Reciprocal Payments, during such Fiscal Year. For purposes of computing Annual Debt Service on any Parity Bonds which constitute Balloon Indebtedness, it shall be assumed that the principal of such Balloon Indebtedness, together with interest thereon at the rate applicable to such Balloon Indebtedness, shall be amortized in equal annual installments over a term equal to the lesser of (1) 25 years or (2) the average weighted useful life (expressed in years and rounded to the next highest integer) of the properties and assets constituting the project (if any) financed out of the proceeds of such Balloon Indebtedness. In calculating the Annual Debt Service, the District may exclude the direct payment the District is expected to receive in respect of any Future Parity Bonds for which the federal government will provide the District with a direct payment of a portion of the interest from the interest portion of Annual Debt Service.

*“Balloon Indebtedness”* means any series or maturity of Parity Bonds that are specifically designated by a resolution as “Balloon Indebtedness.” The principal amount maturing on any date shall be the amount of Bonds scheduled to be amortized by prepayment or redemption prior to their stated maturity date.

*“Bond Fund”* means the Electric System Revenue Bond Fund, which shall be used solely for the purpose of paying debt service on the Bonds and any Future Parity Bonds.

*“Bondowners Trustee”* means a trustee appointed pursuant to the Bond Resolution.

*“Derivative Facility”* means a letter of credit, an insurance policy, a surety bond or other credit enhancement device, given, issued or posted as security for the District’s obligations under one or more Derivative Products.

*“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 Gross Revenues on an equal and ratable basis with the outstanding Parity 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 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 other generating, conservation, transmission or distribution facilities which have been or 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 may be 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 bonds of another such separate utility system of the District other than the Electric System. The Electric System does not include any interest of the District in contracts for the sale to other parties of power and energy from the Priest Rapids Project, but does include the right of the District to receive power and energy from the Priest Rapids Project. The Commission may, by resolution, elect to combine with and include as a part of the Electric System any other separate utility system of the District, provided that full provision for the payment of any outstanding indebtedness of such separate system shall first be made in the manner set forth in Section 5.3 (relating to defeasance) of the Bond Resolution or such indebtedness shall be refunded with bonds issued in accordance with the Bond Resolution.

*“Future Parity Bonds”* means any notes, bonds or other obligations of the District issued after the date of issuance of the Bonds which will have a lien upon the Gross Revenue of the Electric System for the payment of the principal thereof and interest thereon equal to the lien upon the Gross Revenue of the Electric System for the payment of the Bonds.

*“Gross Revenue”* means all income and revenues received by the District from the sale of electric energy through the ownership or operation of the Electric System and all other commodities, services and facilities sold, furnished or supplied by the District through the ownership or operation of the Electric System, 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 Electric System, 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 Electric System, in connection with the ownership and operation of the Electric System (but exclusive of 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 Bonds defeased pursuant to the Bond Resolution or other bonds for which payment has been provided or which have been defeased under any similar provision of any other bond resolution of the District, and exclusive of investment income earned in any arbitrage rebate account, grants for capital purposes, assessments in any local utility district, any Reciprocal Payments and any ad valorem tax revenues).

*“Net Revenue”* means, for any period, the excess of Gross Revenue over Operating Expenses for such period, excluding from the computation of Gross Revenue (a) 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 Electric System, or resulting from the early extinguishment of debt; and (b) insurance proceeds other than proceeds to replace lost revenue.

*“Operating Expenses”* means the District’s expenses for operation and maintenance of the Electric System and shall include ordinary repairs, renewals, replacements and reconstruction of the Electric System, including all costs of delivering electric power and energy and payments into reasonable 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, costs of purchased power (including costs of power and energy required by any resolution or contract of the District to be taken by the District from the Priest Rapids Project for the account of the Electric System), costs of transmission and distribution 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 Electric System, 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, any allowance for depreciation and District Payments.

*“Parity Bonds”* means the Bonds and all Future Parity Bonds.

*“Parity Lien Obligations”* means all charges and obligations against Gross Revenues ranking on a parity of lien with Parity Bonds, including but not limited to reimbursement agreement obligations so designated, any regularly scheduled District Payments, adjusted by any regularly scheduled Reciprocal Payments, and Resource Obligations for any month such obligations are not eligible for payment as Operating Expenses. Parity Lien Obligations do not include Parity Bonds.

*“Permitted Investments”* means any investments or investment agreements permitted under the laws of the State of Washington as amended from time to time.

*“Priest Rapids Development”* means the utility system of the District acquired and constructed pursuant to the provisions of Resolution No. 313, adopted by the Commission on June 19, 1956, including a dam at the Priest Rapids Development, all generating and transmission facilities associated therewith, and all additions, betterments and improvements to and extensions of such system, but shall not include any additional generation, transmission and distribution facilities hereafter constructed or acquired by the District as a part of the Electric System, or any other utility properties of the District acquired as a separate utility system, the revenues of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire such separate utility system.

*“Priest Rapids Project”* means the Priest Rapids Development and the Wanapum Development, which were consolidated pursuant to Resolution No. 8475.

*“Qualified Letter of Credit”* means any irrevocable letter of credit issued by a financial institution for the account of the District on behalf of the owners of any Parity 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 rated in one of the two highest rating categories by Moody’s Investors Service or Standard & Poor’s or their comparably recognized business successors.

*“Qualified Insurance”* means any noncancelable 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 rated in one of the two highest rating categories by Moody’s Investors Service or Standard & Poor’s or their comparably recognized business successors.

*“R&C Fund”* means the Reserve and Contingency Fund of the District created by Resolution No. 4112.

*“Rate Stabilization Account”* means the account within the R&C Fund.

*“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.

“*Refunded Municipals*” means pre-refunded municipal obligations meeting the following conditions: (i) (a) the obligations are not callable prior to maturity, (b) the obligations are callable prior to maturity and the issuer has foregone the right to call the obligations and the obligations are irrevocably escrowed to maturity, or (c) the escrow agent or trustee has been given irrevocable instructions concerning calling and redemption; (ii) the obligations are irrevocably secured by cash or non-callable Government Obligations which may be applied only to interest, principal, and premium payments of such bonds; (iii) the principal and interest of the Government Obligations (plus any cash in the fund) are sufficient to meet the liabilities of the obligations; (iv) the Government Obligations serving as security for the obligations are held by an escrow agent or a trustee; and (v) the Governmental Obligations are not available to satisfy any other claims, including those against the trustee or escrow agent.

“*Reserve Fund Requirement*” means with respect to the Bonds and any Future Parity Bonds secured by the Reserve Fund an amount equal to the least of (a) 125% of average Annual Debt Service, (b) maximum Annual Debt Service or (c) 10% of the initial principal amount of the Bonds. Such Reserve Fund Requirement may be recalculated and determined from time to time. The resolution authorizing Future Parity Bonds may establish a separate debt service reserve account for any such Future Parity Bonds and set forth the reserve fund requirement for such bonds or provide that some or all of such Future Parity Bonds be secured by the Reserve Fund. If the Reserve Fund Requirement applicable to any Future Parity Bonds includes a calculation of Annual Debt Service, the resolution authorizing such Future Parity Bonds shall establish the method to be used for calculating interest on any Variable Rate Bonds for such purpose.

“*Resource Obligation*” means an obligation of the District to pay the following costs associated with a resource from Gross Revenues as (a) Operating Expenses for any month in which any power and energy or other goods and services from such resource were made available to the Electric System during such month (regardless of whether or not the Electric System actually scheduled or received energy from such resource during such month) and (b) at all other times as an indebtedness of the Electric System payable from Gross Revenues on a parity of lien with Parity Bonds and any Parity Lien Obligations:

(i) costs associated with facilities or resources for the generation of power and energy or for the conservation, transformation, transmission or distribution of power and energy (including any common undivided interest therein) hereafter acquired, purchased or constructed by the District and declared by the Commission to be a separate system, which such costs shall include but are not limited to costs of normal operation and maintenance, renewals and replacements, additions and betterments and debt service on the bonds or other obligations of such separate system but shall exclude costs paid or to be paid from the proceeds of the sale of bonds or other obligations of such separate system, or

(ii) costs associated with the purchase of energy, capacity, capability, reserves, conservation or services under a contract.

“*Serial Bonds*” means Parity Bonds other than Term Bonds.

“*Term Bonds*” means Parity Bonds of any principal maturity for which mandatory sinking fund payments are required.

“*2001 Bonds*” means the Electric System Revenue and Refunding Bonds, Series 2001-H authorized by Resolution No. 7485 of the District.

“*Wanapum Development*” means the second stage of the Priest Rapids Hydroelectric Project (F.P.C. (or FERC) Project No. 2114), as more fully described in Section 2.2 of Resolution No. 474 adopted by the Commission on June 30, 1959, or as the same may be modified in accordance with Section 2.3 of Resolution No. 474, but shall not include any generation, transmission and distribution facilities hereafter constructed or acquired by the District as a part of the Electric System, or any other utility properties of the District acquired as a separate utility system,

the revenues of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire such separate utility system.

### **Revenue Fund**

The District will pay into the Revenue Fund all Gross Revenue of the Electric System, exclusive of earnings on money on hand in any arbitrage rebate account, the R&C Fund, or the Reserve Fund or any other debt service account securing Parity Bonds, which may be retained in such funds and account or transferred to other funds as required by the Bond Resolution.

### **Construction Fund**

Money in the Construction Fund shall be used solely for the purpose of paying the cost of the acquisition, construction and installation of the plan and system described in the Bond Resolution, or other improvements to the Electric System, and paying costs of issuing the Bonds. Bond proceeds deposited in the Construction Fund and not immediately needed to pay the costs of acquisition, construction, and installation of the plan and system and costs incidental thereto may be temporarily invested in Permitted Investments which will mature prior to the date on which the moneys so invested shall be needed. All interest earned and income or profits derived by virtue of such investments shall remain in the Construction Fund.

### **Rate Stabilization Account**

In accordance with the priorities set forth in “SECURITY FOR THE PARITY BONDS—Flow of Funds Under the Bond Resolution,” the District may from time to time deposit Net Revenues into the Rate Stabilization Account in the R&C Fund and may from time to time withdraw amounts therefrom to enhance rate stability or for other lawful purposes of the District related to the Electric System. Solely for purposes of calculating the coverage requirement, there shall be added to the Net Revenue in any year any amount withdrawn from the Rate Stabilization Account in such calendar year and deposited in the Revenue Fund, and there shall be subtracted from Net Revenue in any year any amount withdrawn from the Revenue Fund and deposited in the Rate Stabilization Account.

### **Bond Fund**

The District obligates and binds itself irrevocably to set aside and pay into the Bond Fund out of the Gross Revenue of the Electric System certain fixed amounts in the following order of priority:

- (A) Bond Fund: On or before the day on which an installment of interest falls due an amount, together with funds available in such account, equal to the installment of interest next falling due on all outstanding Parity Bonds; in the case of Variable Rate Bonds transfers shall be made as specified in the resolution authorizing such bonds.

On or before the day on which an installment of principal falls due, the amount which, together with funds available in such account, shall equal the installment of principal next falling due on all outstanding Parity Bonds; and

On or before the due date of each Sinking Fund Requirement, an amount which, together with funds available in such account, will equal the Sinking Fund Requirement next falling due;

- (B) Reserve Fund: On or before the 25th day of each of the six months next succeeding each date of valuation of the amount in the Reserve Fund, 1/6th of the amount necessary to make the valuation of the amount in the Reserve Fund equal to 100% of the Reserve Fund Requirement, if the valuation of the amount in the Reserve Fund is less than 100% of the Reserve Fund Requirement. The valuation of the amount in the Reserve Fund must be made by the District on each December 31 and may be made on each June 30.

If the valuation of the amount in the Reserve Fund is greater than 100% of the Reserve Fund Requirement, then and only then may the District withdraw at any time prior to the next date of valuation from the Reserve Fund (i) the interest earned on the amounts credited to the Reserve Fund and (ii) the difference, if any, between the amount of the valuation and the Reserve Fund Requirement. The District has reserved the right to substitute Qualified Insurance or a Qualified Letter of Credit (as defined in the Bond Resolution) to satisfy the Reserve Fund Requirement for any Parity Bonds, provided that the letter of credit or insurance is not cancelable on less than five years' notice.

Money in the Bond Fund may, at the option of the District, be invested or reinvested in Permitted Investments maturing, or which are retirable at the option of the owner, prior to the maturity date of the final installment of principal of the Parity Bonds. For the purpose of determining the amount credited to the Reserve Fund, obligations in which money in the Reserve Fund have been invested are to be valued at the market value thereof plus accrued interest to the date of redemption for obligations maturing more than six months from the valuation date and at the par value thereof for obligations maturing within six months of the valuation date.

The District shall make up any deficiency in the Bond Fund from the funds available in the Reserve Fund. The District will replenish such withdrawals from the Reserve Fund from moneys in the Revenue Fund first available after making current specified payments into the Bond Fund, and after paying and making necessary provision for the payment of Operating Expenses.

The District will calculate the Reserve Fund Requirement as of the issuance of the Bonds, and will, on the date of delivery of the Bonds to the initial purchasers have on deposit in the Reserve Fund an amount equal to the Reserve Fund Requirement for the Bonds.

#### **Additional Bonds**

The District will not issue any bonds or other obligations subsequent to the issuance of the Bonds having a lien or charge on the Gross Revenue of the System prior to the lien and charge of the Bonds. Future Parity Bonds may be issued provided that the District shall comply with the following conditions:

1. At the time of issuance of such Future Parity Bonds there is no deficiency in the Bond Fund or in any of the accounts therein and no Event of Default has occurred or is continuing.
2. The Net Revenue of the Electric System for any 12 consecutive months out of the 24 months next preceding the issuance of such Future Parity Bonds, not including any transfer from the R&C Fund, will equal at least 1.25 times the Annual Debt Service required to be paid in any Fiscal Year thereafter. In calculating Annual Debt Service for purposes of this paragraph, if the interest rate on any Parity Bonds is other than a fixed rate, the rate used shall be any rate published as the Bond Buyer Revenue Bond Index for municipal revenue bonds within the 30-day period prior to the date of calculation. If on the date of such calculation the interest rate on any Variable Rate Bonds shall then be fixed for a specified period, including pursuant to a Derivative Product, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate.

“Net Revenue of the Electric System” may be adjusted to include: (i) a full 12 months of Net Revenue from any customers added during the 12-month period being considered; (ii) the annual estimated Net Revenue to be received as a result of any additions, betterments and improvements to and extensions of the Electric System to be acquired, constructed or installed by the District from the proceeds of the Future Parity Bonds to be issued; and (iii) the additional Net Revenue which would have been received by the District if any rate change adopted prior to the delivery of the Future Parity Bonds, but subsequent to the beginning of the 12-month period being considered, had been in force during the full 12-month period.

3. At or prior to the issuance of such Future Parity Bonds, the District shall obtain and have on file a certificate from the Treasurer which shall certify full compliance with the conditions set forth

above, or in the alternative, the District may obtain a certificate from a Professional Utility Consultant stating that the projected average annual Net Revenue for the Fiscal Years in which the Parity Bonds, including the Future Parity Bonds being issued, are expected to at least equal 1.25 times the Annual Debt Service required to be paid in any Fiscal Year thereafter.

In the event that any Future Parity Bonds are issued for the sole purpose of exchanging with or providing funds to purchase or refund or redeem and retire at or prior to their maturity any or all outstanding Parity Bonds and the issuance of such refunding Future Parity Bonds and retirement of outstanding bonds and such refunding Future Parity Bonds will not require a greater amount (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 debt service on the bonds being refunded, then paragraphs 2 and 3 above need not be complied with to permit such refunding Future Parity Bonds to be issued.

In the event that the District elects to meet the requirements with respect to the Reserve Fund as to any issue of Bonds through the use of a Qualified Letter of Credit, Qualified Insurance or other credit enhancement device, the District may contract with the person providing such Qualified Letter of Credit, Qualified Insurance or other credit enhancement device that the District's reimbursement obligation, if any, to such entity ranks on a parity of lien with payments into the Reserve Fund to secure the Bonds.

In the event that the District elects additionally to secure any issue of Variable Rate Bonds through the use of a letter of credit, insurance or other credit enhancement device, the District may contract with the entity providing such letter of credit, insurance or other credit enhancement device that the District's reimbursement obligation, if any, to such entity ranks on a parity of lien with the Bonds; provided that the payments due under such reimbursement obligation are such that if such reimbursement obligation were a series of Future Parity Bonds and assuming that such credit enhancement device were to be drawn upon for the full amount available, such Future Parity Bonds could be issued in compliance with the provisions regarding additional Bonds, excluding Annual Debt Service on the Variable Rate Bonds.

#### **Separate System Bonds; Resource Obligations**

The District may enter into contracts to purchase energy, capacity, capability, reserves, conservation or services or authorize and issue bonds, notes, certificates or other obligations or evidences of indebtedness, other than Bonds, to acquire or construct facilities or resources for the generation of power and energy, or for the conservation, transformation or transmission of power and energy, and any incidental properties to be constructed or acquired in connection therewith, which facilities or resources shall be a separate system and which contractual obligations, bonds or other obligations or evidences of indebtedness must be payable solely from the revenues or other income derived from the ownership or operation of such separate system. Costs associated with any such separate system may be declared by resolution of the Commission to be a Resource Obligation of the Electric System provided that the following requirements must be met at the time of such declaration:

(1) No Event of Default with respect to any Parity Bonds or Resource Obligations has occurred and is continuing.

(2) There must have been filed with the Secretary of the Commission a certificate of the Professional Utility Consultant stating that the additional source of power and energy or conservation from such Resource Obligation is consistent with sound utility power supply planning.

(3) There must have been filed with the Secretary of the Commission a report of the Professional Utility Consultant stating that estimated annual Net Revenues for the second full Fiscal Year after the date of initial operation of the facilities, costs of which are to be financed as a Resource Obligation, or after the date of first delivery of energy, capacity, reserves or services pursuant to a contract, costs of which are declared to be a Resource Obligation, as the case may be, shall be at least equal to 125% of maximum Annual Debt Service in any future Fiscal Year. In estimating Net Revenues, the Professional Utility Consultant shall base such estimate on factors the Professional Utility Consultant deems to be reasonable and shall treat the costs of the Resource Obligation as Operating Expenses.

(4) In the event that the Resource Obligation is a contract to purchase energy, capacity, reserves or services, there must have been filed with the Secretary of the Commission opinions of counsel to all other parties to the contract, which opinions state that each party to the contract has all requisite right, power and authority to execute and deliver the contract and to perform its obligations thereunder and that the contract constitutes a legally valid and binding obligation of each party thereto.

(5) The Resource Obligation shall not be subject to acceleration if an event of default has occurred.

### **Derivative Products**

To the extent permitted by state law the District may enter into Derivative Products on a parity with the Bonds or 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. 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 outstanding Parity Bonds.

(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.

### **Defeasance**

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 and/or Government Obligations and/or Refunded Municipals in an amount, 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. In such event no further payments need to be made into the Bond Fund and such Bonds shall cease to be entitled to any lien, benefit or security of the Bond Resolution except the right to receive payment from such special account, and such Bonds shall not be deemed to be outstanding for any purpose of the Bond Resolution. Within 30 days following the defeasance of any of the Bonds, written notice will be mailed to S&P and Moody's at their main offices, and to all registered owners of Bonds at their addresses appearing in the bond register.

## Rate Covenant

The District has covenanted to establish, maintain and collect rates or charges for electric energy and all other services, commodities and facilities sold, furnished or supplied by the District in connection with the ownership or operation of the Electric System that shall be fair and nondiscriminatory and adequate to provide (1) Gross Revenue, together with other available money, including without limitation transfers from the R&C Fund, sufficient for the payment of the principal of and interest on all outstanding Parity Bonds and all payments which the District is obligated to set aside in the Bond Fund, and for the proper operation and maintenance of the Electric System, and all necessary repairs, replacements and renewals thereof, the working capital necessary for the operation thereof, and for the payment of any and all amounts that the District may now or hereafter become obligated to pay from said Gross Revenue; and (2) Net Revenue in any Fiscal Year hereafter equal to at least 1.25 times the Annual Debt Service in such Fiscal Year on all outstanding Parity Bonds, excluding any capitalized interest thereon, in such Fiscal Year. Failure to comply with this covenant shall not constitute an Event of Default if the District, before the 90th day of the following Fiscal Year, employs a Professional Utility Consultant (acceptable to the Insurer) to recommend changes in the District's rates and imposes rates at least as high as those recommended by such consultant. For purposes of calculating the coverage requirement, there shall be added to the Net Revenue in any year any amount withdrawn from the R&C Fund in such calendar year and deposited in the Revenue Fund, and there shall be subtracted from Net Revenue in any year any amount withdrawn from the Revenue Fund and deposited in the R&C Fund. See "Rate Stabilization Account" above.

## Additional Covenants

*Efficient Operation of the System.* The District will maintain the Electric System and all additions, betterments and extensions thereto 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.

*Sale/Lease of Property.* The District will not sell, mortgage, lease or otherwise dispose of or encumber all or any portion of the Electric System except that:

(1) The District may sell, lease or otherwise dispose of all or substantially all of the Electric System, provided that simultaneously with such sale, lease or other disposition, the District shall cause all of the Bonds to be, or deemed to be, no longer outstanding.

(2) Except as provided below, the District will not dispose of any part of the Electric System in excess of 5% of the value of the net utility plant of the District in service unless prior to such disposition:

(a) there has been filed with the Secretary of the Commission a certificate of a Professional Utility Consultant stating that such disposition will not impair the ability of the District to comply with the rate covenants set forth in the Bond Resolution; or

(b) provision is made for the payment, redemption or other retirement of a principal amount of Bonds and Future Parity Bonds equal to the greater of the following amounts:

(i) An amount which will be in the same proportion to the net principal amount of Bonds and Future Parity Bonds then Outstanding (defined as the total principal amount of Bonds then Outstanding less the amount of cash and investments in the Bond Fund) that the Gross Revenues attributable to the part of the Electric System sold or disposed of for the 12 preceding months bears to the total Gross Revenues for such period; or

(ii) An amount which will be in the same proportion of the net principal amount of Bonds then outstanding that the book value of the part of the Electric System sold or disposed of bears to the book value of the entire Electric System immediately prior to such sale or disposition.

The District may dispose of any portion of the Electric System that has become unserviceable, inadequate, obsolete, or unfit to be used or no longer necessary for the use in the operation of the Electric System.

*Insurance.* The District will keep the Electric System 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, however, the District may institute or continue a self-insurance program with respect to any and all of the aforementioned risks.

*Accounts, Records and Audits.* The District shall keep proper books of account in accordance with generally accepted accounting principles as applied to governmental entities and with the rules of the Division of Municipal Corporations of the State Auditor's office of the State of Washington, or successors, or 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 over electric public utility companies comparable to the District. The District shall cause its books to be audited annually by the State Auditor's office or, if such an audit shall not be made for 12 months after the close of any Fiscal Year of the District, by independent certified public accountants. Any Bondowner may obtain at the office of the District copies of the balance sheet and income and retained earnings statement of the Electric System as of the close of each Fiscal Year, and the income and expenses of such year, including the amounts paid into the Revenue Fund, the Bond Fund, and in any and all special funds created pursuant to the provisions of the Bond Resolution, and the amounts expended for maintenance, renewals, replacements, and gross capital additions to the Electric System.

*Prohibition of Free Service.* Except as required by law or in an amount not to exceed 1/10th of 1% of Annual Operating Expenses, the District will not furnish electric energy without charge. The District will promptly enforce the payment of delinquent accounts by discontinuing service to the extent then permitted by law, or by legal proceedings, or both; provided, that, to the extent permitted by law, the District may lend money and may provide commodities, services or facilities free of charge or at a reduced charge in connection with a plan of conservation of electric energy adopted by the Commission.

*Other Covenants.* The District shall not dissolve or terminate its existence, or consolidate with another entity, without paying or providing for the payment of all outstanding Parity Bonds. The District will use its best efforts to retain the FERC License for the Priest Rapids Project.

*Continuing Disclosure Obligations.* The District has agreed to provide ongoing disclosure in accordance with Section (b)(5) of SEC Rule 15c2-12. See "CONTINUING DISCLOSURE" for a discussion of this undertaking.

## **Amendments**

Any amendments to the Bond Resolution may be made by the District with the consent of the owners of 66-2/3% in principal amount of the Parity Bonds then outstanding, provided that no such amendment shall extend the date of payment of principal of or any installment of interest on any Parity Bond or reduce the principal or redemption price thereof or the rate of interest thereon or advance the permissible redemption prior to maturity date of any Parity Bond or give any Parity Bond preference over any other Parity Bond, or reduce the percentage of Parity Bonds the owners of which are required to consent to an amendment of the Bond Resolution, or authorize the creation of any pledge prior to or on a parity with the Parity Bonds (except the issuance of Future Parity Bonds) without the consent of the owners of each such Parity Bond affected.

Without the consent of the owners of any Parity Bonds or Parity Lien Obligations, the District may adopt supplemental resolutions to add to the covenants of the District contained in, or to surrender any rights reserved to or conferred upon it by, the Bond Resolution, or to cure any ambiguity or correct any defect in the Bond Resolution which shall not adversely affect the interest of such owners in any material respect.

## Events of Default; Remedies

*Events of Default.* Under the Bond Resolution the happening of the following shall constitute “Events of Default”:

1. Default in the punctual payment of the principal of and premium, if any, on any of the Parity Bonds.
2. Default in the punctual payment of interest on any Parity Bond.
3. Failure to provide for required Sinking Fund Requirement when the same become due.
4. Default in the observance of any other of the covenants and conditions in the Bond Resolution and such default continues for 90 days after the District receives from the Bondowners Trustee or from the owners of not less than 20% in principal amount of any Parity Bonds outstanding a written notice specifying and demanding the cure of such default.
5. If the District shall (except as permitted in the Bond Resolution) sell, transfer, assign or convey any properties constituting the Electric System or interests therein, or make any agreement for such sale or transfer).
6. If an order, judgment or decree is entered appointing a receiver, trustee or liquidator for the District or all or any substantial part of the Electric System; approving a petition filed against the District seeking the bankruptcy, arrangement or reorganization of the District, or assuming custody or control of the District or all or any substantial part of the Electric System and such order, judgment or decree shall not be vacated, set aside, stayed or terminated within 60 days from the date of the entry.
7. If the District admits in writing its inability to pay its debts generally as they become due, files a petition in bankruptcy, makes an assignment for the benefit of its creditors, consents to the appointment of a receiver of all or any substantial part of the Electric System, or consents to the assumption by any court of custody or control of the District or of the whole or any substantial part of the Electric System.

*Remedies/Bondowners’ Trustee.* So long as an Event of Default has not been remedied, a bondowners’ trustee (the “Bondowners’ Trustee”) may be appointed by the owners of 25% in principal amount of Parity Bonds outstanding. The 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 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 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; provided, however, that no such resignation or removal shall be effective until a successor Bondowners’ Trustee shall have been appointed and shall have delivered a written instrument of acceptance of the duties and responsibilities of the Bondowners’ Trustee to the District and the owners of the outstanding Parity Bonds. In the event that any Event of Default in the sole judgment of the Bondowners’ Trustee is cured and the Bondowners’ Trustee furnishes to the District a certificate so stating, that Event of Default shall be conclusively deemed to be cured.

Upon the happening of an Event of Default and during the continuance thereof, the Bondowners’ Trustee may, and upon the written request of the registered owners of not less than 25% in principal amount of Parity Bonds outstanding shall, take such steps and institute such suits or other proceedings, all as it may deem appropriate for the protection and enforcement of the rights of the registered owners of the Parity Bonds, to collect any amounts due and owing to or from the District, or to obtain other appropriate relief, and may enforce the specific performance of any covenant, agreement or condition contained in the Bond Resolution or in any of the Parity Bonds.

Any such suit or proceeding instituted by the Bondowners' Trustee shall be brought for the ratable benefit of all of the registered owners of the Parity Bonds, subject to the provisions of the Bond Resolution. The respective owners of Parity Bonds outstanding, by taking and holding the same, shall be conclusively deemed irrevocably to appoint the Bondowners' Trustee the true and lawful trustee of the respective owners of those Parity Bonds, with authority to institute any such suit or proceeding; to receive as trustee and deposit in trust any sums becoming distributable on account of those Parity Bonds; to execute any paper or documents for the receipt of money; and to do all acts with respect thereto that the registered owner himself or herself might have done in person. Nothing herein shall be deemed to authorize or empower the Bondowners' Trustee to consent to accept or adopt, on behalf of any registered owner of Parity Bonds outstanding, any plan of reorganization or adjustment affecting those Parity Bonds or any right of any registered owner thereof, or to authorize or empower the Bondowners' Trustee to vote the claims of the owners thereof in any receivership, insolvency, liquidation, bankruptcy, reorganization or other proceeding to which the District is a party.

Any money collected by the Bondowners' Trustee at any time pursuant to the Bond Resolution shall be applied in the following order of priority: (i) 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 (ii) 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, 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; (ii) a Bondowners' Trustee has been appointed; (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; (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; (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.

### **Limitations of Remedies**

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 subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to limitations on legal remedies against public utility districts in the State. The opinion to be delivered by Foster Pepper PLLC, as Bond Counsel, concurrently with the issuance of the Bonds, to the effect that the Bonds constitute legal, valid and binding obligations of the District and that the Bond Resolution constitutes a valid and binding obligation of the District, will be subject to such limitations, and the various other legal opinions to be delivered concurrently with the issuance of the Bonds will be similarly qualified. In the event 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.

**APPENDIX B**

**AUDITED FINANCIAL STATEMENTS OF THE DISTRICT  
AS OF DECEMBER 31, 2010 AND 2009**

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Public Utility District No. 2 of  
Grant County, Washington  
Financial Statements  
December 31, 2010 and 2009

**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

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## Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of revenues and expenses and changes in net assets and of cash flows of Public Utility District No. 2 of Grant County, Washington (the "District"), present fairly, in all material respects, the financial position of the District at December 31, 2010 and December 31, 2009, and its changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these 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, 2010 on pages 2 through 8 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 audits were conducted for the purposes of forming an opinion on the financial statements taken as a whole. The Supplemental Disclosure of Telecommunication Activities in Note 11 is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audits 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 25, 2011

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009**

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As of December 31, 2010, Public Utility District No. 2 of Grant County, Washington (the "District") comprises two operating systems: the Electric System and the Priest Rapids Project which consists of the Priest Rapids Hydroelectric Production Development ("Priest Rapids") and the Wanapum Development ("Wanapum"). The Priest Rapids Project is operated under Federal Energy Regulatory Commission ("FERC") License, Project No. 2114. During 2010, per Commission resolution, Priest Rapids and Wanapum were combined into one system, the Priest Rapids Project.

Presented below is a discussion and analysis of the financial activities for the years ended December 31, 2010, 2009 and 2008. 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 wholesale fiber optic network 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 Balance Sheets, Statements of Revenues and Expenses and Changes in Net Assets, Statements of Cash Flows and the Notes to the Financial Statements.

The Balance Sheets include all of the District's assets, liabilities and net assets and provide 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 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 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 operating, investing and financing activities.

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

### **FINANCIAL HIGHLIGHTS**

In April of 2010, the District issued \$349.4 million of bonds associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to refund certain bonds issued previously and to pay issuance costs. The District has revenue bonds outstanding of \$1.1 billion as of December 31, 2010, and had \$786.8 million and \$818.4 million as of December 31, 2009 and 2008, respectively. See Note 5.

In April of 2010, the District implemented rate increases ranging from 2.8% for residential customers to 6.6% for small industrial customers. The combined effect for all rate classes was a 4%

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009**

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increase in retail revenues. Effective February 1, 2011, a 6% rate increase was implemented by the Board of Commissioners ranging from a 4.0% for residential customers to 9.4% for small industrial accounts. The Commission adopted budget and forecast has future overall rate increases of 8% for the years 2012 – 2015.

On April 17, 2008, the Federal Energy Regulatory Commission issued the District a 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.

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, water quality by reducing the amount of spill, total dissolved gas entrainment, fish injury and erosion at Wanapum Dam. Construction began in 2005 and was completed and began operating. 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 finance capital improvements through revenue. With the large industrial loads such as Microsoft, Yahoo!, and SGL Automotive entering the service area and REC Solar Grade Silicon's expansion, the Electric System is required to add transmission and distribution infrastructure. These large industrial customers were required to make Contributions in Aid of Construction ("CIAC") to the Electric System for specific infrastructure required to deliver power to their facilities. CIAC's surged to \$9.1 million in 2008 during a period of concentrated industrial growth. CIAC's for 2009 reflect a return to more normal levels to \$1.0 million. In 2010, CIAC's increased again to \$8.9 million with SGL Automotive and Microsoft making up the majority of the contributions.

The District has installed a wholesale fiber optic network distribution system (the "Wholesale 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 has approved the continued expansion of the fiber optic distribution system and allocates resources for expansion on an annual basis.

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 extend through the new license term, March 31, 2052. The contract provisions relating to Priest Rapids took effect on November 1, 2005, and those relating to Wanapum took effect on November 1, 2009. In accordance with the Federal Energy Regulatory Commission ("FERC") Order in the Public Law 83-544 proceeding, the District dedicates 30% of the combined output of the Priest Rapids Project for sales based on market

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009**

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principles. The power purchasers are 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.

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 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 new power sales contracts, the District has been able to meet all of its forecasted firm load requirements with Priest Rapids and Wanapum generation and other benefits derived from the hydro facilities.

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 began in June 2010 and is scheduled through January 2018. 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%.

The District is in the process of a long-term turbine upgrade project at Wanapum Dam. In April 2010, the installation of the sixth advanced turbine was complete and began generating power. In April 2011, the seventh turbine and the first generator were recently completed and began generating power. The District anticipates replacing the remaining units at a rate of one every ten months, until all ten have been replaced, with a projected completion date of October 2013. As of December 31, 2010, the cost of the remaining turbines to be replaced is estimated at \$43.7 million.

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.

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, 2010, the Priest Rapids Project provided 7,060,574 megawatt hours ("MWh") of electric energy at an average cost of \$18.97 per MWh. During the year ended December 31, 2009, the Priest Rapids Project provided 7,576,725 MWh of electric energy at an average cost of \$15.36 per MWh. During the year ended December 31, 2008, the Priest Rapids Project provided 8,382,876 MWh of electric energy at an average cost of \$14.29 per MWh.

While operating costs have remained generally consistent, the increase in average costs per MWh at both Priest Rapids and Wanapum from 2008 to 2009 was driven by a reduction in water for generation. In 2010, water for generation was even less than 2009. This decrease in water and the

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009**

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increase in debt service cost associated with the new bond issue resulted in a further increase in the cost per MWh in 2010.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009 (AMOUNTS IN THOUSANDS)

### CONDENSED COMPARATIVE FINANCIAL INFORMATION

Balance Sheet	2010	2009	2008
Assets			
Current	\$ 230,558	\$ 332,706	\$ 421,118
Net utility plant	1,330,747	1,208,167	1,115,614
Noncurrent	<u>342,023</u>	<u>58,024</u>	<u>61,514</u>
Total assets	<u>\$ 1,903,328</u>	<u>\$ 1,598,897</u>	<u>\$ 1,598,246</u>
Liabilities			
Current	\$ 134,241	\$ 140,600	\$ 122,067
Noncurrent	<u>1,087,524</u>	<u>798,202</u>	<u>833,289</u>
Total liabilities	<u>1,221,765</u>	<u>938,802</u>	<u>955,356</u>
Net assets			
Invested in capital assets, net of related debt	463,303	452,705	399,831
Restricted	60,672	34,831	31,600
Unrestricted	<u>157,588</u>	<u>172,559</u>	<u>211,459</u>
Total net assets	<u>681,563</u>	<u>660,095</u>	<u>642,890</u>
Total liabilities and net assets	<u>\$ 1,903,328</u>	<u>\$ 1,598,897</u>	<u>\$ 1,598,246</u>
<b>Revenues and Expenses and Changes in Net Assets</b>			
Operating revenues	\$ 267,897	\$ 256,129	\$ 286,961
Operating expenses	<u>216,241</u>	<u>204,027</u>	<u>186,270</u>
Net operating income	<u>51,656</u>	<u>52,102</u>	<u>100,691</u>
Other revenues (expenses)	(39,060)	(35,891)	(27,340)
Contributions in aid of construction	8,872	994	9,103
Net extraordinary loss	<u>-</u>	<u>-</u>	<u>(256)</u>
Change in net assets	<u>\$ 21,468</u>	<u>\$ 17,205</u>	<u>\$ 82,198</u>

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009**

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### **FINANCIAL ANALYSIS**

The following discussion provides comparative financial information for the years ended December 31, 2010, 2009, and 2008.

#### **ASSETS**

Current assets showed a 21% decrease from 2008 to 2009. Current assets were used to buy power needed due to lower than expected water supplies. The inflows of revenues were also lower than forecasted due to decreased surplus power available for resale and lower market prices. Current assets were also used to purchase Net utility plant as discussed below. The \$102 million decrease in current asset from 2009 to 2010 is the result of the continued construction at the Priest Rapids Project and revenue financing of capital improvements in the Electric System combined with lower generation and price associated with surplus power sales.

In 2010, the District recognized a \$123 million increase in Net utility plant from the prior year. The continued growth of the Electric System and the replacement of turbines and generators at Wanapum and other improvements to Priest Rapids and Wanapum have required a considerable investment in plant. Net utility plant increased approximately \$93 million from 2008 to 2009. Noncurrent assets remained relatively constant from 2008 to 2009. The \$284 million increase from 2009 to 2010 is due in large part to the proceeds from the 2010 bond offering and the associated debt service reserve.

#### **LIABILITIES**

The upheaval in the financial markets over recent years has to date had little effect on the District. While the District has approximately \$1.1 billion in bonded debt as of year-end, all of that debt is at fixed rates. During April of 2010, the District issued bonds to finance capital improvements for the Priest Rapids Project. The total par value of the bond offering was \$349.4 million, of which \$35 million was used to refund prior bond issues. The 2010 bonds were issued at fixed interest rates with the District taking advantage of Build America Bonds and Clean Renewable Energy Bonds which offers, respectively, a 35% and 70% refund from the Federal Government on interest payments made.

In March of 2010, Standard & Poor's and Fitch reaffirmed the 'AA-/stable outlook' and 'AA/stable outlook', respectively, for the Electric System, Priest Rapids, Wanapum and the Priest Rapids Project System's bonds. Moody's, on the other hand, downgraded the District's bonds from 'Aa2' to 'Aa3/stable outlook'. The strengths listed by all rating agencies included low-cost hydro electric resources from the Priest Rapids Project and low retail rates in the Electric System.

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2010 AND 2009**

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### **NET ASSETS**

Net assets increased approximately \$21 million and \$17 million in 2010 and 2009, respectively. These are modest increases when compared to prior years and are indicative of the change in river flows for generation, market price for surplus generation, and increasing costs of purchased power for the Electric System.

### **STATEMENT OF REVENUES AND EXPENSES**

The Priest Rapids Project's revenue is directly tied to 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. Overall Retail energy sales increased in 2009, but at a lower rate than in recent years. The lower than expected water flows and the relatively low wholesale prices resulted in a 25.8% decrease in Sales to other utilities for 2009 from 2008. During 2010, Sales to other utilities dropped from 2009 but only by \$1.5 million. This reflects another low generation year coupled with low wholesale prices. Most of the \$11.8 million increase in operating revenue came as the result of increased revenues from commercial and industrial customers.

Reduced generation from the Priest Rapids Project also caused the Electric System to purchase more power in 2009 to meet its loads. This resulted in an increase of purchased power expense by over \$22 million compared to 2008. Operating expenses increased 6% from 2009 to 2010.

The decrease in Other revenues (expenses) from 2008 to 2009 is largely due to the collapse of interest rates on investments and an overall decrease in investment balances of approximately \$93 million due to capital expenditures during 2009. The decrease from 2009 to 2010 is due to the increase in interest expense from the 2010 bond issue and the decrease in interest earning resulting from continued deterioration of interest rates.

As mentioned above, CIAC's surged to over \$9 million in 2008 during a period of concentrated industrial growth. CIAC's for 2009 reflect a return to more normal levels around \$1 million. In 2010, CIAC's increased again to nearly \$9 million with SGL Automotive and Microsoft making up the majority of the contributions.

### **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

## BALANCE SHEETS DECEMBER 31, 2010 AND 2009 (AMOUNTS IN THOUSANDS)

ASSETS	2010	2009
CURRENT ASSETS		
Cash	\$ 5,000	\$ 1,673
Investments	91,045	141,083
Restricted funds		
Cash	9,771	11,271
Investments	81,882	133,339
Customer accounts receivable, net of allowance for uncollectible accounts	18,030	23,159
Materials and supplies	20,490	18,745
Other current assets	4,340	3,436
	230,558	332,706
NONCURRENT ASSETS		
Cash	-	785
Investments	35,424	10,135
Restricted funds		
Cash	5,298	3,521
Investments	285,058	26,386
Unamortized debt expense	8,490	6,467
Conservation loans	550	411
Long-term receivables, net of allowance for uncollectible accounts	-	265
Demand-side management	5,380	6,409
Deposits	-	2,336
Deferred preliminary expenses	1,823	1,309
	342,023	58,024
Utility plant, net of accumulated depreciation and amortization	1,330,747	1,208,167
	1,672,770	1,266,191
TOTAL ASSETS	\$ 1,903,328	\$ 1,598,897

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## BALANCE SHEETS DECEMBER 31, 2010 AND 2009 (AMOUNTS IN THOUSANDS)

LIABILITIES AND NET ASSETS	2010	2009
CURRENT LIABILITIES		
Accounts payable		
Trade	\$ 31,086	\$ 43,714
Wages payable	13,067	11,834
Power purchasers	831	13,042
Accrued taxes	4,315	4,524
Customer deposits	3,108	3,121
Accrued bond interest	30,891	19,858
Unearned revenue	1,300	1,300
Habitat liability	8,163	6,653
Other current liabilities	20	20
Current portion of licensing obligations	5,630	3,429
Current portion of long-term debt	35,830	33,105
	<hr/>	<hr/>
Total current liabilities	134,241	140,600
NONCURRENT LIABILITIES		
Accrued other postemployment benefits	919	441
Long-term unearned revenue	1,607	1,714
Licensing obligations, less current portion	48,410	40,258
Revenue bonds, less current portion	1,032,855	753,725
Unamortized (discount) premium, net	12,016	11,499
Unamortized refunding loss	(8,283)	(9,435)
	<hr/>	<hr/>
Total noncurrent liabilities	1,087,524	798,202
	<hr/>	<hr/>
Total liabilities	1,221,765	938,802
COMMITMENTS AND CONTINGENCIES (NOTES 6, 7, 8, 9, 10 and 11)		
NET ASSETS		
Invested in capital assets, net of related debt	463,303	452,705
Restricted	60,672	34,831
Unrestricted	157,588	172,559
	<hr/>	<hr/>
Total net assets	681,563	660,095
	<hr/>	<hr/>
TOTAL LIABILITIES AND NET ASSETS	\$ 1,903,328	\$ 1,598,897
	<hr/> <hr/>	<hr/> <hr/>

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (AMOUNTS IN THOUSANDS)

	2010	2009
OPERATING REVENUES		
Sales to power purchasers at cost	\$ 54,247	\$ 49,177
Retail energy sales		
Residential	31,252	33,211
Irrigation	16,295	16,422
Commercial and industrial	74,372	64,260
Governmental and others	981	971
Sales to other utilities	86,385	87,908
Fiber optic network sales	3,027	2,660
Other	1,338	1,520
	<u>267,897</u>	<u>256,129</u>
OPERATING EXPENSES		
Purchased power	59,000	57,341
Generation	22,418	27,086
Transmission	11,184	10,248
Distribution	10,998	11,741
Customer and information services	6,367	5,128
Fiber optic network operations	1,451	1,139
Administrative and general	28,017	27,756
License compliance and related agreements	24,515	15,673
Depreciation and amortization	41,911	37,381
Taxes	10,380	10,534
	<u>216,241</u>	<u>204,027</u>
NET OPERATING INCOME	<u>51,656</u>	<u>52,102</u>
OTHER REVENUES (EXPENSES)		
Interest and other income	3,541	5,137
Interest on revenue bonds and other, net of capitalized interest of \$3,083 and \$1,704	(46,629)	(40,297)
Federal rebates on revenue bonds	4,828	-
Amortization of debt expense, discount, and premium	(800)	(731)
	<u>(39,060)</u>	<u>(35,891)</u>
CONTRIBUTIONS IN AID OF CONSTRUCTION	<u>8,872</u>	<u>994</u>
CHANGE IN NET ASSETS	<u>21,468</u>	<u>17,205</u>
NET ASSETS		
Beginning of year	<u>660,095</u>	<u>642,890</u>
End of year	<u>\$ 681,563</u>	<u>\$ 660,095</u>

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (AMOUNTS IN THOUSANDS)

	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from retail energy sales	\$ 124,229	\$ 115,250
Cash received from sales to power purchasers at cost	51,592	54,786
Cash received from sales to other utilities	103,261	92,480
Other cash receipts	4,431	3,768
Cash paid for customer deposits	(27)	(314)
Cash paid for demand-side management	-	(702)
Cash paid for purchase of power	(86,267)	(50,692)
Cash paid to contractors, suppliers, and employees	(111,655)	(100,212)
Cash paid for other noncurrent assets	-	(2,336)
Cash paid for long-term contracts	-	(107)
Taxes paid	(10,534)	(10,876)
	<u>75,030</u>	<u>101,045</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Principal paid on revenue bonds	(33,105)	(31,565)
Interest paid on revenue bonds	(38,662)	(40,439)
Federal interest rebates	4,828	-
Bond proceeds	350,192	-
Payment on refunded debt	(35,568)	-
Bond issuance cost	(819)	-
Cash received from contributions in aid of construction	9,167	2,004
Licensing obligation payments	(3,064)	(2,541)
Acquisition and construction of plant assets	(147,090)	(124,339)
Proceeds on sale of plant assets	784	437
Miscellaneous nonoperating income	912	-
	<u>107,575</u>	<u>(196,443)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investment securities	(781,773)	(442,864)
Sale proceeds of investment securities	604,240	538,902
Investment income proceeds	2,887	7,458
Net repurchase agreement	(5,000)	(4,400)
Cash (paid for) received from conservation loans	(140)	10
	<u>(179,786)</u>	<u>99,106</u>
<b>NET INCREASE IN CASH</b>	<u>\$ 2,819</u>	<u>\$ 3,708</u>

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (AMOUNTS IN THOUSANDS)

	2010	2009
CASH AT END OF YEAR	\$ 20,069	\$ 17,250
CASH AT BEGINNING OF YEAR	17,250	13,542
NET INCREASE IN CASH	\$ 2,819	\$ 3,708
 <b>OPERATING ACTIVITIES</b>		
Net operating income	\$ 51,656	\$ 52,102
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	41,911	37,381
Accretion expense	2,320	-
Earned revenue from deposits	(107)	-
Provision for uncollectible accounts	(27)	(10)
Cash provided by (used in) changes in operating assets and liabilities:		
Change in Habitat funds held in trust	1,983	(12)
Customer accounts receivable	19,083	4,086
Materials and supplies	(1,744)	(550)
Other current assets	1,243	(925)
Deposits and other noncurrent assets	-	(2,336)
Unearned revenue	-	(107)
Demand-side management	-	(702)
Trade and wages payables	(15,100)	1,524
Payable to power purchasers, net	(26,434)	11,142
Accrued taxes	(208)	(319)
Customer deposits	(24)	(314)
Other current liabilities	-	(15)
Accrued other postemployment benefits	478	100
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 75,030	\$ 101,045

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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### 1. ORGANIZATION AND ACCOUNTING POLICIES

Public Utility District No. 2 of Grant County, Washington (the “District”) is comprised of two operating systems: the Electric System and the Priest Rapids Project. The Priest Rapids Project is 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 12. 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 generates, transmits and distributes electric energy and wholesale fiber optic network 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”). GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, requires that governmental utilities also follow accounting principles prescribed by the Financial Accounting Standards Board and predecessor organizations that are not in conflict with GASB pronouncements (“non-conflicting FASB standards”) and that were issued prior to November 30, 1989. It also permits governmental utilities to elect to follow all nonconflicting FASB standards issued after that date, which the District had elected not to do. 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 prescribes for CIAC proceeds to be recorded as a reduction to plant.

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. In 2010, the District implemented GASB Statement No. 51 which has had no material impact to the operations or financial statements.

**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.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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Revenues associated with power sales from the Priest Rapids Project under the Power Sales Contracts described in Note 6 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, amortization, charges paid by the Reserve and Contingency Fund, Renewal, Replacement and Contingency Fund, and Construction Funds 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 due from specific customers for which collection is in question. Such estimates are developed based on historical experience.

***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 may be financed through contributions from other sources, such as other governmental organizations. The District recognizes capital contributions from these sources as nonoperating revenue at the point at which it becomes nonrefundable. The District recognized \$8.9 million and \$1.0 million of contributions in aid of construction for the years ended December 31, 2010 and 2009, 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 4.44% and 5.05% for 2010 and 2009, respectively. Total capitalized interest was \$3.1 million and \$1.7 million during 2010 and 2009, 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 five to 100 years, with a composite rate of 2.42% and 2.28% for 2010 and 2009, 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 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 and the associated impairment loss is charged to operations.

***Energy Conservation and Demand-Side Management (“DSM”) Programs*** – The District’s expenditures for regional conservation programs and other DSM programs which benefit future periods by reducing energy supply requirements have historically been capitalized and amortized over the expected useful lives of the programs. During 2009, the District began

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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expensing DSM costs as Customer information and services expense. The balances accumulated prior to the change in accounting are being amortized over the original useful lives of the programs.

**Cash** – For purposes of the statements of cash flows, the District classifies only amounts held in demand deposit accounts as cash.

**Investments** – Investments with maturities of 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 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 investments with a maturity of less than one year. The purchase and maturity of investment instruments are reported on a gross basis in the Statements of Cash Flows, with the exception of repurchase agreements, which are reported on a net basis. Repurchase agreements are an overnight sweep account, which represents the primary difference between repurchase agreements and other investments.

Unrealized gains and losses on investments with maturities held for more than one year and realized gains and losses during the current year are included in interest and other income on the Statements of Revenues and Expenses and Change 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.

**Deposits** – Deposits consist of a prepaid security deposit for future transmission services. See Note 6.

**Due from (to) Power Purchasers** – This balance represents actual power costs in excess (deficit) of estimated power costs received by the Priest Rapids Project from power purchasers to be collected from, or due to, the power purchasers.

**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 is recognized during the current period.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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**Unearned Revenue** – Contributions in aid of construction that are refundable as of year-end are recorded as unearned revenue. Additionally, the District has two long term exchange contracts under which the District received collective prepayments of \$2 million that are being amortized into revenue on a straight line basis over the life of these agreements.

**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. 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.

With regard to liability risk, the District has elected self-insurance for general liability up to \$500,000 per incident. The District has historically had minimal liability claims activity, and estimates claims incurred but not reported are not significant as of December 31, 2010. There are no significant claims outstanding under this program at December 31, 2010.

**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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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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 paid 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 paid 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.

*Revision* – The District has revised its 2009 balance sheet to correct the presentation of certain noncurrent assets that were classified as current in the 2009 balance sheet. During 2010, management determined that reserve funds that are restricted or designated by the Commission for use in long-term debt repayment or for the construction of capital assets should be classified as noncurrent. The 2009 balance sheet has been revised accordingly. There is no change to the total reported asset balance or restricted asset balance for 2009, and the revision is not considered to have a material effect on the 2009 financial statements.

## 2. CASH AND INVESTMENTS

The District's cash deposits at December 31, 2010 and 2009 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.

Cash and investments are recorded in funds as required by the District's bond indentures. Restricted assets represent funds that are restricted by bond covenants or third party contractual agreements. Funds that are allocated by Commission resolution are considered to be board designated funds. Board designated funds are a component of unrestricted assets as their use may be redirected at any time by Commission approval.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

As of December 31, the District's unrestricted, board designated and restricted assets included on the Balance Sheets as cash and investments, including accrued interest, consisted of the following:

(amounts in thousands)	2010	2009
Unrestricted assets:		
Unrestricted funds:		
Revenue and Service System funds	\$ 34,176	\$ 49,096
Board designated funds:		
Future Generation Development fund	-	8,322
Electric System Reserve and Contingency fund	96,118	95,072
Self-Insurance Reserve fund	1,175	1,186
Total board designated funds	<u>97,293</u>	<u>104,580</u>
Total unrestricted funds	<u>131,469</u>	<u>153,676</u>
Restricted:		
Construction funds	257,969	84,965
Quincy Chute Renewal and Replacement fund	1,708	1,706
Wanapum Reserve and Contingency fund	-	6,022
Renewal, Replacement and Contingency fund	24,242	22,179
Debt Service Reserve fund	19,471	-
Bond Sinking funds	39,492	33,114
Bond Interest funds	30,914	19,878
Habitat funds	8,213	6,653
Total restricted funds	<u>382,009</u>	<u>174,517</u>
Total	<u>\$ 513,478</u>	<u>\$ 328,193</u>

**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.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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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, 2010 and 2009, as identified on the Balance Sheets 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 difference between the totals shown in the previous table and table below is accrued interest of \$2.7 million and \$1.1 million for 2010 and 2009, respectively.

During 2010 and 2009, the District realized \$1.9 million and \$4.0 million, respectively, of interest earnings and realized gains from investments. The unrealized gain (loss) on investments held at December 31, 2010 and 2009 was \$405,204 and (\$279,590), 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) Repurchase agreements collateralized by U.S. Government obligations, 3) Money market funds that have holdings of or are backed by U.S. Government obligations, 4) Municipal bonds and 5) Certificate of deposit.

(amounts in thousands)	2010	2009
U.S. treasuries	\$ 294,486	\$ 149,651
U.S. agencies	97,038	78,142
Repurchase agreements	44,500	39,500
Money market funds	51,917	38,431
Municipal bonds	2,778	-
Certificate of deposit	-	4,100
Total investments	<u>490,719</u>	<u>309,824</u>
Cash	<u>20,069</u>	<u>17,250</u>
Total cash and investments	<u>\$ 510,788</u>	<u>\$ 327,074</u>

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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 Fitch as of December 31, 2010. TSY refers to U.S. Treasury securities and N/R means not rated.

	Credit Rating	2010	2009
U.S. treasuries	TSY	60%	48%
FNMA Discount Notes	AAA	11%	8%
Money market funds	N/R	11%	12%
Repurchase agreements	N/R	9%	13%
Federal Home Loan Bank	n/a	Less than 5%	9%
Federal National Mortgage and Discount Note	n/a	Less than 5%	8%

### 3. UTILITY PLANT

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

(amounts in thousands)	Balance 2009	Additions	Retirements/ Transfers	Balance 2010
Distribution facilities	\$ 357,604	\$ 33,797	\$ (1,076)	\$ 390,325
Transmission facilities	151,661	3,282	-	154,943
Hydro facilities				
Power plant structures	43,745	3,030	-	46,775
Reservoirs, dams, waterways	372,926	220	-	373,146
Power plant equipment	318,895	20,359	(1,776)	337,478
General facilities				
Quincy Chute (Note 6)	17,683	-	-	17,683
Potholes East Canal (Note 6)	16,389	-	-	16,389
Other generation	30	-	-	30
General plant	221,755	29,631	(4)	251,382
FERC License	99,549	18,476	(7,379)	110,646
Other intangible assets	-	1,648	-	1,648
Total	1,600,237	110,443	(10,235)	1,700,445
Accumulated depreciation and amortization	(587,725)	(42,933)	2,810	(627,848)
Subtotal	1,012,512	67,510	(7,425)	1,072,597
Land and land rights	24,572	-	-	24,572
Construction in progress	171,083	153,249	(90,754)	233,578
Total net utility plant	\$ 1,208,167	\$ 220,759	\$ (98,179)	\$ 1,330,747

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

(amounts in thousands)	Balance 2008	Additions	Retirements/ Transfers	Balance 2009
Distribution facilities				
Electric System	\$ 349,044	\$ 9,085	\$ (525)	\$ 357,604
Telecommunications	84,413	50	(84,463)	-
Transmission facilities	142,658	9,003	-	151,661
Hydro facilities				
Power plant structures	42,991	754	-	43,745
Reservoirs, dams, waterways	368,727	4,199	-	372,926
Power plant equipment	292,909	25,991	(5)	318,895
General facilities				
Quincy Chute (Note 6)	17,643	40	-	17,683
Potholes East Canal (Note 6)	16,380	9	-	16,389
Other generation	30	-	-	30
General plant	133,538	3,813	84,404	221,755
FERC License	99,549	-	-	99,549
Total	<u>1,547,882</u>	<u>52,944</u>	<u>(589)</u>	<u>1,600,237</u>
Accumulated depreciation and amortization	<u>(550,520)</u>	<u>(36,472)</u>	<u>(733)</u>	<u>(587,725)</u>
Subtotal	997,362	16,472	(1,322)	1,012,512
Land and land rights	23,366	1,206	-	24,572
Construction in progress	94,886	126,972	(50,775)	171,083
Total net utility plant	<u>\$ 1,115,614</u>	<u>\$ 144,650</u>	<u>\$ (52,097)</u>	<u>\$ 1,208,167</u>

#### 4. LICENSING

On April 17, 2008, the FERC issued the District a 44-year License for the continued operation of the Priest Rapids Project effective April 1, 2008. Issuance of the 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.

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 included in Utility plant and the District is amortizing these costs over the term of the license.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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Certain of the FERC license, conditions require payments to other organizations using funds provided by the District. During 2010, a present value of \$18.5 million of additional required future payments were recorded by the District. The present value of the obligations for which the District will provide funding totaled \$54.0 million as of December 31, 2010 of which approximately \$5.6 million is expected to be paid within one year. The present value of the obligations was \$43.7 million as of December 31, 2009. These amounts are included in the FERC license balance and are reflected as liabilities in the balance sheets. 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), are further discussed in Note 7.

### 5. REVENUE BONDS

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

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

<b>(amounts in thousands)</b>	<b>2010</b>	<b>2009</b>
Electric System, interest rates of 3.875% to 5.375%, maturing through 2019	\$ 127,225	\$ 138,110
Priest Rapids Project, interest rates of 1.55% to 5.83%, maturing through 2043	<u>941,460</u>	<u>648,720</u>
Total revenue bonds outstanding	<u>\$ 1,068,685</u>	<u>\$ 786,830</u>

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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

(amounts in thousands)	Principal	Interest	Total
2011	35,830	49,106	84,936
2012	39,180	53,546	92,726
2013	41,025	51,754	92,779
2014	42,990	49,786	92,776
2015	41,700	47,730	89,430
2016 – 2020	209,360	206,222	415,582
2021 – 2025	122,720	162,397	285,117
2026 – 2030	224,705	117,144	341,849
2031 – 2035	150,485	68,050	218,535
2036 – 2040	133,940	28,429	162,369
2041 – 2043	26,750	2,860	29,610
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Total	<u>\$ 1,068,685</u>	<u>\$ 837,024</u>	<u>\$ 1,905,709</u>

The District is in compliance with all debt covenants related to the outstanding bonds, which includes debt service coverage, at December 31, 2010 and 2009.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

During the years ended December 31 the following changes occurred in the District's long-term debt:

(amounts in thousands)	Balance 2009	Additions	Reductions	Balance 2010	Due Within One Year
Revenue bonds payable	\$ 786,830	\$ 349,430	\$ (67,575)	\$ 1,068,685	\$ 35,830
Unamortized premiums and discounts, net	11,499	2,142	(1,625)	12,016	-
Unamortized refunding loss	(9,435)	(2,073)	3,225	(8,283)	-
<b>Total</b>	<b>\$ 788,894</b>	<b>\$ 349,499</b>	<b>\$ (65,975)</b>	<b>\$ 1,072,418</b>	<b>\$ 35,830</b>

(amounts in thousands)	Balance 2008	Additions	Reductions	Balance 2009	Due Within One Year
Revenue bonds payable	\$ 818,395	\$ -	\$ (31,565)	\$ 786,830	\$ 33,105
Unamortized premiums and discounts, net	13,143	-	(1,644)	11,499	-
Unamortized refunding loss	(11,008)	-	1,573	(9,435)	-
<b>Total</b>	<b>\$ 820,530</b>	<b>\$ -</b>	<b>\$ (31,636)</b>	<b>\$ 788,894</b>	<b>\$ 33,105</b>

### 6. POWER PURCHASER COMMITMENTS

During the year ending December 31, the following resources were used to meet the District's load:

	2010	2009
BPA	42%	44%
Priest Rapids Project	34%	31%
Market and other	24%	25%
	<u>100%</u>	<u>100%</u>

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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### **Priest Rapids Project**

The District met approximately 34% and 31% of its electric power loads for 2010 and 2009, respectively, through generation from the 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.

The new set of Priest Rapids Power Sales Contracts went into effect as of November 1, 2005 for Priest Rapids Dam and as of November 1, 2009 for Wanapum Dam. 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 2010 and 2009, the District incurred 60% and 55% of Priest Rapids Project power costs with power purchasers funding of 40% and 45%, respectively.

The District is committed to cover a minimum annual debt service requirement of approximately \$52 million over the next five years associated with the power costs at the Priest Rapids Project. Debt service requirements for the Priest Rapids Project currently extend to year 2043.

In connection with these Power Sales Contracts, the District received proceeds of \$32.1 million in 2009 to offset purchase power costs associated with the District buying power in the open market to cover its load not met by power from the Priest Rapids Project. These proceeds are recorded as an offset to purchased power expense in the Statements of Revenues and Expenses and Changes in Net Assets. In 2010, the District did not receive any proceeds related to unmet District load from the Priest Rapids Project because the provisions of the contract were not met. This is primarily because of the District’s increased share of Wanapum generation as of November 1, 2009.

Under the provisions in the new Power Sales Contracts, the District sells a portion of the Priest Rapids Project 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 Project power cost. Effective October 1, 2011, this portion of the Power Sales Contract will end. With the expiration of the current BPA contract, as discussed below, the District will retain the Priest Rapids Project generation it would otherwise have sold as a Displacement Product. The District will therefore be left in the same net resource and economic position.

Each purchaser is obligated to pay its share of the cost (excluding depreciation and amortization) of producing and delivering power, plus 115% of its share of the amounts required for debt service payments.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

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### BPA

The District is a statutory preference customer of BPA. The District purchases power and transmission 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, 2010 and 2009. Block deliveries are fixed at a flat rate within each month, but predetermined at different levels each month to more closely follow anticipated seasonal load requirements. The District has 252 MW of transmission associated with this block purchase, which also expires on September 30, 2011. The District signed a follow-up contract during 2008 to serve its Grand Coulee load of approximately 5 average megawatts that expires September 30, 2028. The District has transmission to deliver the power associated with this load through September 30, 2028. In 2009, the District entered into a five-year agreement for 150 MW of Long-Term Firm (LTF) power with a security deposit of \$2.3 million for transmission services commencing January 1, 2011. Rollover rights are included as part of this agreement. In 2010, the District exercised rollover rights associated with 12 MW of transmission for the delivery of power from the Nine Canyon Wind Project in order to extend the term of the reservation to October 1, 2030.

District management estimates the District's minimum commitments to BPA for the next five years are as follows:

#### Estimated BPA Contractual Payments

(amounts in thousands)

2011	\$	41,648
2012		10,557
2013		10,763
2014		7,253
2015		7,465

### 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 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.

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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 and its 25% share of Phase I debt service.

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:

### Nine Canyon Wind Power Purchase Agreement

(amounts in thousands)

2011	\$	1,412
2012		1,410
2013		1,412
2014		1,412
2015		1,412
2016 - 2020		7,058
2021 - 2024		5,647
		<hr/>
Total	\$	19,763
		<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 financial equivalent of 20 aMW for 2007-2009, 15 aMW for 2010-2015 and 10 aMW throughout the term of the agreement less the associated power costs is the benefit paid to the Yakama Nation. 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 the 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 \$2.4 million and \$3.4 million during 2010 and 2009, respectively. These costs were charged to License compliance and related agreements 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:

### Estimated Yakama Nation Agreement Payments

(amounts in thousands)

2011	\$	1,796
2012		1,796
2013		1,796
2014		1,796
2015		1,796

### Other Sources

Pursuant to agreements with three irrigation districts, the District constructed, operates and maintains both the Quincy Chute and Potholes East Canal hydroelectric generation facilities in return for the right to all output from the projects. The construction costs of Quincy Chute and Potholes East Canal are included in Net utility plant and 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.

## 7. NONPOWER COMMITMENTS

### Capital Projects

The District has contractual commitments relating to several Electric System capital improvement projects including fiber design/build, financial system replacement, electrical system upgrades, multiple transformer purchases, and substation construction projects over the next few years totaling approximately \$3.9 million as of December 31, 2010.

The District has undertaken certain improvement programs at the Priest Rapids Project funded by second series revenue bonds. The improvement programs include restoration or replacement of generators and turbines, turbine runner blade replacements, and deleading and painting of six turbines at Wanapum. The District intends to, or has committed by contract to, fulfill these programs, which are projected to be substantially complete by early 2018. The contractually committed amount on future Priest Rapids Project work to be performed on these major capital programs is approximately \$166.5 million as of December 31, 2010.

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## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2010 AND 2009

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### Other Commitments

In 2006, the District entered into a Salmon and Steelhead Settlement 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. This agreement is intended to constitute a comprehensive and long-term adaptive management program for the protection, mitigation, and enhancement of anadromous fish (both listed and not listed species under the Endangered Species Act; ESA) which pass or may be affected by the Priest Rapids Project.

In order to implement the Salmon and Steelhead Settlement Agreement, the District is obligated to establish a habitat conservation account and a no-net-impact fund (referred herein as "Habitat funds") into which the District deposits payments for further distribution in accordance with the requirements of the Salmon and Steelhead Agreement. The purpose of the Habitat funds are two-fold; (1) to establish and shepherd a habitat restoration program that promotes the rebuilding of self-sustaining and harvestable populations of anadromous species and to mitigate for a portion (2%) of unavoidable losses resulting from Project operations and (2) to provide near-term compensation for annual survivals that are less than the survival objectives in the performance standards for the Project for spring Chinook, steelhead, summer Chinook and sockeye. The parties that oversee the distribution of these funds include the signatories to the Priest Rapids Salmon and Steelhead Settlement Agreement (U.S. Fish and Wildlife Service, NOAA Fisheries, Washington Department of Fish and Wildlife, Confederated Colville Tribes, and the Yakama Nation).

In addition to the Habitat funds discussed above, the District is obligated to establish a habitat account into which the District deposits payments for further distribution in accordance with the requirements of the NOAA Fisheries 2008 Biological Opinion ("2008 BiOp") for the Priest Rapids Project. Funds from this account are geared towards habitat actions that directly benefit Upper Columbia River ("UCR") spring-run Chinook salmon and UCR steelhead. The parties identified above and the Confederated Tribes of the Umatilla Reservation have been identified in the 2008 BiOp as responsible for overseeing distribution of these funds.

The Habitat funds are restricted and 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 are made in accordance with the Salmon and Steelhead Settlement Agreement and the 2008 NOAA Fisheries BiOp for the protection and restoration of habitats along the mainstem and tributaries within the UCR watershed including the Okanogan, Methow, Entiat, and Wenatchee river watersheds. The District anticipates funding these accounts up to and through the term of the Priest Rapids Project license.

In October 2006, the District filed a request for a 401 Water Quality Certification ("401 WQC") from the Washington State Department of Ecology ("Ecology"), pursuant to the

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

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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 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 \$1.5 million) 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 toward 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.

In a FERC Order (issued on August 31, 2010) approving the Wildlife Habitat Management Plan (Article 409), the District is required to assist Washington Department of Fish and Wildlife in fire suppression by contributing \$40,000 annually to an account. Funds from the account are to be designated for: 1) revegetating burned areas; 2) revegetating areas known to burn frequently with species carrying lesser fuel loads; 3) creating fire breaks in appropriate locations; and 4) paying for firefighting activities. The District will make contributions to the fund annually in the amount of \$40,000 per year.

The District’s total contributions to these Habitat funds for the years ended December 31, 2010 and December 31, 2009 equaled \$3.1 million and \$2.7 million, respectively. These contributions reduced the Licensing obligations liability as discussed in Note 4.

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The following table shows the District's estimate of the remaining fixed contributions to the Habitat funds as of December 31, 2010 representing required contributions through the New License term.

### Estimated Fixed Habitat Funding Commitments

(amounts in thousands)

2011	\$	5,630
2012		3,654
2013		3,876
2014		3,464
2015		3,524
2016 and thereafter		99,891
Total	\$	<u>120,039</u>

***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 interest due semi-annually at rates ranging from 6.44% 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 14.17% of the bonds. Additionally, NoaNet has obtained financing for other capital costs through lines of credit, which have a total outstanding balance of approximately \$2.4 million at December 31, 2010. 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. The obligation paid in 2010 and 2009 by the District was \$129,552 and \$220,855, respectively.

## 8. 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

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Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at [www.drs.wa.gov](http://www.drs.wa.gov). 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*.

### **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 members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

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PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2 percent of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60 percent of AFC. The monthly benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. A cost-of living allowance (COLA) is granted at age 66 based upon years of service times the COLA amount, which is increased 3 percent annually. Plan 1 members may also elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is \$350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of living allowance is granted at age 66 based upon years of service times the COLA amount (based on the consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service while actively serving in the military, if such credit makes them eligible to retire. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

With a benefit that is reduced by 3 percent for each year before age 65.

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With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member's accumulated contributions. Effective July 22, 2007, said refund (adjusted as needed for specified legal reductions) is increased from 100 percent to 200 percent of the accumulated contributions if the member's death occurs in the uniformed service to the United States while participating in Operation Enduring Freedom or Persian Gulf, Operation Iraqi Freedom.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. The defined benefit portion provides a monthly benefit that is 1 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, PERS 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 for normal retirement at age 65, or they may retire early with the following conditions and benefits:

If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.

If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit and Plan 3 provides the same cost-of-living allowance as Plan 2.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities.

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The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

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

Retirees and Beneficiaries Receiving Benefits	74,857
Terminated Plan Members Entitled to but not yet Receiving Benefits	28,074
Active Plan Members Vested	105,339
Active Plan Members Non-vested	53,896
	<hr/>
Total	262,166
	<hr/> <hr/>

### Funding Policy

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Director of the Department of Retirement Systems sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 percent to 15 percent; two of the options are graduated rates dependent on the employee's age. As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

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The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2010, are as follows:

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

- \* The employer rates include the employer administrative expense fee currently set at 0.16%.
- \*\* The employer rate for state elected officials is 7.89% for Plan 1 and 5.31% 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 3.90% 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:

(amounts in thousands)	PERS Plan 1	PERS Plan 2	PERS Plan 3
2010	\$ 147	\$ 2,378	\$ 628
2009	218	2,921	778
2008	253	2,932	764

***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 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.

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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). Eligible employees can elect to either contribute to the Section 457 deferred compensation plan (variable) or the 401(a) defined contribution plan (fixed). The District's matching employer contributions (50 cents per one dollar of employee contributions) are deposited into the 401(a) plan. The District's match is capped at 2% of straight-time employee wages for the pay period. The District made matching contributions of \$870,721 in 2010, and \$808,741 in 2009.

### **9. 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 59½ 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 non-unit 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. At the age of 59½, 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, 2010 and 2009, the District paid approximately \$206,000 and \$198,000 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 net OPEB obligation represents the cumulative difference in ARC and payments made through the plan since actuarial accounting began in 2007. The following table shows the components of the District's annual OPEB cost for the years ending December 31, 2010 and 2009:

(amounts in thousands)	2010	2009
Normal cost with interest	\$ 157	\$ 150
Amortization amount with interest	337	336
	<u>          </u>	<u>          </u>
Annual required contribution	\$ 494	\$ 486
	<u>          </u>	<u>          </u>
Annual OPEB cost	\$ 494	\$ 486
Less: benefit payments	(206)	(198)
	<u>          </u>	<u>          </u>
Increase in net OPEB obligation	288	288
Temporary actuarial difference	190	(190)
Net OPEB obligation at beginning of year	441	343
	<u>          </u>	<u>          </u>
Net OPEB obligation at end of year	\$ 919	\$ 441
	<u>          </u>	<u>          </u>

### Funded Status and Funding Progress

As of December 31, 2010 and 2009, the District's Actuarial Accrued Liability ("AAL") was \$5.18 million and \$5.16 million, 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 2010 and 2009, the covered payroll (annual payroll of active employees covered by the plan) was \$52.8 million and \$51.8 million, respectively, and the ratio of the unfunded obligation to the covered payroll was 9.8% and 10.0%, 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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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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, 2010. 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 10.0% in 2010 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, 2010. This rate is used because the Plan is "unfunded" and the District's assets would be used to pay benefits.

## **10. 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.

## **11. SUPPLEMENTAL DISCLOSURE OF TELECOMMUNICATION ACTIVITIES**

As described in Note 7, 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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

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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 wholesale fiber optic network activities as of and for the year ended December 31 are as follows:

(amounts in thousands)	2010	2009
Operating revenues		
Wholesale fiber services	\$ 2,890	\$ 2,579
Dark fiber revenue	137	80
	<u>3,027</u>	<u>2,659</u>
Wholesale fiber services	<u>\$ 3,027</u>	<u>\$ 2,659</u>
Operating expenses		
Administrative and general	\$ 543	\$ 748
Repairs and maintenance	908	809
Depreciation	6,439	5,284
	<u>7,890</u>	<u>6,841</u>
Total operating expenses	<u>\$ 7,890</u>	<u>\$ 6,841</u>
Nonoperating revenues		
Contribution in aid of construction	<u>\$ 165</u>	<u>\$ 9</u>
Utility plant		
Additions to utility plant	\$ 10,498	\$ 14,986
Utility plant, net of accumulated depreciation	\$ 74,443	\$ 70,385

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **NOTES TO THE FINANCIAL STATEMENTS**

**DECEMBER 31, 2010 AND 2009**

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### **12. SEGMENTS**

The District has outstanding revenue bonds used to finance the Electric System, as well as the Priest Rapids Project hydroelectric production facilities. As described in Note 5, 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 system has an external requirement to be accounted for separately. The following condensed financial schedules of the operating segments of the District include the Electric System and the Priest Rapids Project. The District's Service System, as well as eliminating internal transactions, are presented as "Other" in order to reconcile to the combined District's results. "Other" is not considered a segment of the District.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 12 - SEGMENTS DECEMBER 31, 2010

### CONDENSED BALANCE SHEET

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
<b>ASSETS</b>				
Total current assets	\$ 145,909	\$ 109,802	\$ (25,153)	\$ 230,558
Net utility plant	474,563	856,184	-	1,330,747
Noncurrent	44,283	297,740	-	342,023
<b>TOTAL ASSETS</b>	<b>\$ 664,755</b>	<b>\$ 1,263,726</b>	<b>\$ (25,153)</b>	<b>\$ 1,903,328</b>
<b>LIABILITIES</b>				
Current	\$ 42,548	\$ 116,846	\$ (25,153)	\$ 134,241
Noncurrent	119,986	967,538	-	1,087,524
<b>TOTAL LIABILITIES</b>	<b>162,534</b>	<b>1,084,384</b>	<b>(25,153)</b>	<b>1,221,765</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	345,669	117,634	-	463,303
Restricted	13,138	47,534	-	60,672
Unrestricted	143,414	14,174	-	157,588
<b>TOTAL NET ASSETS</b>	<b>502,221</b>	<b>179,342</b>	<b>-</b>	<b>681,563</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 664,755</b>	<b>\$ 1,263,726</b>	<b>\$ (25,153)</b>	<b>\$ 1,903,328</b>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 12 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2010

### SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
OPERATING REVENUES	\$ 213,650	\$ 133,945	\$ (79,698)	\$ 267,897
OPERATING EXPENSES				
Depreciation and amortization	26,927	14,984	-	41,911
Other operating expenses	188,453	65,575	(79,698)	174,330
Total operating expenses	215,380	80,559	(79,698)	216,241
NET OPERATING (LOSS) INCOME	(1,730)	53,386	-	51,656
OTHER REVENUES (EXPENSES)				
Interest and other income	576	2,965	-	3,541
Interest on revenue bonds and other, net of capitalized interest of \$3,083	(6,765)	(39,864)	-	(46,629)
Federal rebates on revenue bonds	-	4,828	-	4,828
Amortization of debt expense, discount, and premium	450	(1,250)	-	(800)
Total other revenues (expenses)	(5,739)	(33,321)	-	(39,060)
CONTRIBUTIONS IN AID OF CONSTRUCTION	8,872	-	-	8,872
CHANGE IN NET ASSETS	1,403	20,065	-	21,468
NET ASSETS				
Beginning of year	500,818	159,277	-	660,095
End of year	\$ 502,221	\$ 179,342	\$ -	\$ 681,563

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 12 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2010

### CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by operating activities	\$ 1,035	\$ 43,655	\$ 30,340	\$ 75,030
Net cash (used in) provided by capital and related financing activities	(44,954)	144,881	7,648	107,575
Net cash provided by (used in) investing activities	36,620	(190,048)	(26,358)	(179,786)
NET (DECREASE) INCREASE IN CASH	<u>\$ (7,299)</u>	<u>\$ (1,512)</u>	<u>\$ 11,630</u>	<u>\$ 2,819</u>
CASH AT END OF YEAR	\$ 14,010	\$ 10,597	\$ (4,538)	\$ 20,069
CASH AT BEGINNING OF YEAR	21,309	12,109	(16,168)	17,250
NET (DECREASE) INCREASE IN CASH	<u>\$ (7,299)</u>	<u>\$ (1,512)</u>	<u>\$ 11,630</u>	<u>\$ 2,819</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 12 - SEGMENTS DECEMBER 31, 2009

### CONDENSED BALANCE SHEET

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
<b>ASSETS</b>				
Total current assets	\$ 221,785	\$ 146,829	\$ (35,908)	\$ 332,706
Net utility plant	468,336	739,831	-	1,208,167
Noncurrent	23,090	34,934	-	58,024
<b>TOTAL ASSETS</b>	<b>\$ 713,211</b>	<b>\$ 921,594</b>	<b>\$ (35,908)</b>	<b>\$ 1,598,897</b>
<b>LIABILITIES</b>				
Current	\$ 80,482	\$ 96,026	\$ (35,908)	\$ 140,600
Noncurrent	131,911	666,291	-	798,202
<b>TOTAL LIABILITIES</b>	<b>212,393</b>	<b>762,317</b>	<b>(35,908)</b>	<b>938,802</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	328,106	124,599	-	452,705
Restricted	12,591	22,240	-	34,831
Unrestricted	160,121	12,438	-	172,559
<b>TOTAL NET ASSETS</b>	<b>500,818</b>	<b>159,277</b>	<b>-</b>	<b>660,095</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 713,211</b>	<b>\$ 921,594</b>	<b>\$ (35,908)</b>	<b>\$ 1,598,897</b>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 12 - SEGMENTS DECEMBER 31, 2009

### SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
OPERATING REVENUES	\$ 206,952	\$ 110,376	\$ (61,199)	\$ 256,129
OPERATING EXPENSES				
Depreciation and amortization	23,897	13,484	-	37,381
Other operating expenses	165,272	62,573	(61,199)	166,646
Total operating expenses	189,169	76,057	(61,199)	204,027
NET OPERATING INCOME	17,783	34,319	-	52,102
OTHER REVENUES (EXPENSES)				
Interest and other income	1,644	3,493	-	5,137
Interest on revenue bonds and other, net of capitalized interest of \$1,704	(7,322)	(32,975)	-	(40,297)
Amortization of debt expense, discount, and premium	485	(1,216)	-	(731)
Total other revenues (expenses)	(5,193)	(30,698)	-	(35,891)
CONTRIBUTIONS IN AID OF CONSTRUCTION	994	-	-	994
CHANGE IN NET ASSETS	13,584	3,621	-	17,205
NET ASSETS				
Beginning of year	487,234	155,656	-	642,890
End of year	\$ 500,818	\$ 159,277	\$ -	\$ 660,095

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 12 - SEGMENTS DECEMBER 31, 2009

### CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by (used in) operating activities	\$ 53,552	\$ 83,654	\$ (36,161)	\$ 101,045
Net cash (used in) provided by capital and related financing activities	(77,134)	(122,127)	2,818	(196,443)
Net cash provided by investing activities	29,030	43,240	26,836	99,106
NET INCREASE (DECREASE) IN CASH	<u>\$ 5,448</u>	<u>\$ 4,767</u>	<u>\$ (6,507)</u>	<u>\$ 3,708</u>
CASH AT END OF YEAR	\$ 21,309	\$ 12,109	\$ (16,168)	\$ 17,250
CASH AT BEGINNING OF YEAR	15,861	7,342	(9,661)	13,542
NET INCREASE (DECREASE) IN CASH	<u>\$ 5,448</u>	<u>\$ 4,767</u>	<u>\$ (6,507)</u>	<u>\$ 3,708</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

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## APPENDIX C

### 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  
Electric System Revenue and Refunding Bonds, Series 2011-I – \$156,070,000

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 Electric System Revenue and Refunding Bonds, Series 2011-I, in the aggregate principal amount of \$156,070,000 (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. 8572 of the District’s Board of Commissioners (the “Bond Resolution”) to finance improvements to the Electric System, to refund certain outstanding Electric System revenue bonds, to fund a portion of the Reserve Fund and to pay costs of issuance of the Bonds.

Reference is made to the Bonds and the Bond Resolution for the definitions of capitalized terms used and not otherwise defined herein.

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.

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 Bonds in order to maintain the exclusion of the interest on the Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of Bond proceeds and the facilities financed or refinanced with Bond proceeds, limitations on investing gross proceeds of the Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the 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 Bonds could become taxable retroactive to the date of issuance of the 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 proceeds of the sale of the Bonds to the extent held in the funds established by the Bond Resolution, (ii) the Gross Revenue, subject to prior application to pay Operating Expenses (as such terms are defined in the Bond Resolution),

and (iii) the money and investments, if any, credited to the Revenue Fund, the Bond Fund, the Construction Fund and the Reserve and Contingency Fund, subject only to the terms and conditions set forth 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 Bonds with applicable requirements of the Code, the interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals; however, while interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by corporations is to be taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by certain S corporations may be subject to tax, and interest on the 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 Bonds.

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,

## APPENDIX D

### 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 rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

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.**

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