

*In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the District, interest on the 2010B Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. Bond Counsel expresses no opinion regarding any other tax consequences relating to the ownership or disposition of, or the accrual or receipt of interest on, the 2010B Bonds. See “TAX MATTERS” herein.*



**\$14,050,000**  
**PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON**  
**GENERATION SYSTEM REVENUE BONDS, SERIES 2010B**  
**TAXABLE BUILD AMERICA BONDS (DIRECT PAY)**

**Dated: Date of Delivery****Due: As shown on the inside front cover.**

The Generation System Revenue Bonds, Series 2010B Taxable Build America Bonds (Direct Pay) (the “2010B Bonds”) of Public Utility District No. 1 of Snohomish County, Washington (the “District”) will be issued as fixed rate bonds maturing in the amounts and bearing interest at the rates set forth on the inside front cover of this Official Statement, payable June 1 and December 1 of each year, commencing December 1, 2010.

When issued, the 2010B Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company (“DTC”), New York, New York. DTC will act as securities depository for the 2010B Bonds. Individual purchases will be made in book-entry form in authorized denominations, and purchasers of the 2010B Bonds will not receive certificates representing their interests in the 2010B Bonds. Payments of principal of and interest on the 2010B Bonds are to be paid to purchasers by DTC through DTC Participants, as described in APPENDIX E-“BOOK-ENTRY SYSTEM.” The District has appointed U.S. Bank National Association to act as Stand-by Trustee upon the occurrence of an Event of Default. See “SECURITY FOR THE 2010B BONDS—Stand-by Trustee.” The District intends to appoint the Stand-by Trustee as Bond Registrar and Paying Agent for the 2010B Bonds.

The District will designate the 2010B Bonds as “Build America Bonds” under the provisions of the American Recovery and Reinvestment Act of 2009 (the “ARRA”). The interest on the 2010B Bonds is not excluded from gross income for purposes of federal income tax. See “TAX MATTERS.”

The 2010B Bonds are subject optional and mandatory redemption prior to maturity, as described herein.

The 2010B Bonds are being issued (i) to finance additions, betterments and improvements to and renewals, replacements and extensions to the Generation System, including costs of acquiring and completing construction of the Youngs Creek Project (as defined herein) and (ii) to pay costs of issuing the 2010B Bonds. See “PURPOSE AND APPLICATION OF 2010B BOND PROCEEDS.”

The 2010B Bonds are special limited obligations of the District payable from and secured solely by the Generation System Revenues, subject to the prior payment of Operating Expenses. The 2010B Bonds are secured by a pledge of and lien and charge on Generation System Revenues equal to the pledge of and lien and charge on Generation System Revenues that secure (i) the Generation System Bonds heretofore and hereafter issued pursuant to the Generation System Bond Resolution (as defined herein) and (ii) the District Payments made in connection with Derivative Products (consisting of interest rate swap agreements and other similar agreements). Generation System Revenues consist almost exclusively of revenues derived from the following payments made by the District’s Electric System, all as more fully described under “SECURITY FOR THE 2010B BONDS.” The District has covenanted in the Generation System Bond Resolution to cause the Generation System to sell and the Electric System to purchase in each month all of the electric power and energy of the Generation System available in such month for use in the Electric System. Payment for such electric power and energy must be made at the times and in the amounts sufficient for the timely payment of all costs of the Generation System (as further defined herein, the “Generation System Power Costs”), including debt service on the Generation System Bonds, as the same shall become due. The District is obligated to pay Generation System Power Costs (i) as an operation and maintenance expense of the Electric System for any month in which any power and energy from the Generation System was made available to the Electric System (regardless of whether or not the Electric System actually scheduled or received any such power or energy) and (ii) at all other times on a parity with the Senior Electric System Bonds outstanding from time to time.

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**MATURITY SCHEDULE — See Inside Front Cover**

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**The 2010B Bonds shall not in any manner or to any extent constitute general obligations of the District or of the State of Washington, or of any political subdivision of the State of Washington, or a charge upon any general fund or upon any money or other property of the District or of the State of Washington, or of any political subdivision of the State of Washington, not specifically pledged thereto by the Generation System Bond Resolution, nor shall the full faith and credit of the District or of the State of Washington, or of any political subdivision of the State of Washington, be pledged to the payment of principal, premium, if any, or interest on the 2010B Bonds.**

This cover page is not intended to be a summary of all of the terms of, or security for, the 2010B Bonds. Investors are advised to read the entire Official Statement to obtain information essential to making an informed investment decision.

*The 2010B Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the District, and certain other conditions. Certain legal matters will be passed upon for the District by its General Counsel, Anne Spangler. Certain legal matters will be passed upon for the Underwriters by their counsel, Foster Pepper PLLC, Seattle, Washington. It is expected that delivery of the 2010B Bonds will be made through DTC in New York, New York, by Fast Automated Securities Transfer (FAST), on or about May 25, 2010.*

**Citi****J.P. Morgan**

Dated: May 11, 2010

**\$14,050,000**  
**PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON**  
**GENERATION SYSTEM REVENUE BONDS, SERIES 2010B**  
**TAXABLE *BUILD AMERICA BONDS* (DIRECT PAY)**

**\$3,015,000 5.254% 2010B Term Bonds due December 1, 2025, Priced to yield 5.254% CUSIP No. 833116BT2\*\***

**\$11,035,000 5.680% 2010B Term Bonds due December 1, 2040, Priced to yield 5.688% CUSIP No. 833116BU9\*\***

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\*\*CUSIP numbers are provided by CUSIP Global Services, managed on behalf of the American Bankers Association by Standard & Poor's. CUSIP® is a registered trademark of the American Bankers Association. The CUSIP numbers are not intended to create a database and do not serve in any way as a substitute for CUSIP service. CUSIP numbers are provided for convenience and reference only and are subject to change. Neither the District nor the Underwriter takes responsibility for the accuracy of the CUSIP numbers.

**No dealer, broker, salesperson or other person has been authorized by the District or the Underwriters to give any information or to make any representations other than those contained in this Official Statement in connection with the offering of the 2010B Bonds and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the 2010B Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale.**

**The information set forth herein has been provided by the District or obtained by the District from other sources which 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.**

**In connection with the offering of the 2010B Bonds, the Underwriters may overallocate or effect transactions which stabilize or maintain the market price of the 2010B Bonds at levels above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.**

**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 respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.**

**The 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 their expectations or events, conditions or circumstances on which such statements are based occur.**

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

**2320 California Street  
Everett, Washington 98201  
(425) 783-1000**

**COMMISSION**

**PRESIDENT  
Tanya “Toni” Olson**

**VICE PRESIDENT  
David Aldrich**

**SECRETARY  
Kathleen Vaughn**

**ADMINISTRATIVE MANAGEMENT**

Steve Klein, General Manager

Anne Spangler, General Counsel

Dana Toulson, Assistant General Manager—Power, Rates and Transmission Management

Glenn McPherson, Assistant General Manager—Finance and Treasurer

Christopher Heimgartner, Assistant General Manager—Distribution and Engineering Services

Martha Hobson, Assistant General Manager—Information Services

Kim Moore, Assistant General Manager—Water Resources

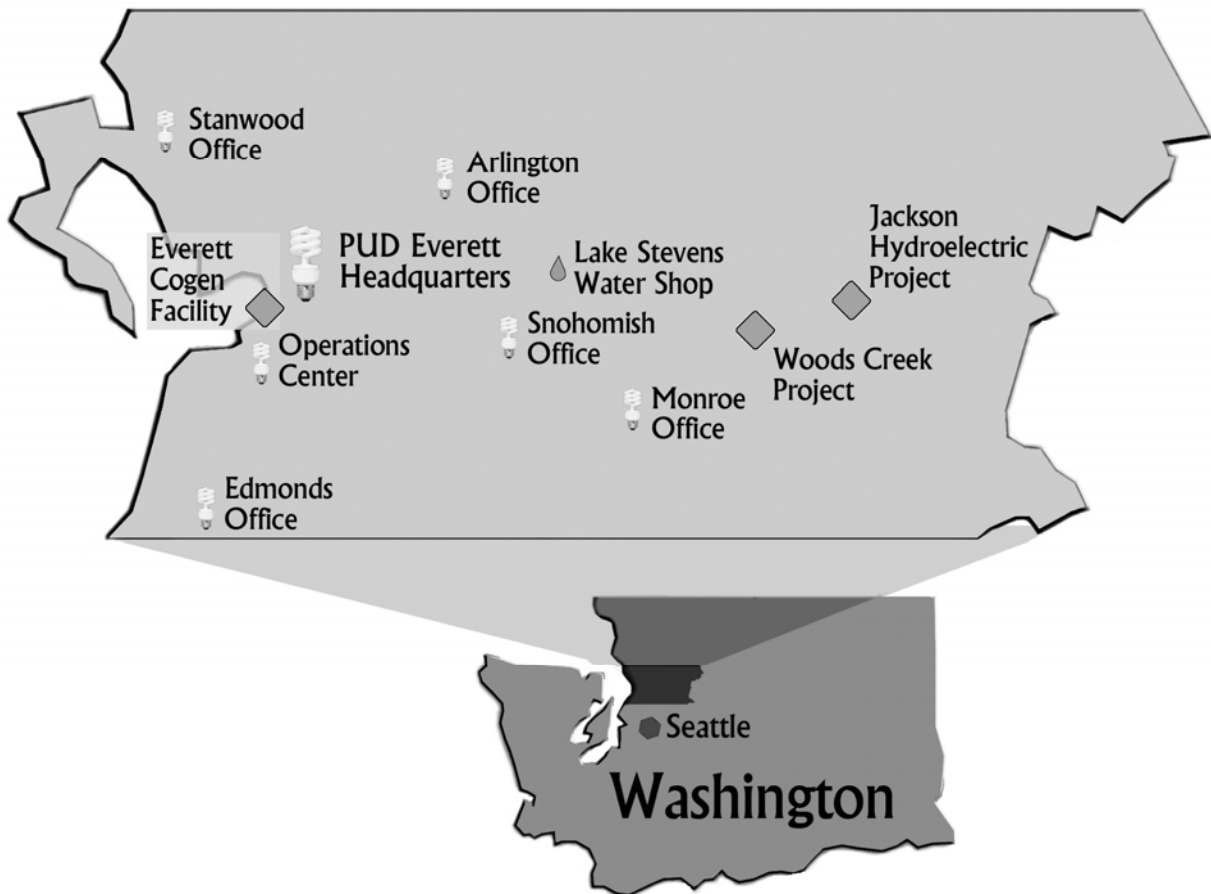
Craig Smith, Assistant General Manager—Customer Services

**CONSULTANTS**

Bond Counsel..... Orrick, Herrington & Sutcliffe LLP  
Financial Advisor..... Montague DeRose and Associates, LLC

**Public Utility District No. 1  
of Snohomish County, Washington  
Service Area**

## Snohomish County and Camano Island



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## **OFFICIAL STATEMENT**

**\$14,050,000**

**PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON  
GENERATION SYSTEM REVENUE BONDS, SERIES 2010B  
TAXABLE *BUILD AMERICA BONDS* (DIRECT PAY)**

### **INTRODUCTION**

The purpose of this Official Statement, which includes the cover page, inside cover page and appendices, is to provide information concerning Public Utility District No. 1 of Snohomish County, Washington (the “District”), its Generation System, its Electric System and its proposed \$14,050,000 Generation System Revenue Bonds, Series 2010B Taxable Build America Bonds (Direct Pay) (the “2010B Bonds”).

The 2010B Bonds are to be issued pursuant to Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington, Chapter 167 of the Laws of Washington, 1983, as amended and supplemented, constituting Chapter 39.46 of the Revised Code of Washington (collectively, the “Enabling Act”) and Resolution No. 2994, adopted by the Commission of the District (the “Commission”) on September 22, 1986, as amended, as revised and restated by Resolution No. 3902 adopted by the Commission on January 28, 1993 (the “Master Generation System Resolution”), as supplemented and amended, including as supplemented by Resolution No. 5496, adopted by the Commission on April 20, 2010 (the “Eighth Supplemental Resolution”). The Master Generation System Resolution, as amended and supplemented, including as supplemented by the Seventh Supplemental Resolution, is hereinafter collectively referred to as the “Generation System Bond Resolution.”

The capitalized terms used in this Official Statement and not otherwise defined herein have the same meanings given in the Generation System Bond Resolution or the Senior Electric System Bond Resolution, as applicable. Definitions of certain terms are set forth in APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Definitions” and APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION – Definitions.”

Under Washington law, the District has the authority to establish separate enterprise funds with respect to its various municipal utility business operations, each of which enterprise funds is accounted for separately. In addition, these utility business operations (referred to as “systems”) can be separately financed through the issuance of debt by the District payable from revenues of that particular system. The District currently has three systems that are separately accounted for and through which it issues debt: the Generation System, the Electric System, and the Water System. See “THE DISTRICT.”

The Generation System currently includes all of the District’s generating resources, including the Jackson Project, the Everett Cogeneration Project, the Woods Creek Project and the Youngs Creek Project (each as defined herein). The Electric System is the District’s retail electric utility. All power produced by the Generation System is purchased by the Electric System at cost for sale to the District’s retail customers. See “THE GENERATION SYSTEM.”

The Electric System currently includes the electric utility 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 or conservation of power and energy 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 properties, rights and assets and declared by the Commission to be included in the Electric System, but does not include the Generation System or any other properties, rights or assets, real or personal, tangible or intangible that hereafter may be purchased, constructed or otherwise acquired by the District as a system that is declared by the Commission 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 system or otherwise may be pledged to the payment of the bonds of another such separate system of the District.

The 2010B Bonds are special limited obligations of the District payable from and secured solely by Generation System Revenues subject to the prior payment of Operating Expenses. The 2010B Bonds are secured by a pledge of and lien and charge on Generation System Revenues equal to the pledge of and lien and charge on Generation System Revenues that secure (i) the Generation System Bonds heretofore and hereafter issued pursuant to the Generation System Bond Resolution and (ii) the District Payments made in connection with Derivative Products. Generation System Revenues consist almost exclusively of revenues derived from the following payments made by the District's Electric System, all as more fully described under "SECURITY FOR THE 2010B BONDS." The District has covenanted in the Generation System Bond Resolution to cause the Generation System to sell and the Electric System to purchase in each month all of the electric power and energy of the Generation System available in such month for use in the Electric System. Payment for such electric power and energy must be made at the times and in the amounts sufficient for the timely payment of all costs of the Generation System (as further defined herein, the "Generation System Power Costs"), including debt service on the Generation System Bonds, as the same shall become due. The District is obligated to pay Generation System Power Costs (i) as an operation and maintenance expense of the Electric System for any month in which any power and energy from the Generation System was made available to the Electric System (regardless of whether or not the Electric System actually scheduled or received any such power or energy), and (ii) at all other times on a parity with the Senior Electric System Bonds outstanding from time to time.

The District's Generation System currently has outstanding its Adjustable Tender Generation System Revenue Refunding Bonds, Series 1995 (the "1995 Generation System Bonds"), its Adjustable Tender Generation System Revenue Refunding Bonds, Series 2001A (the "2001A Generation System Bonds"), its Generation System Revenue Refunding Bonds, Series 2001B (the "2001B Generation System Bonds" and together with the 2001A Generation System Bonds, the "2001 Generation System Bonds"), its Adjustable Tender Generation System Revenue Refunding Bonds, Series 2002A (the "2002A Generation System Bonds") and its Generation System Revenue Refunding Bonds, Series 2002B (the "2002B Generation System Bonds" and together with the 2002A Generation System Bonds, the "2002 Generation System Bonds"), which bonds, together with the 2010A Bonds mentioned below and the 2010B Bonds and any future bonds issued pursuant to the Generation System Bond Resolution are collectively referred to herein as the "Generation System Bonds."

In November 2008, the District issued its Electric System Second Series Notes, Series 2008A (the "2008A Notes"), pursuant to Resolution No. 5384, adopted by the Commission on October 10, 2008 (as amended and supplemented from time to time, the "Electric System Second Series Resolution") to reimburse the District for the purchase and placement in a trust established by the District for the benefit of the District, as the sole beneficiary of such trust (the "1995 Trust"), of the 1995 Generation System Bonds, and in May 2009, the District issued its Electric System Second Series Notes, Series 2009A (the "2009A Notes"), under the Electric System Second Series Resolution to fund a trust established by the District for the benefit of the District, as the sole beneficiary of such trust (the "2001/2002 Trust"), for the purposes of purchasing and placing in trust the 2001A Generation System Bonds and the 2002A Generation System Bonds. For financial reporting purposes, the 1995 Generation System Bonds held in the 1995 Trust and the 2001A Generation System Bonds and the 2002A Generation System Bonds held in



the 2001/2002 Trust are considered investments of the Electric System. Thus, although the 1995 Generation System Bonds, the 2001A Generation System Bonds and the 2002A Generation System Bonds are considered outstanding, the obligations represented by such Generation System Bonds are offset by the matching investments. See “ELECTRIC SYSTEM FINANCIAL INFORMATION—Financial Condition and Liquidity—*Electric System Debt*.”

As of December 31, 2009, the Generation System Bonds were outstanding in the aggregate principal amount of \$285,855,000 (including the 1995 Generation System Bonds, 2001A Generation System Bonds and 2002A Generation System Bonds). Shortly before issuing the 2010B Bonds, the District expects to issue \$212,465,000 principal amount of its Generation System Revenue Refunding Bonds, Series 2010A (the “2010A Bonds”). The District intends to use proceeds of the 2010A Bonds, together with other available funds of the District, to redeem the 1995 Generation System Bonds and to terminate the 1995 Trust and to redeem the 2001A Generation System Bonds and the 2002A Generation System Bonds (collectively with the 1995 Generation System Bonds, the “Redeemed Bonds”) and to terminate the 1995 Trust and the 2001/2002 Trust. After giving effect to the issuance of the 2010A Bonds and the 2010B Bonds and the redemption of the Redeemed Bonds, the Generation System Bonds will be outstanding in the aggregate principal amount of approximately \$277,705,000.

In July 2009, the District issued its Electric System Second Series Notes, Series 2009B (the “2009B Notes”) under the Electric System Second Series Resolution to refund the 2008A Notes. The 2009A Notes and the 2009B Notes and any other bonds, notes or other evidences of indebtedness heretofore or hereafter issued under the Electric System Second Series Resolution on a parity therewith are referred to collectively herein as the “Electric System Second Series Obligations.”

As of December 31, 2009, the Electric System Second Series Obligations were outstanding in the aggregate principal amount of \$232,475,000. The 2009A Notes and the 2009B Notes mature on May 26, 2010, and August 5, 2010, respectively. As mentioned above, the District intends to use the proceeds of the 2010A Bonds, together with other available funds of the District, to redeem the Redeemed Bonds and to terminate the 1995 Trust and the 2001/2002 Trust, and to use the proceeds received by the District from the termination of the 1995 Trust and the 2001/2002 Trust to retire the outstanding 2009B Notes and the outstanding 2009A Notes, respectively, at maturity. After giving effect to the retirement of the 2009A Notes and the 2009B Notes, the District will have no Electric System Second Series Obligations outstanding.

The District’s Electric System currently has outstanding its Electric System Revenue Bonds, Series 1999 (the “1999 Electric System Bonds”), 2002, 2004 and 2005, which bonds, together with any future bonds issued the Senior Electric System Bond Resolution, are collectively referred to as the “Senior Electric System Bonds.” Simultaneously with the issuance of the 2010B Bonds, the District intends to issue \$135,070,000 aggregate principal amount of its Electric System Revenue Bonds, Series 2010A and Series 2010B (collectively, the “2010 Electric System Bonds”) for capital purposes of the Electric System. The District intends to use available funds of the District to defease the outstanding 1999 Electric System Bonds prior to the issuance of the 2010 Electric System Bonds. As of December 31, 2009, the Senior Electric System Bonds were outstanding in the aggregate principal amount of \$249,610,000, and after giving effect to the issuance of the 2010 Electric System Bonds and the defeasance of the 1999 Electric System Bonds, the Senior Electric System Bonds will be outstanding in the approximate aggregate principal amount of \$379,075,000.

As of December 31, 2009, the District’s Electric System also had outstanding \$3,651,700 principal amount of other junior lien obligations of the Electric System (the “Prior Junior Lien Bonds”), which are secured by a lien on Electric System Revenues on a parity with the lien securing the Electric System Second Series Obligations.

For information regarding the District's Electric System finances, see "ELECTRIC SYSTEM FINANCIAL INFORMATION."

The District also has a credit facility with Bank of America, N.A. pursuant to which Bank of America, N.A. has issued a letter of credit to secure the District's payment obligations under certain transmission contracts. The District's obligation under the credit facility to reimburse Bank of America, N.A. for any payments made pursuant to the letter of credit is secured by a lien on Electric System Revenues junior to the lien securing the Senior Electric System Bonds, including the 2010 Electric System Bonds, the Electric System Second Series Obligations and the Prior Junior Lien Bonds.

This Official Statement includes summaries and descriptions of the terms of the 2010B Bonds, the Generation System Bond Resolution and the Senior Electric System Bond Resolution. The summaries of and references to any documents, statutes, reports and other instruments referred to herein do not purport to be complete, comprehensive or definitive, and each such summary and reference is qualified in its entirety by reference to each such document, statute, report or instrument.

In the preparation of the projections in this Official Statement, the District has made certain assumptions with respect to conditions that may occur in the future. While the District believes these assumptions are reasonable for the purpose of the projections, they depend upon future events, and actual conditions may differ from those assumed. The District does not represent or guarantee that actual results will replicate the estimates in this Official Statement. Potential purchasers of the 2010B Bonds should not rely on the projections in this Official Statement as statements of fact. Such projections are subject to change, and will change, from time to time. The District has not committed itself to provide investors with updated forecasts or projections.

#### **PURPOSE AND APPLICATION OF 2010B BOND PROCEEDS**

The proceeds of the 2010B Bonds are to be used (i) to finance additions, betterments and improvements to and renewals, replacements and extensions of the Generation System, including costs of acquiring and completing construction of the Youngs Creek Project and (ii) to pay costs of issuing the 2010B Bonds.

The proceeds of the 2010B Bonds and other funds of the District are estimated to be applied as follows:

**Estimated Sources of Funds:**

Par Amount of 2010B Bonds	\$14,050,000
Net Original Issue Premium/(Discount)	(12,910)
Release from Debt Service Reserve Account	11,225,720
Total Sources	<u>\$25,262,810</u>

**Estimated Use of Funds:**

Deposit to Generation System Project Fund	\$25,000,000
Costs of Issuance**	262,810
Total Uses	<u>\$25,262,810</u>

\*\*Includes printing costs, Underwriters' discount, rating agency, financial advisor and legal fees and other costs.

## **DESCRIPTION OF THE 2010B BONDS**

The following is a summary of certain provisions of the 2010B Bonds. Reference is made to the Generation System Bond Resolution for more detailed descriptions of such provisions. The discussion herein is qualified by such reference. Copies of the Generation System Bond Resolution are available upon request from the District at 2320 California Street, Everett, Washington 98201. A summary of additional provisions of the Generation System Bond Resolution is set forth in APPENDIX B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION."

### **General**

The 2010B Bonds will be issued pursuant to the Generation System Bond Resolution in the form of fully registered bonds of each maturity without coupons in authorized denominations and dated their date of delivery. Upon their initial issuance, the 2010B Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"). Purchases of beneficial interests in the 2010B Bonds will be made in book-entry form, without certificates. See APPENDIX F—"BOOK-ENTRY SYSTEM."

If the book entry only system for the 2010B Bonds is discontinued, the principal of each 2010B Bond will be payable to the Bondowner thereof by check or draft at maturity upon the presentation and surrender of each such 2010B Bond at the corporate office of the Bond Registrar.

If the book entry only system for the 2010B Bonds is discontinued, interest on each 2010B Bond will be payable by the Bond Registrar on each interest payment date by check or draft mailed to each owner as of the Record Date, at the most recent address shown on the Books of Registry; provided, however, that payment of interest to each Bondowner who owns of record \$1,000,000 or more in aggregate principal amount of 2010B Bonds may be made to such Bondowner by wire transfer to such wire address within the United States as that Bondowner may request in writing prior to the Record Date.

If at any time the book entry only system is discontinued for the 2010B Bonds, the 2010B Bonds will be exchangeable for other fully registered certificated 2010B Bonds in any authorized denominations. See APPENDIX E—"BOOK-ENTRY SYSTEM." The Bond Registrar may require the payment by the

owner of the 2010B Bond requesting such exchange of any tax or other governmental charges required to be paid with respect to such exchange.

Capitalized terms used herein not otherwise defined shall have the meanings given in APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Definitions.”

## **2010B Bonds**

### ***General***

The 2010B Bonds will be issued in the aggregate principal amount of \$14,050,000 as fixed rate bonds maturing in the amounts and bearing interest at the rates set forth on the inside front cover of this Official Statement. Interest on the 2010 Bonds, calculated based upon a 360-day year consisting of twelve 30-day months, is payable on each June 1 and December 1, commencing December 1, 2010, until maturity or prior redemption. The authorized denominations of the 2010 Bonds will be \$5,000 or any integral multiple of \$5,000 within each maturity.

### ***Redemption***

#### **Optional Redemption of the 2010B Bonds.**

The 2010B Bonds of each maturity will be subject to redemption prior to their respective stated maturity dates, at the option of the District, from any source of available funds, as a whole or in part by lot in Authorized Denominations on any date, at a redemption price equal to 100% of the principal amount of 2010B Bonds to be redeemed plus the Make-Whole Premium (as defined herein), together with accrued interest, if any, to the date fixed for redemption.

“Make-Whole Premium” means, with respect to any 2010B Bond to be redeemed, an amount calculated by an Independent Banking Institution (as defined herein) equal to the positive difference, if any, between:

- (1) The sum of the present values, calculated as of the date fixed for redemption of:
  - (a) Each interest payment that, but for the redemption, would have been payable on the 2010B Bond or portion thereof being redeemed on each regularly scheduled Interest Payment Date occurring after the date fixed for redemption through the maturity date of such 2010B Bond (excluding any accrued interest for the period prior to the date fixed for redemption); provided, that if the date fixed for redemption is not a regularly scheduled Interest Payment Date with respect to such 2010B Bond, the amount of the next regularly scheduled interest payment will be reduced by the amount of interest accrued on such 2010B Bond to the date fixed for redemption; plus
  - (b) The principal amount that, but for such redemption, would have been payable on the maturity date of the 2010B Bond or portion thereof being redeemed; minus

- (2) The principal amount of the 2010B Bond or portion thereof being redeemed.

The present values of the interest and principal payments referred to in (1) above will be determined by discounting the amount of each such interest and principal payment from the date that each such payment would have been payable but for the redemption to the date fixed for redemption on a semiannual basis (assuming a 360-day year consisting of twelve (12) 30-day months) at a discount rate equal to the Comparable Treasury Yield (as defined herein), plus 25 basis points.

“Comparable Treasury Yield” means the yield which represents the weekly average yield to maturity for the preceding week appearing in the most recently published statistical release designated “H.15(519) Selected Interest Rates” under the heading “Treasury Constant Maturities,” or any successor publication selected by the Independent Banking Institution that is published weekly by the Board of Governors of the Federal Reserve System and that establishes yields on actively traded United States Treasury securities adjusted to constant maturity, for the maturity corresponding to the remaining term to maturity of the 2010B Bond being redeemed. The Comparable Treasury Yield will be determined as of the third business day immediately preceding the applicable date fixed for redemption. If the H.15(519) statistical release sets forth a weekly average yield for United States Treasury securities that have a constant maturity that is the same as the remaining term to maturity of the 2010B Bond being redeemed, then the Comparable Treasury Yield will be equal to such weekly average yield. In all other cases, the Comparable Treasury Yield will be calculated by interpolation on a straight-line basis, between the weekly average yields on the United States Treasury securities that have a constant maturity (i) closest to and greater than the remaining term to maturity of the 2010B Bond being redeemed; and (ii) closest to and less than the remaining term to maturity of the 2010B Bond being redeemed. Any weekly average yields calculated by interpolation will be rounded to the nearest 1/100th of 1%, with any figure of 1/200th of 1% or above being rounded upward.

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

“Comparable Treasury Issue” means the United States Treasury security selected by the Independent Banking Institution as having a maturity comparable to the remaining term to maturity of the 2010B Bond being redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term to maturity of the 2010B Bond being redeemed.

“Independent Banking Institution” means an investment banking institution of national standing which is a primary United States government securities dealer in the City of New York designated by the District (which may be the Underwriters). If the District fails to appoint an Independent Banking Institution at least 45 days prior to the date fixed for redemption, or if the Independent Banking Institution appointed by the District is unwilling or unable to determine the Comparable Treasury Yield, the Comparable Treasury Yield will be determined by an Independent Banking Institution designated by the Standby Trustee, as Paying Agent.

“Comparable Treasury Price” means, with respect to any date on which an 2010B Bond or portion thereof is being redeemed, either (a) the average of five Reference Treasury Dealer quotations for the date fixed for redemption, after excluding the highest and lowest such quotations, and (b) if the Independent Banking Institution is unable to obtain five such quotations, the average of the quotations that are obtained. The quotations will be the average, as determined by the Independent Banking Institution, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of principal amount) quoted in writing to the Independent Banking Institution, at 5:00 p.m. New York City time on the third business day preceding the date fixed for redemption.

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

Optional Redemption of Term Bonds. If less than all of the 2010B Bonds maturing on December 1, 2025 or 2040 are optionally redeemed as provided above, the principal amount of Bonds of such maturity that is redeemed shall be applied to reduce such mandatory sinking fund payments with respect to such Bonds as shall be directed by the District.

**Extraordinary Optional Redemption of the 2010B Bonds.** The 2010B Bonds of each maturity will be subject to redemption prior to their respective stated maturity dates, at the option of the District upon the occurrence of a Tax Law Change, from any source of available funds, as a whole or in part by lot in Authorized Denominations on any date, at a redemption price equal to 100% of the principal amount of 2010B Bonds to be redeemed plus the Make-Whole Premium (using a discount rate equal to the Comparable Treasury Yield plus 100 basis points), together with accrued interest, if any, to the date fixed for redemption.

“Tax Law Change” means legislation has been enacted by the Congress of the United States or passed by either House of the Congress, or a decision has been rendered by a court of the United States, or an order, ruling, regulation (final, temporary or proposed) or official statement has been made by or on behalf of the Treasury Department of the United States, the Internal Revenue Service or other governmental agency of appropriate jurisdiction, the effect of which, as reasonably determined by the District, would be to suspend, reduce or terminate the timely payment from the United States Treasury to the District with respect to the 2010B Bonds, or to state or local government issuers generally with respect to obligations of the general character of the 2010B Bonds, pursuant to Sections 54AA or 6431 of the Code of an amount equal to at least 35% of the interest due thereon on each interest payment date (the “Subsidy Payments”); provided, that such suspension, reduction or termination of the Subsidy Payments is not due to a failure by the District to comply with the requirements under the Code to receive such Subsidy Payments.

**Mandatory Sinking Fund Redemption of the 2010B Bonds.** The 2010B Bonds maturing on December 1, 2025 are Term Bonds subject to mandatory sinking fund redemption prior to their respective stated maturity dates in part by lot in Authorized Denominations on December 1, 2020, and each December 1 thereafter to and including December 1, 2025 at a redemption price equal to 100% of the principal amount of the 2010B Bonds to be redeemed, without premium, together with accrued interest thereon, if any, to the date fixed for redemption, as set forth in the following table:

<u>Mandatory Redemption Dates</u> <u>(December 1)</u>	<u>Mandatory Redemption Payments</u>
2020	\$460,000
2021	475,000
2022	495,000
2023	510,000
2024	530,000
2025**	545,000

\*\* Maturity

The 2010B Bonds maturing on December 1, 2040 are Term Bonds subject to mandatory sinking fund redemption prior to their respective stated maturity dates in part by lot in Authorized Denominations on December 1, 2026, and each December 1 thereafter to and including December 1, 2040 at a redemption price equal to 100% of the principal amount of the 2010B Bonds to be redeemed, without premium, together with accrued interest thereon, if any, to the date fixed for redemption, as set forth in the following table:

<u>Mandatory Redemption Dates</u> <u>(December 1)</u>	<u>Mandatory Redemption Payments</u>
2026	\$565,000
2027	585,000
2028	605,000
2029	630,000
2030	655,000
2031	675,000
2032	700,000
2033	725,000
2034	755,000
2035	780,000
2036	810,000
2037	840,000
2038	870,000
2039	905,000
2040**	935,000

\*\* Maturity

**Selection.** If less than all of a maturity of the 2010B Bonds is to be redeemed, the Stand-by Trustee will select the 2010B Bonds to be redeemed by lot from the Outstanding 2010B Bonds of such maturity not previously called for redemption.

**Notice and Effect of Redemption.** Written notice of any redemption of 2010B Bonds shall be given by the Stand-by Trustee, as Bond Registrar, on behalf of the District by first class mail, postage prepaid, not less than 30 days nor more than 60 days before the date fixed for redemption to the registered owners of 2010B Bonds that are to be redeemed at their last addresses shown on the Books of Registry. So long as the 2010B Bonds are in book-entry form, notice of redemption shall be given as provided in the Letter of Representations. Any notice of redemption, unless moneys are received by the Stand-by Trustee, as Paying Agent, prior to giving such notice sufficient to pay the principal of and accrued interest, if any, on the 2010B Bonds to be redeemed, may state that such redemption is conditional upon the receipt of such moneys by the close of business of the Stand-by Trustee, as Paying Agent, on the date fixed for redemption. If such moneys are not received, such notice will be of no force and effect, the District will not redeem such 2010B Bonds and the Stand-by Trustee, as Bond Registrar, is to give notice, in the manner in which the notice of redemption was given, that such moneys were not so received and such redemption did not take place. In such event, the Stand-by Trustee, as Bond Registrar, is to promptly return the 2010B Bonds they have received to the owners thereof as shown on the Books of Registry. Unless the District has revoked a notice of redemption, the District is to transfer to the Stand-by Trustee, as Paying Agent, amounts that, in addition to other money, if any, held by the Stand-by Trustee, as Paying Agent, will be sufficient to redeem, on the date fixed for redemption, all the 2010B Bonds to be redeemed. From the date fixed for redemption interest on each 2010B Bond to be redeemed will cease to accrue.

### ***Defeasance***

The Generation System Bond Resolution provides that the obligations of the District and the liens, pledges, charges, trusts, assignments, covenants and agreements of the District made or provided for in the Generation System Bond Resolution shall be fully discharged and satisfied as to any Generation System Bond and such Generation System Bond shall be deemed to be no longer outstanding under the Generation System Bond Resolution when payment of the principal of and premium, if any, on such Generation System Bond, plus interest on such principal to the due date thereof (whether such due date be

by reason of maturity or upon redemption through the application of mandatory sinking fund installments or optional redemption or prepayment or otherwise), either (a) shall have been made or caused to be made in accordance with the terms thereof, or (b) shall have been provided by depositing with the Escrow Trustee, in a special trust account, and appropriating and setting aside exclusively for such payment, either (i) money sufficient to make such payment or (ii) Governmental Obligations maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient money to make such payment, or (iii) a combination of both such money and such Governmental Obligations, whichever the District deems to be in its best interest. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Defeasance; Discharge of Liens and Pledges.” Defeasance of any 2010B Bond may result in a reissuance thereof for federal income tax purposes. In that event, a holder will recognize taxable gain or loss equal to the difference between the amount the holder is deemed to have realized from the reissuance (less any accrued qualified stated interest which will be taxable as such) and the holder’s adjusted tax basis in the 2010B Bond.

### **Bond Registrar**

The District intends to appoint U.S. Bank National Association, the Stand-by Trustee, as Bond Registrar and Paying Agent for the 2010B Bonds.

### **Book-Entry System**

The 2010B Bonds will be delivered in fully registered form only, and when delivered, will be registered in the name of Cede & Co., as nominee of DTC. DTC will act as securities depository for the 2010B Bonds. Ownership interests in the 2010B Bonds may be purchased in book-entry only form, in authorized denominations. So long as DTC acts as securities depository for the 2010B Bonds, the District and the Bond Registrar shall have no responsibility or obligation with respect to (i) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any beneficial ownership interest in the 2010B Bonds, (ii) the delivery to any Participant or any other person, other than an Owner as shown in the Books of Registry, of any notice with respect to the 2010B Bonds, or (iii) the payment to any Participant or any other person, other than an Owner as shown in the Books of Registry, of any amount with respect to principal of or interest on the 2010B Bonds. The District and the Bond Registrar may treat and consider the person in whose name each 2010B Bond is registered in the Books of Registry as the holder and absolute owner of such 2010B Bond for the purpose of payment of principal and interest on such 2010B Bond, for the purpose of giving notices with respect to such 2010B Bond, and for all other purposes whatsoever. See APPENDIX E—“BOOK-ENTRY SYSTEM.”

## **SECURITY FOR THE 2010B BONDS**

### **Pledge of Generation System Revenues**

The 2010B Bonds are special limited obligations of the District payable from and secured solely by Generation System Revenues, subject to the prior payment of Operating Expenses. The 2010B Bonds are secured by a pledge of and lien and charge on Generation System Revenues equal to the pledge of and lien and charge on Generation System Revenues that secure (i) the Generation System Bonds heretofore and hereafter issued pursuant to the Generation System Bond Resolution and (ii) the District Payments made in connection with Derivative Products. Generation System Revenues consist almost exclusively of the income, revenues and receipts derived by the District through the ownership and operation of the Generation System, including revenues derived from the sale of electric power and energy from the Generation System to the District’s Electric System. See “—Payment of Generation System Power Costs as an Operating Expense of the Electric System.”



“Generation System Revenues” means the income, revenues, and receipts derived by the District through the ownership and operation by it of the Generation System, but, except as provided in the Generation System Bond Resolution, does not include any income derived by the District through the ownership and operation by it of the Electric System or of any other generation, transmission and distribution facilities that may be purchased, constructed or otherwise acquired by the District as a separate electric utility system, or any Reciprocal Payments.

“Operating Expenses” means (i) all the District’s expenses for operation and maintenance of the Generation System, and ordinary repairs, replacements and reconstruction of the Generation System not constituting a unit of property (as prescribed in the Uniform System of Accounts of FERC), including all costs of producing and delivering electric power and energy from the Generation System and payments (other than payments out of Generation System Bond proceeds) into reasonable reserves in the Generation System Revenue Fund for items of Operating Expenses and other costs the payment of which is not immediately required, and shall include costs of transmission service, generating capacity reserve service and scheduled, emergency, economy or other interchange service, all other costs of purchased power (except costs under any purchased power contracts which secure the payment of debt issued to finance the facilities providing such power), 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 or payments in lieu of taxes, all to the extent properly allocable to the Generation System, (ii) any current expenses or obligations required to be paid by the District under the provisions of the Generation System Bond Resolution or by law, all to the extent properly allocable to the Generation System, and (iii) the fees and expenses of the Stand-by Trustee and Bond Registrar. Operating Expenses do not include District Payments, any costs or expenses for new construction or any allowance for depreciation and include only that portion of the total administrative and general expenses of the District that are properly allocable to the Generation System.

Section 54.24.040 of the Revised Code of Washington (“RCW”) provides that the revenue obligations and interest thereon issued by a public utility district shall be a valid claim of the owner thereof only as against the special fund or funds provided for the payment of such obligations and the amount of the revenues pledged to such fund or funds, and that such pledge of the revenues or other money shall be valid and binding from the time made, that the revenues or other money so pledged and thereafter received by a district shall immediately be subject to the lien of such pledge without any physical delivery or further act, and that the lien of any such pledge shall be valid and binding as against any parties having claims of any kind in tort, contract or otherwise against a district irrespective of whether such parties have notice thereof.

### **Payment of Generation System Power Costs as an Operating Expense of the Electric System**

The District has covenanted in the Generation System Bond Resolution to cause the Generation System to sell and the Electric System to purchase in each month all of the electric power and energy of the Generation System available in such month for use in the Electric System. Payment for such electric power and energy must be made at the times and in the amounts sufficient for the timely payment of all Generation System Power Costs, including debt service on the Generation System Bonds, as the same shall become due. The District is obligated to pay Generation System Power Costs (i) as an operation and maintenance expense of the Electric System for any month in which any power and energy from the Generation System was made available to the Electric System (regardless of whether or not the Electric System actually scheduled or received any such power or energy) and (ii) at all other times on a parity with the Senior Electric System Bonds outstanding from time to time.

“Generation System Power Costs” means with respect to each month all costs attributable to the Generation System, to the extent not paid from the proceeds of Generation System Bonds or other sources (including income from investment of such proceeds), resulting from the ownership, operation,

maintenance and termination of, and repair, renewals, replacements, additions, improvements, betterments, and modifications to, the Generation System, including (i) Operating Expenses; (ii) the amount required under the Generation System Bond Resolution to be paid or deposited during such month into the Bond Fund; (iii) any amount which the District may be required during such month to pay for the prevention or correction of any unusual loss or damage or for renewals, replacements, repairs, additions, improvements, betterments and modifications that are necessary to keep the Generation System in good operating condition, to improve the operation thereof, or to prevent a loss of revenues therefrom, but in each case only to the extent that (a) funds for such payment are not available to the District from any funds or accounts established under the Generation System Bond Resolution for such purpose, or (b) funds for such payment are not provided by the issuance of Generation System Bonds; (iv) all other charges or obligations payable by the District from Generation System Revenues of whatever nature imposed by the Generation System Bond Resolution by law or contract, excluding depreciation, amortization and other non-cash charges).

The District is required to pay into the Generation System Revenue Fund, on or prior to the last day of the month in which any power and energy were made available from the Generation System to the Electric System, an amount, together with amounts then on deposit in the Generation System Revenue Fund and available for such purpose, which is equal to the sum of (i) Generation System Power Costs for that month remaining unpaid, plus (ii) estimated Generation System Power Costs for the next month.

The Electric System is obligated to pay Generation System Power Costs as an operation and maintenance expense of the Electric System only with respect to months during which any power and energy from the Generation System were made available to the Electric System (regardless of whether or not the Electric System actually scheduled or received such energy). In any month during which power and energy were not made available to the Electric System from the Generation System, Generation System Power Costs are payable from Electric System Revenues after payment of operating expense of the Electric System as further described below under “—Payment of Generation System Power Costs on Parity of Lien with Senior Electric System Bonds.”

#### **Payment of Generation System Power Costs on Parity of Lien with Senior Electric System Bonds**

In any month during which power and energy are *not* made available to the Electric System from the Generation System, the District is obligated irrevocably to set aside and pay into the Generation System Revenue Fund, out of Electric System Revenues (after payment of operating expenses of the Electric System, including the amounts, if any, required to be paid by the District in such month for power and energy that was made available from the Generation System to the Electric System), on a parity of lien with the Senior Electric System Bonds, an amount sufficient, together with amounts then on deposit in the Generation System Revenue Fund, to pay estimated Generation System Power Costs for the next succeeding month and to pay any deficiencies in the payment of Generation System Power Costs for the then current or any prior month.

#### **Limitation of Liability**

**The 2010B Bonds shall not in any manner or to any extent constitute general obligations of the District or of the State of Washington, or of any political subdivision of the State of Washington, or a charge upon any general fund or upon any money or other property of the District or of the State of Washington, or of any political subdivision of the State of Washington, not specifically pledged thereto by the Generation System Bond Resolution, nor shall the full faith and credit of the District or of the State of Washington, or of any political subdivision of the State of Washington, be pledged to the payment of principal, premium, if any, or interest on the 2010B Bonds.**

## **Generation System Bonds**

As of December 31, 2009, the Generation System Bonds were outstanding in the aggregate principal amount of \$285,855,000 (including the District's 1995 Generation System Bonds, 2001A Generation System Bonds and 2002A Generation System Bonds, which are held in the 1995 Trust and the 2001/2002 Trust and treated as investments of the Electric System for financial reporting purposes). After giving effect to the issuance of the 2010A Bonds and the 2010B Bonds and the redemption of the Redeemed Bonds, the Generation System Bonds will be outstanding in the aggregate principal amount of approximately \$277,705,000. Certain covenants and other provisions of the Generation System Bond Resolution are summarized in APPENDIX B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION."

## **Senior Electric System Bonds**

As of December 31, 2009, the Senior Electric System Bonds were outstanding in the aggregate principal amount of \$249,610,000, and after giving effect to the issuance of the 2010 Electric System Bonds and the defeasance of the 1999 Electric System Bonds, the Senior Electric System Bonds will be outstanding in the approximate aggregate principal amount of \$379,075,000. Certain covenants and other provisions of the Senior Electric System Bond Resolution are summarized in APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION."

## **Flow of Funds**

Pursuant to the Generation System Bond Resolution, the District continued a special fund known as the Revenue Fund (the "Generation System Revenue Fund"). See APPENDIX B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Revenues and Flow of Funds—*Revenue Fund*." All Generation System Revenues (and all Electric System Revenues required to be deposited under the Generation System Bond Resolution) are required to be deposited in the Generation System Revenue Fund to be applied in the following order of priority:

- (a) First, for the payment of Operating Expenses; and
- (b) Second, equally and ratably and without priority, (i) for the payment of the principal of and interest and redemption premium, if any, on any Generation System Bonds; (ii) in the event the District has entered into any Derivative Product that ranks on parity of lien with the Generation System Bonds, to pay any sums due to the Reciprocal Payor; and (iii) in the event the District has entered into a reimbursement agreement pursuant to the Generation System Resolution that ranks on a parity of lien with the Generation System Bonds, to make all payments required to be made pursuant to such reimbursement agreement in connection with a Qualified Letter of Credit, Qualified Insurance or other credit facility, provided if there is not sufficient money to make all payments under more than one such reimbursement agreement, the payments shall be made on a pro rata basis.

The balance of Generation System Revenues may, in the discretion of the District, be used for any of the following purposes: (i) to pay debt service on Generation System Bonds; (ii) for transfer to any other fund or account created by the Generation System Bond Resolution; (iii) for the purchase or redemption of Generation System Bonds; (iv) to pay any subordinated indebtedness of the Generation System; or (v) for any lawful corporate purpose of the District.

Pursuant to the Senior Electric System Bond Resolution, the District created a special fund known as the Revenue Fund (the "Electric System Revenue Fund"). See APPENDIX C – "SUMMARY

OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION – Revenues and Flow of Funds – *Revenue Fund*.” The District has covenanted in the Senior Electric System Bond Resolution to pay into the General Account in the Electric System Revenue Fund all Electric System Revenues and all other amounts required by the Senior Electric System Resolution to be deposited into the Electric System Revenue Fund and to pay from such Electric System Revenue Fund, prior to the payment of debt service on any outstanding Senior Electric System Bonds, any operating expenses of the Electric System, including Generation System Power Costs, as appropriate.

### **Debt Service Reserve Account**

The Generation System Bond Resolution established a Debt Service Reserve Account in the Bond Fund (the “Debt Service Reserve Account”) to secure the payment of principal of, premium, if any, and interest on the Generation System Bonds. The Generation System Bond Resolution provides that to the extent permitted under the Code, there shall be deposited from each Series of Generation System Bonds into the Debt Service Reserve Account an amount so that there will be on deposit therein moneys and Value of Investment Securities equal to the Debt Service Reserve Requirement calculated immediately after the issuance of such Generation System Bonds. If with respect to any Series of Generation System Bonds the amount of proceeds of such Series of Generation System Bonds permitted by the Code to be deposited into the Debt Service Reserve Account is less than the Debt Service Reserve Requirement allocable to such Series of Generation System Bonds, the Generation System Bond Resolution provides that the Supplemental Resolution providing for the issuance of such Series of Generation System Bonds shall provide for further and additional payments into the Debt Service Reserve Account from moneys in the Generation System Revenue Fund in such amounts and at such times so that by no later than five years from the date of issuance of such additional Series of Generation System Bonds or by the final maturity thereof, whichever occurs first, there will be credited to the Debt Service Reserve Account an amount equal to the Debt Service Reserve Requirement. The Debt Service Reserve Account may also be funded with any other money lawfully available therefor or with Qualified Insurance or a Qualified Letter of Credit. The rating requirement for the provider of a letter of credit or insurance is as of the date the policy is issued, and the rating does not need to be maintained. See “APPENDIX B—SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Certain Definitions” for the definition of Qualified Insurance, Qualified Letter of Credit and Value of Investment Securities.

The Generation System Bond Resolution requires that the District make a determination as to the moneys and Value of Investment Securities in the Debt Service Reserve Account as of January 1 and July 1 of each year and immediately following any withdrawal of amounts in the Debt Service Reserve Account to pay when due debt service on the outstanding Generation System Bonds. If the moneys and Value of Investment Securities in the Debt Service Reserve Account are less than the Debt Service Reserve Requirement as of the date of any valuation, the District is required to notify any insurer of Generation System Bonds and, beginning with the last day of the month next succeeding such date, after paying Operating Expenses and making the transfers described in “second” under “—Flow of Funds,” is required to make monthly transfers from the Generation System Revenue Fund to the Debt Service Reserve Account equal to one-sixth (1/6th) of the amount as originally determined by which the moneys and Value of Investment Securities in the Debt Service Reserve Account is less than the Debt Service Reserve Requirement, until there shall be on deposit in the Debt Service Reserve Account moneys and Value of Investment Securities equal to the Debt Service Reserve Requirement based upon the most recent valuation of that account; provided, however, that if a Series of Generation System Bonds is issued at any time during a period in which a deficiency exists in the Debt Service Reserve Account, to the extent permitted under the Code, the District is required to deposit proceeds of such Series into the Debt Service Reserve Account in an amount sufficient to make up any of the deficiency in the Debt Service Reserve Account at the time of such issuance, based upon the most recent valuation of that account.

The 2010B Bonds are to be secured by the Debt Service Reserve Account, which the District will fund in an amount equal to the least of (i) 10 percent of the principal amounts of all Generation System Bonds secured by the Debt Service Reserve Account, (ii) the maximum Annual Debt Service on the Generation System Bonds secured by Debt Service Reserve Account; and (iii) 125 percent of the average Annual Debt Service on the Generation System Bonds secured by the Debt Service Reserve Account, in each case determined as of the date of issuance of the 2010B Bonds and as redetermined from time to time thereafter.

The District has entered into investment agreements for some of the moneys on deposit in the Debt Service Reserve Account. The District has on deposit in the Debt Service Reserve Account \$28,410,279 of which \$6,817,820 is invested in the state of Washington Local Government Investment Pool and \$21,592,459 is invested pursuant to a forward delivery investment agreement with Bank of America, N.A. (the "Forward Delivery Agreement"). The Forward Delivery Agreement, which pays 4.312% and will mature on December 1, 2019, requires Bank of America to provide collateral in the event its long term senior unsecured debt rating falls below "A" by Standard & Poor's or "A3" by Moody's. The collateral must have a market value equal to or greater than the termination amount, which is approximately the market value of the forward delivery agreement. The District intends to amend the Forward Delivery Agreement to provide that a portion of such invested amounts be released from the Debt Service Reserve Account, with the balance continuing to be held and invested pursuant to the Forward Delivery Agreement.

After giving effect to the issuance of the 2010B Bonds, the Debt Service Requirement for the Debt Service Reserve Account will be \$15,139,779.55, which amount is equal to 125 percent of the average Annual Debt Service on the Generation System Bonds secured by the Debt Service Reserve Account, as of the date of issuance of the 2010B Bonds. The District intends to fund the Debt Service Reserve Requirement with a portion of the \$21,592,459 in the Debt Service Reserve Account invested pursuant to the Forward Delivery Agreement.

The Debt Service Reserve Account is held in trust by the District for the benefit of the Owners of the Generation System Bonds. In the event of the bankruptcy or insolvency of the District, a bankruptcy court may be able to direct the application of money in the Debt Service Reserve Account to other purposes. Money in the Debt Service Reserve Account, including any amounts drawn under a Qualified Letter of Credit or paid pursuant to Qualified Insurance, are to be used for the purpose of paying the principal of or interest on any Generation System Bonds secured thereby in the event that money in other accounts in the Bond Fund is insufficient therefor. Whenever money is withdrawn from the Debt Service Reserve Account, the amount in that account is to be restored as described in the Generation System Bond Resolution.

See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Revenues and Flow of Funds—Bond Fund—Debt Service Reserve Account."

## **Additional Indebtedness**

### **Generation System Bond Resolution**

The District may issue additional Generation System Bonds in one or more series for the purposes set forth in the Generation System Bond Resolution only upon compliance with the terms set forth in the Generation System Bond Resolution as summarized in APPENDIX B – "SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION – Additional Indebtedness."

The Generation System Bond Resolution also permits the District to issue bonds or other evidences of indebtedness for a separate system for any lawful purpose of the District, payable on a parity with the payment of Generation System Power Costs upon compliance with the terms and conditions stated in the Generation System Bond Resolution. See “—Flow of Funds” and APPENDIX B — “SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION — Additional Indebtedness — Obligations Payable from Revenues.”

### **Senior Electric System Bond Resolution**

Under the Senior Electric System Bond Resolution, the District is not permitted to issue bonds or other evidences of indebtedness of the Electric System secured by a pledge of or a lien on or charge upon Electric System Revenues prior to the pledge, lien and charge of the Senior Electric System Bonds (other than Generation System Bonds). The District may issue additional Senior Electric System Bonds from time to time in one or more series for any lawful purpose of the District only upon compliance with the terms and conditions stated in the Senior Electric System Bond Resolution. See APPENDIX C— “SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Additional Indebtedness—Additional Bonds.”

### **Prior Junior Lien Bonds and Electric System Second Series Obligations**

The District may issue bonds or other evidences of indebtedness for any corporate use or purpose of the District payable from, and having a lien and charge against, Electric System Revenues junior to the Senior Electric System Bonds. As of December 31, 2009, the District also had outstanding \$3,651,700 aggregate principal amount of Prior Junior Lien Bonds and \$232,475,000 aggregate principal amount of Electric System Second Series Obligations. After giving effect to the retirement of the 2009A Notes and the 2009B Notes, the District will have no Electric System Second Series Obligations outstanding.

Upon compliance with certain terms and conditions contained in the Electric System Second Series Resolution, the District may issue additional Electric System Second Series Obligations and enter into Payment Agreements payable from the Electric System Revenues on a parity with the Electric System Second Series Obligations and secured by an equal pledge of and charge and lien on such Electric System Revenues.

The Electric System Second Series Resolution does not restrict the District’s ability to create or incur indebtedness having a lien or charge on Electric System Revenues junior to that of the Electric System Second Series Obligations.

## **Derivative Products and Payment Agreements**

### **Generation System Bond Resolution**

To the extent permitted by state law, the Generation System Bond Resolution permits the District to enter into Derivative Products secured by a pledge and lien on Generation System Revenues on a parity with the Generation System Bonds subject to the satisfaction of certain conditions precedent. The Generation System Bond Resolution defines “Derivative Product” as a written contract or agreement 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. To the extent that the District’s obligations under any Derivative Products constitute Generation System Power Costs, the District Payments under such Derivative Products constitute operating expenses of the Electric

System during any period in which the Generation System is delivering power to the Electric System. During any period in which the Generation System is not delivering power to the Electric System, the District Payments under such Derivative Products are secured by a pledge and lien on Electric System Revenues on a parity with the Senior Electric System Bonds and the Parity Lien Obligations (as defined in the Senior Electric System Resolution). If an interest rate swap entered into by District relating to a series of Generation System Bonds constitutes a “Derivative Product” under the Generation System Bond Resolution, the District’s obligations to make regularly scheduled payments under such agreements would be on a parity with the Generation System Bonds, and if such an interest rate swap is terminated prior to the maturity of the applicable series of Generation System Bonds, the District would no longer receive variable rate payments and may be required to make a termination payment or payments. Any termination payment due from the District would be payable on a basis subordinate to the payment of debt service on the Generation System Bonds, although prior to or on a parity with debt service on the Senior Electric System Bonds as a Generation System Power Cost. See “– Payment of Generation System Power Costs as an Operating Expense of the Electric System,” “THE GENERATION SYSTEM—Interest Rate Swaps – Generation System Bonds” and APPENDIX B —“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION –Additional Indebtedness—Derivative Products.”

The District has previously entered into three interest rate swaps constituting Derivative Products: one with AIG Financial Products (“AIG-FP”) in connection with the 1995 Generation System Bonds (the “AIG Swap Agreement”) and two with Citigroup Financial Products Inc. (“Citigroup”) in connection with the 2001A Generation System Bonds and the 2002A Generation System Bonds (collectively, the “Citigroup Swap Agreements” and together with the AIG Swap Agreement, the “Swap Agreements”).

In anticipation of the redemption of the 2001A Generation System Bonds and the 2002A Generation System Bonds, the District terminated the Citigroup Swap Agreements, effective as of April 20, 2010. The District paid an aggregate amount of \$20 million from available funds of the District. This included final scheduled payments of \$2.6 million, plus a termination amount of \$17.4 million (which compensates Citigroup for the economic loss and the District’s corresponding economic gain from terminating the Citigroup Swap Agreements).

On July 6, 2009, the District was served with a lawsuit filed by AIG-FP related to the AIG Swap Agreement. Following a mediation held on March 22, 2010, AIG-FP and the District reached a settlement that will include releases of all claims, a termination of the AIG Swap Agreement, effective as of April 12, 2010, and a payment by the District to AIG-FP in the amount of \$14 million as payment in part for the economic loss to AIG-FP arising from the termination of the AIG Swap Agreement. See “THE GENERATION SYSTEM—Interest Rate Swaps—Generation System Bonds” and “LITIGATION—AIG Swap Agreement.”

### **Electric System Second Series Resolution**

Upon compliance with certain terms and conditions contained in the Electric System Second Series Resolution, the District may enter into Payment Agreements payable from the Electric System Revenues on a parity with the Electric System Second Series Obligations and secured by an equal pledge of and charge and lien on such Electric System Revenues. The Electric System Second Series Resolution defines “Payment Agreement” as any financial instrument that (a) is entered into by the District with a party that is a qualified counterparty at the time the instrument is entered into; (b) is entered into with respect to all or a portion of a series of Electric System Second Series Obligations; (c) is for a term not extending beyond the final maturity of a series of Electric System Second Series Obligations, or portion thereof to which it relates; (d) provides that the District shall pay to such qualified counterparty an amount accruing at either a fixed rate or a variable rate, as the case may be, on a notional amount equal to or less than the principal amount of the Electric System Second Series Obligations, or portion thereof to

which it relates, and that such qualified counterparty shall pay to the District an amount accruing at either a variable rate or fixed rate, as appropriate, on such notional amount; (e) provides that one party shall pay to the other party any net amounts due under such instrument; and (f) which has been designated by the District as a Payment Agreement with respect to the Electric System Second Series Obligations. The District has not entered into any Payment Agreements with respect to any Electric System Second Series Obligations.

### **Resource Obligations**

Upon compliance with certain requirements in the Senior Electric System Bond Resolution (see APPENDIX C —“SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Additional Indebtedness—Separate System Bonds; Resource Obligations”), the District may declare costs (including debt service on bonds) associated with (1) contracts entered into by the District for the purchase of energy, capacity, capability, reserves, conservation or service or (2) separate system facilities or resources for the generation of power and energy or for the conservation, transportation, transmission or distribution of power and energy to be a resource obligation (“Resource Obligation”) of the Electric System to be paid as an operation and maintenance 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 Electric System Revenues on a parity of lien with the Senior Electric System Bonds. The District has covenanted that Resource Obligations will not be subject to acceleration in the event of a default. There are currently no Resource Obligations outstanding (other than the obligations of the Electric System, described above, with respect to the payment of Generation System Power Costs), and the District has no current plans to enter into any Resource Obligations.

### **Rates and Charges**

The District has covenanted in the Generation System Bond Resolution to fix, establish, maintain and collect rates and charges for electric power and energy and other goods and services, facilities and commodities sold, furnished or supplied through the facilities of the Generation System which will provide the District with Generation System Revenues sufficient to pay Generation System Power Costs. The Electric System is obligated under the Generation System Bond Resolution to purchase, in each month for use in the Electric System, all the electric power and energy of the Generation System available in such month.

The District also has covenanted in the Generation System Bond Resolution to establish, maintain and collect rates and charges for electric power and energy and other services supplied through the Electric System sufficient to pay the cost of operation and maintenance of the Electric System and certain other payments (including payments for available Generation System power and energy), to pay the amounts required to be deposited in the bond fund under the Senior Electric System Resolution, to provide Electric System Revenues sufficient, together with amounts then on deposit in the Generation System Revenue Fund, to pay all Generation System Power Costs (including debt service on the 2010B Bonds), to pay necessary repairs, replacements and renewals to the Electric System, to pay the cost of extensions, betterments and improvements thereto and to pay all other charges and obligations against Electric System Revenues imposed by law or contract.

### **Other Covenants**

The District has covenanted in the Generation System Bond Resolution to maintain, preserve and keep the properties of the Generation System in good repair, working order and condition, to make all



necessary and proper repairs, renewals, replacements, additions, extensions and betterments thereto and to operate the properties and business of the Generation System in an efficient manner and at a reasonable cost. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Additional Covenants.”

### **Contingent Payment Obligations**

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

These agreements may include interest rate swap and other similar agreements, power purchase agreements, commodities futures contracts with respect to the delivery of electric energy or capacity, investment agreements, including for the future delivery of specified securities, electric energy and fuel price swap and similar agreements, other financial and energy hedging transactions, and other agreements.

Such contingent payments or posting of collateral may be conditioned upon the future credit ratings of the District and/or other parties to the agreement, maintenance by the District of specified financial ratios, future changes in electric energy, fuel or related prices, and other factors.

If any such payments, or portions thereof, were subject to characterization as Operating Expenses or operating expenses of the Electric System, as applicable, they would be payable from Generation System Revenues and/or Electric System Revenues, as applicable, prior to the payment of debt service on the Generation System Bonds, including the 2010B Bonds, or the Senior Electric System Bonds. However, if they constituted “extraordinary, non-recurring expenses,” as set forth in the respective definitions of Operating Expenses, they would be payable after debt service on the Generation System Bonds or the Senior Electric System Bonds, as applicable. Other such payments also may be payable on a parity with the Generation System Bonds or the Senior Electric System Bonds subject to the satisfaction of certain conditions precedent, including any “regularly scheduled payments” with respect to Derivative Products, which include interest rate swaps and could include commodities swaps. The District’s three outstanding Swap Agreements include such contingent payment obligations. See “—Derivative Products and Payment Agreements—Generation System Bond Resolution” and “THE GENERATION SYSTEM—Interest Rate Swaps—Generation System Bonds.”

Other such payments may be payable on a parity with debt service the Electric System Second Series Obligations, including any Payment Agreement Payments made with respect to any Payment Agreements. See “—Payment Agreements and Derivative Products—Electric System Second Series Obligations.”

The District’s Block-Slice Power Sales Agreement with the Bonneville Power Administration (“Bonneville”) and power purchase agreements with Hay Canyon Wind, LLC (“Hay Canyon”) and Wheatfield Wind Power Project, LLC (“Wheatfield”) include requirements that the District post collateral upon the District’s long-term credit rating dropping below BBB- in the case of Bonneville and Hay Canyon and BBB in the case of Wheatfield. The District has entered into a reimbursement agreement with Bank of America, N.A. to provide Bonneville with two irrevocable letters of credit in the amount of \$5.5 million for participation in the 2008 Network Open Season Precedent Transmission Service

Agreement. See “ELECTRIC SYSTEM POWER SUPPLY—Long-Term Third-Party Power Purchase Contracts.”

### **The District’s Ability to Consolidate Generation System and Electric System**

Under Washington law, public utility districts may create separate utility systems or consolidate utilities into one or more systems. Separate accounts must be kept for each separate system and all services rendered by one system to another system must be paid for at its true and full value.

Once the 1995 Generation System Bonds, the 2001B Generation System Bonds and the 1999 Electric System Bonds are no longer outstanding, the District may combine the Generation System and the Electric System into a single system for accounting and financing purposes. In such event, the revenues of both Systems would be pledged and available to pay and secure debt service on the Generation System Bonds and the Senior Electric System Second Series Obligations, including the 2010B Bonds, and the operating expenses, capital costs and other obligations of both Systems would be payable from the revenues of both Systems. Prior to consolidating the Systems, the District would be required to provide (i) written confirmation from each Rating Agency then rating the Generation System Bonds and the Senior Electric System Bonds that such consolidation will not cause a reduction or withdrawal of the then-current rating(s) on the Generation System Bonds and the Senior Electric System Bonds and (ii) an opinion of Bond Counsel that such consolidation will not adversely affect the exclusion of interest on any tax-exempt Generation System Bonds or Senior Electric System Bonds from gross income for federal income tax purposes. The District has no current plans to consolidate these systems.

## Outstanding Debt of the Electric System and Generation System

The table on the following page presents the District's outstanding Electric System and Generation System debt as of December 31, 2009.

### Outstanding Debt of the Electric System and the Generation System As of December 31, 2009 (\$000)

Series of	Final Maturity Date	Original Principal Amount	Amount Outstanding
<u>GENERATION SYSTEM BONDS</u>			
1995 <sup>(1)</sup>	1/1/2025	\$ 58,260	\$ 58,260
2001A <sup>(1)</sup>	12/1/2017	61,870	61,870
2001B	12/1/2010	53,450	11,585
2002A <sup>(1)</sup>	12/1/2019	114,535	114,535
2002B	12/1/2012	<u>\$ 133,610</u>	<u>\$ 39,605</u>
<b>Total Generation System Bonds</b>		<b><u>\$ 421,725</u></b>	<b><u>\$ 285,855</u></b>
<u>SENIOR ELECTRIC SYSTEM BONDS</u>			
1999	12/1/2011	\$170,400	\$ 5,605
2002	12/1/2024	50,720	50,720
2004	12/1/2028	88,550	72,305
2005	12/1/2024	<u>120,980</u>	<u>120,980</u>
<b>Total Senior Electric System Bonds</b>		<b><u>\$ 430,650</u></b>	<b><u>\$ 249,610</u></b>
<u>PRIOR JUNIOR LIEN BONDS (ELECTRIC SYSTEM)</u>			
1995 – 1999 <sup>(2)</sup>		<u>\$ 4,128</u>	<u>\$ 3,652</u>
<b>Total Prior Junior Lien Bonds (Electric System)</b>		<b><u>\$ 4,128</u></b>	<b><u>\$ 3,652</u></b>
<u>ELECTRIC SYSTEM SECOND SERIES OBLIGATIONS</u>			
2009B Notes	8/5/2010	\$ 57,595	\$ 57,595
2009A Notes	5/26/2010	<u>174,880</u>	<u>174,880</u>
<b>Total Electric System Second Series Obligations</b>		<b><u>\$ 232,475</u></b>	<b><u>\$ 232,475</u></b>
<b>Total Outstanding Debt</b>		<b><u>\$1,089,623</u></b>	<b><u>\$ 771,592</u></b>
Less: Generation System Bonds Held in Trust by the District		<u><u>\$ ( 234,665)</u></u>	<u><u>\$ ( 234,665)</u></u>
<b>Total Outstanding Debt Held by Investors</b>		<b><u>\$ 854,958</u></b>	<b><u>\$ 536,927</u></b>

- (1) The 1995 Generation System Bonds, 2001A Generation System Bonds and 2002A Generation System Bonds held in the 1995 Trust and in the 2001/2002 Trust are considered investments of the Electric System for financial reporting purposes and investments of the Electric System and the obligations represented by such Generation System Bonds are offset by the matching investments. The District intends to use the proceeds of the 2010A Bonds, together with other available funds of the District, to redeem the Redeemed Bonds and to terminate the 1995 Trust and the 2001/2002 Trust and to use the amounts received by the District from the termination of the Trusts to retire the 2009A Notes and the 2009B Notes at their respective maturity dates. If the District does not redeem the Redeemed Bonds, the District will have the option in the future to either (i) deliver the Redeemed Bonds to the applicable bond registrar for cancellation or (ii) remarket the Redeemed Bonds to investors with the existing bond insurance policies and bank facilities. Any such remarketing would, in effect, constitute a new issue, and would be subject to the same covenants and agreements of the District that apply to its outstanding Generation System Bonds. See APPENDIX B —“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Additional Indebtedness.”

- (2) Some Prior Junior Lien Bonds were issued as capital appreciation bonds. Taking into account accreted value of the capital appreciation bonds, the Prior Junior Lien Bonds are outstanding in the principal amount of \$4,626,602.

## **District Market Access**

The 2009A Notes and the 2009B Notes mature on May 26, 2010 and August 5, 2010, respectively. There is no credit or liquidity facility in place to pay the maturing principal amount of the 2009A Notes or the 2009B Notes. The District expects to issue the 2010A Bonds on or about May 13, 2010, and intends to use proceeds of the 2010A Bonds, together with other available funds of the District, to redeem the 1995 Generation System Bonds, the 2001A Generation System Bonds and the 2002A Generation System, to terminate the 1995 Trust and the 2001/2002 Trust and to use the amounts received by the District upon the termination of the 2001/2002 Trust and the 1995 Trust, together with other available funds of the District, to retire the 2009A Notes and the 2009B Notes upon their respective maturity dates. If for any reason the District is unable to issue the 2010A Bonds or other refunding bonds or notes, including in particular as a result of a lack of market access, the District can provide no assurance that it will have sufficient moneys available to pay the maturing principal of the 2009A Notes and the 2009B Notes. The District, for at least the past 30 years, has always had market access to sell its revenue bonds at such times and in such amounts as it has chosen to issue. The District cannot provide any assurance that it will have such market access to retire the 2009A Notes or the 2009B Notes upon their maturity. This could result from then-existing market conditions or from an unanticipated and substantial deterioration in the District's financial condition. The funds available to the District to pay the maturing principal of the 2009A Notes and the 2009B Notes would include any amounts in the District's Rate Stabilization Account, in other capital or operating reserve funds, and/or any other unencumbered funds of the District, which likely would consist primarily of working capital in the Electric System Revenue Fund. Any failure of the District to pay the 2009A Notes or the 2009B Notes upon maturity would constitute an Event of Default under the Electric System Second Series Resolution.

## **Authorized Investments**

All moneys in any of the funds and accounts held and established pursuant to the Generation System Bond Resolution may be invested in any obligation or investment in which the District may legally invest its funds. For a description of the District's current investment policies and practices, see "THE DISTRICT—Investment Policy."

## **No Acceleration Upon Default**

Upon the occurrence and continuance of an Event of Default under the Generation System Bond Resolution, payment of the principal of and accrued interest on the Generation System Bonds is not subject to acceleration. The District thus is liable for principal and interest payments only as they become due. The inability to accelerate the Generation System Bonds upon an Event of Default could give rise to varying interests between holders of earlier and later maturing Generation System Bonds. The nature and extent of any such variance would depend in part upon the nature and duration of any default. In the event of multiple defaults in payment of principal or interest on the Generation System Bonds, the bondholders would be required to bring a separate action for each such payment not made. Any such action to compel payment or for money damages would be subject to the limitations on legal claims and remedies against public bodies under Washington law. The District has never defaulted in the payment of principal or interest on any of its bonds.

## **Stand-by Trustee**

U.S. Bank National Association has been appointed to act as stand-by trustee (the "Stand-by Trustee") for the owners of all Generation System Bonds upon the occurrence of an Event of Default as set forth in the Generation System Resolution. See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Events of Default and Remedies." The Stand-by Trustee may resign or may be discharged by the District as long as an Event of

Default under the Generation System Bond Resolution has not occurred or by the owners of a majority of the outstanding Generation System Bonds. If the position of Stand-by Trustee becomes vacant because of resignation, discharge or otherwise, the District is required to appoint a Stand-by Trustee to fill the vacancy. At any time within one year after such appointment, the owners of a majority of outstanding Generation System Bonds may appoint a successor Stand-by Trustee, which will supersede any appointment of a Stand-by Trustee by the District. Once the 1995 Generation System Bonds and the 2001 Generation System Bonds are no longer outstanding and prior to an Event of Default, the District may discharge the Stand-by Trustee and would no longer be required to appoint a Stand-by Trustee prior to an Event of Default under the Generation System Bond Resolution, provided that the bondholders may appoint a Bondowners' Trustee upon an Event of Default. See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Events of Default and Remedies." The District intends to appoint the Stand-by Trustee as Bond Registrar and Paying Agent.

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## DEBT SERVICE

The following table shows the debt service requirements for the outstanding Generation System Bonds, excluding the Redeemed Bonds and including the 2010A Bonds, and for the 2010B Bonds.

### Generation System Debt Service Requirements

<b>Fiscal Year<sup>(2)</sup></b>	<b>Outstanding Generation System Bonds<sup>(1)</sup></b>		<b>2010B Bonds</b>		<b>Total</b>
	<b><u>Principal</u></b>	<b><u>Interest</u></b>	<b><u>Principal</u></b>	<b><u>Interest</u></b>	
2010	\$27,810,000	\$ 7,938,865		\$ 405,685	\$36,154,550
2011	19,445,000	10,783,700		785,196	31,013,896
2012	20,415,000	9,816,162		785,196	31,016,358
2013	21,170,000	9,061,850		785,196	31,017,046
2014	22,095,000	8,135,200		785,196	31,015,396
2015	23,070,000	7,161,150		785,196	31,016,346
2016	24,060,000	6,169,950		785,196	31,015,146
2017	25,205,000	5,022,200		785,196	31,012,396
2018	26,315,000	3,917,275		785,196	31,017,471
2019	27,605,000	2,622,725		785,196	31,012,921
2020	4,850,000	1,274,750	\$ 460,000	785,196	7,369,946
2021	5,030,000	1,080,750	475,000	761,028	7,346,778
2022	5,270,000	829,250	495,000	736,071	7,330,321
2023	5,525,000	565,750	510,000	710,064	7,310,814
2024	5,790,000	289,500	530,000	683,269	7,292,769
2025			545,000	655,422	1,200,422
2026			565,000	626,788	1,191,788
2027			585,000	594,696	1,179,696
2028			605,000	561,468	1,166,468
2029			630,000	527,104	1,157,104
2030			655,000	491,320	1,146,320
2031			675,000	454,116	1,129,116
2032			700,000	415,776	1,115,776
2033			725,000	376,016	1,101,016
2034			755,000	334,836	1,089,836
2035			780,000	291,952	1,071,952
2036			810,000	247,648	1,057,648
2037			840,000	201,640	1,041,640
2038			870,000	153,928	1,023,928
2039			905,000	104,512	1,009,512
2040			935,000	53,108	988,108
Total <sup>(3)</sup>	<u>\$263,655,000</u>	<u>\$74,669,078</u>	<u>\$14,050,000</u>	<u>\$17,238,407</u>	<u>\$369,612,485</u>

<sup>(1)</sup> Outstanding Generation System Bonds includes the 2001B Generation System Bonds and the 2002B Generation System Bonds and the 2010A Bonds and excludes the Redeemed Bonds.

<sup>(2)</sup> Fiscal year ending December 31.

<sup>(3)</sup> Totals may not add due to rounding.

## THE DISTRICT

### General

The District is a municipal corporation of the State of Washington established in 1936. The District maintains three systems: the Generation System, the Electric System and the Water System. Each of these systems is separately financed, and the District maintains separate books and records for each system. The District has reserved the right to combine the Generation System and the Electric System. The District began its electric utility operations in 1949 by purchasing the electric distribution facilities of Puget Sound Power & Light Company in Snohomish County and in the Camano Island portion of Island County. Its service area consists of virtually all of Snohomish County and Camano Island in Island County. The District is the largest public utility district and the second largest municipally owned utility in the Pacific Northwest in terms of customers served and energy sold by its Electric System. The administrative offices of the District are located in the City of Everett, the county seat of Snohomish County, which is approximately 20 miles north of Seattle.

Pursuant to the Enabling Act, the District is empowered to (i) purchase electric energy, (ii) sell electric energy at wholesale and retail, (iii) acquire, construct and operate electric generating plants and transmission and distribution facilities, and (iv) issue revenue obligations for the purpose of financing the acquisition and construction of electric properties and for other corporate purposes. The District also has authority to provide wholesale telecommunications services through its Electric System.

The District also is empowered and required by the Enabling Act to establish, maintain and collect rates and charges for services that will be fair, nondiscriminatory and adequate to provide revenues sufficient for (i) the payment of principal of and interest on its revenue obligations for which payment has not otherwise been provided and (ii) the proper operation and maintenance of its electric facilities and (iii) renewals and replacements thereto.

Cities in the District's service area have statutory authority to provide electric service, although no city in the District's service area presently provides electric service, nor is the District aware of any city that is considering providing electric service. The District also has statutory rights of eminent domain that, subject to certain limitations, enable the District to acquire various assets and property rights, including electric distribution facilities in Snohomish County of any private utility company that may seek to serve Snohomish County and Camano Island. The District's facilities in any city and its right to provide electric service in any city are subject to the reasonable police power regulation of such city.

### Commission

The District is governed by the Commission, which is comprised of three members, each elected from a separate commissioner district. The commissioners are elected at large for staggered six-year terms. The legal responsibilities and powers of the District, including the establishment of rates and charges for services rendered, are exercised through the Commission. The present commissioners of the District are as follows:

*Tanya "Toni" Olson, President*

Toni Olson began her first term as Commissioner on January 1, 2005. Ms. Olson previously held a number of management positions at the District until her retirement after 22 years of service. In addition to her utility background, she has extensive experience in public education and was the co-founder of a non-profit organization that delivered performing and visual arts programs to students throughout Washington State. Ms. Olson's term expires on December 31, 2010.

*David Aldrich, Vice-President*

David Aldrich began his first term as a Commissioner on January 1, 2003, and was re-elected to the Commission in November 2008. Mr. Aldrich previously served for six years as a Commission Policy Analyst for the District. Mr. Aldrich's prior experience also includes working as a forensic consultant and as policy analyst for the State Attorney General's Office. Mr. Aldrich holds a bachelor's degree in history from the University of California, Berkeley, and completed work for a bachelor's degree in philosophy at California State University, Hayward. Mr. Aldrich's term expires on December 31, 2014.

*Kathleen Vaughn, Secretary*

Kathleen Vaughn began her first term as a Commissioner on January 1, 1995, and was last re-elected to the Commission in November 2006. Ms. Vaughn is the owner of Goldmark Financial Corporation, a Snohomish County mortgage company. She also is co-owner with her husband of a construction firm. Prior to her election to the Commission, she was active in the community, running many youth organizations and serving as a precinct committee person. Ms. Vaughn's term expires on December 31, 2012.

**Administration**

The present administrative management of the District is as follows:

*Steve Klein, General Manager*

Before joining the District in April 2006, Mr. Klein was the Superintendent for Tacoma Power for 13 years. From 1988 to 1993, Mr. Klein was Tacoma Power's Power Manager; he began his career at Tacoma Power in 1978 as an engineer. He received a Bachelor of Science degree in electrical engineering from the University of Washington. He has served on many industry boards, often in a leadership capacity, including the Pacific Northwest Utilities Conference Committee (the "PNUCC"), Transmission Issue Group (the "TIG"), Bonneville Administrator's "Kitchen Cabinet," Bonneville Customer Collaborative, Public Power Council, Northwest Public Power Association, Public Generating Pool, and the Institute of Electrical and Electronics Engineers. Mr. Klein is recognized for creating the concept of "Electricom," which speaks to the integration of advanced telecommunications technology with the electric distribution delivery system. His vision led to construction and successful operation of the Click! Network in Tacoma. Mr. Klein is also a leader in the study and development of renewable energy, having been instrumental in the filing of the first permits for the study of tidal power in the Puget Sound area.

*Anne Spangler, General Counsel*

Ms. Spangler joined the District in May 2008 after serving four years as the Chief Assistant Attorney for Tacoma Public Utilities. Ms. Spangler's background includes practice with the Office of the Attorney General, representing the State Department of Transportation, with the City of Seattle as a land-use litigation attorney, and with the City of Tacoma, first as advisor to the City's wastewater, surface water and solid waste utilities, and later as chief counsel to the City of Tacoma's power, water and railroad utilities. Ms. Spangler has a Bachelor of Arts degree in anthropology from Reed College, a J.D. cum laude from the University of California, Hastings College of the Law, and a Utility Management Program Certificate from Willamette University's Atkinson Graduate School of Management. She has also been active in the Washington State Bar Association's Environmental and Land Use Section.



*Dana Toulson, Assistant General Manager – Power, Rates and Transmission Management*

Ms. Toulson joined the District in May 2006. Previously, she worked for Tacoma Power as an Assistant Power Manager and then as General Manager of the utility's Click! Network, which provides retail and wholesale telecommunications services. She brings experience from her long tenure with economic consultants Barakat & Chamberlin, Inc., where she served first as Senior Consultant and then as a Principal, where she provided economic consulting services to electric and gas utilities, regulatory commissions, and unregulated energy companies. Ms. Toulson has also managed the West Coast office of Energy Management Associates, Inc. and served as a senior economist for the California Public Utilities Commission. She holds a bachelor's degree in economics from Sonoma State University and a Master's degree in economics from San Francisco State University.

*Glenn McPherson, Assistant General Manager – Finance and Treasurer*

Mr. McPherson was appointed to his position in 1997. He joined the District in 1991 as controller and senior manager of budget and financial planning. Before coming to the District, Mr. McPherson was employed as controller for Scandia Down Corporation. Prior to that time, he was a senior manager with KPMG Peat Marwick. Mr. McPherson holds a Bachelor of Science degree in business administration from California State University at Long Beach and is a certified public accountant.

*Christopher Heimgartner, Assistant General Manager – Distribution and Engineering Services*

Mr. Heimgartner joined the District in May 2009 with over 28 years of experience in the electric utility industry and has served in a variety of leadership roles throughout his career. Mr. Heimgartner worked with Seattle City Light as its Customer Service & Energy Delivery Officer from 2006 to 2009. Prior to 2006, Mr. Heimgartner worked for Pacific Gas & Electric Company ("PG&E") in California for 25 years. During those years at PG&E, Mr. Heimgartner served as the Fresno division construction superintendent and managed an electrical distribution system with more than 13,000 miles of distribution wire, 285 feeders and a combined annual capital and operating budget of \$46 million. Mr. Heimgartner holds a Bachelor of Science degree in Electric Power Engineering from Rensselaer Polytechnic Institute and a Masters of Business Administration from St. Mary's College.

*Martha Hobson, Assistant General Manager – Information Services*

Ms. Hobson joined the District in September 2001 as a Senior Information Technology ("IT") Consultant and worked primarily as an IT project manager. In July 2004, she was appointed Interim Senior Manager of Applications and in April 2005, appointed Senior Manager of the Program Management Office and then Chief Technology Officer. Ms. Hobson brings more than 24 years of IT experience, of which 14 years have been in IT management. She has extensive project management experience as well as a wide range of industry IT experience including utility, retail, distribution, insurance and consulting. Ms. Hobson came to the District from Eddie Bauer where she was an Application Development Manager. She holds a Bachelor of Science degree in Human Development from the University of Vermont.

*Kim Moore, Assistant General Manager – Water Resources*

Mr. Moore joined the District on June 4, 2007. Mr. Moore had 27 years of experience with Tacoma Power and Tacoma Water in a variety of engineering and management positions, most recently as the power utility's assistant generation manager. He has worked in a broad range of areas, including site development, building construction, water distribution, hydroelectric power generation, and dam

safety. Mr. Moore holds a bachelor's degree in civil engineering from the University of Washington. He also holds numerous certifications in the water distribution field and as a professional engineer.

*Craig Smith, Assistant General Manager – Customer Services*

Mr. Smith joined the District in 1998 as a Senior Manager in the Power & Business Services Division. In November 2001, he was appointed Strategic Planning and Policy Governance Director. In October 2002, he became the Assistant General Manager of the Customer Services Division. In February 2006, his division was expanded by the addition of the Energy Efficiency, Business Services, Facilities, and Security and Emergency Planning Departments. Mr. Smith has over 20 years of related experience in the electric utility industry. Prior to joining the District, he was a Senior Manager for the Tennessee Valley Authority, and served as a Division Director and Senior Policy Advisor at the Michigan Public Service Commission. In addition to his public sector experience, Mr. Smith has also held various management positions with Pacific Gas and Electric Company, and Pacific Power and Light Company. He currently serves as Chairman of the Board of Directors at the Northwest Energy Efficiency Alliance and holds a bachelor's degree in Urban Planning and Social Policy Analysis from Antioch College.

## **The Generation System**

Pursuant to the Generation System Bond Resolution, the District established the Generation System, which is financed and accounted for as a system separate from the Electric System. The Generation System currently consists of the Henry M. Jackson Hydroelectric Project (the "Jackson Project"), the Everett Cogeneration Project (the "Cogeneration Project"), the Youngs Creek Hydroelectric Project (the "Youngs Creek Project") and the Woods Creek Hydroelectric Project (the "Woods Creek Project"). The Generation System could include any other electric generating, transmission and/or conservation facilities undertaken by the District in the future. The Jackson Project is an operating hydroelectric generating facility with a nameplate capacity of 111.8 MW located on the Sultan River 24 miles east of the City of Everett, Washington. The Cogeneration Project is situated on premises owned by the Kimberly-Clark Corporation ("Kimberly-Clark") in Everett, Washington. The District owns the Cogeneration Project, but the premises on which the Cogeneration Project sits is leased by the District. Kimberly-Clark is obligated to produce or otherwise provide the District with 325,000 MWh of electric energy per year. The Woods Creek Project is a small hydroelectric project in Snohomish County with a nameplate capacity of 0.65 MW. The Youngs Creek Project is currently under construction and is expected to be completed in mid-2011. When completed, it is expected to have a capacity of 7.5 MW. As of December 31, 2009, the total assets of the Generation System were \$320,500,000. See "THE GENERATION SYSTEM" and see "SECURITY FOR THE 2010B BONDS" for a discussion of the obligations of the Electric System to the Generation System.

## **The Electric System**

The Electric System presently consists of the District's transmission lines, substations, distribution lines, transformers, meters, and general plant. For the year ended December 31, 2009, the Electric System served an average of 318,530 customers and had energy sales of 8,428,832 MWh and operating revenues of \$586,229,000. In 2009, 83% of the District's Long-Term Energy Resources came from Bonneville, 9% from long-term contracts, 5% from the Jackson Project and 3% from the Cogeneration Project. The District also makes certain short-term purchases and sales to balance seasonal and daily variations in load and resources. The Electric System is primarily a distributor of power at retail rates. As of December 31, 2009, the total assets of the Electric System were \$1,712,228,000. See "ELECTRIC SYSTEM POWER SUPPLY."

## **The Water System**

The District's Water System became operational in 1946. The Water System is operated, financed, and accounted for separately from the Electric System and the Generation System. For the year ended December 31, 2009, the Water System served an average of 19,398 customers. The revenues of the Electric System and the Generation System are not pledged to the payment of operating expenses or debt of the Water System. The revenues of the Water System are not pledged to the payment of the expenses and obligations of the Electric System or Generation System. As of December 31, 2009, the total assets of the Water System were \$118,389,000 and its long-term debt was \$33,121,000. For additional information regarding the Water System, see Appendix A.

## **Labor Relations**

The District had the full-time equivalent of approximately 1,003 employees as of December 31, 2009. Of those, 562 employees are covered by a three-year collective bargaining agreement with the International Brotherhood of Electrical Workers – Local #77, which expires on March 31, 2012. The District strives to promote sound labor relations policies which are beneficial to the District and its employees. The District has not experienced any work stoppages in the past 20 years.

## **Insurance**

The District maintains a comprehensive insurance program. Property insurance coverage and retention levels under the District's insurance program are customary in the industry. The District's property insurance coverage has a \$400 million per occurrence limit with a \$250,000 deductible. The District's general liability coverage has a \$35 million per occurrence limit, in excess of a \$2 million self-insured retention. The District's self-insured retention fund balance at December 31, 2009, was approximately \$12.4 million. The District's general liability coverage of \$35 million includes acts of terrorism; however, coverage is limited to an aggregate of \$250 million for acts of terrorism for all policyholders of the provider. Thus, the amount of coverage available to the District under such policy may be limited. There is no guarantee that the District will maintain these coverage levels in the future.

## **Accounting**

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor's Office, under the authority of Chapter 43.09 RCW. The District uses the Federal Energy Regulatory Commission ("FERC") uniform system of accounts for class A electric systems. The District's financial statements include the financial position and results of operations for all enterprise operations which the District manages. The District qualifies for application of Financial Accounting Standards Board Accounting Code System 980 Regulated Operations, which allows for deferral of certain unrecognized gains and losses. See APPENDIX A – "FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND INDEPENDENT AUDITOR'S REPORT, Note 1."

The District contracts with Moss Adams LLP to perform the annual audit of the financial statements of the District. Moss Adams LLP has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. Moss Adams LLP also has not performed any procedures relating to this Official Statement. The District's latest audited financial statements are attached as Appendix A.

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

The District's full-time employees are members of the Washington Public Employees Retirement System ("PERS"), a cost sharing multi employer retirement system. Contributions to the system by both

employee and employer are based upon the gross wages covered by the plan benefits. PERS includes three plans: Plans I and II are defined benefit plans and Plan III is a combination defined benefit/defined contribution plan. Participation eligibility in the three plans is based on hire date and/or participant elections. The District's required contribution to PERS for the year ended December 31, 2009 was \$5.5 million. The Washington State Legislature sets employer contribution rates for PERS Plans I, II and III; the employer rate in effect as of December 31, 2009 was 5.31% of covered payroll. For a description of the state retirement plan, see APPENDIX A – "FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND INDEPENDENT AUDITOR'S REPORT, Note 5." 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.

The District provides post-employment health care and life insurance benefits to its retired employees. In 2007, the District adopted Governmental Accounting Standard No. 45, which provides guidance for the accounting and financial reporting for post-employment benefits other than pensions. Based on an actuarial study completed as part of the disclosure requirements, the unfunded actuarial accrued liability for these benefits as of January 1, 2010 was \$53.6 million. The District's annual post-employment healthcare benefit cost is calculated based on the annual required contribution (the "ARC") of the District. The ARC represents a level of funding that, if paid on an on-going basis, is projected to cover normal costs each year and amortize any unfunded liabilities (or funding excess) over a 30-year period. The District has established a separate fund to supplement the costs for the net post-employment obligation. That fund has \$2.3 million as of December 31, 2009. In addition, the Commission has approved an additional \$1.5 million in contributions to the net post-employment obligation in 2010. For a description of the post-employment related disclosures, see APPENDIX A—"FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND INDEPENDENT AUDITOR'S REPORT, Note 5."

In addition, the District offers its employees deferred compensation plans under Internal Revenue Code Sections 401(k) and 457, which permit employees to defer a portion of their compensation until future years.

In January 2010, the District submitted a "voluntary correction" to the District's 401(k) savings plan for approval by the Internal Revenue Service ("IRS") pursuant to its Employee Plans Compliance Resolution System ("EPCRS"). EPCRS is specifically designed to facilitate amendments to qualified plans to ensure their continued tax-favored status. The request for approval covered a two-month delay in adopting a separate plan amendment after the District's receipt of a letter ruling from the IRS formally approving that amendment, as well as a failure to execute a "second amendment" to that plan. The IRS has acknowledged receipt of the voluntary correction application, and the District is hopeful of receiving approval from the IRS, and in any event does not anticipate that resolution of these matters will have a material adverse effect on the District or its financial condition.

## **Investment Policy**

The District invests its available funds pursuant to an investment policy adopted by the Commission that emphasizes preserving principal, maintaining necessary liquidity, matching investment maturities to estimated cash flow requirements, and achieving maximum yield. Eligible investments include U.S. Treasury bonds, notes, bills or other government obligations of the U.S. Government or agencies of the U.S. Government; Governmental Sponsored Enterprise agency securities; 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 government 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 under the laws of the State of Washington, such as obligations of the State of Washington and of any political subdivision

of the State, including the District. For financial reporting purposes, the 1995 Generation System Bonds held in the 1995 Trust and the 2001A Generation System Bonds and the 2002A Generation System Bonds held in the 2001/2002 Trust are considered investments of the Electric System.

The District's investment policy also establishes maximum investment levels and other guidelines for various types of these investments. As of December 31, 2009, the District's major portfolio holdings include the Washington State Local Investment Pool (30.1%), Federal Home Loan Bank Notes (38.0%), Temporary Liquidity Guarantee Program Notes (10.2%), Federal Farm Credit Bank Notes (6.0%), Federal Home Loan Mortgage Corporation ("Freddie Mac") Notes (2.0%), Federal National Mortgage Association ("Fannie Mae") Notes (2.6%), Bank of America deposit (7.0%), and U.S. Bank deposit (3.3%). The majority of the District's investments in Freddie Mac and Fannie Mae notes mature on various dates through April 2010. The percentages listed above do not reflect the 1995 Generation System Bonds held in the 1995 Trust or the 2001A Generation System Bonds and the 2002A Generation System Bonds held in the 2001/2002 Trust. On September 7, 2008, the director of the Federal Housing Finance Agency (the "FHFA") announced that two Government Sponsored Enterprises ("GSEs"), Fannie Mae and Freddie Mac, were being placed into conservatorship run by FHFA. The U.S. Treasury committed to invest as much as \$200 billion in preferred stock and extend credit through 2012 to keep the GSEs solvent and operating. The Generation System Bond Resolution provides that money in the Bond Fund be invested in Investment Securities, as defined in the Generation System Bond Resolution. See APPENDIX A—"FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND INDEPENDENT AUDITOR'S REPORT," Note 2, and Table 2 for a summary of the District's investments.

### **General Obligation Bonds and Taxing Power**

The District is authorized to issue nonvoter-approved general obligation bonds for any corporate purpose of the District in an amount up to 3/4 of 1% of the total assessed value of the taxable property within the District. In addition, the District is authorized to levy an annual tax on all taxable property within the District up to 45¢ per \$1,000 of assessed value in any one year, exclusive of interest and redemption for general obligation bonds. The District has no outstanding general obligation bonds and does not levy a tax. The proceeds of any such tax would not be available to pay or secure the Generation System Bonds, including the 2010B Bonds, or the Senior Electric System Bonds.

### **Seismic and Other Risks**

The District is located in a seismically active region. The Puget Sound region has experienced a number of major earthquakes. There have been four major earthquakes in the last 50 years, the most recent in 2001. The 2001 earthquakes caused more than \$2 billion in damages in the region, but caused minimal damage within the District's service area and to District facilities. The largest known earthquake in the region occurred in approximately 1700, and is estimated to have been of a magnitude 9.0 or greater. Such an earthquake could cause extensive and even catastrophic damage within the District's service area, including District facilities. Earthquakes of that magnitude are currently estimated to occur in the region every 200 to 1,000 years. Such an earthquake along the Washington coast or elsewhere in the Pacific could result in a major tsunami, which in turn could cause additional and extensive damage to areas within the District's service area adjacent to Puget Sound. See "THE GENERATION SYSTEM—The Jackson Project—*Dam Safety Assessments*."

## THE GENERATION SYSTEM

### General

Pursuant to the Generation System Bond Resolution, the District has established the Generation System, which is financed and accounted for as a system separate from the District's Electric System. The Generation System is currently composed of the Jackson Project, the Cogeneration Project, the Youngs Creek Project (currently under construction) and the Woods Creek Project. In the future the District may construct, develop or acquire additional facilities and resources for the generation, transmission or conservation of power and energy as a part of the Generation System or another separate system. The District expects that any new generating resources developed or acquired by the District would become part of the Generation System. See "ELECTRIC SYSTEM POWER SUPPLY – The District's Future Power Supply Strategy." Pursuant to the Generation System Bond Resolution, the Electric System pays for all Generation System Power Costs to the extent not paid from other sources.

### The Jackson Project

The Jackson Project, located on the Sultan River approximately 24 miles east of the City of Everett (the "City") in south central Snohomish County, is a hydroelectric project that provides water supply to the City and power for the District. The Jackson Project's generating facilities comprise two large generating units rated at 47.5 MW each and two small generating units rated at 8.4 MW each, for a total nameplate capacity of 111.8 MW. The power output of the Jackson Project is delivered to the Electric System at a switchyard adjacent to the powerhouse.

The District operates the Jackson Project to produce the optimum amount of electrical energy, subject to specified minimum releases of water into the Sultan River for maintenance of the fishery and diversion of water as necessary into the City's water system reservoir. An agreement in 1961 and subsequent amendments in 1981, 2007 and 2008 set out the rights and duties of the City and District to use water at the Project. Jackson Project storage is used to capture water during high runoff periods and to provide water during low precipitation periods to maintain stream flows and for power production. Actual energy varies substantially throughout the year and from year to year.

The following table shows Jackson Project production for the last 11 years.

#### Jackson Project Energy Production

<u>Year</u>	<u>MWh</u>	<u>Annual Precipitation (Inches)</u>	<u>Cost of Energy Produced (cents/kWh)</u>
2009	394,246	147	7.7
2008	457,493	169	6.4
2007	431,341	172	6.3
2006	416,572	153	6.0
2005	303,260	119	8.4
2004	409,514	157	6.1
2003	407,846	154	6.2
2002	452,695	156	3.9
2001	338,846	166	6.8
2000	382,436	144	5.8
1999	540,722	202	4.3

The electrical generation output of the Jackson Project varies annually with the amount and timing of the precipitation received, and their impact on the stream flows feeding the project. Power production is highest in the late fall through late spring periods due to precipitation and snowmelt. This

output shape roughly matches the District's seasonal load pattern. However, requirements to maintain stream flows and technical restrictions limit the Jackson Project's ability to follow the District's load within a day. Under critical water conditions based on the lowest water year on record, output for the project is planned at 29.5 aMW or 258,420 MWh, but the Jackson Project can average as much as 45 aMW or 428,200 MWh under normal precipitation and stream flow conditions.

### **FERC License**

The District operates the Jackson Project with its co-licensee, the City of Everett, under a 50 year license issued on June 1, 1961 by the Federal Power Commission, predecessor to the FERC. In anticipation of the expiration of the license on May 31, 2011, the District and the City entered into an agreement in 2007 such that the City is not required to be a co-applicant on any application for a new license pursuant to the Federal Power Act. FERC approved this agreement in 2008.

The District filed a Final Application for New License ("FLA") with FERC as sole-licensee, on May 29, 2009. In the FLA, the District entered into settlement discussions with federal, state and local agencies, the cities of Everett and Sultan, the Tulalip Tribes and American Whitewater. Thereafter, a Settlement Agreement ("SA") was approved by all parties and filed with FERC on October 14, 2009. The SA did not contain conditions that substantially altered the physical characteristics of the Jackson Project, and called for a 45-year license term. The District anticipates it is likely to receive the new license for the Jackson Project, although it cannot predict with certainty that such license will not contain conditions that substantially alter the physical characteristics or power production capabilities of the Jackson Project, substantially increase the capital costs, or reduce the term of the new license. FERC also has the ability to issue a non power license, which would require the District to cease electrical production at the Jackson Project; to deny a new license; or to issue a license to a different licensee. Although it believes these alternatives are unlikely, the District in such case could, under the terms of the Federal Power Act, be entitled to compensation for its net investment, not to exceed fair value, in the Jackson Project. The District believes that both the "fair value" and "net investment" of the Jackson Project upon expiration of the District's original license would be at least equal to the amount of indebtedness outstanding at such time with respect to the Jackson Project, but cannot predict those values with certainty. The District would remain obligated to pay debt service on any Generation System Bonds outstanding if the FERC license renewal were denied.

### **Endangered Species Issues**

Fish listings that may affect Jackson Project operations include Puget Sound Chinook salmon, steelhead, and bull trout. Listed Puget Sound Chinook salmon and steelhead trout spawn and rear in the lower Sultan River below the City's diversion dam. Bull trout have a wide geographic range in the Pacific Northwest, with sub-populations using the lower Sultan River to forage for food. Studies are undertaken regularly to determine the status of the populations and any potential impacts of the Jackson Project. While it is unclear how these listings might affect operations, the District already has in place extensive measures to protect fish, including complex flow controls, a minimum flow regime and non-flow measures such as habitat restoration, research, monitoring and evaluation.

The U.S. Fish and Wildlife Service (the "USFWS") Western Washington field office web site indicates that five federally listed wildlife species may occur in Snohomish County. These species are the, northern spotted owl, marbled murrelet, gray wolf, grizzly bear and Canada lynx. Designated critical habitat for two of these species, the northern spotted owl and marbled murrelet, is also present in Snohomish County. USFWS also identified two candidate species for listing, the yellow-billed cuckoo and Oregon spotted frog, as possibly occurring in Snohomish County. Only the marbled murrelet (Federal threatened species) are known to occur within the Project area. The Jackson Project Wildlife Habitat Management Plan protects and enhances habitat used by this species. Project operations that might affect

this species such as road maintenance and repairs follow State Forest Practice guidelines to protect these species as appropriate. In addition as part of the SA, the Marbled Murrelet Habitat Protection Plan (“MMHPP”) was approved by the settlement parties and filed with FERC for the Commission’s approval. If FERC adopts the MMHPP as submitted, there will be minimal changes to current operations. However, it is unclear whether or how management of these species will change during relicensing, though it is possible that changes will result in increased expenditures and staff time from the District.

The studies conducted by the District as part of relicensing have not identified any Federally endangered plant species on Jackson Project lands. A Special Status Plant Survey was conducted in 2007 as part of relicensing for the Jackson Project. No federally-listed or state-listed species were documented during the survey. One species of lichen (*Usnea longissima*) designated sensitive on National Forest System lands by the U.S. Forest Service was observed on Jackson Project lands. The lichen is relatively common on the northern half of the Mt. Baker-Snoqualmie National Forest. Three U.S. Forest Service special status lichens (*Cetrelia cetrarioides*, *Nephroma bellum* and *Hypogymnia duplicate*) were observed on Project lands. All three sites are located in areas reserved from timber harvest activity and recreational use is limited to walk-in access. No risk to these populations is anticipated based on ongoing Jackson Project operations and Jackson Project-related recreation activity, though this is a topic for review during the relicensing process and could result in additional management and operational requirements. None of the four species are tracked by the U.S. Forest Service or the Washington Natural Heritage Program.

### **Dam Safety Assessments**

The Jackson Project is required by FERC to hire an independent consultant every five years to review all aspects of the project facilities for safe construction and operation. In 2006, an additional FERC-required exercise assessing the Potential Failure Modes of Culmback Dam was conducted by the District and an independent consultant, Montgomery Watson Harza. As part of these studies, previous analysis for a Maximum Credible Earthquake (“MCE”) was reviewed for currency with FERC engineering guidelines. The MCE is the highest credible earthquake loading to which the dam would be subject, based on FERC standards and such previous analysis includes a detailed review of both local crustal faults and larger regional or subduction events. Culmback Dam can withstand all of the earthquake loads analyzed as part of the MCE evaluation.

### **Project Security**

FERC required all licensees with dams whose failure would have significant impact on downstream populations to undertake a vulnerability assessment and develop a project security plan. The District’s current plan includes limiting public access to Culmback Dam by gating the approach roads, and the District has installed security cameras at strategic locations on and around the dam and powerhouse. FERC is requiring all licensees to update their security plans in 2010 in accordance with revised guidelines. As part of the SA and beginning in 2011, the District will allow motorized traffic to cross Culmback Dam to access public lands north of the dam. In response to this increased traffic, the District plans to augment the current security systems by adding additional cameras and improving fencing and signage. Security functions are monitored at all times, and may change through relicensing or reassessment of security risks and approaches.

### **The Cogeneration Project**

In 1993, the District and Scott Paper Company (“Scott”) entered into the Cogeneration Project Construction Agreement (the “Construction Agreement”) and the Cogeneration Project Operating Agreement (the “Operating Agreement”) (collectively, the “Cogeneration Agreements”) for the construction and operation of the Cogeneration Project as a renewable resource cogeneration facility. In 1995, Scott was merged into Kimberly-Clark, and Kimberly-Clark has assumed all of Scott’s



responsibilities under the Cogeneration Agreements. The Cogeneration Project is obligated to provide the District with 325,000 MWh of electric energy per year. The Cogeneration Project also provides Kimberly-Clark with steam for use in its pulp and paper manufacturing process. Commercial operations began on August 1, 1996. Under the terms of the Cogeneration Agreements, the District funded the Cogeneration Project's capital requirements, up to an agreed amount of \$115,151,000, and Kimberly-Clark assumed responsibility for Cogeneration Project construction and operation during the initial 15 years and any additional renewal terms elected by Kimberly-Clark. Renewable terms are in five-year increments until either the end of the useful life of the turbine generator or the last day of the 50th operating year.

In 1997, design review and modifications were performed on the new boiler constructed as a part of the Cogeneration Project. Performance tests were completed in March 1998. The boiler did not meet its original design criteria. The District and Kimberly-Clark began negotiations in 1997 for compensation to the District for the failure of the boiler to meet its performance criteria. In the settlement executed on April 13, 1999 between Kimberly-Clark and the District, Kimberly-Clark extended the Operating Agreement for an additional six years through 2017 as compensation for the failure of the boiler to perform. The additional six years extends Kimberly-Clark's obligations to operate and maintain the Cogeneration Project, to deliver 325,000 MWh annually, and to pay replacement power costs for energy not delivered, according to the terms outlined below.

If the Cogeneration Project is unable to deliver the obligated 325,000 MWh per year, the Operating Agreement provides that the District and Kimberly-Clark share the responsibility for replacement power costs based upon the following criteria: (i) If the shortfall is due to Kimberly-Clark's failure to operate and maintain the Cogeneration Project in accordance with mutually agreed upon standards, Kimberly-Clark must reimburse the District for the cost of replacement power; (ii) If the shortfall results from an unplanned outage on the turbine generator, Kimberly-Clark is not responsible for reimbursing the District for replacement power to cover the shortfall; and (iii) If the shortfall is the result of reduced steam output from the new boiler, Kimberly-Clark is responsible for 100% of the cost of replacement power.

In June 2007, the Cogeneration Project's turbine-generator experienced a three-month unplanned outage. Following an investigation and repairs, the turbine generator was placed back in service in September 2007. According to the Operations and Maintenance Standards in the Operating Agreement, Kimberly-Clark is obligated to compensate the District for power that was purchased from the wholesale market during the period that the Cogeneration Project did not produce energy. The District filed a claim against Kimberly-Clark for compensation for certain purchased power costs incurred during the period that the Cogeneration Project did not produce energy in accordance with its contractual obligation. See "LITIGATION – District Claim Against Kimberly-Clark."

### **Small Hydroelectric Generation Projects**

The District is currently evaluating additional renewable and non-greenhouse gas emitting resources, including small hydroelectric generating resources in the surrounding area, to meet future load. The District's investigation of small hydroelectric projects focuses on projects that the District anticipates will have minimal negative environmental impacts and will be cost effective. See "ELECTRIC SYSTEM POWER SUPPLY—The District's Future Power Supply Strategy—*District's 2008 Integrated Resource Plan*."

#### **Woods Creek Project**

The Woods Creek Project is located in Snohomish County, north of the city of Monroe, Washington, and has a nameplate capacity of 0.65 MW. This project is adjacent to Woods Creek, a

tributary of the Skykomish River, with the powerhouse located at a natural impassible barrier to anadromous fish. Prior to acquisition of this resource, the District had been purchasing the output from this small hydroelectric project since its construction in 1982. The Project received an exemption from FERC licensing in 1982 though the exemption places certain restrictions on the operation of the Wood Creek Project. The District purchased the powerhouse, two residences and 150 acres of land for \$1,600,000 in February 2008 and the appraised value of the land alone exceeded the purchase cost. The expected annual operation and maintenance costs for this facility is approximately \$50,000, with generating revenue being more than twice that amount.

### **Youngs Creek Project**

Located just south of the city of Sultan, Washington, the Youngs Creek Project is a FERC-licensed project that is partially constructed. The project has a capacity of 7.5 MW and is located on an approximately 23-acre site. The powerhouse will be located above a natural impassible barrier to anadromous fish on Youngs Creek, a tributary of Elwell Creek. In August 2008, the District entered into an agreement with Snoqualmie River Hydro to purchase the Youngs Creek Project, including associated lands and rights of access. Several conditions precedent were included in the agreement, including FERC approval of license transfer. All of these conditions were met, including transfer of the FERC license to the District, and the sale was finalized on October 10, 2008.

In fall 2008, the District requested that FERC extend the project's construction deadline to December 2011. FERC approved this request for extension in February 2009. The District anticipates construction and commissioning of the Youngs Creek Project will be complete by mid 2011. The estimated cost for energy for this project is approximately \$80 per MWh. The current estimate for project costs, including purchase, design, construction and construction management of both the generation and transmission facilities is approximately \$30 million.

### **Other Projects**

The District is also looking at various other generating projects, including, but not limited to tidal and geothermal energy projects, which are more fully described in "ELECTRIC SYSTEM POWER SUPPLY—The District's Future Power Supply Strategy." The District expects that these projects, to the extent they come to fruition, will be included as a part of the Generation System.

## Generation System Net Project and Annual Costs

The Generation System Bond Resolution requires the District to account for the revenues and expenses of the Generation System separately from the Electric System. The District has covenanted to purchase for use in the Electric System all power and energy available from the Generation System. The following table sets forth the annual costs of the Generation System since 2005 (in \$000s):

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Jackson Project	\$ 25,597	\$ 25,137	\$ 27,175	\$ 29,367	\$30,418
Cogeneration Project	<u>10,015</u>	<u>12,168</u>	<u>12,329</u>	<u>13,528</u>	<u>13,059</u>
Net Project Costs <sup>(1)</sup>	35,612	37,305	39,504	42,895	43,477
Other Costs <sup>(2)</sup>	<u>13,310</u>	<u>13,623</u>	<u>13,791</u>	<u>17,084</u>	<u>18,357</u>
Net Annual Costs	\$ <u>48,922</u>	\$ <u>50,928</u>	\$ <u>53,295</u>	\$ <u>59,979</u>	\$ <u>61,834</u>
Jackson Energy Output (MWh) <sup>(3)</sup>	303,260	416,572	431,341	457,493	394,426
Cogeneration Energy Output (MWh) <sup>(4)</sup>	<u>304,044</u>	<u>278,897</u>	<u>175,883</u>	<u>234,921</u>	<u>221,418</u>
Total Energy Output	<u>607,304</u>	<u>695,469</u>	<u>607,224</u>	<u>692,414</u>	<u>615,665</u>
Net Project Costs (\$/MWh) <sup>(5)</sup>	\$59	\$54	\$65	\$62	\$71
Net Annual Costs (\$/MWh)	\$81	\$73	\$88	\$87	\$100

<sup>(1)</sup> Net Project Costs include operating and maintenance, capital, tax, and debt service expenditures associated with the project, net of interest and other income, which are charged to the Electric System.

<sup>(2)</sup> Other Costs represents debt service expenditures on Generation System Bonds which are not directly related to current Generation System projects.

<sup>(3)</sup> Jackson energy output varies annually based on the timing of precipitation received in the Sultan River basin.

<sup>(4)</sup> In June 2007, the Cogeneration Project's turbine generator failed. See "THE GENERATION SYSTEM—The Cogeneration Project." Following an investigation and repairs, the turbine generator was placed back in service by Kimberly-Clark in September 2007.

<sup>(5)</sup> Excludes Other Costs (see Note 2 above). Variations in unit costs per MWh are primarily dependent on annual precipitation levels.

Forecasted annual costs of the Jackson Project and Cogeneration Project are not expected to vary materially from historical results; costs are expected to increase modestly as a result of inflationary pressures on the costs of labor and materials. Energy output is expected to vary annually based on the timing of the precipitation levels received in the Sultan River Basin for the Jackson Project and as a result of unforeseen mechanical disruptions in the case of the Cogeneration Project.

The Generation System had negative equity of \$104,208,000 at December 31, 2009. The accumulated deficit occurs because the Generation System receives revenue from the Electric System equal to Generation System cash operating costs, including debt service. Since non-cash operating expenses, such as depreciation, are not included in the calculation of revenue to be paid by the Electric System to the Generation System, the Generation System realizes annual net losses roughly equal to its non-cash expenses net of principal payment components of debt service.

## Future Generation System Expenditures

Total Generation System costs are expected to increase in future years as the District operates the Woods Creek Project (650 kW); constructs and operates the Youngs Creek Project (7.5 MW); and potentially identifies, develops, constructs or acquires other resources to meet future Electric System retail loads in accordance with the District's current IRP. The 2008 IRP, adopted by the Board in August 2009, forecast significant Generation System capital requirements with \$236,960,000 forecast from 2009 to 2014 and \$438,889,000 from 2015 to 2020. The District now expects to receive 50 aMW of additional

Tier 1 Power from Bonneville beyond the levels forecast in the 2008 IRP. See “Bonneville Power Administration – Regional Dialogue and New Contracts”. The result of this 50 aMW increase in Bonneville power beginning in 2012 is that the District will be able to defer many Generation System expenditures forecast in the 2008 IRP to future years. Revisions to this forecast are part of the 2010 IRP, which is underway. The District is considering participation in a 5 MW solar project that would be structured with a prepayment and buyout option after seven years. The prepayment option would amount to \$14 million due upon project completion in 2010. The District would likely finance the prepayment from reserves. Any other future resources would likely be funded, in part, through future issues of tax-exempt debt. See “ELECTRIC SYSTEM SUPPLY—The District’s Future Power Supply Strategy.”

## **Interest Rate Swaps – Generation System Bonds**

### **General**

The District has previously entered into three Swap Agreements: one with AIG in connection with the 1995 Generation System Bonds and two with Citigroup in connection with the 2001A Generation System Bonds and 2002A Generation System Bonds. See “SECURITY FOR THE 2010B BONDS - Payment of Generation System Power Costs as an Operating Expense of the Electric System” and “—Derivative Products and Payment Agreements—Generation System Bond Resolution” above and “APPENDIX A – Financial Statements for the Years Ended December 31, 2009 and 2008 and Independent Auditor’s Report.”

### **AIG Swap Agreement**

On July 6, 2009, the District was served with a lawsuit filed by AIG-FP related to the AIG Swap Agreement. Following a mediation held on March 22, 2010, AIG-FP and the District reached a settlement that will include releases of all claims, a termination of the AIG Swap Agreement, effective as of April 12, 2010, and a payment by the District to AIG-FP in the amount of \$14 million as payment in part for the economic loss to AIG-FP arising from the termination of the AIG Swap Agreement. See “SECURITY FOR THE 2010B BONDS—Derivative Products and Payment Agreements—Generation System Bond Resolution” and “LITIGATION—AIG Swap Agreement.”

### **Citigroup Swap Agreements**

In anticipation of the redemption of the 2001A Generation System Bonds and the 2002A Generation System Bonds, the District terminated the Citigroup Swap Agreements, effective as of April 20, 2010. The District paid an aggregate amount of \$20 million from available funds of the District. This included final scheduled payments of \$2.6 million, plus a termination amount of \$17.4 million (which compensates Citigroup for the economic loss and the District’s corresponding economic gain from terminating the Citigroup Swap Agreements).

## **THE ELECTRIC SYSTEM**

### **Electric System Properties**

The properties of the Electric System presently include transmission lines, substations, distribution lines, transformers, meters and general plant. As of December 31, 2009, the District had approximately 314 miles of 55/115 kV transmission lines. It is anticipated that future transmission lines will be at least 115 kV. The District’s distribution facilities generally consist of 12,470-volt overhead lines, supported by wood poles, 12,470-volt underground lines, 84 substations, distribution transformers, meters, and secondary lines and services, both overhead and underground. As of December 31, 2009, these facilities included 3,265 miles of overhead lines and 2,467 miles of underground lines. The District

has continually increased the substation and distribution line capacity to meet the needs of its customers and further increases are planned. See “ELECTRIC SYSTEM FINANCIAL INFORMATION – Management’s Discussion of the Electric System’s Financial Results – *Capital Expenditures*.” As of December 31, 2009, the District had 84 distribution substations with a combined capacity of 2,761,000 kVA. In addition, the District has three mobile transformer units with a combined capacity of 75,000 kVA.

The District and Verizon Northwest Inc. (as successor in interest to GTE Corporation) (“Verizon”) are parties to a Joint Pole Ownership Agreement (the “Verizon Joint Pole Ownership Agreement”) covering approximately 60% of the District’s utility poles. The Verizon Joint Pole Ownership Agreement became effective October 1, 2009 and has an initial term of five years, which may be extended for an additional five-year term upon mutual agreement of the parties. In May 2009, Verizon announced that it was planning to sell local wireline operations in predominately rural areas in 14 states, including Washington, to Frontier Communications (“Frontier”). Verizon and Frontier have announced that they expect to complete the transaction in 2010, contingent upon obtaining adequate financing and required regulatory and shareholder approvals.

As used in this Official Statement, consistent with its ordinary use in electrical engineering, the term “transmission” denotes the District’s 115-kV system, which, after voltage is stepped down in Bonneville’s substations, moves power delivered by Bonneville at 230 kV to lower-voltage feeders which exclusively serve the District’s retail electric customers. However, the District is neither a “Transmitting Utility” within the meaning of Section 3(23) of the Federal Power Act nor subject to FERC “reciprocity” requirements because the District’s Electric System neither moves electricity in interstate commerce nor serves wholesale customers, except with respect to certain obligations related to Bonneville, which do not implicate reciprocity requirements. Accordingly, nothing in this Official Statement is intended to imply that the District has acceded either to FERC jurisdiction over its electric system or to the reciprocity requirements of FERC Orders No. 888 and 890.

## **Electric Rates**

The District is required and empowered under Washington state law to establish, maintain and collect rates or charges for electric energy which are fair and nondiscriminatory and adequate to provide revenues sufficient for the payment of the principal of and interest on its revenue obligations and for the proper operation and maintenance of the Electric System and all necessary repairs, replacements and renewals thereof.

Retail rates and charges of the District are fixed by the Commission. The Commission holds public meetings to consider the District’s proposed budget, seven year construction plan, load forecast and effects on the District’s revenue requirements. Based on these planning documents, the District’s staff estimates revenue requirements and prepares various rate proposals designed to produce this revenue based on cost of service studies. Although the Commission typically holds multiple public meetings in order to introduce and explain its rate proposals to the public and to receive public comments, there is no particular statutory process that must be followed in order to enact a rate increase, and the Commission can accordingly enact rate increases very quickly, if necessary and reasonable to preserve financial stability.

The following table shows the rate adjustments approved by the Commission during the last 10 years:

<b><u>Effective Date</u></b>	<b><u>Average Increase (Decrease)</u></b>
April 1, 1999	5.0%
January 1, 2001	35.0
October 1, 2001	18.0
April 1, 2002	(5.0)
April 1, 2009	3.5
October 1, 2009	2.9

The January 1, 2001 rate increase of 35% was the result of an unprecedented increase in the market price of power for 2001 and beyond. At that time, the District was buying approximately 21% of its overall power supply from the short-term market (terms of one year or less). The high prices for that power had a significant impact on the District's total costs. The October 1, 2001 rate increase of 18% was the result of a 46% increase in the cost of power purchased from Bonneville. The District was able to decrease rates 5% effective April 1, 2002.

In July 2009, the Commission adopted a statement in its rate schedules expressing the District's intent to pass through any increases or decreases in the cost of power or transmission services from Bonneville, subject to the discretion of the Commission. Because the District contracts for over 80% of its power supply from Bonneville, changes Bonneville makes to its power and transmission rates have a significant effect on the District's overall power supply costs. The District's rate increase effective October 1, 2009 consisted solely of a pass through of the increased costs of power purchased from Bonneville.

Electric rates and charges of the District are not subject to the jurisdiction or control of the Washington Utilities and Transportation Commission (the "WUTC") or any other state or federal regulatory body. The FERC could potentially assert that it has jurisdiction over rates of licensees of hydroelectric projects and customers of such licensees under the Federal Power Act, although to date it has not exercised or sought to exercise such jurisdiction. The Public Utility Regulatory Policies Act of 1978 (the "PURPA") directs state regulatory authorities and non FERC jurisdictional utilities (including the District) to consider certain standards for rate design and other utility procedures. The District believes that it is operating in compliance with these PURPA ratemaking requirements.

## Electric Rates and Monthly Bills

The following table sets forth unit revenues and monthly bills for selected levels for typical residential, commercial and industrial customers of the District as of January 1, 2010.

Electric System Typical Rates and Monthly Bills				
	Average Rate (¢/kWh)		Monthly Bill	
	<u>Summer</u>	<u>Winter</u>	<u>Summer</u>	<u>Winter</u>
<b>Residential:</b>				
1,000 kWh per month	8.038	8.362	\$ 80	\$ 84
2,000 kWh per month	8.038	8.362	161	167
<b>Commercial:</b>				
1,500 kWh per month (12 kW demand)	7.721	8.547	116	128
9,000 kWh per month (30 kW demand)	7.195	8.024	648	722
<b>Industrial:</b>				
150,000 kWh per month (400 kW demand)	6.589	7.491	9,884	11,237
400,000 kWh per month (1,000 kW demand)	6.435	7.348	25,739	29,392
1,800,000 kWh per month (5,000 kW demand)	5.889	5.769	106,000	103,840

The District has a good record of collecting on its customer billings. Accounts receivable write-offs in 2009 were approximately 0.36% of energy sales revenue. Subject to statutory prohibitions against disconnecting customers in winter months, the District's collection policy provides for disconnection of power for nonpayment of amounts due the District.

### Comparative Electric Rates

The following table compares the District's average monthly electric bills with those of several other public and investor-owned Pacific Northwest utilities. The 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.

#### Electric System Comparable Monthly Electric Bills as of February 2010<sup>(1)</sup>

	Residential (1,000 kWh) (2,000 kWh)		Commercial (30 kW Demand 9,000 kWh Use)		Industrial (400 kW Demand 150,000 kWh Use)	
	<u>Summer</u>	<u>Winter</u>	<u>Summer</u>	<u>Winter</u>	<u>Summer</u>	<u>Winter</u>
<b>The District</b>	\$ 80	\$ 167	\$ 648	\$ 722	\$ 9,884	\$ 11,237
<b>Washington Cities</b>						
City of Seattle	80	163	574	574	8,696	8,696
City of Tacoma	68	130	577	577	7,297	7,297
<b>Investor-Owned Utilities</b>						
Avista Corp., Inc.	72	152	931	931	11,713	11,713
Pacific Power (a PacifiCorp Company)	69	148	600	635	8,467	9,062
Portland General Electric Co.	106	206	764	764	11,714	11,714
Puget Sound Energy	92	189	782	809	11,815	12,951
<b>Selected Western Washington State Public Utility Districts</b>						
PUD No. 1 of Clark County	85	161	680	680	9,016	9,811
PUD No. 1 of Cowlitz County	56	107	597	597	8,939	8,939

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

Source: The District and individual utilities.

### Largest Customers

The Electric System's ten largest customers in terms of revenues accounted for approximately 14% of total retail MWh energy sales and 11% of retail energy sales revenue in 2009. The top two customers accounted for less than 9% of total retail MWh energy sales and less than 7% of retail sales revenue for the year ended December 31, 2009. The District's ten largest customers in alphabetical order for calendar year 2009 in terms of retail energy sales revenue are: The Boeing Company, City of Everett, Fred Meyer Inc., Kimberly-Clark Corporation, Safeway Stores, Snohomish County, State of Washington, Tulalip Tribes Inc., United States Navy (Everett Naval Homeport) and Verizon Communications. For a discussion of Kimberly Clark Corporation, see "THE GENERATION SYSTEM—The Cogeneration Project."



## Customers, Energy Sales and Peak Demand

The following table presents the Electric System's customers, energy sales and peak demand during the five calendar years 2005 through 2009.

### Electric System Customers, Energy Sales, and Peak Demand

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Average Number of Customers					
Residential	272,829	278,812	283,927	287,253	288,691
Commercial	27,270	27,830	28,446	28,997	29,444
Industrial	77	78	78	75	76
Other <sup>(1)</sup>	477	312	316	320	319
Total Customers	<u>300,653</u>	<u>307,032</u>	<u>312,767</u>	<u>316,645</u>	<u>318,530</u>
Retail Energy Sales (MWh)					
Residential	3,188,146	3,306,472	3,478,709	3,606,495	3,583,254
Commercial	2,243,071	2,284,338	2,374,925	2,440,076	2,428,976
Industrial	850,519	865,568	896,203	880,789	833,967
Other	23,440	23,883	24,804	25,630	26,599
Total Retail Energy Sales (MWh)	<u>6,305,176</u>	<u>6,480,261</u>	<u>6,774,641</u>	<u>6,952,990</u>	<u>6,872,796</u>
Energy Losses and Electric System Usage (MWh) <sup>(2)</sup>	326,566	349,223	327,331	273,274	282,885
Wholesale Power Sales (MWh)	<u>1,862,105</u>	<u>2,417,671</u>	<u>1,480,494</u>	<u>1,664,656</u>	<u>1,556,036</u>
Total System Energy Requirements	<u>8,493,847</u>	<u>9,247,165</u>	<u>8,582,466</u>	<u>8,890,920</u>	<u>8,711,717</u>
Peak Demand (MW)	<u>1,368</u>	<u>1,401</u>	<u>1,417</u>	<u>1,560</u>	<u>1,531</u>

<sup>(1)</sup> In 2006, the District restructured the suburban street lighting ("SSL") program such that these billings are now included in customers' regular billings; as a result, SSL customer accounts are no longer included in the "Retail Energy Sales – Other" category.

<sup>(2)</sup> Includes non-revenue MWh used internally by the Electric System, line losses and energy unbilled at the end of the period.

The District's average number of customers increased by 17,877, reflecting a compound annual rate of 1.5% from 2005 to 2009. During this period average residential customers increased at a compound annual rate of 1.5%, average commercial customers increased at a compound annual rate of 2.0%, and average industrial customers decreased at a compound annual rate of 0.5%, primarily as a result of reclassifying accounts to more accurately define industrial and commercial customers.

Residential energy sales between 2005 and 2009 increased from 3,188,146 MWh to 3,583,254 MWh, a compound annual rate of 3.0%. Commercial sales increased from 2,243,071 MWh in 2005 to 2,428,976 MWh in 2009, a compound annual rate of 2.0%. Industrial sales increased at a compound annual rate of 2.6% from 2005 to 2007; however, industrial energy sales declined in 2008 and 2009 as a result of the impacts of the economic recession.

Wholesale power sales decreased from 1,862,105 MWh in 2005 to 1,556,036 MWh in 2009. The amount of wholesale power sales varies year-to-year due to changes in annual hydrological conditions, increasing retail customer demand, and the expiration of power supply contracts. Approximately half of the power provided from Bonneville to the District is delivered under the "Slice" contract, which provides power based on the production of the Federal System (as defined below in "ELECTRIC SYSTEM POWER SUPPLY – Bonneville Power Administration – *Background*"). At certain times of the year, and under certain hydrological conditions, the Slice product delivers power to the District in excess of retail consumption which the District sells in the wholesale market. See "ELECTRIC SYSTEM POWER SUPPLY—Bonneville Power Administration —*Bonneville Contracts*."

## ELECTRIC SYSTEM POWER SUPPLY

### Overview

In 2009, over 83% of the District's long-term energy resources came from Bonneville, 9% from long-term contracts, 5% from the Jackson Project and 3% from the Cogeneration Project. The District purchases and sells power in the short-term energy markets to balance the seasonal and daily variations in customer loads and the District's owned and contracted resources.

The following table presents the Electric System's energy resources for 2005 through 2009:

<b>Electric System Energy Resources (Megawatt Hours)</b>					
	<u><b>2005</b></u>	<u><b>2006</b></u>	<u><b>2007</b></u>	<u><b>2008</b></u>	<u><b>2009</b></u>
Long-Term Energy Resources:					
Bonneville	6,562,489	7,217,148	6,807,991	6,873,275	6,565,381
Power Purchase Contracts <sup>(1)</sup>	438,000	438,000	219,000	219,600	219,000
Jackson Project	303,260	416,572	431,341	457,493	394,246
Cogeneration Project <sup>(2)</sup>	304,044	278,897	175,883	234,921	221,418
New Renewable Energy Contracts <sup>(3)</sup>	43,800	43,800	58,026	133,221	541,166
Other	694	639	873	1,411	1,039
Total Long-Term Energy Resources	7,652,287	8,395,056	7,693,114	7,919,921	7,942,250
Short-Term Energy Purchases <sup>(6)</sup>	<u>841,560</u>	<u>852,109</u>	<u>889,352</u>	<u>970,999</u>	<u>769,467</u>
Total Energy Resources	8,493,847	9,247,165	8,582,466	8,890,920	8,711,717
Wholesale Power Sales <sup>(5)</sup>	<u>(1,862,106)</u>	<u>(2,417,671)</u>	<u>(1,480,494)</u>	<u>(1,664,656)</u>	<u>(1,556,036)</u>
Total Net Energy Resources	<u><u>6,631,741</u></u>	<u><u>6,829,494</u></u>	<u><u>7,101,972</u></u>	<u><u>7,226,264</u></u>	<u><u>7,155,681</u></u>

<sup>(1)</sup> Power Purchase Contracts reflects two long-term power purchase contracts for approximately 219,000 MWh each that expired in 2006 and 2009, respectively.

<sup>(2)</sup> Kimberly-Clark, which operates the Cogeneration Project, is contractually obligated to produce or otherwise provide 325,000 MWh per year. Any shortfalls in annual production are reflected in Short-Term Energy Purchases. Kimberly-Clark compensates the District for these additional purchases at wholesale market rates.

<sup>(3)</sup> New Renewable Energy Contracts include the Klickitat County PUD Landfill Gas contract, which began in 1998 and expired in May 2009, a new Klickitat County PUD Landfill Gas contract that began in November 2008, the Packwood Hydroelectric Project contract, which began in October 2008, the White Creek Wind Contract, which began in January 2008, and the Hay Canyon and Wheatfield Wind Project Contracts, which began in March and April 2009, respectively. See "ELECTRIC SYSTEM POWER SUPPLY – Long-term Third-Party Purchase Contracts."

<sup>(4)</sup> Short-Term Energy Purchases represent energy purchases made daily to balance customer demand with power resource availability and purchases to make up for any Cogeneration Project shortfalls.

<sup>(5)</sup> Wholesale Power Sales include energy sales made daily to balance customer demand with power resource availability, a 10 aMW conservation transfer to Puget Sound Energy which ended February 2010, and a long-term power sales contract to the Sacramento Municipal Utility District, which ended September 2007.

The following table presents purchased power costs for the Electric System for 2005 through 2009:

**Electric System  
Purchased Power Costs  
(\$000s)**

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Long-Term Energy Purchases:					
Bonneville <sup>(1)</sup>	\$ 198,747	\$ 198,768	\$ 187,105	\$ 160,295	\$ 168,265
Power Purchase Contracts <sup>(2)</sup>	60,020	41,739	40,995	23,058	22,995
Jackson Project	25,598	25,137	27,175	29,367	30,418
Cogeneration Project <sup>(3)</sup>	8,234	10,144	3,990 <sup>(2)</sup>	7,455	9,235
<b>Other Generation System Costs</b> <sup>(4)</sup>	13,310	13,623	13,790	17,084	18,357
New Renewable Energy Contracts <sup>(5)</sup>	1,665	1,698	2,320	6,880	38,799
Other	6,524	6,515	3,810	4,091	4,323
Total Long-Term Energy Purchases	314,098	297,624	279,185	248,230	292,392
Short-Term Energy Purchases:					
Market Purchases	45,744	44,552	53,890	65,833	45,807
Other	1,644	1,545	2,844	3,312	3,978
Total Purchased Power Costs	361,486	343,721	335,919	317,375	342,178
Wholesale Power Sales	(90,058)	(105,467)	(65,948)	(80,761)	(51,076)
Net Cost of Energy Purchased	\$ 271,428	\$ 238,254	\$ 269,971	\$ 236,614	\$ 291,102
Total Energy Purchases (MWh)	8,493,847	9,247,165	8,582,466	8,890,920	8,711,717
Less: Wholesale Power Sales	(1,862,106)	(2,417,671)	(1,480,494)	(1,664,656)	(1,556,036)
Net Energy Purchases (MWh)	6,631,741	6,829,494	7,101,972	7,226,264	7,155,681
Total Purchased Power (cents/kWh) <sup>(6)</sup>	4.3¢	3.7¢	3.9¢	3.6¢	3.9¢
Net Purchased Power (cents/kWh) <sup>(6)</sup>	4.1¢	3.5¢	3.8¢	3.3¢	4.1¢

<sup>(1)</sup> In 2008 and 2009, expenditures for Bonneville power purchases were reduced by a credit related to the settlement of a dispute regarding the level of Residential Exchange benefits provided to investor-owned utilities. This credit was \$30.1 million in 2008 and \$17.1 million in 2009. See "BONNEVILLE POWER ADMINISTRATION – Bonneville Residential Exchange Program."

<sup>(2)</sup> Power Purchase Contracts reflect the impact of two long-term power purchase contracts for approximately 219,000 MWh each that expired in 2006 and 2009. Additionally, the 2005 and 2006 results included \$19.9 million and \$1.7 million, respectively, related to the amortization of a termination payment for a third power purchase contract, and the 2007 results included an \$18 million termination payment on a fourth long-term power purchase contract.

<sup>(3)</sup> In June 2007, the Cogeneration Project's turbine-generator experienced a three-month unplanned outage. Following an investigation and repairs, the turbine generator was placed back in service in September 2007. According to the Operation and Maintenance Agreement, Kimberly-Clark is obligated to compensate the District for power that was purchased from the wholesale market during the period that the Cogeneration Project did not produce energy. See "THE GENERATION SYSTEM—Cogeneration Project." The District has made a claim against Kimberly-Clark for compensation for certain purchased power costs incurred during the period that the Cogeneration Project did not produce energy in accordance with its contractual obligation. The claim for compensation (See Footnote 1 above) was treated as an offset to the Cogeneration Project costs in 2007. See "LITIGATION – District Claims Against Kimberly-Clark."

<sup>(4)</sup> Represents that portion of the Generation System's Series 1995, 2001A and 2001B debt service used by the Generation System to purchase the Electric System's interest in a coal-based power project; the District's interest in the project was sold to a third party in 2000.

<sup>(5)</sup> New Renewable Energy Contracts costs include the Klickitat County PUD Landfill Gas contract which began in 1998 and expired in May 2009, a new Klickitat County PUD Landfill Gas contract that began in November 2008, the Packwood Hydroelectric Project contract, which began in October 2008, the White Creek Wind Contract which began in January 2008, and the Hay Canyon and Wheatfield Wind Project Contracts which began in March and April 2009, respectively. See "ELECTRIC SYSTEM POWER SUPPLY – Long-term Third-Party Power Purchase Contracts."

<sup>(6)</sup> Total Purchased Power (cents/kWh) represents the Total Purchased Power Costs divided by the Total Energy Purchases expressed in kWh. Net Purchased Power (cents/kWh) represents Net Cost of Energy Purchased divided by Net Energy Purchases expressed in kWh.

## **Bonneville Power Administration**

### **Background**

The Bonneville Power Administration is a self-financed, not-for-profit federal agency under the Department of Energy that markets wholesale electricity generated at 31 federal hydroelectric projects in the Columbia River basin, one nonfederal nuclear plant and several other small nonfederal power plants. The federal hydroelectric projects are built and operated by the United States Bureau of Reclamation and the United States Army Corps of Engineers, and are located in the Columbia River basin. Bonneville markets power from resources having an expected aggregate output of approximately 11,078 annual aMW under average water conditions and approximately 8,863 annual aMW under critical water conditions. The federal hydroelectric projects and the electrical system are known collectively as the Federal Columbia River Power System (the “Federal System”), and currently produce more than one-third of the region’s electric energy requirements. Bonneville sells electric power at wholesale rates to more than 125 utility, industrial, tribal and governmental customers in the Pacific Northwest. Its service area covers over 300,000 square miles in Idaho, Oregon, Washington and parts of Montana, Nevada, Utah and Wyoming, with a population of about 12 million. Bonneville is responsible for paying all hydroelectric-related operation and maintenance and capital recovery costs of the Federal System.

### **Bonneville Power Contracts**

In 2001, the District entered into a long-term power sales agreement with Bonneville, purchasing a product called “Block-Slice.” The Block-Slice product is a combination of two energy products: the Block component provides a set amount of energy delivered in a flat block over all hours in a given month, with the energy amount varying each month based on the District’s loads; the Slice component represents a “slice” or percentage of the actual output of the Federal System. The contract term ends September 30, 2011, at which time a new long-term power sales agreement becomes effective for the period October 1, 2011 through September 30, 2028.

*Block Product.* The Block product provides the District with power in flat monthly amounts that average 353 aMW over a contract year. The amount of energy the District receives from the Block product is based on the District’s typical monthly load shape. In January, for example, the Block product provides 449 aMW, while in June, the total is 287 aMW. In 2009, the District received 3,093,462 MWh from the Block product, at a total annual cost of \$80.3 million. In October 2010, the Block product rate will rise from \$25.95/MWh to just under \$28/MWh.

*Slice Product.* The Slice product is delivered in variable amounts that reflect the actual output of the Federal System. It provides the District with the ability to follow its customer loads by storing and dispatching energy within the contractual constraints and physical limits of the Federal System. Under the Slice product, the District takes responsibility for managing its portion of the Federal System, and assumes the inherent risks. If snowpack and water conditions are above average in the region, the energy output is also above average. If snowpack and water conditions are low, the District’s energy supply is correspondingly reduced. As a purchaser of the Slice product, the District has an obligation to pay its pro-rata share of Bonneville’s actual operating costs. The District’s share of the Slice of the Federal System is 4.9929%. At critical water conditions, this represents 353 aMW. In 2009, the District received 3,471,919 MWh in total Slice energy, at a total annual cost of \$112 million, which equates to \$32.26 per MWh. The majority of the District’s short-term wholesale market sales are from surplus Slice energy, which varies with the seasonal and daily variations in the Slice product’s output.

After the end of each fiscal year, Bonneville “true up” the difference between its actual costs and the budget for the year through the Slice True-Up Adjustment charge or credit. The District’s share of the

2009 True-Up Adjustment was a credit of \$3.4 million. Bonneville has estimated the District's share of the 2010 True-Up Adjustment is to be a credit of \$2.2 million.

The Slice portion of the District's power sales agreement with Bonneville includes a separate Creditworthiness Agreement to secure the District's payment obligations. Under the provisions of the Creditworthiness Agreement, the District would be required to provide credit support through a letter of credit if the District's long-term credit rating were to drop below BBB-. The maximum amount of credit support or collateral is based on the factor of 0.12 multiplied by the District's total annual cost for Slice, or \$14 million. To date, the District has not had to provide collateral for this purpose.

During Bonneville fiscal years 2006 through 2009, the District participated in the agency's Customer Flexible Priority Firm Program. The Customer Flexible Priority Firm Program helped reduce power rates for all of Bonneville's preference customers. As part of its formal power ratemaking process for fiscal years 2010-2011, conducted in 2009, Bonneville considered and decided not to renew the Customer Flexible Priority Firm Program and on June 2, 2009, advised the District that it was terminating the program effective June 30, 2009. The program had obligated the District to provide a \$21 million dollar irrevocable letter of credit, which was paid for by Bonneville. Bonneville returned the District's letter of credit to Bank of America, N.A. and, at the District's request, Bank of America, N.A. terminated the letter of credit effective as of June 5, 2009. There were no draws on this letter of credit. See "SECURITY FOR THE 2010B BONDS – Contingent Payment Obligations."

### **The Regional Dialogue and New Contracts**

In 2000 and early 2001, the West Coast experienced unprecedented increases in energy prices, which resulted in publicly-owned utilities placing additional load on Bonneville. Given Bonneville's statutory obligation to serve and commitments made to investor-owned utilities (the "IOUs") and direct service industries, the agency was forced to purchase roughly 3,000 aMW of power from the high-priced and volatile energy market. These actions led to large Bonneville rate increases, with associated adverse impacts on the Pacific Northwest economy and District customers. Bonneville's operations came under scrutiny by both federal and regional groups, with many parties advocating that the Pacific Northwest would be best served by limiting the role of Bonneville to primarily that of a marketer of cost-based Federal System power. Bonneville began a Regional Dialogue process with its customers and other stakeholders, which culminated in July 2007 with the publication of the Long-Term Regional Dialogue Policy Record of Decision (the "Regional Dialogue Decision").

The Regional Dialogue Decision called for allocating Federal System power to Bonneville's preference customers using a tiered rate construct. Beginning October 2011, utilities will purchase power from Bonneville's existing Federal System resource base ("Tier 1 Power") at cost (the "Tier 1 Rate") in an amount equal to their share of the total load placed on Bonneville in 2010 or in some cases, in a fiscal year prior to 2010. In 2011, Bonneville will determine the amount of energy each utility will be eligible to purchase at the Tier 1 Rate. The allocation will reflect the utility's actual 2010 (or in some cases, in a fiscal year prior to 2010) retail load (in aMW), less certain resources the utility has contractually defined to serve its load. This amount will be considered the utility's "High Water Mark."

A utility may elect to purchase power from Bonneville for customer loads above its High Water Mark ("Tier 2 Power"), at a rate reflecting Bonneville's incremental costs for additional resources ("Tier 2 Rate"). Alternatively, a utility may acquire power itself to serve loads above its High Water Mark. In either case, publicly-owned utilities will face the cost of new resource acquisitions directly and will be responsible for serving their own load growth. Bonneville will no longer combine the costs of existing and new resources in its power rates.

On December 1, 2008, the District formally executed a new Bonneville power contract, purchasing Bonneville's Block-Slice product for the period October 2011 through September 2028.

The Block component of the new Block-Slice product is identical to the District's existing Block contract. It provides a set amount of energy delivered in a flat block over all hours in a given month, with the energy amount varying each month based on the District's loads. Beginning in October 2011, the District's Block component will increase from 353 aMW to approximately 403 aMW and will be priced at the Tier 1 Rate.

The Slice component under the new contract will provide the District with variable amounts of power that reflect the actual output of the existing Federal System. The Slice purchase amount is based on a calculated percentage which represents the amount of output the District is entitled to purchase from Bonneville at the Tier 1 Rate. The District's current Slice percentage is 4.9929% or 353 aMW under critical water conditions. Under the new contract, the District's Slice percentage will increase from 4.992% to 5.4894%, or from 353 aMW to approximately 412 aMW at critical water conditions.

In October 2009 the Commission elected to use its existing resources to serve the District's customer load above its High Water Mark for the 2012 through 2014 period. The District has the option to purchase Tier 2 Power from Bonneville in later periods as long as it provides formal notice of its intent to do so. These notice periods are (i) September 2011 for Fiscal Years 2015-2019, (ii) September 2016 for fiscal years 2020-2024 and (iii) September 2021 for fiscal years 2025-2028

The quantity of Tier 1 Power the District will be allocated will vary from rate period to rate period depending on: (1) the District's actual load measured in 2010, or in some cases, in a fiscal year prior to 2010; (2) the forecast output capability of the Federal System; (3) and the total demand for Tier 1 Federal System power from all of Bonneville's preference customers. Preliminary estimates from Bonneville indicate the District could receive roughly 815 aMW of Tier 1 power annually through the end of the contract period.

### **Bonneville Residential Exchange Program**

The Northwest Power Act of 1981 provides that a utility may offer power to Bonneville, and Bonneville will purchase power from the utility at the utility's average system cost (ASC). In exchange, Bonneville sells an equivalent amount of power to the utility's residential and small farm customers at its established Priority Firm (PF) Exchange rate. This "exchange rate" is a price per megawatt-hour, established in the rate case. Under Bonneville's Residential Exchange Program, benefits are settled financially with no energy exchanged.

In Bonneville's 2002 rate case (the "WP-02"), preference power rates included costs for Residential Exchange Program Settlement Agreements with six IOUs (the "Settlement Agreements"). Bonneville allocated the majority of these costs to the preference power rate, which increased costs to preference customers, including the District. A number of parties challenged the WP-02 power rate in the Ninth Circuit Court of Appeals, alleging that the Settlement Agreements violated the Northwest Power Act. In May 2007, the Ninth Circuit held that the Settlement Agreements were inconsistent with the Northwest Power Act and remanded the issue back to Bonneville.

Following the Ninth Circuit remand, Bonneville temporarily suspended payments to the IOUs, but continued to collect the cost of the Settlement Agreements in power rates. To determine the amount of residential exchange benefits the IOUs received during fiscal years 2002-08 as compared to the amount the IOUs would have received absent the Settlement Agreements, Bonneville re-opened its 2007 wholesale power rate case (the "WP-07 Supplemental"). The WP-07 Supplemental rate case addressed the difference between the two benefit amounts and established new power rates for fiscal year 2009.

Bonneville offered two interim agreements to address the overcollection of residential exchange benefits and to re-start benefits to the IOUs prior to completion of the supplemental rate case. For overcollections in Bonneville's 2007 and 2008 fiscal years, the District received an interim payment in April 2008 of \$20.6 million, the amount Bonneville estimated the District overpaid during those fiscal years.

At the conclusion of the WP-07 Supplemental Rate Case in September 2008, Bonneville issued its Record of Decision (the "ROD"). The ROD determined that the District would receive an additional \$4.4 million to adjust for the remaining overcollection of costs in the 2007-2008 periods. Under the ROD, Bonneville also determined "Lookback Amounts" due to preference customers for overcollection of Residential Exchange benefit costs for the 2002 through 2006 period. The Lookback Amounts are to be credited to preference customers' power bills on a monthly basis spread out over a period of eight years. The District's Lookback Amount for 2009 was a credit of \$15.6 million. In 2010 and 2011, \$9 million per year will be credited, and for 2012 through 2016, approximately \$6 million per year is estimated to be credited. The ROD also established the terms of Residential Purchase and Sale Agreements ("RPSAs") offered to those utilities who will be participating in the Residential Exchange Program during 2009. Finally, the ROD also established a one percent decrease to Bonneville power rates for fiscal year 2009.

There have been a number of petitions for review filed in the Ninth Circuit, seeking review of portions of Bonneville's decision made in the WP-07 Supplemental Rate Case. In December 2008, a number of parties, including the District, filed petitions seeking review of Bonneville's residential exchange benefit related decisions. A group of investor-owned utilities filed petitions seeking review of Bonneville's RPSA-related decisions. In October 2009, after FERC approved the rates established in the WP-07 Supplemental rate case, Avista Corporation and other utilities, both investor-owned and publicly owned, also filed petitions seeking review of the 2009 rate decisions made by Bonneville in the WP-07 Supplemental Rate Case.

The Ninth Circuit initially stayed the petitions for review of the WP-07 Supplemental Rate Case and RSPA matters to allow the parties to discuss a possible settlement. The schedule was amended to permit the briefing to be filed with the court, and a subsequent settlement effort is scheduled for April and May of 2010.

During Bonneville's ratemaking process for fiscal years 2010-2012, Bonneville determined that the District's residential customers were eligible to participate in its Residential Exchange Program for Bonneville's fiscal year 2010 and 2011. The District expects to receive \$9 million in benefits in fiscal year 2010 and \$8 million in fiscal year 2011. These benefits are to be distributed to the District's residential customers in the form of rate credits.

### **Bonneville's Transmission Service Contracts**

The District contracts with Bonneville for its firm transmission needs. In the late 1990s, Bonneville unbundled its electric power and transmission services, requiring that each be purchased separately. The District and Bonneville entered into a service agreement for firm point-to-point transmission for approximately 1,618 MW through September 30, 2006. In 2002, the District extended its transmission contract through September 30, 2026. These contracts now include 19 different Points-of-Receipt (where Bonneville will receive power for delivery to the District) and nine Points-of-Delivery (where Bonneville will deliver power for the District). Of the 1,618 MW of capacity, 1,157 MW are designated for delivery to the District's service territory. The remaining 461 MW are used to move power in the spring and summer when energy from the Slice product exceeds District loads. When the District requires more than 1,157 MW delivered to its service area, the staff formally requests Bonneville, through

its Open Access Same-Time Information System (the “OASIS”), to “redirect” its contract capacity to other District interconnection points.

As part of its long-term planning, the District participated in Bonneville’s 2008 Network Open Season process and requested an additional 350 MW of transmission capacity spread out in 50 MW and 100 MW increments over the period 2011-2018. Through this process the District received 250 MW of additional transmission capacity, with the remaining 100 MW to be received pending completion of construction of new transmission lines, which Bonneville is proceeding to build. Bonneville used the Network Open Season process to identify regional transmission requirements over the next 10 years and required a financial commitment from utilities seeking to reserve future transmission capacity. See “SECURITY FOR THE 2010B BONDS—Contingent Payment Obligations.”

The District also has contractual rights on the Pacific Northwest AC Intertie (the “Third AC”), the 500 kV transmission line constructed by Bonneville between John Day, Oregon, and the California-Oregon border in 1993. The line added 1,600 MW of capacity to Bonneville’s network, and as a result of Congress’ requirement for nonfederal participation, Bonneville offered ownership rights to nonfederal customers. In 1994, the District executed a Pacific Northwest Intertie Capacity Ownership Agreement with Bonneville for 42 MW or a 1.217% share of the Third AC capacity.

The Pacific Northwest Intertie Capacity Ownership Agreement allows the District bi-directional use of the Third AC capacity for numerous business transactions and requires the District to pay a portion of the annual operating costs. Bonneville operates and maintains the north end of the Third AC. The District and other capacity owners may participate in decisions regarding the operation and maintenance of the Third AC and, depending on circumstances, may be able to appeal to arbitration for resolution of conflicts over management of the Third AC.

In accordance with the provisions of the Pacific Northwest Intertie Capacity Ownership Agreement, the District can assign its Third AC capacity scheduling rights to another party, subject to Bonneville approval. In February 2009, the District executed a 15 year agreement assigning 100% of its Third AC scheduling rights to Iberdrola Renewables, Inc. Bonneville approved the assignment of the District’s Third AC capacity and scheduling rights to Iberdrola on March 31, 2009.

Under the 15 year assignment agreement, Iberdrola is required to make two lease payments to the District. The first lease payment was received by the District in April 2009, with the second payment due in April 2010. Iberdrola has assumed responsibility for the District’s share of the annual operating costs and any capital expenditures that may arise during the term of the assignment. At the end of the 15 year contract term, the Third AC capacity and scheduling rights revert back to the District. See – “*Long Term Third-Party Power Purchase Contracts - Hay Canyon Wind Project.*”

### **Bonneville and Energy Northwest**

Energy Northwest is a municipal corporation and a joint operating agency organized and existing under the laws of the State of Washington. It has the authority to acquire, construct and operate works, plants and facilities for the generation and transmission of electric power and energy. The membership of Energy Northwest includes 28 member utilities, all located in the State of Washington. The District is currently a member of Energy Northwest and holds a seat on the Board of Directors with two votes.

Energy Northwest’s Columbia Generating Station nuclear plant is included with Bonneville’s federal facilities for purposes of integrated resource planning and operation. Bonneville markets power from and is responsible for paying the capital costs of certain Energy Northwest nuclear projects and other non-federal projects.



The District, Energy Northwest, and Bonneville have entered into separate Net Billing Agreements with respect to approximately \$6.1 billion in outstanding bonds for Energy Northwest's Project No. 1 (Columbia Generating Station), and 70% ownership share of Project No. 3 (collectively, the "Net Billed Projects") under which the District has purchased from Energy Northwest and, in turn, assigned to Bonneville a maximum of 19.584%, 15.363%, and 19.334% of the capability of Projects Nos. 1 and 2, and Energy Northwest's ownership share of Project No. 3, respectively. 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 (Project Nos. 1 and 3 were terminated). Under the Net Billing Agreements, Bonneville is responsible for the District's percentage share of the total annual cost of each project, including debt service on revenue bonds issued to finance the costs of construction. The District's electric revenue requirements are not directly affected by the cost of the Net Billed Projects. The revenue requirements are affected only to the extent that the costs of the projects result in increases in Bonneville's wholesale power rates or if Bonneville failed to pay Energy Northwest. Bonneville and Energy Northwest executed an agreement with respect to each Net Billed Project ("Direct Pay Agreements") pursuant to which, beginning May 2006, Bonneville agrees to pay at least monthly all costs for each Net Billed Project, including debt service on the bonds for the Net Billed Projects, directly to Energy Northwest. In the Direct Pay Agreements, Energy Northwest agrees to promptly bill the District and other participants their share of the costs of the respective project under the Net Billing Agreements if Bonneville fails to make a payment when due under the Direct Pay Agreements.

The other Energy Northwest project the District participates in is the Packwood Hydroelectric Project, located in Packwood, Washington. See "ELECTRIC SYSTEM POWER SUPPLY – Long-Term Third-Party Power Purchase Contracts – *Packwood Hydroelectric Project Contract*."

### **District-Owned Power Supply**

The District relies on three District-owned generation projects: the Jackson Project, the Cogeneration Project and the Woods Creek Project. In addition, the Youngs Creek Project is currently under construction and is expected to be completed in 2011. See "THE GENERATION SYSTEM."

#### **Jackson Project**

The Jackson Project is located on the Sultan River, north of the city of Sultan and is owned and operated by the District. See "THE GENERATION SYSTEM—The Jackson Project." The District receives all of the generation output from this project. The City of Everett receives its water supply from Lake Chaplain, which the Jackson Project feeds. Under the current FERC operating license, the City of Everett is a co-licensee with the District of the project. Significant activity has been underway from 2006-2009 as the District has worked to relicense the project with FERC. The relicensing process is slated for completion in May 2011, at which time it is anticipated the District will become the sole licensee. See "GENERATION SYSTEM – The Jackson Project - *FERC License*."

#### **Cogeneration Project**

The Cogeneration Project is located at Kimberly-Clark Corporation's Everett pulp and paper facility. It is owned by the District and is operated under an Operating Agreement with Kimberly-Clark. The Cogeneration Project was commissioned in December 1996. It has a 52 MW nameplate capacity rating. Under the terms of the contract, Kimberly Clark receives steam for its mill operations and is contractually obligated to produce or otherwise provide the District with 325,000 MWh, or 37 aMW, per year. For the first 10 years, the District sold the project's output to the Sacramento Municipal Utility District (SMUD). Since the expiration of the power sales contract with SMUD in October 2007, the District has used the output from the Cogeneration Project to serve its own customer load. The operating

contract with Kimberly-Clark will expire at the end of 2016. Kimberly-Clark has the option to extend the contract in five year blocks. See “THE GENERATION SYSTEM—The Cogeneration Project.”

### **Woods Creek Project**

In 2008, the District acquired the Woods Creek Project, a small hydroelectric project in Snohomish County with a nameplate capacity of 0.65 MW. See “THE GENERATION SYSTEM – Small Hydroelectric Projects – *Woods Creek Project*.”

### **Long-Term Third-Party Power Purchase Contracts**

The District currently has a number of long-term contracts for power supply. All but one of these contracts is tied to the output of specific generating plants.

### **Hay Canyon Wind Project**

As part of its long term resource strategy (See “ELECTRIC SYSTEM POWER SUPPLY – The District’s Future Power Supply Strategy – *District’s 2008 Integrated Resource Plan*”), the District executed two power purchase agreements in February 2009 with Hay Canyon Wind, LLC, for 100% of the wind energy and RECs from the Hay Canyon Wind Project. This 100.8 MW nameplate project interconnects with the Bonneville transmission system and is located in north central Oregon along the Columbia River Gorge. The project was developed by Hay Canyon Wind, LLC, a subsidiary of Iberdrola Renewables, Inc. (“Iberdrola”), whose parent company is Iberdrola Renovables, one of the world’s largest wind developers with over 9000 MW of installed wind capacity in the United States and Europe. The District began receiving energy output under the agreements on March 1, 2009. The project has an estimated annual output of approximately 29 aMW. The District will receive 50% of the project’s output under a 15-year power purchase agreement and 50% under an 18-year power purchase agreement. As part of the 15-year power purchase agreement the District assigned its transmission capacity and scheduling rights for its share on the Third AC transmission line to Iberdrola. See “— Bonneville Transmission Service Contracts.” The Hay Canyon Wind Project qualifies as an eligible renewable resource under Initiative 937. See “— Washington State Energy Initiatives and Legislation.”

### **Wheatfield Wind Project**

The District signed a 20-year power purchase agreement with Wheat Field Wind Project, LLC for the entire output and RECs from the 97 MW nameplate wind project known as the Wheat Field Wind Project. This project interconnects with the Bonneville transmission system and is located near the City of Arlington in north central Oregon. The project was developed by Wheat Field Wind Project, LLC, in conjunction with Horizon Wind Energy, LLC, which is affiliated with Energías de Portugal. The District began taking delivery on April 1, 2009. The District is purchasing 100% of the output from the Wheatfield Wind Project, which at a 30% capacity factor is equivalent to 29.1 aMW each contract year. The Wheatfield Wind Project qualifies as an eligible renewable resource under Initiative 937. See “— Washington State Energy Initiatives and Legislation.”

### **White Creek Wind Contract**

In January 2007, the District executed a 20-year power purchase contract with LL&P Wind, L.L.C., a wholly owned subsidiary of Lakeview Light & Power, Tacoma, Washington, for the output of approximately 10% of the White Creek Wind Project. The project is located in south-central Washington along the Columbia River Gorge. The District’s share of the White Creek output is equivalent to 20 MW of wind capacity, with 6 aMW of wind energy forecasted per each contract year. The project began commercial operation in November 2007, and the District began taking output from the project in January

2008. This wind project qualifies as an eligible renewable resource under Initiative 937. See “— Washington State Energy Initiatives and Legislation.” The District contracted separately with Bonneville to provide a firming service to support the variable output from the White Creek Wind Project. Under this contract, Bonneville takes the output into its system as it is generated, and re-delivers the energy seven days later to a central market hub in a flat energy block, where the District can then schedule it for delivery to serve its customers.

### **Packwood Hydroelectric Project Contract**

The Energy Northwest Packwood Hydroelectric Project, located 20 miles south of Mount Rainier in Packwood, Washington, began operation in 1964. It has a nameplate capacity of 27.5 MW. The District has a 20% share, or 2 aMW, of the energy output of the project. From 2002 to 2008, the District assigned its share to Franklin and Benton County PUDs. In October 2008, the District recalled its 20% share and negotiated the purchase of the balance of the project output from the other participants for the period October 2008 through September 2011. This short-term power purchase agreement for 100% of the project’s output added 9 aMW of firm energy to the District’s power portfolio.

### **Klickitat County PUD Landfill Gas Contract**

In 1999, the District contracted with Klickitat County PUD for 5 aMW of energy and the associated RECs from the H.W. Hill Landfill Gas project located in Klickitat County, Washington. This long-term agreement expired in May 2009. The District secured a second power purchase agreement for 2 aMW beginning November 2008 and expiring in October 2015. The output of this resource is delivered as a flat block of energy and qualifies as an eligible renewable resource under Initiative 937. See “— Wholesale Power Market Purchases, Sales and Trades—*Renewable Energy Credits*” and “— Washington State Energy Initiatives and Legislation.”

### **Hampton Lumber Mill Co-Generation Contract**

In 2006, the District executed a contract with Hampton Lumber Mills-Washington, Inc. for the electrical output of a cogeneration project located at the Hampton Lumber Mill in Darrington, Washington. The project utilizes wood waste and has a nameplate capacity of 7 MW and is recognized as an eligible renewable resource under Initiative 937. It is producing approximately 1 aMW of energy on a continuous basis. The project began commercial operation in November 2006 and the District has contracted for the project’s output through October 2016. The District has first rights to purchase any RECs associated with the project’s energy production.

### **Morgan Stanley Contract**

In 2001, the District entered into a long-term power supply contract with Morgan Stanley Capital Group, Inc. (“MSCG”) for a 25 MW block of power (the “Morgan Stanley Contract”). The Morgan Stanley Contract expired on December 31, 2009. See “LITIGATION – Morgan Stanley Contract.”

### **Conservation**

The District has offered energy efficiency programs to its customers for over twenty years. These programs provide energy savings opportunities over a broad range of electric uses— from installing compact fluorescent bulbs to complex customized projects for commercial and industrial customers. In 2009, District programs enabled customers to reduce their energy consumption by approximately 71,000 MWh. On a cumulative basis, average electric loads in 2009 were nearly 100 aMW lower than would have occurred without the existence of the District’s long-standing programs.

## **Residential Programs**

Programs currently available to the residential customers include incentives and technical assistance to encourage home weatherization, including adoption of high-efficiency heating, lighting and appliances. Customers can take advantage of loans, upfront cash incentives and rebates for weatherization (floor, wall, ceiling and duct insulation, high-efficiency heat pumps, and insulated windows); rebates for efficient appliances (clothes washers, dishwashers, and refrigerators); discount coupons for compact fluorescent lighting; and cash incentives for disposing of inefficient second refrigerators or freezers.

The District also has a program that encourages residential builders to include ENERGY STAR® appliances (clothes washers, refrigerators and dishwashers, and efficient lighting) in newly built homes. In 2009, the District added loans and rebates to promote the use of ductless heat pumps, and introduced its Solar Express program to promote customer and small business installation of solar domestic hot water systems, and solar photovoltaic arrays. The District installed a 10 kW solar array at its Headquarters Building to increase visibility of practical applications for photovoltaic technology in its service territory.

## **Commercial and Industrial Programs**

Commercial and industrial customers receive technical assistance, incentives and rebates for lighting controls and fixtures, heating, ventilating, and air conditioning equipment, compressed air systems, motors, pumps and fans, refrigeration, heat recovery systems, controls and variable frequency drives. The District's Executive Account Managers and Energy Engineers work closely together to identify custom efficiency solutions for large customers. To make it easier for smaller- sized businesses to adopt energy efficiency measures, the District established standardized rebate amounts for lighting and commercial cooking equipment.

The District also offers incentives for new construction projects. These incentives enable staff to influence design decisions and show builders and architects new efficiency technologies they may wish to incorporate in buildings. The District is collaborating with Electric Power Research Institute (the "EPRI") to develop emerging efficient technologies, and has put in place demonstration projects for LED Street Lighting and data center efficiency improvements.

## **Other Initiatives**

Other energy efficiency programs include online power monitoring tools available to all customers, and monetary support to local agencies providing weatherization and energy efficiency improvements for low-income consumers. The District has installed distribution efficiency measures throughout its system and is aggressively pursuing efficiency installations in its own facilities. The District is actively involved in regional conservation and efficiency efforts, working with the Northwest Power and Conservation Council, the Northwest Energy Efficiency Alliance, Bonneville Power Administration, the Consortium for Energy Efficiency and EPRI.

**Solar Power.** Throughout 2008, the District investigated ways to bring solar opportunities to Snohomish County's residential and small business customers. In March 2009, the District introduced its new solar program called "Solar Express." This program provides low interest loans and incentives to encourage installation of customer-owned solar photovoltaic and hot water systems and technical advice and education for the District's customers. In 2009, 33 photovoltaic and 10 solar hot water systems were installed under the program. The District also installed a 10 kW solar demonstration project on its Headquarters Building in downtown Everett, Washington, during the Summer of 2009. The demonstration project is connected to a kiosk in the main lobby where customers can view the system's

electrical output. The District's goal for 2010 is to encourage the installation of an additional 48 photovoltaic and 12 solar hot water systems.

## **Wholesale Power Market Purchases, Sales and Trades**

### **Power Scheduling Operations**

The District's Power Scheduling Operations sell power in the wholesale energy market when the District's contracted resources and surpluses associated with the Bonneville Slice product exceed its load and make purchases from the wholesale power market when required to meet the District's loads. In 2009, the District sold 1,466,308 MWh in the short-term market and purchased 769,467 MWh. The short-term market purchases were made to serve customer loads during the winter months when peak demands exceed the capabilities of the District's owned and contracted resources. Short term wholesale market purchases and sales fluctuate throughout the year, reflecting seasonal variations in customer loads, weather and market conditions.

### **Energy Risk Management**

Models and tests for managing a variety of risks are outlined in the District's Energy Risk Management Policy and Procedures Manual, adopted in 2002 and last revised by the Commission in June 2008. All employees involved in the District's energy supply, risk management and accounting functions have the obligation to see that proper procedures are followed and where necessary, intervene to mitigate risks.

The District manages its physical and financial positions and exposures through a variety of transactions over various time horizons including real-time, day ahead, monthly, quarterly, and annually. Within the time limits and guidelines established in the District's Energy Risk Management Policies and Procedures Manual, the District seeks to optimize the use of its physical and contractual power, including transmission resources, purchased to meet its native load. This includes utilizing the flexibility inherent in some resources to reduce overall costs to the District through low risk transactions.

The District produces power with District-owned resources and enters into short-term transactions of various terms in order to meet its customers' loads. The market risk inherent in the agreements as well as the exposure related to the District's assets is managed for a period of 18-30 months forward in conformance with the District's Risk Management Policies and Procedures Manual.

### **Physical Energy**

In order to meet the monthly, daily and hourly energy demands of the District's customers and contractual obligations, District staff purchase and sell power in the wholesale energy market, primarily at the Mid-Columbia market hub. Contracts for short-term energy are made in accordance with the District's Energy Risk Management Policies and Procedures Manual on a rolling 18- to 30- month planning horizon.

### **Risk Management Tools**

In addition to buying and selling physical energy, the Commission has authorized the use of call and put options as additional tools to manage price and supply certainty. These instruments allow the District to avoid buying large amounts of energy to cover a small number of peak load days. Options are purchased from approved and credit-worthy counterparties.

In 2008, the Commission adopted a resolution authorizing the use of financial hedges to mitigate the District's exposure to energy price risk. This authorization will allow the District to enter into financial hedging contracts wherein the District would pay to or receive from the counterparty a fixed sum of money calculated based on a fixed price multiplied by a number representing megawatts per hour of power over a period specified in the contract. The counterparty would receive or pay the District a sum of money based upon a market index rate multiplied by the megawatts per hour. These transactions would, in essence, allow the District to lock in a known expense or revenue for a future short-term power market purchase or sale in advance. The payment received from the counterparty would be used to purchase power in the future period. Because of recent disruptions in the financial and credit markets, the District has not entered into any such hedges.

### **Conservation Transfer Agreement**

The Puget Sound Energy Conservation Transfer Agreement began in 1990 when Bonneville initiated a pilot program to transfer the benefits of conservation between three public utility districts, including the District, and Puget Sound Energy ("PSE"). For the District, the amount of energy transferred was set at 10.6 aMW per year. The Agreement expired February 28, 2010.

### **Renewable Energy Credits**

Renewable Energy Credits ("RECs") are the environmental attributes associated with one MWh of electrical output from a qualifying renewable energy resource. Markets for RECs support both voluntary green power programs and mandated state renewable portfolio standards. Under the Washington state approved Initiative-937, utilities are required to use certain qualifying renewable resources to serve 3%, 9% and 15% of their load in the years 2012, 2016 and 2020, respectively. See "Washington State Energy Initiatives and Legislation – Washington State's Renewable Portfolio and Conservation Standard." For the District, these targets translate into approximately 25 aMW, 78 aMW and 134 aMW, in 2012, 2016 and 2020, respectively. With the signing of the long-term contracts for Hay Canyon Wind, Wheat Field Wind and Klickitat County PUD's Landfill Gas, the District has acquired approximately 68 aMW toward these targets.

As a matter of policy, the Commission approved the sale of up to 100% of any RECs surplus to the District's Initiative 937 needs through 2011. The proceeds from such sales are earmarked to both reduce the cost of renewable energy resources, and fund research and development of new renewable resources and technologies. The market price for RECs fluctuates according to supply and demand, resource fuel type, year of generation, and timing of the renewable portfolio standards established in nearby states. The District expects to be in a surplus position with its RECs as the District procures or develops resources to meet its load growth. In 2008 the District received approximately \$506,000 from the sales of its surplus RECs, and approximately \$2.9 million in 2009.

### **The District's Future Power Supply Strategy**

The District expects its loads will grow by 16.7% from 2010 to 2020 with a compound annual growth rate of 1.7% per year during that period. The District expects to meet this increased demand and is pursuing a diverse mix of conservation and new renewable resources.

**District's 2008 Integrated Resource Plan.** The District is currently developing its 2010 Integrated Resource Plan, which will be presented to the Commission for consideration during the summer of 2010. The District's 2008 Integrated Resource Plan (the "2008 IRP") was adopted by the Commission in August 2008. The 2008 IRP sets forth the following policy and actions necessary to meet the District's expected load growth: implement all cost-effective energy conservation measures; actively pursue conservation "stretch" goals and continue to seek new opportunities for customers to save energy

and reduce demand; work with Bonneville to establish and implement the new power supply contract to maximize the benefits of the Federal System to the District; negotiate long-term contracts for renewable resources with third-party providers; develop geothermal resources in or near Snohomish County with a target commercial operation date of 2014 for the first power plant; continue research and development of tidal energy systems in the Puget Sound; evaluate and pursue small-scale hydroelectric opportunities in Snohomish County; where appropriate, encourage customer ownership of small-scale resources; participate in regional transmission forums to ensure adequate transmission capacity is available to deliver Bonneville and other generating resources to District loads; and continue to monitor emerging technologies and further develop staff knowledge, tools and databases to evaluate both supply and demand-side resource options.

The 2008 IRP established an action plan to ensure that enough resources would be available, at reasonable cost, to meet the District's future load growth. Achieving this objective requires consideration of all possible options and a plan that is adaptable to changing circumstances. Energy efficiency, renewable power supplies, purchased power contracts, and District-owned resources are all among potential alternatives. Pursuant to the 2008 IRP, the District is planning on exploring the following resources. Actual development of a resource is dependent on various factors.

**Geothermal.** The District is exploring geothermal potential within or near Snohomish County. In 2009, a geothermal expert, Black Mountain Technology conducted a high level feasibility study. The results were positive and warranted moving forward to detailed exploration. The District also contracted with GeothermEx, a national leader in geothermal exploration, to design and manage a geothermal exploration program. Temperature gradient drilling is scheduled for summer 2010.

**Tidal Energy.** The District has taken a leadership role in the research and development of tidal energy in the Pacific Northwest. Work to date has included measurement of the velocity and direction of tidal currents in Puget Sound, evaluations of different technologies for hydrokinetic energy, and assessment of environmental issues and regulatory requirements. The results are being shared with and input is being sought from local tribes, environmental groups and interested stakeholders, as well as technical partners such as Bonneville, the EPRI, the U.S. Department of Energy, and the University of Washington. Once the studies are complete, the District will evaluate the technical, economic, and environmental viability of a pilot demonstration plant. In December 2009, the District submitted a draft license application to FERC for a pilot demonstration plant in Admiralty Inlet. For planning purposes, the District has assumed up to 1 aMW of tidal energy beginning in 2015, growing to 5 aMW by 2020.

**Small Hydroelectric Generation.** The District considers small hydroelectric generation an attractive power supply option because it is free of greenhouse gas emissions, is a long-lived asset (up to 50 years), can be simple to permit, has low operation and maintenance costs, and can produce relatively predictable output. The District has identified several potentially viable new hydroelectric sites within or near its service territory. In 2008, the District purchased the partially-constructed Youngs Creek Project, located on 23 acres within the District's service territory. The Youngs Creek Project has received its FERC license and has an estimated capacity of 7.5 MW. Construction of the Youngs Creek Project is underway, with commercial operation expected in mid-2011. See "GENERATION SYSTEM – Small Hydroelectric Projects – *Youngs Creek Project*."

**Utility Scale Photovoltaic (PV) Solar.** District staff is assessing two potential utility scale PV solar projects expected to be developed in the northwest in 2010 and 2011. The nameplate capacity of each project is estimated at 5 MW. In the past, the cost for utility-scale PV projects has been prohibitive. The weaker global economy and oversupply of photovoltaic panels, combined with federal and some state tax incentives have significantly reduced the cost of utility-scale solar resources. Washington State's Initiative-937 identifies solar as a qualifying renewable resource, making the output from this resource a contributor towards the District's renewable portfolio standard targets.

## **District Climate Change Policy, Principles and Strategies**

The District was one of the first utilities in the region to adopt an official climate change policy including supporting principles and strategies. In adopting the policy, the Commission recognized that climate change is a serious global problem and emphasized its commitment to using natural resources more efficiently. The District is located in one of the fastest-growing counties in the country and wants to meet the challenges that rapid growth presents with thoughtfulness and a sensitivity to helping preserve the environment.

In the policy, the District commits that it, among other things, (i) will provide electric, water and associated services to its customers in an environmentally responsible way while increasing economic value, financial stability and operational safety and security for its ratepayers; (ii) recognizes that climate change is a serious global problem that should be addressed through the development of thoughtful and forward-looking legislation that actually results in the reduction of greenhouse gas emissions in a workable and cost-effective manner; (iii) recognizes that the Pacific Northwest's investments in energy efficiency and renewable hydroelectricity have yielded substantial environmental benefits and this legacy should be continued by meeting customer growth through conservation and a diverse mix of renewable technologies including, but not limited to, wind, tidal, solar, biomass, and geothermal; and (iv) recognizes that using natural resources more efficiently and wisely makes good environmental and economic sense.

In the policy, the District proposes to reduce energy use by improving the energy efficiency of the District's own utility generation, transmission, distribution and administrative facilities. The policy commits the District to utilize integrated resource planning standards that: (i) consider the long-term costs and risks associated with greenhouse gas emitting generation sources; (ii) consider a diversity of resource options that provide the optimum balance of environmental and economic elements; (iii) monitor and evaluate the actual changes that are occurring in the climate and the actual impacts of climate change on the District's utility operations; and (iv) educate District customers and promote public awareness on climate change issues.

## **Washington State Energy Initiatives and Legislation**

### **Washington State's Renewable Portfolio and Conservation Standard**

In the fall of 2006, voters of Washington state approved Initiative-937 ("I-937"), codified as the Energy Independence Act, Ch. 19.285 RCW, requiring electric utilities with over 25,000 customers to accomplish all cost-effective conservation and, by 2020, use certain eligible renewable resources to serve at least 15% of retail loads. Specifically, I-937 requires such utilities to: (i) estimate the cost-effectiveness of conservation programs using methodologies consistent with the approach of the Northwest Power and Conservation Council ("NWPPCC"); (ii) utilize the NWPPCC's Power Plan to gauge regional pro-rata shares of achievable conservation potential; (iii) beginning January 1, 2010, and every two years thereafter, calculate and document 10-year conservation potential; (iv) produce detailed analyses of how energy will be conserved through end-user programs, production and distribution efficiencies, co-generation, and/or distributed generation; (v) use eligible renewable resources to serve 3%, 9% and 15% of utility loads by 2012, 2016 and 2020, respectively; and (vi) beginning January 1, 2012, report yearly compliance with the law's requirements. Eligible renewable resource types include wind, solar energy, geothermal energy, landfill gas, wave, ocean, or tidal power, gas from sewage treatment facilities, specific biodiesel fuels, biomass energy, and incremental hydroelectric power (power produced as a result of efficiency improvements at existing hydroelectric facilities). At this time, incremental hydropower is the only form of hydro-related energy designated as an approved renewable.

The legislation imposes significant penalties for non-compliance—\$50 for every MWh the utility falls short of its conservation and renewables goals; however, I-937 also includes a cost cap of 4% of a



utility's annual revenue requirement as a limit for compliance costs for the renewable resource (but not the conservation) requirement.

For the District, the 3%, 9% and 15% I-937 requirements translates into approximately 25, 78 and 134 aMW, respectively, of eligible renewable generation. With the signing of the Hay Canyon Wind, Wheat Field Wind, and Klickitat County PUD Landfill Gas long-term purchase agreements, the District has acquired approximately 68 aMW toward these targets.

The table below shows that the District anticipates it will have adequate renewable resources to meet its I-937 requirements:

<b>Progress toward I-937 Targets (aMW)</b>				
	<b>2012</b>	<b>2016</b>	<b>2020</b>	
<b>Projected Load</b>	832	862	893	
<b>I-937 % Requirement</b>	3%	9%	15%	
<b>I-937 Requirements (aMW)</b>	25	78	134	
<b>Existing Renewable Resources</b>	70	68	68	
<b>Planned Renewable Resources</b>	7	40	113	
<b>Surplus</b>	<b>52</b>	<b>30</b>	<b>47</b>	

*Source:* Public Utility District No. 1 of Snohomish County, Washington

### **Washington State Integrated Resource Planning Requirements**

In 2006, the Washington State Legislature passed a law requiring electric utilities with more than 25,000 customers (that are not full requirements customers of Bonneville) to develop an Integrated Resource Plan ("IRP") by September 1, 2008. Each utility must report on its progress every two years, and update its plan every four years. At a minimum, the IRP must include: (i) a range of forecasts, for at least the next 10 years, of forecasted customer demand that takes into account econometric data and customer usage; (ii) an assessment of commercially available conservation and efficiency resources; (iii) an assessment of commercially available, utility scale renewable and nonrenewable generating technologies; (iv) a comparative evaluation of renewable and nonrenewable generating resources, including transmission and distribution delivery costs, and conservation and efficiency resources using "lowest reasonable cost" as a criteria; (v) the integration of the demand forecasts and resource evaluations into a long-range assessment describing the mix of supply-side generating resources and conservation and efficiency resources that will meet current and forecasted needs at the lowest reasonable cost and risk to the utility and its ratepayers; and (vi) a short-term plan identifying the specific actions to be taken by the utility consistent with its long-range integrated resource plan.

The governing body of a consumer-owned utility, such as the District, is required to hold public hearings before approving its IRP. The Department of Commerce will aggregate the data, prepare an electronic report for the Legislature, and assess the overall adequacy of Washington's electricity supply. The Commission adopted the 2008 IRP on August 16, 2008, which was filed with Commerce on August 29, 2008. The District's 2010 IRP submission will be submitted in September 2010. See "— The District's Future Power Supply Strategy."

### **Washington State Emissions Performance Standards**

Washington legislation enacted in 2008 requires the Governor to develop policy recommendations for achieving specific greenhouse gas ("GHG") reduction targets: 1990 emission levels

by 2020, 25% below 1990 levels by 2035, and 50% below 1990 levels by 2050. In 2010, the State's Department of Ecology must adopt rules requiring a person to report their 2009 greenhouse gas (GHG) emissions for sources that emit at least 10,000 metric tons of direct GHG emissions annually.

One provision in particular involves power supply contracts. Generation sources underlying contracts of five years or more that are entered into after July 2008 must comply with a permissible ceiling of 1,100 pounds of GHG emissions per MWh (or the average available GHG emissions output as derived by the Department of Commerce ("Commerce") analysis of appropriate combined cycle combustion turbines). Some emissions are allowable if sequestered or mitigated under a plan approved by the Energy Facilities and Site Evaluation Council (the "EFSEC"). In June 2008, the DOE, EFSEC, Commerce, and Bonneville coordinated and adopted rules to implement and enforce standards.

### **Voluntary Green Power Program Legislation**

Legislation enacted in 2001 requires larger electric utilities in Washington state to offer retail customers an option to purchase qualified alternative energy resources—often referred to as green power. The law also requires electric utilities to report annually to the WUTC and Commerce on the details of their green power programs between the years 2002 and 2012. Utilities have two options for providing customers with qualified green power: actual power from qualified green resources or green tags, often known as RECs. See "— Wholesale Power Market Purchases, Sales and Trades—Renewable Energy Credits."

The District's residential Planet Power program transitioned from a REC-based program to one where voluntary contributions are used to fund the development of small-scale solar generation projects within the District's service area. Planet Power customers can contribute \$3 or more each month as part of their bill payment or make a one-time contribution of \$15 or more. Every dollar contributed goes directly to operate the program, educate the community, and increase the level of energy that is produced from renewable sources. The program exemplifies the District's efforts to develop and promote green energy sources throughout its service territory. Planet Power has funded solar projects at several schools and public buildings throughout Snohomish County. Schools receive solar installations as well as educational curriculum and teacher training.

The District's business customers can support green power through a second voluntary program option, Green Blocks. When they purchase Green Blocks, business customers support their corporate green and sustainability initiatives and can claim that a specific share of their power is coming from preferred renewable sources. Customers have the option of purchasing a minimum of five blocks per month or making a one-time \$15 or more purchase. The Green Blocks program is supplied with RECs from various wind projects throughout the Northwest.

### **The Washington Climate Change Challenge and Western Climate Initiative**

In 2007, Washington's Governor signed an Executive Order to establish goals for reducing greenhouse gas emissions, increasing energy-related jobs and reducing expenditures on imported fuel. The Washington Climate Change Challenge directed the Directors of the Department of Ecology and Commerce to meet with stakeholders to address transportation, forestry, energy, and agriculture emission sectors. It was determined in September 2009 that mandatory reporting of greenhouse gases, for 25,000 tons CO<sub>2</sub> equivalent, would begin in 2011. Other agency recommendations may directly or indirectly affect the District over the long-term. The District's Climate Change Policy, adopted by the Commission in March 2007, has already moved the utility forward on many of these issues.

The Western Climate Initiative (the "WCI") is a collaboration formed in 2007 by the Governors of Arizona, California, New Mexico, Oregon and Washington to work toward common climate goals.

Other states, Canadian provinces and states of Mexico later joined as members or observers. These partners have set an overall regional goal of reducing greenhouse gas emissions to 15% below 2005 levels by 2020. While the WCI partner states completed a draft design of a market-based mechanism to achieve reduction goals, each state is now working out its level of involvement and how to proceed with follow-up legislation and regulation. In the 2009 and 2010 sessions, the Washington state legislature declined to pass a cap and trade or other greenhouse gas emission regulation bill. Arizona has since opted out of any sort of market-based mechanism. The WCI process is on-going, and District staff continue to monitor its activities.

### **Federal Energy Legislation and Federal Funding**

Several climate change bills have been introduced in the United States Congress and variations of climate bills continue to be drafted. One such bill, the American Clean Energy and Security Act, also known as the Waxman-Markey bill, was passed in the U.S. House of Representatives on June 26, 2009 and is currently being considered, along with other climate bills, in the U.S. Senate. The District expects to be well positioned to respond to whatever form the final legislation may take. The District's hydro- and renewable based power portfolio, its future resource plans, and its past and continuing energy efficiency programs are all consistent with federal policy goals. As a participant in Pacific Northwest short-term power markets, the District is closely monitoring carbon reduction and other legislative proposals that could impact wholesale power prices.

On February 17, 2009, the \$787 billion economic recovery package titled the American Recovery and Reinvestment Act of 2009 was signed into law. The Department of Energy's Office of Energy and Efficiency and Renewable Energy received \$16.8 billion in stimulus dollars. The District received \$15.8 million for smart grid implementation and \$2.17 million for energy efficiency efforts. Under the Fiscal Year 2009 Appropriations Bill adopted on March 11, 2009, the District received two appropriations in the amounts of \$475,750 for its tidal energy project and \$475,750 for a geothermal project. The District is actively pursuing funding opportunities for geothermal and tidal energy projects through FY 2011 Federal Appropriations and the Department of Energy grant program.

### **Regional Transmission Planning**

#### **Regional Transmission Organization**

In 1999, FERC issued its Order 2000, which mandated the formation of regional transmission organizations ("RTOs") and set forth various standards for their organization and operation. In response to this order, Bonneville and several Pacific Northwest utilities proposed formation of a regional transmission organization known as "RTO West." After several years of controversial development work, the effort was discontinued. In 2006, a new transmission planning group was formed by Northwest utilities, called ColumbiaGrid. ColumbiaGrid is comprised of major private and public utilities, including Bonneville, Avista Corporation, Puget Sound Energy, Seattle City Light, Grant County PUD, Chelan County PUD, and Tacoma Power. In 2010 the District officially became a member of ColumbiaGrid. This group is intended to provide regional transmission planning and to coordinate and facilitate transmission expansion using contractual mechanisms such as functional and facility agreements.

ColumbiaGrid has approved its first biennial transmission plan and has developed a functional agreement related to OASIS. ColumbiaGrid is actively involved in a Joint Initiative, which is developing products for assisting the complex operations of integrating intermittent resources.

## **Transmission Constraints in the Pacific Northwest**

Growing Puget Sound area loads combined with Bonneville's obligation to return energy to Canada under the Columbia River Storage Treaty can, under certain circumstances, result in transmission congestion that impacts the District. In December 2007 Bonneville implemented a re-dispatch pilot designed to relieve transmission constraints by calling upon generation from local Puget Sound area power plants. The District, Seattle City Light and Puget Sound Energy all participated. While the program met with some technical success, cost and compensation issues proved difficult to solve. The pilot program expired in October 2009 and was not renewed.

On November 3, 2009, concerns over transmission limits caused Bonneville to curtail transmission schedules flowing north through the Puget Sound area. Actions taken by Puget Sound Energy and Seattle City Light to dispatch local generation averted the need to drop customer load. However, the incident highlighted the need for a coordinated approach to solving congestion problems. The District and the other Puget Sound utilities are meeting with Bonneville to identify both short-term and long-term solutions.

## **Open Access**

FERC Order 890, first issued in 2006 and revised in 2007, affects the way transmission is planned by the electric utility industry. Its goal is to prevent discrimination by owners of transmission facilities against utilities and power producers desiring transmission service. Order 890 strengthens the Open Access Transmission Tariff ("OATT") standards, reduces opportunities for the exercise of market power, makes it easier to detect abuses, facilitates enforcement efforts, and increases transparency in the areas of planning and transmission system use.

While the OATT modifications have little direct impact on the District, since it does not provide transmission services to others, the nine planning principles adopted in the order are beneficial. These include coordination, openness, transparency, information exchange, comparability, dispute resolution, regional participation, economic planning studies, and cost allocation for new projects.

## **Reliability**

In March 2007, FERC issued Order No. 693, which addresses mandatory reliability standards for utilities. The National Electric Reliability Council (the "NERC") was tasked with developing reliability standards for all utilities and for ensuring those standards are met. All users, owners and operators of the bulk power system are required to identify functions they perform and register the information with the NERC or their regional reliability organization. In the District's case, this is the WECC.

The District has developed an internal compliance program to manage reporting requirements and ensure implementation of new WECC and NERC required procedures. The program defines a process by which applicable NERC standards are identified and staff is assigned to review and document compliance, or, if necessary, prepare mitigation plans. To date, the District has filed 24 mitigation plans with WECC, of which 12 have been completed and accepted by WECC. Currently, the District has 12 active mitigation plans that are on track to be completed by their mitigation completion dates. All completed mitigation plans to date have satisfied the required actions to the WECC requirements.

## ELECTRIC SYSTEM FINANCIAL INFORMATION

### Financial Results

The following table presents income statements of the Electric System for the five calendar years 2005 through 2009. Appendix A contains the audited financial statements for the District for calendar years 2008 and 2009. See “— Financial Condition and Liquidity” for a description of the District’s cash balances and liquidity reserves.

### Electric System Operating Results (\$000s)

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Operating Revenues					
Sales of Electric Energy					
Residential	\$ 248,569	\$ 257,683	\$ 271,745	\$ 282,431	\$ 286,529
Commercial	156,254	159,384	165,496	169,918	173,048
Industrial	47,929	48,437	50,034	49,100	46,996
Other	3,107	3,235	3,325	3,470	3,521
Sales for Resale	90,058	105,467	65,948	80,761	51,076
Unbilled Revenue	1,800	6,400	1,261	6,939	2,000
Total Sales of Electric Energy	<u>547,717</u>	<u>580,606</u>	<u>557,809</u>	<u>592,619</u>	<u>563,170</u>
Other Operating Revenues	<u>35,130</u>	<u>40,536</u>	<u>38,365</u>	<u>32,984</u>	<u>23,059</u>
Total Operating Revenues	<u>582,847</u>	<u>621,142</u>	<u>596,174</u>	<u>625,603</u>	<u>586,229</u>
Operating Expenses					
Purchased Power and Generation	361,486	343,721	335,919	317,375	342,178
Operations	106,367	106,806	115,223	121,816	134,808
Maintenance	14,852	27,607	17,037	22,608	15,797
Depreciation	33,488	34,414	35,917	38,843	41,614
Taxes	27,869	27,178	30,508	30,516	29,102
Total Operating Expenses	<u>544,062</u>	<u>539,726</u>	<u>534,604</u>	<u>531,158</u>	<u>563,499</u>
Net Operating Income	<u>38,785</u>	<u>81,416</u>	<u>61,570</u>	<u>94,445</u>	<u>22,730</u>
Other Interest and Other Income	<u>14,574</u>	<u>27,958</u>	<u>28,424</u>	<u>30,222</u>	<u>14,625</u>
Interest Charges					
Interest	17,411	15,541	15,219	14,905	17,951
Other, Net of Capitalized Interest	(547)	913	552	(230)	(1,549)
Total Interest Charges	<u>16,864</u>	<u>16,454</u>	<u>15,771</u>	<u>14,675</u>	<u>16,402</u>
Net Income	\$ 36,495	\$ 92,920	\$ 74,223	\$ 109,992	\$ 20,953
Interest charges	16,864	16,454	15,771	14,341	12,367
Depreciation	33,488	34,414	35,917	38,843	41,614
Amortization of power supply contract settlement <sup>(1)</sup>	19,944	1,662	-	-	-
Net (increase) decrease in the fair value of investments <sup>(2)</sup>	920	(2,735)	(2,447)	(3,142)	5,668
Rate stabilization fund transfer <sup>(3)</sup>	(25,944)	-	-	-	-
Balance Available For Debt Service Coverage	<u>\$ 81,767</u>	<u>\$ 142,715</u>	<u>\$ 123,464</u>	<u>\$ 160,034</u>	<u>\$ 80,602</u>
Senior Lien Debt Service	<u>\$ 21,723</u>	<u>\$ 20,993</u>	<u>\$ 20,895</u>	<u>\$ 19,777</u>	<u>\$ 19,790</u>
Electric System Senior Lien Bonds Debt Service Coverage	3.8x	6.8x	5.9x	8.1x	4.1x

<sup>(1)</sup> In February 2003, the District reached a settlement relating to a high-priced power contract calling for the District to remit a \$59 million payment in 2003 which was amortized over the original term of the contract (through January 2006). This termination payment was financed using short-term notes with a term similar to the original contract.

<sup>(2)</sup> The District typically holds investments to maturity. However, generally accepted accounting principles require certain unrealized gains and losses be recorded as a component of net income. Because the effect of recording the mark-to-market value of these investments has no impact on District cash flows, the impact is removed from the debt service coverage calculation.

<sup>(3)</sup> In 2005, the District transferred \$25.9 million into the Rate Stabilization Account. As required by certain bond covenants, the amount transferred into the Rate Stabilization Account is excluded from the debt service coverage calculation as more fully described in APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Additional Covenants.”

## **Management's Discussion of the Electric System's Financial Results**

Revenues from the District's annual sales of electric energy increased from \$547.7 million in 2005 to \$563.1 million in 2009, an increase of \$15.4 million or 3% over the period. Excluding sales for resale, sales of electric energy increased by \$54.4 million, an increase of 12% over the period. The overall increase in energy sales revenue during this period reflects customer growth. The total average number of customers of the District increased from 300,653 in 2005 to 318,530 in 2009, an increase of 6%. The growth in customers reflects the steady population growth rate in Snohomish County.

The District is not dependent on large corporate customers for its retail sales. In 2009, industrial customers represented only about 9% of the District's retail sales, while residential and commercial customers made up 57% and 34% of retail sales, respectively. The District's two largest customers in terms of power consumption accounted for less than 7% of retail energy sales revenues in 2009.

The Sales for Resale category reflects the sale of power originally purchased to serve the District's forecasted load, but due to actual load variations and changes in hydrological conditions that impact the output from the District's Slice product, are surplus to its needs. Power received from the "Slice" product with Bonneville can exceed the District's retail power requirements during certain periods of the year, resulting in Sales for Resale (or wholesale market sales). Fluctuations in resale revenues have resulted from changes in retail load, annual hydrological conditions, changes in District resources, and variations in wholesale power prices. Resale revenues of \$51.1 million in 2009 were \$29.7 million lower than in 2008 due to lower wholesale power market prices and unfavorable hydrological conditions, resulting in less power available for resale.

Other operating revenues include line extension contributions from developers, revenues from the sales of the District's transmission capacity, lease revenue for use of District facilities and customer fees. These revenues decreased from \$35.1 million in 2005 to \$23.1 million in 2009, due to reduced real estate development activity within the District's service area attributable to the national economic recession and lower demand for the District's transmission capacity.

Operating expenses for the period 2005 to 2009 increased 4% from \$544.1 million to \$563.5 million. This increase is the result of the 6% growth in the number of customers leading to higher operations, maintenance and tax expenditures.

Purchased power and generation expense decreased from \$361.5 million in 2005 to \$342.2 million in 2009, a decrease of 5%; however there were more significant annual fluctuations during this period. From 2005 to 2006, purchased power and generation costs decreased from \$361.5 million to \$343.7 million, a decrease of \$17.8 million due to the completion of the amortization period for a power contract settlement in January 2006. Purchased power and generation expenditures were \$335.9 million in 2007, or \$7.8 million lower than 2006. While an \$18 million power contract termination settlement was included in this category in 2007 and power market purchases were higher, these increases were offset by the expiration of a power contract in December 2006 and lower Bonneville power costs in 2007. In 2008, the purchased power and generation costs decreased \$18.5 million to \$317.4 million due to the \$30.1 million credit from Bonneville related to the settlement of a dispute regarding the level of residential exchange provided to investor-owned utilities. Purchased power and generation expense increased to \$343.8 million in 2009 due primarily to new renewable resource power purchase agreements and smaller settlement credit received from Bonneville.

Combined operation and maintenance expense increased from a total of \$121.2 million in 2005 to \$150.6 million in 2009, an increase of \$29.4 million or approximately 24%. This increase in operating and maintenance expenditures reflects a number of factors including a 6% increase in customers served by the District, a 5% higher number of distribution system line miles built and maintained, annual

increases in wages and salaries, increases in commodity costs affecting essential materials such as copper and aluminum wire, transformers, wood poles and fuel, the expansion of line maintenance programs such as tree and vegetation trimming around overhead lines and expanded energy conservation programs.

Maintenance expenses are subject to annual fluctuations based on the level of restoration efforts necessary following periodic high wind, snow and flooding conditions that impact the Pacific Northwest. In 2006, maintenance expenses were \$27.6 million, an 85% increase from the \$14.9 million spent on maintenance in 2005. Maintenance expense then decreased \$10.6 million to \$17.0 million in 2007. This one year anomaly was the result of three major declared weather emergencies, significant wind or heavy snow that occurred in February, November and December of 2006. The majority of the cost of the restoration efforts following these storms was recorded as maintenance expenses. In 2008, maintenance expenses increased \$5.6 million to \$22.6 million primarily due to repairs associated with a severe winter storm in December 2008. Maintenance expense decreased \$5.4 million to \$15.8 million in 2009 as the District experienced no major storm activity during the year.

The District pays an excise and privilege tax (in lieu of property tax) levied by the State of Washington. These taxes are assessed as a percentage of the District's revenue from retail electric sales. Privilege tax is also assessed based on energy generated from power plants. The District has pursued renewable resource tax deductions, capital construction exemptions and other tax deductions and exemptions available under Washington State law. The District anticipates that taxes in future years will be approximately 5.9% of retail electric sales.

## **Financial Condition and Liquidity**

### **Cash and Temporary Investments**

As of December 31, 2009 the Electric System's cash and temporary investments totaled \$295.9 million, excluding bond and other special funds. Cash and temporary cash investments for each of the years 2005 through 2009 are summarized in the following table.

#### **Electric System Cash and Temporary Investments (\$000s)**

<b><u>Year</u></b>	<b><u>Balance</u><sup>(1)</sup></b>
2005	\$211,556
2006	268,283
2007	296,800
2008	328,055
2009	295,866

<sup>(1)</sup> Balance does not include the Rate Stabilization Account which is treated as a special fund and totaled \$115.0 million in 2005 through 2009. The Electric System's 2009 budget provided for the use of a portion of the Electric System's reserves to fund certain capital and project expenditures; as a result, Cash and Temporary Investments declined in 2009. Excludes the 1995 Generation System Bonds held in the 1995 Trust and the 2001A Generation System Bonds and the 2002A Generation System Bonds held in the 2001/2002 Trust as investments of the Electric System.

### **Reserve Policy**

In August 2007, the Commission adopted a resolution establishing a financial reserve policy. The policy enables the District to prudently and consistently meet its financial obligations while allowing for

flexibility in the development and implementation of its capital plan and operations and maintenance budget. The reserve funds allow the District to mitigate risks from unforeseen financial variability and reduce the need for temporary rate surcharges.

At December 31, 2009, the District's cash position exceeded reserves suggested in its financial policies. The Electric System had \$295.9 million in unrestricted cash. In addition, the Electric System had \$115.0 million on hand at December 31, 2009 in the Rate Stabilization Account for a total of \$410.9 million. The District's financial reserve policies call for an initial balance of \$398 million.

Two types of reserve funds were established. On-going Long-Term Reserves may be utilized at the discretion of the General Manager or his designee under certain circumstances as defined in the resolution. The On-going Long-Term Reserves are required to be managed such that when funds are withdrawn, they will be replenished by means of cost of service allocated rate revenue, surplus operating cash or other method approved by the Commission. Project Specific Reserves may be utilized to fund projects as approved by the Commission, either through the adopted budget or as otherwise directed by the Commission. It is intended that Project Specific Reserves will not be replenished and will terminate when all the funds have been utilized.

The policy provides for three On-going Long-Term Reserves: the Operating Reserve, the Power Market Volatility Reserve, and the Self-Insurance Reserve.

The financial reserve policy established the Operating Reserve at \$68 million, a level that provides 90 days of non-power budgeted expenses in order to maintain adequate working capital during unforeseen events such as natural disasters, economic downturns, customer loss, revenue interruption and other operational contingencies. The \$171 million Power Market Volatility Reserve provides for the risks associated with wholesale market exposures resulting from power supply portfolio imbalances created by weather, contract purchase/product variability, fuel prices, load variances, or resource failures. The Power Market Volatility Reserve includes the Electric System's \$115 million Rate Stabilization Account. The Self-Insurance Reserve was set at \$12 million in order to provide for the estimated cost to support self-insured retention, insurance carrier deductibles, and where appropriate, settle claims and liabilities.

The policy provides for three project-specific reserves: the Litigation Claims Reserve, the Resource Re-investment Reserve, and the Electric System Infrastructure Reserve.

The Litigation Claims Reserve was established at \$45 million and was created to address unique risks associated with major claim settlement or the results of litigation that are not insured losses and could otherwise create significant rate pressure. Since this reserve was established, the District reached a settlement on a power purchase contract termination for \$18 million, and this termination payment was made from this reserve. The remainder of this reserve was transferred to the Resource Re-investment Reserve and the Litigation Claim Reserve was terminated.

The Resource Re-investment Reserve represents the proceeds from the sale of operational assets to be utilized to fund capital investments in replacement or new assets. The balance in this reserve was \$64 million as of December 31, 2009. The Electric System Infrastructure Reserve began at \$59 million and represents previously collected revenues that were originally intended to be invested into the Electric System during the period 1998 to 2004, but was deferred due to industry uncertainties. The balance in the Electric System Infrastructure Reserve as of December 31, 2009 is \$44 million.

### **Electric System Debt**

As of December 31, 2009, the Senior Electric System Bonds were outstanding in the aggregate principal amount of \$249,610,000, the Prior Junior Lien Bonds were outstanding in the aggregate



principal amount of \$3,651,700, and the Electric System Second Series Obligations were outstanding in the aggregate principal amount of \$232,475,000. After giving effect to the issuance of the 2010 Electric System Bonds and the defeasance of the 1999 Electric System Bonds, the Senior Electric System Bonds will be outstanding in the approximate aggregate principal amount of \$379,075,000. The 2009A Notes and the 2009B Notes mature on May 26, 2010 and August 5, 2010, respectively. The District intends to retire the 2009A Notes and the 2009B Notes at maturity. Upon the retirement of the 2009A Notes and the 2009B Notes, there will be no Electric System Second Series Obligations outstanding. See “SECURITY FOR THE 2010B BONDS—Outstanding Debt of the Electric System and the Generation System.”

### **Capital Expenditures**

Capital expenditures for the years 2005 through 2009 and forecasted expenditures for 2010 through 2014 are presented in the following table.

#### **Electric System Capital Expenditures (\$000s)**

<b>Historical</b>		<b>Forecasted</b>	
<b><u>Year</u></b>	<b><u>Amount</u></b>	<b><u>Year</u></b>	<b><u>Amount</u></b>
2005	\$46,976	2010	\$ 107,000
2006	61,041	2011	103,000
2007	78,697	2012	103,000
2008	83,842	2013	124,000
2009	72,156	2014	112,000

The capital expenditures above include costs incurred in connection with construction of new electrical transmission and distribution lines and substations to serve new customer loads, construction of electrical connections to new customers, and general facilities of the District.

The District does not commit funds to capital construction projects or future growth until it is clear that forecast loads and new customer connections are likely to develop. The District pays for its capital construction program from four sources: cash and temporary investments, line extension fees, general rates, and bond proceeds.

### **Interfund Loans with Water System**

In December 2008, the Commission adopted a resolution authorizing the Electric System to loan funds to the Water System from time to time in the maximum aggregate amount of \$10,000,000 at a market rate of interest, to be repaid from either (i) Water System revenue bond proceeds or (ii) revenues of the Water System, on a basis which is junior and subordinate to payment of debt service on Water System bonds, notes or other obligations for borrowed money. See APPENDIX A—“FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND INDEPENDENT AUDITOR’S REPORT,” Note 6.

### **Intersystem Loans between the Electric System and the Generation System**

The Electric System and the Generation System periodically enter into loan transactions between the systems for various purposes. See APPENDIX A—“FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 AND INDEPENDENT AUDITOR’S REPORT,” Note 6.

## Financial Plan

As part of its continuing planning efforts, the District prepares a five-year financial plan including forecasted operating results. Forecasted operating results are based on forecasts of loads, market prices for energy, energy resources, and capital and operating expenditures. The District believes the underlying assumptions in the forecasted operating results are reasonable. However, there will be differences between the actual and forecasted results because events and circumstances frequently do not occur as expected, and these differences may be material. The District tests the sensitivity of its forecasted operating results to certain factors which it believes could significantly affect its operating results, such as variations in load forecasts and the cost of purchased power.

The District has established financial guidelines developed for its Electric System in connection with a comprehensive financial study. The District has concluded that a minimum debt service coverage ratio of 1.75x on its Senior Electric System Bonds, no more than 40% debt financing of capital improvements, and a minimum of 90 days of non-power operating cash reserve provide a capital structure which will minimize rates and maintain the financial stability of the District.

### *Load Forecast*

The District uses end-use, trend, and econometric analysis to prepare its load forecast. The end-use analysis focuses on space heating characteristics and the effects of the District's conservation program. The District's load forecasts include base case, low growth and high growth forecasts. The District believes that the base case load forecast is the most likely to occur. Trend and econometric analysis are used to predict short-term new customer connections, employment growth and to estimate price and income elasticities. The long-term forecasts for residential and commercial customers are based upon the population forecasts from an econometric model of the Snohomish County economy prepared by regional experts. The model inputs include various measures of national and regional economic and demographic data. The forecasts also take into account load growth projections for The Boeing Company, the largest employer in the service territory and one of the District's largest industrial customers, and certain economic impacts associated with the U.S. Navy Homeport Project in Everett, Washington. Plug-in hybrid vehicles have also been taken into consideration, starting in 2009.

### *Resource Forecast*

The District's resources must meet its expected loads. Resource planning is an ongoing process and documented within the District's 2008 IRP. The District currently has resources available and planned to meet its forecasted loads through 2020. See "ELECTRIC SYSTEM POWER SUPPLY – The District's Future Power Supply Strategy – *District's 2008 Integrated Resource Plan*." Development of the District's 2010 IRP is underway.

To the extent that such resources are in excess of actual loads, the District will sell its surplus power in the wholesale power market. These sales can produce significant additional revenues to the District. Conversely, to the extent that such resources are not sufficient to meet actual loads, the District will purchase additional power in the wholesale power market. These purchases can result in significant additional costs to the Electric System for purchased power. A variety of factors will influence whether the District incurs additional costs or produces additional revenue. Among these factors are: retail load variances as compared to forecast, relative precipitation levels and hydroelectric power generation in the Federal System and at the Jackson Project, variations in power production at the Cogeneration Project, seasonal variations in temperature and variations from average temperatures, wind energy variability, population changes, the addition or loss of large single loads of commercial or industrial customers, the price of power in the forward wholesale power market, fuel switching between natural gas and electricity

or other sources, interruptions in power deliveries on the regional transmission system and local, regional and national economic conditions.

Because the District receives approximately 87% of its long-term power resource requirements from Bonneville, changes in Bonneville wholesale power rates can significantly influence the District's purchased power costs. The District's forecasted financial results include Bonneville's most recent forecast for wholesale power costs. Bonneville's power contracts provide the ability to adjust its approved rates for a variety of reasons, including changes in its own purchased power costs and poor financial results. Under Bonneville's Slice power contract, the District receives a variable amount of power based on water volumes in the Federal System.

### **Forecasted 2010 and 2011 Financial Results**

In projecting the financial results for the Electric System, the District has made certain assumptions regarding various factors that affect financial performance. Changes in these assumptions can have material effects on the forecasted financial performance. While numerous factors (or combinations of factors) could affect the District's financial performance, the factors most likely to affect the projections are water conditions, Bonneville rate adjustments, the effect of the conservation response, temperature variations and market price factors. Changes to the assumptions regarding these factors would have material effects on the outcome of the District's financial projections.

The District does not, as a matter of course, make public projections as to future sales, earnings, or other results. However, the management of the District has prepared the prospective financial information set forth below to present the forecasted financial results of the Electric System. The accompanying prospective financial information was not prepared with a view toward public disclosure or with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of the District's management, was prepared on a reasonable basis, reflects the best currently available estimates and judgments, and presents, to the best of its management's knowledge and belief, the expected course of action and the expected future financial performance of the District. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and prospective investors should not place undue reliance on the forecasted financial information.

Neither the District's independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures with respect to the District's forecasted financial information, nor have they expressed any opinion or any other form of assurance on such information or its achievability and assume no responsibility for, and disclaim any association with, the forecasted financial information.

The forecasted financial results for 2010 were prepared based primarily on the District's 2010 approved budget as modified by the results for January and February 2010 and reflect (i) a decrease in retail revenues despite the impact of two average retail rate increases in 2009 due to warmer than average winter temperatures in the first quarter of 2010 and the impacts of the national and local economic recession; (ii) lower wholesale power revenue as a result of below average hydrological conditions and lower power market prices, (iii) slightly lower purchased power costs as a net result of the expiration of a long-term power contract, partially offset by increased Bonneville wholesale power costs, (iv) decreased interest income due to the impact of a lower interest rate environment and (v) issuance of approximately \$128 million of Senior Electric System Bonds to fund system infrastructure projects.

The 2011 forecasted financial results were prepared based on the following assumptions: (i) an increase in retail revenues due to moderate load growth, a 4.5% retail rate increase and the expiration of the Bonneville Residential Exchange Credit beginning October 1, 2011, (ii) lower purchased power costs

despite a 4% increase in wholesale power costs from Bonneville due to a higher volume of energy available from Bonneville to serve retail load offsetting wholesale power market purchases and (iii) increased operating and maintenance costs reflecting increased labor, materials, and fuel costs, additional investments in demand-side management and upgrade costs for certain District software systems. Financial projections assume water volumes at the midpoint between critical (historically lowest year) and average water levels. The forecasted financial results can be significantly impacted by these wide-ranging actual water levels.

The following table presents the forecasted Electric System financial results for the years ending December 31, 2010 and 2011.

**Electric System  
Forecasted Financial Results  
(\$000s)**

	<b>2010<sup>(1)</sup></b>	<b>2011<sup>(2)</sup></b>
Sales of Electric Energy	\$ 539,790	\$ 576,368
Other Operating Revenue	55,842	47,709
Total Operating Revenues	<u>595,631</u>	<u>624,077</u>
Purchased Power and Generation <sup>(3)</sup>	344,002	328,176
Operating and Maintenance	167,070	177,539
Depreciation	42,862	44,148
Taxes	30,709	32,646
Total Operating Expenses	<u>584,644</u>	<u>582,509</u>
Net Operating Income	10,988	41,568
Other Income	14,309	15,388
Interest Charges	(22,009)	(20,411)
Net Income <sup>(2)</sup>	<u>\$ 3,288</u>	<u>\$ 36,545</u>
Interest Expense	22,009	20,411
Depreciation	42,862	44,148
Short Term Bonds Interest	<u>(5,446)</u>	<u></u>
Balance Available for Debt Service	<u>\$ 62,713</u>	<u>\$ 101,104</u>
Senior Lien Debt Service	\$ 24,021	\$ 28,526
Senior Electric System Bonds Debt Service		
Coverage:	2.6 x	3.5 x

<sup>(1)</sup> The forecasted 2010 financial results are based on the District's 2010 Electric System Budget, adjusted for financial results from January and February 2010. These figures are subject to adjustment when actual figures are available for the year ending December 31, 2010 and from the annual independent audit.

<sup>(2)</sup> The forecasted 2011 financial results are based on the District's detailed load and resource forecasts as well as forecasted changes in other revenues and expenditures from the 2010 Electric System Budget levels.

<sup>(3)</sup> Purchased Power and Generation Costs includes debt service on the Generation System Bonds. For purposes of this forecast, interest associated with the Redeemed Bonds and the proposed 2010A Bonds and the proposed 2010B Bonds have been prorated based upon the timing of the proposed financings in 2010.

In addition to the new renewable resource power contracts that began in 2009, the District is pursuing and evaluating new power resources to address growing loads in the District's service area and the requirements of Initiative-937, which requires the District to use certain eligible renewable resources

to serve at least 3%, 9% and 15% of its load by 2012, 2016 and 2020, respectively. These resources will likely be significantly more costly than inexpensive power purchased from Bonneville, which currently supplies approximately 87% of the energy that the District sells to customers. As a result, forecasted operating results beyond 2010 are expected to include higher purchased power and generation costs, as well as capital investments in power resource infrastructure, creating pressure on retail energy rates in order to maintain debt service coverage levels.

## **ECONOMIC AND DEMOGRAPHIC INFORMATION**

Snohomish County (the “County”) is located on Puget Sound about 15 miles north of downtown Seattle. It is one of the largest counties in Washington State and encompasses a land area of approximately 2,100 square miles. The County is home to The Boeing Company’s largest assembly plant as well as urban areas, rich agricultural land and many small communities that give it rich character and unparalleled quality of life. As shown in the following table, since 2005, the County’s population has grown by approximately 7.40%.

### **Population**

<u>Year</u>	<u>Snohomish County</u>
2009	704,300
2008	696,600
2007	686,300
2006	671,800
2005	655,800

*Source: Washington State Office of Financial Management*

### **Industry and Employment**

The County’s economy is an urban-rural mix. Agriculture and logging predominate in the northern and eastern regions of the County, while a high technology, urban job market predominates in Everett and the southern part of the County. While forestry and wood products manufacturing are important industries locally, the economic base of the County has expanded due to diversification into major industries, including aircraft production, high technology, biotechnology, electronics and electrical equipment manufacturing. Although Snohomish County has benefited from significant economic and population growth in western Washington over the last decade, Snohomish County has been impacted by recent economic conditions. Snohomish County has recently experienced a decrease in housing prices and an increase in housing sales. According to Northwest Multiple Listing Services, closed sales for houses and condos in the County increased from 359 closed sales in January 2009 to 495 in January 2010, or by approximately 38%, with the median selling price for houses declining by approximately 11% from \$312,900 to \$279,995 and the median selling price for condos declining by approximately 5% from \$243,225 to \$232,000 over the same period. According to Realtytrac.com, as of February 2010 home foreclosure activity within the County has increased from 478 foreclosures in February 2009 to 498 foreclosures in February 2010, an increase of approximately 4%. Residential construction in Snohomish County has slowed significantly compared to recent years.

As of November, 2009 the Boeing Company (“Boeing”) was the County’s largest employer, with an estimated 32,000 workers in the County and 72,162 employed state-wide. Boeing established an airplane manufacturing plant at the south end of the City of Everett in 1966. The plant was built to assemble wide-bodied 747 aircraft. In 1980 the plant was expanded for production of the new-generation 767 wide-body twin jet, and in the early 1990s Boeing completed a \$1.5 billion expansion project to accommodate 777 production. Located adjacent to the Snohomish County Airport (Paine Field), the complex presently includes the world’s largest volume building with 472 million cubic feet together with

nine office buildings and one 500,000 square foot supply building. The plant currently accommodates production lines for the 747, 767, 777 and Boeing's new 787 Dreamliner. Flight tests of the 787 began at the end of 2009 with the first delivery expected to occur in the fourth quarter of 2010. Production is projected at ten 787s per month by late 2013.

In early 2009, Boeing announced that it would lay off approximately 10,000 workers company wide. By the end of 2009, these lay offs reduced Boeing's Washington state workforce by nearly 4,000, including a reduction of approximately 1,000 aerospace workers in Snohomish County from Boeing and its suppliers.

In later October, 2009, Boeing announced that it had chosen its North Charleston, South Carolina facility as the location for a second final assembly site for the 787 Dreamliner. Until this new assembly line is brought on line, Boeing said that it would establish a traditional surge production capacity at its City of Everett plant and reiterated its commitment to produce airplanes in the Puget Sound; however, Boeing has indicated that when the additional line in North Charleston is fully operational, the surge capability in Everett will be phased out.

The U.S. Navy operates a \$265 million homeport for a nuclear aircraft carrier battle group in Everett. Naval Station Everett is home to two destroyers, three frigates, one nuclear-powered aircraft carrier and a Coast Guard buoy tender. There are approximately 6,000 sailors and civil service persons assigned to commands located at Naval Station Everett. The Naval Station itself has about 350 sailors and civilians assigned.

## Economic Indicators

Following are economic indicators for Snohomish County. The major private and public employers in the County as of November 2009, are shown on the following tables:

### Major Private Employers

Employer	Product/Business	FTE 2009 Employment
The Boeing Company	Aircraft Manufacturing	32,000
Providence Regional Medical Center	Medical services	3,200
Premiera Blue Cross	Health insurer	3,200
Tulalip Tribes Enterprises	Real estate, retail, gaming	3,020
Philips Medical Systems	Ultrasound technology	1,600
Verizon Northwest	Communications	1,500
Zumiez	Sporting goods	1,400
Aviation Technical Services	Aircraft repair, maintenance, parts	1,400
Everett Clinic	Health care	1,400
CEMEX (Rinker Materials)	Sand/gravel mining operations	1,200
Fluke Corporation (Danaher)	Electronic test and measurement	1,200
Kimberly-Clark	Paper Products	850
C&D Zodiac	Aerospace supplier, composites	750
Wal-Mart	Retail	740
Frontier Financial Corp.	Banking/Financial	700
Eldec Corp. (Crane Aerospace)	Aerospace electronics	700
Esterline Control Systems (Korry)	Aerospace electronics	600
Canyon Creek Cabinets	Cabinets	510
Sonosite	Medical Devices	510
Intermec Technologies	Wireless data collection; RFID	500
Panasonic Avionics	Aircraft Equipment	500

### Major Public Employers

Naval Station Everett	U.S. Navy Base	6,000
Snohomish County Government	County Government	2,965
State of Washington	State Government	2,800
Everett School District	School District	1,700
Stevens Healthcare	Health Care	1,400
Edmonds School District	School District	1,350
Marysville School District	School District	1,200
Monroe Correctional Complex	Correctional Facility	1,200
City of Everett	City Government	1,200
Snohomish County PUD	Electric Utility	900
Community Transit	Public Transit	695
Everett Community College	Higher Education	600
Edmonds Community College	Higher Education	520

Source: Snohomish County Economic Development Council.

**Snohomish County  
Taxable Retail Sales  
(\$000s)**

<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
\$8,276,392	\$9,292,805	\$10,438,480	\$11,209,499	\$10,320,565	\$9,244,408

*Source: Washington State Department of Revenue.*

**Assessed Valuation of  
Snohomish County  
(\$000s)**

<u>Collection Year</u>	<u>Valuation</u>
2009	\$101,983,434
2008	99,315,203
2007	84,124,565
2006	68,597,771
2005	60,801,066

*Source: Snohomish County Assessor's Office.*

**Personal and Per Capita Income  
Snohomish County**

<u>Year</u>	<u>Personal Income (\$000s)</u>	<u>Per Capita Income</u>
2007 <sup>(1)</sup>	\$ 27,179,614	\$ 40,302
2006	24,958,351	37,658
2005	22,798,883	35,125
2004	21,322,871	33,349
2003	20,191,501	31,902
2002	19,899,982	31,604

<sup>(1)</sup> Most recent data available.

*Source: U.S. Bureau of Economic Analysis.*

**Employment Data  
Snohomish County**

	<u>Annual Averages</u>				
	<u>2009<sup>(1)</sup></u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Civilian Labor Force	382,090	372,120	363,900	359,580	346,740
Employed	342,860	353,270	348,990	343,470	329,140
Unemployed	39,220	18,850	14,910	16,110	17,600
County Unemployment Rate	10.3%	5.1%	4.1%	4.5%	5.1%

<sup>(1)</sup> Preliminary, average through December 2009.

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



**Nonagricultural Wage and Salary Employment  
Snohomish County**

NAICS Industry Title	Annual Averages				
	2009	2008	2007	2006	2005
<i>Goods Producing</i>					
Construction, Mining and Logging	18,700	22,800	25,100	22,100	19,900
Manufacturing	53,000	55,500	54,000	48,400	44,500
Total <sup>(1)</sup>	71,600	78,200	79,100	70,600	64,500
<i>Services Providing</i>					
Trade, Transportation and Utilities	42,800	45,300	44,700	41,300	39,200
Information	5,000	5,500	5,900	5,200	4,100
Financial Activities	11,600	12,600	13,200	13,200	12,900
Professional and Business Services	20,900	22,700	23,200	20,400	19,200
Education and Health Services	25,800	25,000	23,900	22,300	21,400
Leisure and Hospitality	22,900	23,600	23,600	22,000	20,700
Other Services	8,900	8,900	8,700	8,400	8,800
Government	39,000	38,200	36,900	36,400	36,500
Total <sup>(1)</sup>	176,900	181,800	180,100	169,100	162,700
Total Nonfarm <sup>(1)</sup>	248,500	260,100	259,200	239,700	227,100

<sup>(1)</sup> Totals may not add due to rounding.

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

**LIMITATIONS ON REMEDIES**

Any remedies available to the owners of the 2010B Bonds upon the occurrence of an event of default under the Generation System 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 Generation System Bond Resolution or to pay principal of or interest on the 2010B Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the 2010B Bonds.

In addition to the limitations on remedies contained in the Generation System Bond Resolution, the rights and obligations under the 2010B Bonds and the Generation System 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 opinions to be delivered by Orrick, Herrington & Sutcliffe LLP, as Bond Counsel to the District, concurrently with the issuance of the 2010B 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 2010B Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D.

## **INITIATIVE AND REFERENDUM**

Under the State Constitution, the voters of Washington State have the ability to initiate legislation and modify existing legislation through the powers of initiative and referendum, respectively. The initiative power in Washington may not be used to amend the State Constitution. Initiatives and referenda are submitted to the voters upon receipt of a petition signed by at least eight percent (initiative) and four percent (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. See “ELECTRIC SYSTEM POWER SUPPLY — Washington State Energy Initiatives and Legislation.”

## **LITIGATION**

### **No Litigation Affecting the 2010B Bonds**

There is no litigation now pending or threatened restraining or enjoining the issuance and delivery of the 2010B Bonds or the power and authority of the District to impose, prescribe or collect rates or charges for the services of the Electric System or Generation System, or in any manner questioning the power and the authority of the District to impose, prescribe or collect such rates or charges or sell the 2010B Bonds or affecting the validity of the 2010B Bonds.

### **Morgan Stanley Contract**

On December 26, 2001, the District initiated a challenge to its long-term power contract with MSCG, and subsequently filed a formal complaint with FERC on February 11, 2002, alleging that the contract violated the “just and reasonable” standard of the Federal Power Act and seeking refunds. The District maintained that the contract arose out of gross market dysfunction during the Western wholesale electric market crisis of 2000-01, when the Western markets lacked effective competition, which is a prerequisite for FERC allowing market-based rates under the “just and reasonable” standard. The District also maintained that FERC’s June 2001 Western price cap order caused a fundamental regulatory change that disrupted the contracts’ underlying assumptions.

After FERC rejected the District’s claims in November 2003, the District appealed. The Ninth Circuit ruled in the District’s favor on December 19, 2006, setting forth a different standard for such contracts and remanding the proceeding back to FERC. The United States Supreme Court granted petitions for review by Morgan Stanley and other allied-electricity marketers, and issued a decision on June 26, 2008. The Supreme Court reversed the Ninth Circuit’s decision, affirmed that a presumption of just and reasonable rates will be applied to voluntary contracts unless the contracts harm the public interest or a challenger can show specific manipulation, but nonetheless remanded the case to FERC because FERC erred in its analysis and/or did not explain its rationale. FERC issued an order on December 18, 2008, reopening the record but establishing “paper” hearing procedures, and staying the hearing schedule until after the conclusion of settlement proceedings. The District cannot predict when this lawsuit will be resolved or its outcome.

### **FERC Proceeding on Refunds for California and Pacific Northwest Market Abuses**

Following extensive investigations of market manipulation and market power abuse that occurred during the Western wholesale power crisis of 2000-01, FERC initiated numerous proceedings against those accused of violating market rules. On June 25, 2003, FERC initiated show cause proceedings against a large number of entities that operated in the Western markets during the 2000-01 crisis requiring

them to answer evidence uncovered in a FERC Staff Report showing that they may have engaged in market manipulation or market power abuse. The District intervened. Most parties originally named in the show cause orders were dismissed or entered into settlements with FERC Staff. Although its claims against Enron have been settled, the District retains a claim for recovery against the funds collected by FERC, which claim was deferred to a second, “distribution” phase of the proceedings. The amount available through FERC settlements for the second phase is about \$38.5 million. After the first, or “liability” phase of the proceedings was concluded, FERC staff initiated settlement discussions for the distribution phase. The majority of the parties reached a settlement in 2008. FERC approved the settlement over the objection of one non-participating party on March 19, 2009 and an appeal challenging the settlement was filed in the U.S. Court of Appeals for the Ninth Circuit on May 18, 2009. Under the settlement, the District is expected to receive approximately \$1 million, distributed over time as the funds are collected by FERC.

### **District Claim Against Kimberly-Clark**

A failure occurred on June 21, 2007 in the turbine generator at the Cogeneration Project facility located at the Kimberly-Clark's Everett paper mill, resulting in a potential claim by the District in the approximate amount of \$4 million. The Cogeneration Project Operating Agreement provides for this matter to be settled by arbitration, which was scheduled for 2009. On September 8, 2008, Kimberly-Clark notified the District it was invoking a provision in the Operating Agreement which provides that either party may require good faith negotiations to amend the Agreement to “restore” the relative intended benefits in the event of a change in economic circumstances. The change in economic circumstances cited was a dramatic increase in the price of woodwaste fuel. The Agreement requires that any such amendment be agreed to by both parties. The District identified several possible changes in the Operating Agreement that might provide additional benefits to the District, which formed the basis for discussions about possible changes to the agreement. During this discussion, Kimberly-Clark raised several new significant claims for additional compensation that were based upon prior amendments to the Operating Agreement. After working with a mediator, the parties reached a comprehensive settlement in September 2009 that resolves the turbine generator outage claim and the additional claims raised by Kimberly-Clark, and which includes an amendment and restatement of the Operating Agreement and other ancillary agreements between the District and Kimberly-Clark to incorporate other benefits to the District. The parties have agreed to a settlement, which includes payments by the District to Kimberly-Clark totaling \$7.5 million, and payment to the District of \$3 million, for a net payment by the District of \$4.5 million. The settlement also includes an amended and restated Cogeneration Operating Agreement that clarifies ambiguities about the term of the Agreement, restricts the conditions under which future changes can be triggered under the Agreement, clarifies ambiguities in the provisions addressing replacement power obligations and transfers certain liabilities from the District to Kimberly-Clark at the conclusion of the Agreement.

### **AIG Swap Agreement**

On July 6, 2009, the District was served with a lawsuit filed by AIG-FP related to the AIG Swap Agreement. The AIG Swap Agreement was executed in connection with the issuance of the 1995 Generation System Bonds. See “SECURITY FOR THE 2010B BONDS—Derivative Products and Payment Agreements—Generation System Bond Resolution,” “THE GENERATION SYSTEM – Interest Rate Swaps – Generation System Bonds” and APPENDIX B —“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION –Additional Indebtedness—Derivative Products.” AIG is obligated under the AIG Swap Agreement to pay the actual variable rate of interest from time to time on the 1995 Generation System Bonds. The interest rate on the 1995 Generation System Bonds rose to extraordinary levels in 2008 following downgrades of MBIA Insurance Corporation, which insures the 1995 Generation System Bonds, and Depfa Bank plc (the “Bank”), which provides liquidity support for the 1995 Generation System Bonds. The District thus caused the 1995

Generation System Bonds to be purchased into the 1995 Trust to avoid the 1995 Generation System Bonds being put to the Bank if there were any failure to remarket them.

AIG-FP alleged, among other things, that the District breached the AIG Swap Agreement by causing the purchase of the 1995 Generation System Bonds into the 1995 Trust. The District has been involved in negotiations with AIG-FP for more than a year regarding the potential termination of the AIG Swap Agreement.

Late in July 2009, the District filed a lawsuit in the U.S. District Court in Seattle alleging that AIG had violated the AIG Swap Agreement, and sought a preliminary injunction to prevent AIG-FP from terminating the AIG Swap Agreement. The District also removed the New York case from state to federal court, and filed a motion challenging the jurisdiction of the New York courts, or in the alternative, seeking a transfer of the case to Washington state. On December 14, 2009, the New York court granted the District's motion to transfer the case to Washington. Subsequently, the Washington court on January 8, 2010, denied the District's preliminary injunction motion, noting that because AIG-FP had committed not to terminate the AIG Swap Agreement, the District would not be irreparably harmed by waiting for a trial on the merits. The Washington court set the matter for trial on an expedited basis in June 2010. Following a mediation held on March 22, 2010, AIG-FP and the District reached a settlement that will include releases of all claims, a termination of the AIG Swap Agreement, effective as of April 12, 2010, and a payment by the District to AIG-FP in the amount of \$14 million as payment in part for the economic loss to AIG-FP arising from the termination of the AIG Swap Agreement.

### **Other Litigation**

The District is a party to other lawsuits and claims 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.

## **TAX MATTERS**

In the opinion of Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, interest on the 2010B Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or accrual or receipt of interest on, the 2010B Bonds. A copy of the proposed form of opinion of Bond Counsel relating to the 2010B Bonds is set forth in Appendix D.

### ***Circular 230 Disclaimer***

Investors are urged to obtain independent tax advice regarding the 2010B Bonds based upon their particular circumstances. The tax discussion above regarding the 2010B Bonds was not intended or written to be used, and cannot be used, for the purposes of avoiding taxpayer penalties. The advice was written to support the promotion or marketing of the 2010B Bonds.

## **CONTINUING DISCLOSURE**

The District will covenant for the benefit of Owners and Beneficial Owners of the 2010B Bonds to provide certain financial information and operating data relating to the Electric System (the "Annual Report") by not later than nine months following the end of the District's fiscal year (which fiscal year currently ends on December 31), commencing with the Annual Report for the fiscal year ended December 31, 2010, and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report and the notices of material events will be filed by the District with the Municipal Securities

Rulemaking Board. The specific nature of the information to be contained in the Annual Report and the notices of material events is summarized in APPENDIX F – “FORM OF CONTINUING DISCLOSURE AGREEMENT.” These covenants will be made in order to assist the Underwriters for the 2010B Bonds in complying with Rule 15c2-12(b)(5) of the Securities and Exchange Commission, promulgated under the Securities Exchange Act of 1934, as amended (“Rule 15c2-12”). The District has never failed to comply in all material respects with any previous undertaking with regard to Rule 15c2-12 to provide annual reports or notices of material events.

## **RATINGS**

Moody’s Investors Service, Inc. (“Moody’s”), Standard & Poor’s Rating Services, a Division of The McGraw-Hill Companies, Inc. (“S&P”) and Fitch Ratings (“Fitch”) have assigned their ratings of “Aa3,” “AA-,” and “AA-,” respectively, to the 2010B Bonds. Such ratings reflect only the views of the respective rating agency and are not a recommendation to buy, sell or hold the 2010B Bonds. An explanation of the significance of such ratings should be obtained from the rating agency furnishing the same at the following addresses: Moody’s Investors Service, 250 Greenwich Street, Public Finance Group - 23rd Floor, New York, New York 10007; Standard & Poor’s Ratings Services, 55 Water Street, New York, New York 10041; Fitch Ratings, One State Street Plaza, New York, New York 10004. The District has furnished to each rating agency certain information and materials with respect to the 2010B 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 that have been assigned to the 2010B 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. A downward revision or withdrawal of the ratings may have an adverse effect on the market price of the 2010B Bonds.

## **UNDERWRITING**

The Underwriters have agreed, subject to certain conditions, to purchase the 2010B Bonds from the District at an aggregate purchase price of \$13,951,051.15, representing the aggregate principal amount of the 2010B Bonds, less Underwriters’ discount of \$86,037.90, and less original issue discount of \$12,910.95. The Underwriters’ obligations are subject to certain conditions precedent, and they will be obligated to purchase all 2010B Bonds if any such 2010B Bonds are purchased. The 2010B Bonds may be offered and sold to certain dealers at prices lower than such public offering prices, and such public offering prices may be changed, from time to time, by the Underwriters. The Underwriters may offer and sell the 2010B Bonds into unit investment trusts or money market funds, certain of which may be managed or sponsored by the Underwriters, at prices lower than the public offering prices.

Citigroup Global Markets Inc., one of the Underwriters of the 2010B Bonds, has provided the following language for inclusion in this Official Statement, and the District cannot and does not make any representation as to its accuracy or completeness: Citigroup Inc., parent company of Citigroup Global Markets Inc., one of the Underwriters of the 2010B Bonds, has entered into a retail brokerage joint venture with Morgan Stanley. As part of the joint venture, Citigroup Global Markets Inc. will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, Citigroup Global Markets Inc. will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the 2010B Bonds.

J.P. Morgan Securities Inc., one of the Underwriters of the 2010B Bonds, has provided the following language for inclusion in this Official Statement, and the District cannot and does not make any representation as to its accuracy or completeness: J.P. Morgan Securities Inc. (“JPMSI”), one of the Underwriters of the 2010B Bonds, has entered into negotiated dealer agreements (each, a “Dealer

Agreement”) with each of UBS Financial Services Inc. (“UBSFS”) and Charles Schwab & Co., Inc. (“CS&Co.”) for the retail distribution of certain securities offerings at the original issue prices. Pursuant to each Dealer Agreement (if applicable to this transaction), each of UBSFS and CS& Co. will purchase 2010B Bonds from JPMSI at the original issue price less a negotiated portion of the selling concession applicable to any 2010B Bonds that such firm sells.

### **CERTAIN LEGAL MATTERS**

Upon delivery of the 2010B Bonds, Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the District, will render an opinion as to the validity of and tax treatment of the interest on the 2010B Bonds in substantially the form attached hereto as Appendix D. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters in connection with the issuance of the 2010B Bonds will be passed upon for the District by Anne Spangler, General Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, Foster Pepper PLLC, Seattle, Washington, and any opinion of such firm will be limited in scope and cannot be relied upon by investors.

From time to time, Bond Counsel represents the Underwriters in matters unrelated to the sale of the 2010B Bonds.

### **MISCELLANEOUS**

Any statements made in this Official Statement involving matters of opinion, estimates or projections, whether or not so expressly stated, are set forth as such and not as representations of fact. No representation is made that any of such estimates will be realized. The descriptions contained in this Official Statement of the 2010B Bonds, the Generation System Bond Resolution, the Senior Electric System Bond Resolution and certain legislation do not purport to be complete and are qualified in their entirety by reference to the respective documents and laws. Copies of the Generation System Bond Resolution and the Senior Electric System Bond Resolution are available at the offices of the District. The execution and delivery of this Official Statement by its Treasurer and Assistant General Manager-Finance have been duly authorized by the District.

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This Official Statement is not to be construed as a contract with the owners of any of the 2010B Bonds.

PUBLIC UTILITY DISTRICT NO. 1 OF  
SNOHOMISH COUNTY, WASHINGTON

By: /s/ Glenn S. McPherson  
Assistant General Manager –  
Finance and Treasurer

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**APPENDIX A**

**FINANCIAL STATEMENTS FOR THE YEARS ENDED  
DECEMBER 31, 2009 AND 2008  
AND INDEPENDENT AUDITOR'S REPORT**

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# Independent Auditor's Report

**MOSS-ADAMS** LLP

CERTIFIED PUBLIC ACCOUNTANTS | BUSINESS CONSULTANTS

## INDEPENDENT AUDITOR'S REPORT

To the Commissioners  
Public Utility District No. 1  
of Snohomish County, Washington

We have audited the accompanying combined balance sheets of Public Utility District No. 1 of Snohomish County, Washington ("the District") as of December 31, 2009 and 2008, and the individual balance sheets of the Electric, Generation, and Water Systems as of December 31, 2009; the related combined statements of revenues, expenses, and changes in equity and cash flows for the years ended December 31, 2009 and 2008; and the individual statements of revenues, expenses, and changes in equity and cash flows for the Electric, Generation, and Water Systems for the year ended December 31, 2009. 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 in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of the District as of December 31, 2009 and 2008, and the combined results of its operations and its cash flows for the years then ended, the individual financial positions of the Electric, Generation, and Water Systems as of December 31, 2009, and the individual results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures that 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.

*Moss Adams LLP*

Everett, Washington  
April 7, 2010

# Management's Discussion and Analysis

The following discussion provides an overview of Snohomish County Public Utility District (the PUD) financial activities for the years ended December 31, 2009 and 2008. This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

## FINANCIAL HIGHLIGHTS

### POSITIVE OPERATING RESULTS

The 2009 operating results for Snohomish County PUD remained positive despite the continued impacts of the recession on the local and national economy. The PUD continued to experience growth in its customer base. The average number of Electric System customers increased from 316,645 in 2008 to 318,530 in 2009, an increase of 0.6%. *Figure 1* illustrates the five-year growth in the number of customers. From 2008 to 2009, retail electric sales increased slightly from \$511.9 million to \$512.1 million. Retail MWh sales decreased slightly from 6,952,990 MWh in 2008 to 6,872,796 MWh in 2009.

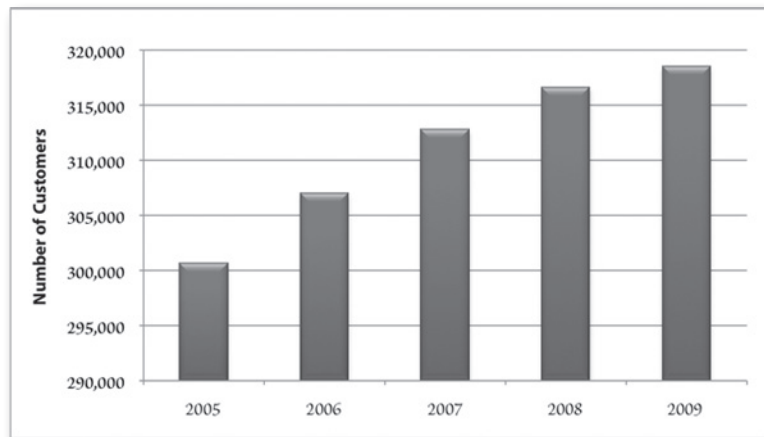


Figure 1 – Growth in Electric Customers

Wholesale energy sales decreased in 2009 primarily as a result of lower wholesale market power prices. Wholesale electric power sales were slightly lower, 1,556,036 MWh in 2009 as compared with 1,664,656 MWh in 2008. In terms of revenues, the PUD recorded \$51.1 million in wholesale electric sales in 2009 versus \$80.8 million in 2008.

Combined purchased power costs were 7.8% higher in 2009 as compared with 2008. The increase in the power costs was a result of recording a \$30.1 million credit from BPA in 2008, as well as two significant new power purchase agreements from renewable power sources that began in 2009. The difficult economy also impacted the PUD's customers and developers as combined contributions for new services decreased in 2009 by \$12.1 million.

Despite the impacts of the recession, the PUD recorded combined net operating income of \$71.9 million in 2009; combined net operating income in 2008 was \$144.6 million. Similarly, combined net income was \$45.9 million in 2009, \$135.4 million in 2008.

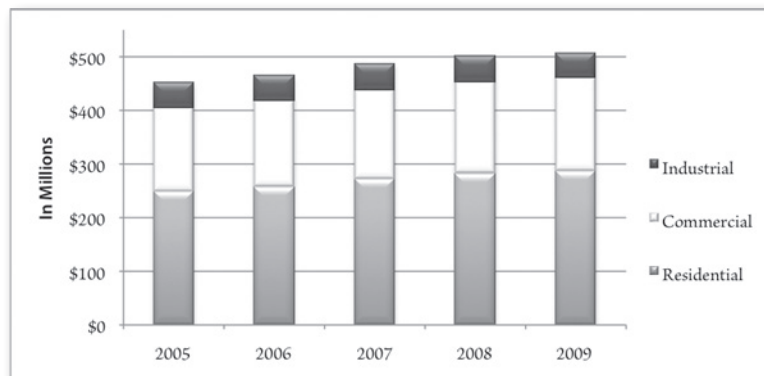


Figure 2 – Growth in Retail Energy Sales

## 2009 CHANGES IMPACTING CUSTOMERS

### **Electric Rate Changes**

For the first time since 2001, the PUD Board of Commissioners authorized an electric rate increase in 2009. The rate change was approved to address the impact of inflation on the cost of materials and services, as well as the higher costs of renewable energy resources that have been acquired in compliance with Washington State's renewable portfolio standard. The 3.5% system average rate increase became effective April 1, 2009. In conjunction with the approval of the rate increase, the Board approved a 2009 budget reduction plan.

Effective October 1, 2009, the Bonneville Power Administration (BPA) increased its wholesale rates to the PUD by approximately 7%. In order to address the impact of higher costs from BPA, the PUD Board of Commissioners implemented a pass-through retail rate adjustment of approximately 3% to recover the increased cost of power purchases from BPA. The impact of the retail rate increase to residential customers was offset by a "Residential Exchange Credit" that the PUD sought and received from BPA on behalf of its eligible customers. Intended to equitably allocate the benefits of the Federal Columbia River Power System among public power utilities and investor-owned utility customers, the Residential Exchange Credit offsets the overall costs that the PUD pays for energy from BPA and must be passed through to residential customers. The PUD received \$3.9 million in credits from BPA during 2009, and the program is expected to continue through September 2011.

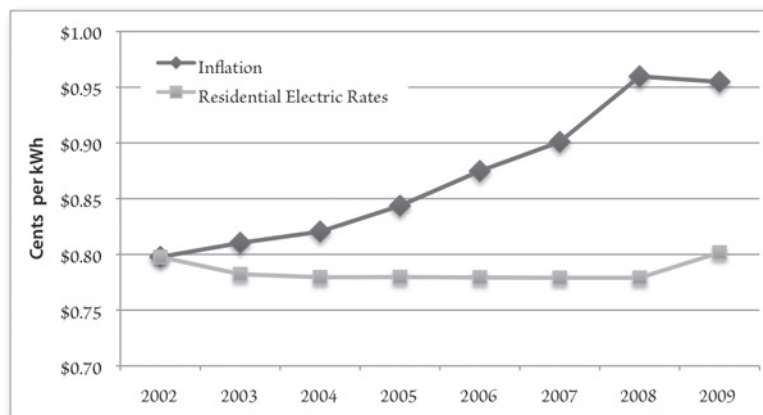


Figure 3 – Changes in Residential Electric Rates vs. Inflation

### **Bill Payment Options**

In November 2008, the PUD expanded its electronic bill payment options for customers by introducing its "SnoPAY" payment system on the PUD Web site, [www.snopud.com](http://www.snopud.com). During 2009, the program's popularity grew significantly; more than 10% of the PUD's customers were enrolled in the program by the end of 2009. This program not only allows customers to pay their utility bills through electronic check or debit or credit card but also allows them to view their PUD bills and account history online. SnoPAY also provides customers the option of eliminating paper bills and envelopes in order to demonstrate their commitment to the environment.

### **Progress on New Customer Information System**

During 2008, the PUD entered into an agreement with SAP to purchase and install a new customer information software system to replace its current customer billing and collection program. The PUD dedicated substantial resources during 2009 to the review and modification of business processes, technical adaptation, testing and training necessary to implement the system in early 2010. Operating expenses for 2009 include \$4.6 million of costs related to this project; in addition, \$8.2 million has been capitalized as project costs. Installation of this system lays the foundation for the PUD to move forward with its Strategic Plan that includes Smart Grid, demand-side management and outage management.

## RENEWABLE POWER RESOURCES

The PUD is committed to adding clean environmentally-friendly renewable energy sources to its energy portfolio. In demonstrating this ongoing commitment, the PUD continued its investment in renewable energy sources and energy efficiency projects.

### ***Northwest Wind Generation Power Purchase Agreements***

During 2009, the PUD began receiving power from the Hay Canyon Wind Project, located in north central Oregon, along the Columbia River Gorge. The PUD signed a 15-year power purchase agreement with Hay Canyon Wind, LLC, a wind development subsidiary of Iberdrola Renewables, Inc. This project is expected to generate approximately 26 aMW of renewable power.

In addition, the PUD entered into a 20-year agreement to purchase power from the Wheat Field Wind Project located in north central Oregon, along the Columbia River. This project is expected to generate approximately 25 aMW of renewable power. These power purchase agreements complement the PUD's other wind power purchase agreement to take output from the White Creek Wind Project. That project is located in south central Washington near Roosevelt, and the PUD purchases approximately 5 aMW of energy. The total cost of these wind power purchase contracts was \$34.5 million in 2009.

### ***Youngs Creek Hydroelectric Project***

In 2009, the PUD began development on Youngs Creek, located in central Snohomish County, to construct a 7.5 aMW low-impact hydroelectric system. The project is estimated to cost approximately \$30 million to design and construct and will consist of a 20-foot-high, 65-foot-wide diversion dam with a crest elevation of 1,530 feet. As currently licensed by FERC, it will also include an intake structure, a 14,300-foot-long penstock, a powerhouse with an 8.3 MW turbine and a 6.1 mile long underground transmission line. The PUD spent approximately \$7.5 million in 2009 on engineering, site preparation, materials procurement and regulatory costs to prepare for construction. Project construction is expected to begin in 2010, and it is expected to begin producing power in April 2011.

### ***Distributed Solar Energy Program***

The PUD introduced a new campaign to promote the use of distributed solar-energy-generating projects called the "Solar Express." The program provides cash incentives or low-interest loans to customers who install photovoltaic energy producing or hot-water systems. In addition, the PUD joined the movement towards solar energy in 2009 and installed a 10-kW 54-panel photovoltaic system at its headquarters building in Everett.

### ***Energy Efficiency Programs***

The PUD continues to be a regional leader for its conservation/energy efficiency programs, which include commercial and industrial new construction and retrofit incentives, compact fluorescent lighting discounts, energy-efficient appliance rebates, and low-interest loans for home weatherization, including a new program for ductless heat pumps. The PUD also launched a new Energy Challenge program encouraging residential and commercial customer to reduce their energy consumption by 10 percent. Operation expenses in 2009 include approximately \$15.0 million related to energy efficiency programs, an increase of \$5.0 million over 2008 levels.

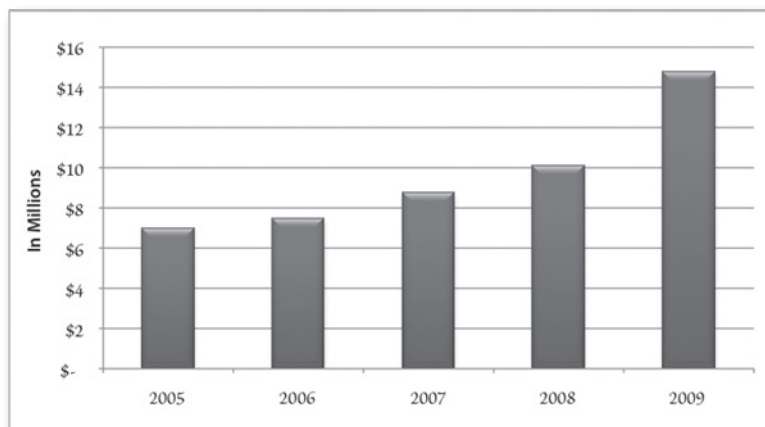


Figure 4 – Conservation Expenditures

### **Renewable Portfolio Standard**

The PUD is committed to meeting the requirements of the Washington state renewable portfolio standard (RPS), which requires a utility to use eligible renewable resources to meet three percent of its load by January 1, 2012, nine percent of its load by January 1, 2016, and fifteen percent of its load by January 1, 2020. The PUD has already entered into agreements for power purchases from wind and cogeneration power producers that significantly exceed the 2012 RPS. As a result, the PUD was able to sell \$2.9 million of the renewable energy credits associated with the resources in 2009; this funding will be used to invest in future renewable resources.

Resource	Nameplate Capacity in MW	I-937 Eligible
White Creek Wind Project	20	6
Wheat Field Wind Project	97	29
Hampton Lumber Cogeneration	7	1
Klickitat Landfill Gas Project	2	2
Hay Canyon Wind Project	100	32
<i>Totals</i>	226	70

Year	I-937 Target	aMW Target
2012	3%	26
2016	9%	80
2020	15%	137

*Figure 5 – PUD progress toward RPS compliance*

## **GRANT AWARDS**

In 2009, the PUD received grant awards for several purposes:

### **Tidal Energy Research**

During 2009, the PUD continued its three-year effort to research and study several tidal energy sites in the Puget Sound region, which, if developed, could produce enough energy for up to 70,000 homes. The PUD received funding from a federal spending bill that appropriated \$475,000 to this project in addition to a \$600,000 grant from the US Department of Energy to help determine the potential effects of tidal energy turbines on aquatic life in the Puget Sound. The PUD was awarded a total of \$2.7 million in grant funds in support of this effort. In addition, during April 2009, the PUD selected Open Hydro, an Irish technology company, to design, build and install up to three marine turbines for its Admiralty Inlet pilot project.

### **Energy Efficiency Services**

In October 2009, the PUD was awarded a \$2.2 million grant for its continued effort to promote conservation and energy efficiency. The grant is funded from the American Recovery and Reinvestment Act for programs providing energy-efficiency upgrades. The PUD will work in partnership with Snohomish County and the City of Everett to support projects in multi-family homes and small businesses in selected neighborhoods throughout Snohomish County.

### **Smart Grid Technology Infrastructure**

In October 2009, the PUD was awarded a \$15.8 million grant funded by the American Recovery and Reinvestment Act to be used to support the installation of a smart grid framework, including a digital telecommunication network, substation automation and a robust distribution system infrastructure. When completed, a fiber optic network will connect 62 substations, two radio sites and various PUD buildings. It will also allow for future smart grid technologies, which will help the utility and its customers manage power consumption, plan for energy use and reduce green house gases. The project is expected to take three years to complete at a total estimated cost of \$31.7 million.

## DEBT AND INVESTMENTS SECURITIES

### Generation System Variable Rate Bonds

The Generation System has three series of variable rate bonds outstanding: Series 1995, 2001A and 2002A. Each has an associated variable-to-fixed interest rate swap. Figure 6 is a summary of these bonds, their terms, and the financial partners for each of these bond issues. The deterioration of the financial markets in late 2008 negatively impacted the insurers and liquidity providers for the Generation System's variable rate bonds, which affected interest costs in 2008 and 2009.

Figure 6  
**Generation System Variable Rate Bonds**

	1995 Series	2001A Series	2002A Series
Variable Rate Bonds Outstanding	\$ 58,260,000	\$ 61,870,000	\$ 114,535,000
Variable-to-Fixed Rate Swap Terms	Bond Rate Swap - PUD pays 6.2% and variable rate, AIG pays variable rate	LIBOR Swap - PUD pays 4.43% and variable rate, Citigroup pays 67% of LIBOR Index	LIBOR Swap - PUD pays 3.65% and variable rate, Citigroup pays 70% of LIBOR Index
Swap Counterparty	AIG	Citigroup	Citigroup
Bond Insurer	MBIA	FSA	FSA
Liquidity Provider	Depfa Bank	Dexia Bank	Dexia Bank
Remarketing Agent	Citigroup	Citigroup	Citigroup

As the insurer and liquidity provider for the Series 1995 bonds began to have credit and liquidity problems during 2008, the weekly reset rate on the variable rate bonds increased significantly. The same problem impacted the variable rate interest on the Series 2001A and 2002A variable rate bonds in late 2008 and early 2009. The Electric System acquired the outstanding Series 1995, 2001A and 2002A Generation System variable rate bonds and placed them in a trust, issuing short-term Electric System revenue notes to fund the purchases. As of December 31, 2009, the PUD had issued \$232.5 million of Series 2009A and 2009B Electric System revenue notes at yields of 0.55 and 0.46 percent, respectively. The Series 1995, 2001A and 2002A bonds are still considered outstanding. The PUD will continue to monitor financial market conditions to determine options to address these bonds and the associated notes in the future.

### Lower Long-Term Debt Levels

Strong operating results over the past several years have enabled the PUD to reduce Electric and Generation System debt levels. The PUD has used rate-based revenue and greater-than-expected wholesale power sales revenue to fund investments in the electric distribution system infrastructure. While both systems have completed short-term and refinancing transactions, no additional net long-term debt has been added to the Electric and Generation System since 2002.

As a result, for the last five years, overall long-term debt levels have decreased for the combined Electric and Generation systems. The growth in capital infrastructure provides additional debt capacity and flexibility for future financing activity. Combined long-term debt for the Electric and Generation systems, including current maturities, totaled \$529.9 million as of December 31, 2009, compared with \$561.9 million in 2008. Figure 7 illustrates the decline in long-term debt for the combined Electric and Generation Systems over the past five years.

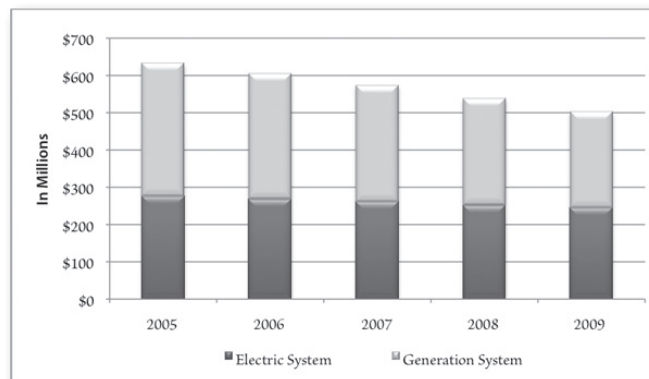


Figure 7 – Long-Term Debt Level History



### **Investment Returns**

Financial market and recessionary pressure have decreased interest returns on the governmental instruments that make up the majority of the PUD's investments, lowering 2009 interest income. At December 31, 2009, combined interest income was \$15.4 million; \$5.6 million lower than the \$21.0 million recorded in 2008.

## **GENERATION SYSTEM**

### **Jackson Hydroelectric Project Relicensing**

In May 2009, the Board of Commissioners authorized the General Manager to file the final license application with the Federal Energy Regulatory Commission (FERC) to secure a new license for the Henry M. Jackson Hydroelectric Project. FERC has the authority to issue a new license for a term of up to 50 years. Since the preliminary license proposal was filed in late 2008, the PUD has been meeting with the various stakeholders to reach a final settlement agreement. A final settlement agreement was reached in October 2009. The agreement calls for a series of measures to continue to protect and enhance Spada Lake and the Sultan River basin.

The current license expires in May 2011. The Jackson Project currently generates about 5% of the PUD's energy supply. It also creates water storage that allows the City of Everett to provide approximately 80% of the water supply for residents of Snohomish County. Costs incurred related to the relicensing effort have been capitalized as a deferred charge in the Generation System and will be amortized over the life of the new license.

### **Kimberly-Clark Settlement Agreement**

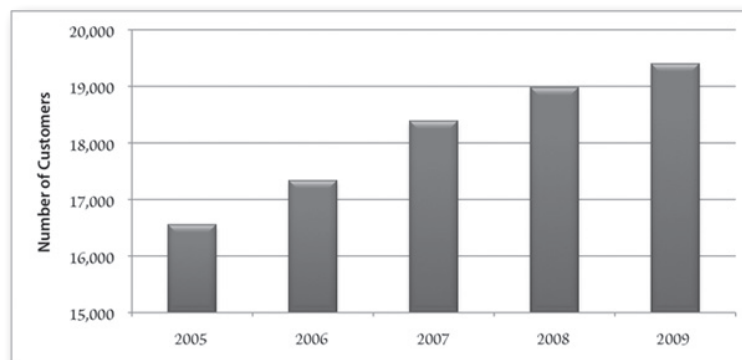
The PUD and Kimberly-Clark (K-C) have negotiated a settlement agreement regarding the Everett Cogeneration project. The agreement addresses a claim made by the PUD for power replacement costs resulting from a 2007 generator failure; it also clarifies the terms of the associated Operating Agreement. The terms of the agreement call for K-C to pay the PUD \$3 million for the cost of replacement power. The PUD will pay K-C \$7.5 million in settlement of claims made by K-C, and assigns the cost of decommissioning and remediation to K-C upon the December 31, 2016, termination date of the Operating Agreement. The \$7.5 million termination payment has been recorded by the Generation System as an accrued liability and a deferred charge. The settlement agreement is expected to be signed in April, 2010.

## **WATER SYSTEM**

### **Strong Operating Results**

The Water System exhibited growth in 2009 despite the difficult economy. The average number of Water System customers increased from 18,981 in 2008 to 19,398 in 2009, an increase of 2.2%. *Figure 8* illustrates the five-year growth in the number of customers. Retail water sales were \$7.3 million in 2009 compared with \$6.1 million in 2008, an increase of 19.7%. The recession's impact on the housing market and new construction caused a decrease in other operating revenues, which is dependent on customer and developer fees for new connections, from \$5.7 million in 2008 to \$3.8 million in 2009.

The Water System recorded net operating income of \$4.3 million in 2009; net operating income in 2008 was \$4.7 million. Similarly, net income was \$3.6 million in 2009 as compared with \$4.1 million in 2008.



*Figure 8 – Growth in Water Customers*

### ***Rate Increases***

In December 2008, the Board of Commissioners approved revisions to the Water System's service rate schedule. The new schedule, effective January 1, 2009, included annual rate increases through 2012. Several factors led to the rate increase schedule, including an expected increase in wholesale water prices, rising material and construction costs, and the need for funding capital infrastructure improvements to address growth in Snohomish County. For 2009, retail water rates increased approximately 13%.

### ***Water Operations Facility***

In May 2009, the PUD began construction of a new Water System operations facility. The facility will provide office space for most of the Water System's dedicated personnel. In addition, the complex provides a new warehouse and shop, a vehicle storage building and four canopy structures to house materials and equipment. The estimated project cost is \$9.5 million and will be funded with the proceeds of the Series 2009 Water System Revenue bonds.

### ***Series 2009 Revenue Bonds***

In November 2009, the PUD issued \$13.1 million of Series 2009 Water System Revenue bonds. Proceeds of the bonds will be used to finance the construction of the Water System operations facility, as well as a portion of the Water System's capital improvement plan for 2009 through 2011, including water main replacement projects and other improvements. Moody's Investors Service and Standard & Poor's rated the bonds A1 and AA, respectively, indicating their confidence in the Water System's financial stability.

### ***Washington State Low-Interest Loan Awards***

In 2009, the Washington State Public Works Board (PWB) approved a \$2.3 million Drinking Water State Revolving Fund loan, bearing interest at 1.5%, to partially finance the installation of a reservoir. The PWB also awarded the PUD a no-interest \$100,000 Public Works Trust Fund loan to fund the preparation of the PUD's Water System plan.

## **OVERVIEW OF THE FINANCIAL STATEMENTS**

### ***Basic Financial Statements***

The Balance Sheets present the PUD's assets and liabilities, with the difference between the two reported as equity. The Balance Sheets provide information about the nature and amount of investments in resources (assets), and the obligations to creditors (liabilities). Equity increases when revenues exceed expenses. The Statements of Revenues, Expenses, and Changes in Equity report the revenues and expenses during the periods indicated. The Statements of Cash Flows provide information about the PUD's cash receipts and payments from operations, as well as funds provided and used in investing and financing activities.

### ***Notes to the Financial Statements***

The notes to the financial statements provide additional information that is essential to a full understanding of the figures provided in the basic financial statements.

### ***Financial Analysis***

Analysis of the comparative financial information is provided in the following table.

## Condensed Combined Financial Information

(In millions)

	2009	December 31, 2008	2007
Current Assets and Special Funds	\$ 877.7	\$ 718.8	\$ 610.6
Net Utility Plant	1,087.5	1,047.0	1,000.0
Deferred Charges and Other Assets	63.5	74.0	47.6
<b>Total Assets</b>	<b><u>\$2,028.7</u></b>	<b><u>\$1,839.8</u></b>	<b><u>\$1,658.2</u></b>
Current Liabilities	\$ 376.2	\$ 201.6	\$ 151.0
Long-Term Debt	526.7	545.6	577.7
Deferred Credits & Other Liabilities	56.0	68.7	41.0
<i>Total Liabilities</i>	<u>958.9</u>	<u>815.9</u>	<u>769.7</u>
Invested in Capital Assets, Net of Debt	534.7	470.0	395.1
Restricted	167.2	167.5	171.3
Unrestricted	367.9	386.4	322.1
<i>Total Equity</i>	<u>1,069.8</u>	<u>1,023.9</u>	<u>888.5</u>
<b>Total Liabilities &amp; Equity</b>	<b><u>\$2,028.7</u></b>	<b><u>\$1,839.8</u></b>	<b><u>\$1,658.2</u></b>
Operating Revenues	\$ 601.6	\$ 643.9	\$ 618.2
Operating Expenses	529.7	499.3	512.4
<i>Net Operating Income</i>	<u>71.9</u>	<u>144.6</u>	<u>105.8</u>
Interest Charges	37.0	36.7	36.4
Other Income and Expense	11.0	27.5	27.7
<i>Net Income</i>	<u>45.9</u>	<u>135.4</u>	<u>97.1</u>
Equity – beginning of year	1,023.9	888.5	791.4
<b>Equity – end of year</b>	<b><u>\$1,069.8</u></b>	<b><u>\$ 1023.9</u></b>	<b><u>\$ 888.5</u></b>

### Assets

Current assets and special funds increased \$158.9 million in 2009, primarily as a result of the Electric System's \$174.9 million investment in Series 2001A and 2002A Generation System Adjustable Tender Revenue bonds. Current assets and special funds increased \$108.2 million in 2008 as a result of strong operating results due to a \$20.3 million increase in retail energy and water sales reflecting growth in the PUD's customer base, a \$14.8 million increase in wholesale energy sales and lower purchased power costs due to a \$30.1 million credit related to a settlement with BPA. Also contributing to the 2008 increase was the Electric System's \$58.2 million investment in Series 1995 Generation System Adjustable Tender Revenue bonds.

The PUD had \$1,087, \$1,047, and \$1,000 million invested in a broad range of net utility capital assets as of December 31, 2009, 2008 and 2007, respectively. Utility capital assets include a hydroelectric power generation plant, a cogeneration facility, electric transmission and distribution lines, water lines, storage and pump station facilities, buildings and equipment. Utility plant additions were \$94.5 million in 2009 and \$96.3 million in 2008, reflecting investments in the distribution and transmission systems, including construction associated with growth and general facilities of the PUD. The increase in utility plant was offset by \$9.0 and \$15.3 million in plant asset retirements in 2009 and 2008, respectively, and an increase in accumulated depreciation of \$45.1 million in 2009 and \$34.0 million in 2008.

Deferred charges and other assets decreased \$10.5 million in 2009 due primarily to the \$19.6 million decrease in the market value of the PUD's three variable-to-fixed interest rate swaps, which were executed as cash flow hedges. The difference between the notional and market value of these hedges is treated as a deferred regulatory charge. This decrease was partially offset by the recording of a \$7.5 million deferred settlement. Deferred charges and other assets increased \$26.4 million in 2008 due primarily to an increase in market value of the interest rate swaps.

### ***Liabilities***

Current liabilities increased \$174.6 million in 2009 as a result of issuing \$174.9 million of short-term Series 2009A Electric System Revenue notes. Current liabilities increased \$50.6 million in 2008 as a result of issuing \$58.2 million of short-term Series 2008A Electric System Revenue notes. The effect of the 2008 notes was partially offset by the payment of an \$18.0 million power contract termination settlement.

Long-term debt decreased \$18.9 million in 2009 due to scheduled principal repayments on outstanding tax-exempt bonds, net of \$13.1 million from the sale of Series 2009 Water System Revenue bonds. Long-term debt decreased \$32.1 million in 2008 as a result of scheduled principal repayments.

Deferred credits and other liabilities decreased \$12.7 million in 2009 and increased \$27.7 million in 2008 due primarily to the change in the market value of the PUD's interest rate swaps.

### ***Equity***

Equity invested in capital assets, net of debt increased \$64.7 and \$75.4 million in 2009 and 2008, respectively. The 2009 and 2008 increases reflect the growth in net utility plant, along with a lower level of long-term debt because of scheduled principal repayments. Capital expenditures are generally funded through rate-based revenues, contributions from customers and developers for requested facilities, and debt proceeds. The PUD added 4,049 and 4,438 Electric System customer connections in 2009 and 2008, respectively. Water System customer connections grew 465 in 2009 and 454 in 2008.

Restricted equity represents resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements, and resources restricted by Board resolution. Restricted equity decreased \$0.3 million in 2009 as a result of a lower level of customer deposits. Restricted equity decreased \$4.3 million in 2008, due in part to a \$3.0 million transfer of Water System general facility charge fund to the revenue fund.

Unrestricted equity is available to finance day-to-day operations without constraints established by debt covenants or other legal requirements. Unrestricted equity decreased by \$18.5 million in 2009 due to the scheduled use of cash reserves to fund a portion of system infrastructure capital expenditures. Unrestricted equity increased by \$64.3 million in 2008 due to strong operating results including a \$30.1 million BPA credit in 2008.

### ***Operating Revenues***

In 2009, operating revenues decreased \$42.3 million from 2008. Lower wholesale power market prices resulted in a \$29.6 million decrease in wholesale revenue. In addition, developer contributions decreased \$12.1 million due to the weakened economy, and sales of surplus transmission capacity were lower by \$2.7 million. In 2008, operating revenues increased \$25.7 million from 2007. Higher retail and wholesale sales of \$20.3 and \$14.9 million, respectively, contributed to the improvement. These increases were partially offset by a \$3.5 million reduction in developer contributions, and a \$4.4 million decrease in the sales of surplus transmission capacity.

### ***Operating Expenses***

Operating expenses increased \$30.4 million in 2009. Purchased power costs were \$20.4 million higher primarily due to the cost of two new renewable power resource purchase agreements. In addition, the PUD increased funding for energy conservation programs and incurred costs related to the purchase and implementation of a customer information system.

Operating expenses decreased \$13.1 million in 2008. Purchased power costs were lower by \$28.2 million due to a \$30.1 million credit related to a settlement with BPA. This was partially offset by higher maintenance costs due to budgeted increases in the PUD's vegetation management program and winter storm damage repair costs incurred in December 2008. In addition, in 2008 the PUD increased funding for energy conservation programs and began a project to replace its customer information system.

### ***Other Income and Expense***

Other income and expense decreased \$16.5 million in 2009 due to lower market interest rates, which provided lower investment returns in 2009, as well as the effects of adjusting the PUD's investments to current market prices. Lower interest earnings in 2008 resulted in a \$0.2 million decrease in other income and expense.

## **REQUESTS FOR INFORMATION**

The basic financial statements, notes, and management's discussion and analysis are designed to provide a general overview of the PUD's finances. Questions concerning any of the information provided in this report should be directed to the PUD at 2320 California Street, Everett, WA 98201.

## COMBINED BALANCE SHEETS

December 31, 2009 and 2008

(In thousands)

ASSETS	2009				2008
	Electric System	Generation System	Water System	Combined	Combined
<b>Current Assets:</b>					
Cash and temporary investments:					
Cash and cash equivalents	\$ 111,502	\$ 17,262	\$ 11,405	\$ 140,169	\$ 129,481
Temporary investments	184,364	—	—	184,364	215,593
	295,866	17,262	11,405	324,533	345,074
Accounts and other receivables, net	111,963	6,015	1,662	117,929	119,120
Materials and supplies	14,219	—	91	14,310	11,532
Prepayments and other	942	84	24	1,050	709
<b>Total Current Assets</b>	<b>422,990</b>	<b>23,361</b>	<b>13,182</b>	<b>457,822</b>	<b>476,435</b>
<b>Special Funds - Bond Funds and Other</b>	<b>379,882</b>	<b>33,290</b>	<b>6,660</b>	<b>419,832</b>	<b>242,360</b>
<b>Utility Plant:</b>					
Plant in service	1,182,993	355,696	108,041	1,646,730	1,585,636
Construction work in progress	48,247	10,048	9,363	67,658	43,210
Total utility plant	1,231,240	365,744	117,404	1,714,388	1,628,846
Less: Accumulated depreciation	446,892	159,636	20,378	626,906	581,817
<b>Net Utility Plant</b>	<b>784,348</b>	<b>206,108</b>	<b>97,026</b>	<b>1,087,482</b>	<b>1,047,029</b>
<b>Deferred Charges and Other Assets:</b>					
Unamortized debt expense	3,332	2,516	636	6,484	6,811
Conservation loans and other notes receivable, net	6,853	—	885	7,738	7,611
Intersystem loans and receivables	110,306	10,366	—	—	—
Deferred regulatory charges	—	33,927	—	33,927	53,480
Other deferred charges	4,517	10,932	—	15,449	6,055
<b>Total Deferred Charges and Other Assets</b>	<b>125,008</b>	<b>57,741</b>	<b>1,521</b>	<b>63,598</b>	<b>73,957</b>
<b>Total Assets</b>	<b>\$1,712,228</b>	<b>\$ 320,500</b>	<b>\$ 118,389</b>	<b>\$2,028,734</b>	<b>\$ 1,839,781</b>

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

## COMBINED BALANCE SHEETS

December 31, 2009 and 2008

(In thousands)

LIABILITIES	2009				2008
	Electric System	Generation System	Water System	Combined	Combined
<b>Current Liabilities:</b>					
Accounts payable	\$ 48,237	\$ 3,040	\$ 2,139	\$ 52,020	\$ 55,923
Accrued taxes	14,392	132	29	14,553	15,585
Accrued interest	2,842	2,796	144	5,467	8,112
Other accrued liabilities	17,882	7,506	–	25,388	17,619
Customer deposits	6,877	–	–	6,877	7,906
Current maturities of long-term debt	8,562	27,810	1,567	37,939	37,688
Notes payable	234,021	–	–	234,021	58,736
<b>Total Current Liabilities</b>	<b>332,813</b>	<b>41,284</b>	<b>3,879</b>	<b>376,265</b>	<b>201,569</b>
<b>Long-Term Debt:</b>					
Revenue bonds	254,821	238,744	29,754	523,319	543,473
Other notes payable	–	–	3,367	3,367	2,133
<b>Total Long-Term Debt</b>	<b>254,821</b>	<b>238,744</b>	<b>33,121</b>	<b>526,686</b>	<b>545,606</b>
<b>Deferred Credits and Other Liabilities:</b>					
Intersystem loans and payables	11,113	109,559	–	–	–
Deferred regulatory credits	–	33,927	–	33,927	53,480
Other deferred credits	20,542	1,194	337	22,073	15,194
<b>Total Deferred Credits and Other Liabilities</b>	<b>31,655</b>	<b>144,680</b>	<b>337</b>	<b>56,000</b>	<b>68,674</b>
<b>Commitments and Contingencies</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Total Liabilities</b>	<b>619,289</b>	<b>424,708</b>	<b>37,337</b>	<b>958,951</b>	<b>815,849</b>
<b>Equity (Deficit):</b>					
Invested in capital assets, net of related debt	513,329	(160,771)	68,913	534,678	470,003
Restricted	132,985	29,300	4,643	167,243	167,535
Unrestricted	446,625	27,263	7,496	367,862	386,394
<b>Total Equity (Deficit)</b>	<b>1,092,939</b>	<b>(104,208)</b>	<b>81,052</b>	<b>1,069,783</b>	<b>1,023,932</b>
<b>Total Liabilities and Equity</b>	<b>\$1,712,228</b>	<b>\$ 320,500</b>	<b>\$ 118,389</b>	<b>\$2,028,734</b>	<b>\$ 1,839,781</b>

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

# COMBINED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN EQUITY

Years ended December 31, 2009 and 2008

(In thousands)

	2009				2008
	Electric System	Generation System	Water System	Combined	Combined
<b>Operating Revenues:</b>					
Retail sales	\$ 512,094	\$ –	\$ 7,300	\$ 519,394	\$ 517,918
Wholesale sales	51,076	58,961	463	51,539	81,170
Other	23,059	3,825	3,832	30,716	44,762
<b>Total Operating Revenues</b>	<b>586,229</b>	<b>62,786</b>	<b>11,595</b>	<b>601,649</b>	<b>643,850</b>
<b>Operating Expenses:</b>					
Purchased power	342,178	–	–	283,217	262,752
Purchased water	–	–	1,960	1,960	1,592
Operations	134,808	4,349	1,956	141,113	129,608
Maintenance	15,797	1,923	794	18,514	24,073
Depreciation	41,614	11,107	2,193	54,914	49,860
Taxes	29,102	532	399	30,033	31,402
<b>Total Operating Expenses</b>	<b>563,499</b>	<b>17,911</b>	<b>7,302</b>	<b>529,751</b>	<b>499,287</b>
<b>Net Operating Income</b>	<b>22,730</b>	<b>44,875</b>	<b>4,293</b>	<b>71,898</b>	<b>144,563</b>
<b>Interest Charges:</b>					
Interest	17,951	22,181	1,027	35,492	33,572
Amortization of debt expense, discounts & premiums	(394)	3,465	29	3,100	4,591
Allowance for funds used during construction	(1,155)	(230)	(174)	(1,559)	(1,444)
<b>Total Interest Charges</b>	<b>16,402</b>	<b>25,416</b>	<b>882</b>	<b>37,033</b>	<b>36,719</b>
<b>Other Income and Expense:</b>					
Interest income	19,032	1,803	230	15,398	20,951
Net increase (decrease) in the fair value of investments	(5,668)	–	(5)	(5,673)	3,135
Other income and expense, net	1,261	–	–	1,261	3,492
<b>Total Other Income and Expense</b>	<b>14,625</b>	<b>1,803</b>	<b>225</b>	<b>10,986</b>	<b>27,578</b>
<b>Net Income</b>	<b>20,953</b>	<b>21,262</b>	<b>3,636</b>	<b>45,851</b>	<b>135,422</b>
Equity (Deficit), Beginning of year	1,071,986	(125,470)	77,416	1,023,932	888,510
<b>Equity (Deficit), End of year</b>	<b>\$ 1,092,939</b>	<b>\$ (104,208)</b>	<b>\$ 81,052</b>	<b>\$ 1,069,783</b>	<b>\$ 1,023,932</b>

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



## COMBINED STATEMENTS OF CASH FLOWS

Years ended December 31, 2009 and 2008

(In thousands)

	2009				2008
	Electric System	Generation System	Water System	Combined	Combined
<b>Cash Flows From Operating Activities:</b>					
Cash received from customers	\$ 567,423	\$ 62,713	\$ 10,455	\$ 578,516	\$ 596,438
Cash payments to suppliers	(435,014)	(7,641)	(1,781)	(382,361)	(362,659)
Cash payments to employees	(64,762)	(1,494)	(1,715)	(67,971)	(65,284)
Cash payments for taxes	(30,589)	(544)	(393)	(31,526)	(30,186)
Other cash received	17,424	4,216	186	21,826	20,646
<b>Net Cash Provided by Operating Activities</b>	<b>54,482</b>	<b>57,250</b>	<b>6,752</b>	<b>118,484</b>	<b>158,955</b>
<b>Cash Flows From Non-Capital Financing Activities:</b>					
Proceeds from debt	236,009	—	—	236,009	58,863
Repayment of debt	(58,240)	—	—	(58,240)	—
Interest paid on debt	(3,981)	—	—	(3,981)	—
Debt issuance costs	(1,396)	—	—	(1,396)	(678)
<b>Net Cash Provided by Non-Capital Financing Activities</b>	<b>172,392</b>	<b>—</b>	<b>—</b>	<b>172,392</b>	<b>58,185</b>
<b>Cash Flows From Capital &amp; Related Financing Activities:</b>					
Capital construction, including interest paid on debt charged to capital projects	(70,899)	(11,160)	(9,462)	(91,521)	(88,773)
Proceeds from debt	—	—	14,420	14,420	789
Repayment of debt	(8,766)	(26,426)	(1,096)	(36,288)	(33,422)
Interest paid on debt	(13,563)	(23,704)	(795)	(32,595)	(29,781)
Debt issuance costs	—	—	(331)	(331)	—
Intercompany loans	(3,503)	3,503	—	—	—
<b>Net Cash Provided by (Used for) Capital &amp; Related Financing Activities</b>	<b>(96,731)</b>	<b>(57,787)</b>	<b>2,736</b>	<b>(146,315)</b>	<b>(151,187)</b>
<b>Cash Flows From Investing Activities:</b>					
Sale of special funds and investment securities	268,047	1,741	—	269,788	411,580
Purchase of special funds and investment securities	(420,554)	—	(1,152)	(421,706)	(447,221)
Interest on investment securities	21,404	1,866	242	18,045	19,589
<b>Net Cash Provided by (Used for) Investing Activities</b>	<b>(131,103)</b>	<b>3,607</b>	<b>(910)</b>	<b>(133,873)</b>	<b>(16,052)</b>
<b>Net Increase (Decrease) in Cash &amp; Cash Equivalents:</b>	(960)	3,070	8,578	10,688	49,901
Beginning of Year	112,462	14,192	2,827	129,481	79,580
<b>End of Year Cash &amp; Cash Equivalents</b>	<b>\$ 111,502</b>	<b>\$ 17,262</b>	<b>\$ 11,405</b>	<b>\$ 140,169</b>	<b>\$ 129,481</b>
<b>Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:</b>					
Net Operating Income	\$ 22,730	\$ 44,875	\$ 4,293	\$ 71,898	\$ 144,563
Adjustments to reconcile net operating income to net cash provided by operating activities:					
Depreciation	41,614	11,107	2,193	54,914	49,860
Non-cash & unearned cash contributions	(746)	—	(1,579)	(2,325)	(6,502)
(Increase) decrease in receivables	(2,546)	3,752	659	(1,249)	(17,613)
(Increase) decrease in other assets	(3,884)	(1,795)	—	(5,679)	(363)
Increase (decrease) in payables	(7,120)	(1,077)	1,180	(3,903)	(12,020)
Increase (decrease) in other liabilities	4,434	388	6	4,828	1,030
Total adjustments	31,752	12,375	2,459	46,586	14,392
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 54,482</b>	<b>\$ 57,250</b>	<b>\$ 6,752</b>	<b>\$ 118,484</b>	<b>\$ 158,955</b>

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

# Notes to Combined Financial Statements

December 31, 2009 and 2008

## **NOTE 1** **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **General**

Public Utility District No. 1 of Snohomish County, Washington, (the PUD) is a public electric and water utility serving Snohomish County and Camano Island in Island County, Washington. The PUD's operations consist of three systems: the Electric System, the Generation System and the Water System.

The Electric System is made up of the PUD's electric transmission and distribution system. The Generation System is composed of the PUD's Jackson Hydroelectric Project, the Everett Cogeneration Project, and one small low-impact hydroelectric project. The Water System is made up of the PUD's water distribution system.

The accompanying financial statements for 2009 include the individual and combined balance sheets for the Electric System, Generation System and Water System, and the results of operations and cash flows for each system. System columns presented in the financial statements and notes may not add to the combined totals due to the elimination of intercompany transactions, which consist of intersystem loans and routine intercompany transactions.

The PUD's financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when incurred. Revenues and costs that are directly related to the generation, purchase, transmission and distribution of electricity or water are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. In addition, the PUD has elected to implement, where not in conflict with GASB pronouncements, GAAP prescribed by the Financial Accounting Standards Board (FASB).

The PUD's other significant accounting and financial policies are described in the following sections.

### **Revenues**

Electric System customers are billed on a monthly or bimonthly cyclical basis. The accompanying financial statements include estimated unbilled revenues for energy delivered to customers between the last billing date and the end of the year, amounting to \$56.6 million in 2009 and \$54.6 million in 2008.

Water System customers are billed on a bimonthly cyclical basis. The accompanying financial statements include estimated unbilled revenues for water delivered to customers between the last billing date and the end of the year, amounting to \$656,000 in 2009 and \$500,000 in 2008.

### **Power Sales and Purchases**

Power sales and purchase transactions are recognized over the duration of the contracts as a component of retail and wholesale revenue and purchased power operating expenses.

### **Capital Contributions**

The PUD records capital contributions from customers and developers, primarily relating to expansions to the PUD's distribution facilities, as other operating revenue at fair market value. The PUD recorded capital contributions totaling \$16.4 million in 2009 and \$28.4 million in 2008.

### **Cash Equivalents**

The PUD considers highly liquid, short-term investments with original maturities of three months or less to be cash equivalents.

### **Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. A reserve is established for uncollectible accounts receivable based upon historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. The allowance for doubtful accounts was \$3.0 million and \$5.0 million as of December 31, 2009 and 2008, respectively.

### **Material and Supplies**

Material and supplies are recorded at cost and consist primarily of materials for construction and maintenance of utility plant.

### **Special Funds**

Special funds are restricted or limited-use funds that have been established in accordance with Board of Commissioner resolutions, bond resolutions, state law or other agreements. These funds – which consist of cash, cash equivalents and investments – are restricted for specific purposes, including debt service, bond reserves, extraordinary power purchases, post-employment benefits, and other reserve requirements.

### **Utility Plant**

Utility plant is stated at cost, including an allowance for funds used during construction (AFUDC). The PUD's capitalization threshold for utility plant is \$5,000. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, ranging from 5 to 50 years. When utility plant assets are retired, the original cost together with removal costs, less salvage, is charged to accumulated depreciation. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and betterments is capitalized. See Table 1 for additional utility plant details.

The PUD periodically reviews the carrying value of its utility plant and other equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. To the extent the estimated future cash inflows attributable to the asset, less estimated future cash outflows, is less than the carrying amount, an impairment loss is recognized.

### **Unamortized Debt Expense and Reacquisition Costs on Bond Refundings**

Costs relating to the sale of bonds are amortized over the lives of the various bond issues using the straight-line or effective-interest methods.

The difference between the cost to defease outstanding debt and the carrying value of bonds defeased by refunding bonds is deferred and amortized over the shorter of the remaining term of the refunded bonds or the term of the refunding bonds, using the straight-line or effective-interest method. This difference for bonds defeased by operating funds is charged to operations currently.

### **Deferred Regulatory Charges and Credits**

Financial accounting standards require that the fair value of all derivative financial instruments be recognized as either assets or liabilities on the balance sheet, with a corresponding charge or credit to operations.

The PUD has reviewed its various contractual arrangements and concluded that the majority of the contracts for the purchase, sale, transportation and exchange of power constitutes normal purchases and sales under existing accounting standards.

The Board of Commissioners establishes rates for the PUD that are designed to recover the costs of providing services. As a result, the PUD qualifies for the application of FASB Accounting Standards Codification (ASC) 980, Regulated Operations, which allows for the deferral of certain unrecognized gains and losses. The PUD entered into floating-to-fixed interest rate swap agreements to hedge the effect of interest rate changes on variable rate bonds. These contracts meet the definition of derivative assets or

**Table 1**  
**Utility Plant**  
(In thousands)

	2007	2008			2009		
	Ending Balance	Additions	Retirements & Transfers	Ending Balance	Additions	Retirements & Transfers	Ending Balance
<b>Electric System</b>							
Transmission	\$ 90,635	\$ 13,795	\$ (754)	\$ 103,676	\$ 1,072	\$ 248	\$ 104,996
Distribution	766,445	71,988	(9,144)	829,289	54,525	(7,970)	875,844
General Plant & Other	193,774	6,009	(3,876)	195,907	7,282	(1,036)	202,153
Plant in Service <sup>(1)</sup>	1,050,854	91,792	(13,774)	1,128,872	62,879	(8,758)	1,182,993
Construction Work in Progress	46,920	(7,950)	–	38,970	9,277	–	48,247
Utility Plant	1,097,774	83,842	(13,774)	1,167,842	72,156	(8,758)	1,231,240
Less Accumulated Depreciation	390,672	39,727	(15,354)	415,045	42,574	(10,727)	446,892
<b>Net Utility Plant</b>	<b>\$ 707,102</b>	<b>\$ 44,115</b>	<b>\$ 1,580</b>	<b>\$ 752,797</b>	<b>\$ 29,582</b>	<b>\$ 1,969</b>	<b>\$ 784,348</b>
<b>Generation System</b>							
Generation/Production	\$ 341,722	\$ 4,924	\$ (1,531)	\$ 345,115	\$ 2,766	\$ (158)	\$ 347,723
Transmission	2,695	31	(14)	2,712	–	–	2,712
Distribution	980	–	–	980	–	–	980
General Plant & Other	4,137	–	(8)	4,129	152	–	4,281
Plant in Service <sup>(2)</sup>	349,534	4,955	(1,553)	352,936	2,918	(158)	355,696
Construction Work in Progress	1,947	(153)	–	1,794	8,254	–	10,048
Utility Plant	351,481	4,802	(1,553)	354,730	11,172	(158)	365,744
Less Accumulated Depreciation	141,226	9,010	(1,560)	148,676	11,125	(165)	159,636
<b>Net Utility Plant</b>	<b>\$ 210,255</b>	<b>\$ (4,208)</b>	<b>\$ 7</b>	<b>\$ 206,054</b>	<b>\$ 47</b>	<b>\$ 7</b>	<b>\$ 206,108</b>
<b>Water System</b>							
Generation/Production	\$ 8,248	\$ 50	\$ –	\$ 8,298	\$ 542	\$ (11)	\$ 8,829
Transmission & Distribution	82,086	8,515	–	90,601	3,056	(63)	93,594
General Plant & Other	4,805	124	–	4,929	689	–	5,618
Plant in Service <sup>(3)</sup>	95,139	8,689	–	103,828	4,287	(74)	108,041
Construction Work in Progress	3,492	(1,046)	–	2,446	6,917	–	9,363
Utility Plant	98,631	7,643	–	106,274	11,204	(74)	117,404
Less Accumulated Depreciation	15,926	2,170	–	18,096	2,356	(74)	20,378
<b>Net Utility Plant</b>	<b>\$ 82,705</b>	<b>\$ 5,473</b>	<b>\$ –</b>	<b>\$ 88,178</b>	<b>\$ 8,848</b>	<b>\$ –</b>	<b>\$ 97,026</b>

<sup>(1)</sup> Plant in service includes land and non-depreciable assets of \$62.5 million, \$66.8 million and \$73.3 million as of December 31, 2007, 2008 and 2009, respectively.

<sup>(2)</sup> Plant in service includes land and non-depreciable assets of \$9.3 million, \$11.2 million and \$11.5 million as of December 31, 2007, 2008 and 2009, respectively.

<sup>(3)</sup> Plant in service includes land and non-depreciable assets of \$4.4 million, \$4.4 million and \$4.6 million as of December 31, 2007, 2008 and 2009, respectively.

liabilities and as such, the fair value of these derivatives has been recorded on the balance sheet. The Board has approved resolutions that allow the change during the period in the fair value of these contracts to be deferred and recorded as regulatory charges and/or liabilities, which have no impact on operating results.

## Equity

Equity consists of the following components:

**Invested in capital assets, net of related debt** – This component consists of capital assets, net of accumulated depreciation reduced by the net outstanding debt balances related to capital assets, net of unamortized debt expenses.

**Restricted** – This component consists of equity with constraints placed on use. Constraints include those imposed by bond covenants or third-party contractual agreements, and resources restricted by Board resolution.

**Unrestricted** – This component consists of assets and liabilities that do not meet the definition of “invested in capital assets, net of debt” or “restricted.”

## Compensated Absences

Employees accrue paid time off (PTO) or vacation in varying amounts according to their years of service. Accrued liability for PTO and vacation was \$8.6 million and \$8.0 million at December 31, 2009 and 2008, respectively.

## Estimates

The preparation of financial statements in conformity with GAAP 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. The PUD has used estimates in determining reported amounts including unbilled revenue, allowance for doubtful accounts receivable, accrued liability for injuries and damages, depreciable lives of utility plant and other contingencies. Actual results could differ from these estimates.

## Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 presentation.

## Accounting Changes

The PUD reviews on an annual basis any changes in GAAP. Any material accounting changes are reflected in the financial statements and the accompanying notes.

In 2009, the PUD elected early implementation of GASB Statement No. 53, which addresses accounting and financial reporting for derivative instruments. The disclosures required by GASB Statement No. 53 are included in Note 4.

## NOTE 2

### SPECIAL FUNDS AND CASH AND TEMPORARY INVESTMENTS

The PUD's investment policy authorizes the investment of funds in U.S. Treasury, federal and state agency obligations, interest-bearing demand or time deposits, repurchase agreements, bankers' acceptances and certain other investments. Interest-bearing demand or time deposits with a qualified public depository of the State of Washington are protected and collateralized under the Washington State Public Deposit Protection Act. In all instances, the PUD evaluates the creditworthiness of the financial institutions with which it invests.

All PUD investments are in compliance with the State of Washington statutes and PUD bond resolutions. Substantially all PUD investments are recorded at fair value based on quoted market prices. Premiums and discounts are amortized over the life of the investment using the straight-line method. The PUD's investments at December 31, 2009 and 2008 are summarized in Table 2.

**Table 2**  
**Special Funds, Cash and Temporary Investments**  
*(In thousands)*

	2009		2008	
	Fair Value	Percent of Total	Fair Value	Percent of Total
<b>Electric System</b>				
U.S. government securities	\$ 296,810	44%	\$ 341,304	64%
Cash and interest-bearing demand or time deposits	39,918	6%	87,523	17%
Investment in associated company bonds	234,665	35%	58,260	11%
Government Investment Pool	104,355	15%	42,784	8%
	<b>\$ 675,748</b>	<b>100%</b>	<b>\$ 529,871</b>	<b>100%</b>
<b>Generation System</b>				
Cash and interest-bearing demand or time deposits	\$ 21,667	43%	\$ –	–
Government Investment Pool	28,885	57%	49,223	100%
	<b>\$ 50,552</b>	<b>100%</b>	<b>\$ 49,223</b>	<b>100%</b>
<b>Water System</b>				
U.S. government securities	\$ –	–	\$ 505	6%
Cash and interest-bearing demand or time deposits	1,291	7%	–	–
Government Investment Pool	16,774	93%	7,835	94%
	<b>\$ 18,065</b>	<b>100%</b>	<b>\$ 8,340</b>	<b>100%</b>

The PUD invests funds consistent with the following objectives: preserve principal, maintain adequate liquidity and maximize yield. The PUD's investments are purchased with the objective of holding the security until maturity.

Investment securities owned by the PUD are registered in the PUD's name and held in trust by banks or trust companies. Repurchase agreements are fully collateralized by eligible securities registered in the PUD's name. Other PUD investments are insured by federal depository insurance or protected against loss since they are on deposit with financial institutions recognized as qualified public depositories of the State of Washington.

The PUD's investment policy specifies that the investment portfolio be structured so maturing investments match projected cash flow needs in order to mitigate interest rate risk. In order to address custodial credit risk, all investments except cash, interest-bearing demand or time deposits, and funds held in the Government Investment Pool, which are not evidenced by securities, are held in the PUD's name by a third-party custodian. The PUD addresses concentration of credit risk by investing in a diversified portfolio.

The PUD manages its exposure to decreases in the fair value of its investments arising from increasing interest rates by setting maturity limits for its investments. While bond reserves are invested in U.S. government securities that approximate the term of the related bonds, all other funds are invested in instruments with maturities of less than five years, and most are invested for terms of one year or less. Investment maturities for combined special funds and cash and temporary investments as of December 31, 2009, were as follows:

Maturity	Amount Invested (In thousands)	Percent of Invested Fund
Less than 30 days	\$ 193,123	26%
30 to 90 days	20,321	3%
90 days to 1 year	83,714	11%
1 year to 5 years	172,828	23%
Over 5 years	234,836	32%
Bond reserves invested to bond maturity	39,543	5%
	<b>\$ 744,365</b>	<b>100%</b>

### **NOTE 3**

#### **GENERATION SYSTEM PROJECTS**

The Generation System currently consists of the PUD's Henry M. Jackson Hydroelectric Project (Jackson Project), the Everett Cogeneration Project (Cogeneration Project), and one small low-impact hydroelectric project.

##### **Jackson Project**

The Jackson Project is a multipurpose hydroelectric project with a nameplate capacity of 111.8 megawatts. In 2009 and 2008, the Jackson Project supplied 5% of the PUD's energy needs.

The PUD operates the Jackson Project under a license issued by the Federal Energy Regulatory Commission (FERC), which expires in 2011. FERC has the authority to issue a new license for a term of up to 50 years. The PUD began studies and consultations for the relicensing process in 2002 and filed an application for license renewal in 2009.

The City of Everett (City), which receives water from the Spada Lake reservoir operated by the Jackson Project and provides drinking water for much of Snohomish County, is a co-licensee. In 2007, the PUD and City entered into a Supplemental Agreement, which modifies the rights and responsibilities of both parties and provides for the PUD to become the sole licensee for the project upon FERC approval of a new license.

The relicensing costs have been recorded as deferred charges, and are expected to be amortized over the life of the license to be acquired. The PUD's relicensing costs at December 31, 2009 and 2008, were \$8.4 million and \$6.6 million, respectively.

##### **Cogeneration Project**

The Cogeneration Project is a wood-waste burning steam cogeneration project funded by the PUD. The Cogeneration Project has a nameplate capacity of 52 megawatts and is designed to generate 325,000 MWh of electricity per year. The facility began commercial operation in August 1996 and provides Kimberly-Clark (K-C) with steam for use in its pulp and paper manufacturing process. The Cogeneration Project supplied 3% of the PUD's energy needs in 2009 and 2008.

K-C is responsible for its operation for an initial term of 21 years, expiring in 2017 and renewable for additional consecutive periods of five years each, up to a total of 50 years. K-C procures fuel for the term of the agreements and is responsible for 90% of fuel costs through 2010, and 70% of fuel costs thereafter. In addition, K-C is responsible for all operating and maintenance costs for the first 20 years of the agreement and 60% thereafter.

##### **Small Low-Impact Hydroelectric Project**

In 2008, the PUD purchased a small low-impact hydroelectric project located in central Snohomish County on Woods Creek. Low-impact hydroelectric systems capture the energy of flowing/falling water and convert it to usable energy with little environmental impact. The Woods Creek Hydroelectric Project, built in the 1980s, was upgraded to meet current operating standards. In 2009 and 2008, the project produced approximately 850 and 650 kW, respectively.

The PUD also purchased land surrounding Youngs Creek in central Snohomish County in order to construct a 7.5 aMW hydroelectric project. The PUD received a FERC license for this project in 2008, and construction of the hydroelectric project is scheduled to be completed in 2011.

### **NOTE 4**

#### **LONG-TERM DEBT**

Debt service (principal and interest) payments on the PUD's Revenue bonds and other notes payable to maturity, excluding intersystem borrowing, are set forth in Table 3.

**Table 3**  
**Future Debt Service**  
*(In thousands)*

	Electric System		Generation System		Water System	
	Principal	Interest	Principal	Interest	Principal	Interest
2010	\$ 8,562	\$ 12,836	\$ 27,810	\$ 13,216	\$ 1,567	\$ 1,446
2011	7,997	12,570	28,520	11,761	2,105	1,372
2012	15,459	12,239	9,515	10,357	2,152	1,299
2013	10,350	11,208	28,870	9,884	2,002	1,224
2014	11,019	10,828	33,380	8,764	1,867	1,148
2015–2019	71,320	42,903	123,140	29,769	9,664	4,462
2020–2024	99,695	22,817	27,895	7,492	8,294	2,312
2025–2029	28,860	3,429	6,725	417	5,048	950
2030–2031	–	–	–	–	1,765	117
<b>Total</b>	<b>\$253,262</b>	<b>\$128,830</b>	<b>\$285,855</b>	<b>\$91,660</b>	<b>\$34,464</b>	<b>\$14,330</b>

The majority of the PUD's long-term debt is tax-exempt bonds that are subject to Internal Revenue Service Code (the Code) requirements for arbitrage rebate. The rebate is calculated based on earnings on gross proceeds of the bonds that are in excess of the amount prescribed by the Code. The arbitrage liability as of December 31, 2009 and 2008, was \$1.0 million and \$0.6 million, respectively.

### Electric System

A summary of principal outstanding on Electric System long-term debt follows:

	December 31,	
	2009	2008
	(In thousands)	
2005 Revenue Refunding bonds, 4.0–5.0%, due 2012–2024, earliest call 2015	\$ 120,980	\$ 120,980
2004 Revenue bonds, 4.5–5.0%, due 2010–2028, earliest call 2014	72,305	76,640
2002 Revenue bonds, 5.0–5.5%, due 2012–2024, earliest call 2012	50,720	50,720
1999 Revenue & Refunding bonds, 5.0–5.5%, due 2010–2011	5,605	8,190
1995 – 1999 Junior Lien Revenue bonds,		
Interest Bearing bonds, 4.70–5.85%, due 2010–2014	2,673	3,818
Capital Appreciation bonds, 4.70–5.85%, due 2010–2014	979	1,680
<b>Total Principal Outstanding on Long-Term Debt</b>	<b>\$ 253,262</b>	<b>\$ 262,028</b>

Changes in the Electric System long-term debt during the years ended December 31, 2009 and 2008, follow (in thousands):

	2007	2008		2009	
	Balance	Reductions	Balance	Reductions	Balance
Revenue bonds, face amount	\$ 269,822	\$ (7,794)	\$ 262,028	\$ (8,766)	\$ 253,262
Unamortized bond premium	12,651	(741)	11,910	(741)	11,169
Unamortized bond discount	(134)	7	(127)	6	(121)
Unamortized refunding loss	(3,135)	1,255	(1,880)	953	(927)
Total Debt	279,204	(7,273)	271,931	(8,548)	263,383
Current Portion of Long-Term Debt	9,100		9,761		8,562
<b>Total Long-Term Debt</b>	<b>\$ 270,104</b>		<b>\$ 262,170</b>		<b>\$ 254,821</b>

The PUD's revenue bonds are payable solely from the income, revenues and receipts derived by the PUD from the ownership and operation of the Electric System.



The Junior Lien Revenue bonds are subject to redemption twice annually at the option of the bondholders, to the extent the PUD has surplus revenues. As of December 31, 2009, the PUD has incurred 146 redemptions on these bonds, totaling \$163,400. The PUD's obligation to redeem the bonds in any calendar year is limited to 5% of the original principal amount. The redeemable portion of the bonds, \$1.3 and \$2.8 million in 2009 and 2008, respectively, is included in current maturities of long-term debt.

The PUD had a \$10 million unsecured bank line-of-credit agreement used to provide a letter of credit to support collateral provisions of a power contract. The line of credit expired on November 30, 2009. The PUD did not have any borrowings under this line of credit.

The PUD provided two irrevocable letters of credit to Bonneville Power Administration (BPA): a \$21 million letter of credit as part of an amendment to its power supply agreement with BPA, and a \$5.5 million letter of credit to secure transmission projects under an agreement. The \$21 million letter of credit expired on September 30, 2009, and the \$5.5 million letter of credit will expire on June 27, 2011. The PUD has not had any draws on this letter of credit since its inception.

The Electric System is required to maintain a reserve account of not less than the maximum annual interest requirement in any calendar year for the 2004 and 2002 Series bonds. At December 31, 2009 and 2008, the PUD maintained the reserve requirement of \$9.5 million in the Electric System.

At December 31, 2009 and 2008, the fair value of the Electric System's long-term debt was \$273.1 million and \$260.3 million, respectively. The fair value of the Electric System's long-term debt is estimated based on quoted market prices for the same or similar issues. The carrying amount for the Junior Lien Revenue bonds approximates fair value since the bonds are subject to redemption twice annually by the bondholder and are currently callable by the PUD at par.

### Generation System

A summary of principal outstanding on Generation System long-term debt follows:

	December 31,	
	2009	2008
	(In thousands)	
2002A Adjustable Tender Revenue Refunding bonds, 3.65%, due 2013–2019	\$ 114,535*	\$ 114,535
2002B Revenue Refunding bonds, 5.25%, due 2010–2012	39,605	55,020
2001A Adjustable Tender Revenue Refunding bonds, 4.43% due 2011–2017, currently callable	61,870*	61,870
2001B Revenue Refunding bonds, 4.40–5.25%, due 2010	11,585	22,595
1995 Adjustable Tender Revenue bonds, 6.20%, due 2014–2025, currently callable	58,260*	58,260*
<b>Total Principal Outstanding on Long-Term Debt</b>	<b>\$ 285,855</b>	<b>\$ 312,280</b>

\*Held in trust by the Electric System – see Note 6.

Changes in the Generation System long-term debt during the years ended December 31, 2009 and 2008, follow (in thousands):

	2007	2008		2009	
	Balance	Reductions	Balance	Reductions	Balance
Revenue bonds, face amount	\$ 336,480	\$ (24,200)	\$ 312,280	\$ (26,425)	\$ 285,855
Unamortized bond premiums	6,401	(1,420)	4,981	(1,360)	3,621
Unamortized bond discounts	(4,001)	507	(3,494)	507	(2,987)
Unamortized refunding loss	(27,691)	3,916	(23,775)	3,840	(19,935)
Total Debt	311,189	(21,197)	289,992	(23,438)	266,554
Current Portion of Long-Term Debt	24,200		26,425		27,810
<b>Total Long-Term Debt</b>	<b>\$ 286,989</b>		<b>\$ 263,567</b>		<b>\$ 238,744</b>

The Series 2001A and 2002A Adjustable Tender Revenue Refunding bonds, and the Series 1995 Adjustable Tender Revenue bonds bear interest at variable rates adjusted weekly. In conjunction with the sale of these bonds, the PUD entered into interest rate swap agreements with financial products companies. The terms of the outstanding swaps as of December 31, 2009, are as follows.

<b>Associated Bond Series</b>	<b>Counter-Party</b>	<b>Guarantor</b>	<b>Current Notional Amount</b>	<b>Fixed Rate Paid</b>	<b>Rate Received</b>	<b>Swap Termination Date</b>	<b>Guarantor Credit Rating</b>
1995	AIIG-FP	American Intl. Group, Inc.	\$ 58,260,000	6.20%	Variable rate on bonds	01/01/25	A3/P-1
2001A	Citigroup Financial Products, Inc.	Citigroup, Inc.	\$ 61,870,000	4.43%	67% of LIBOR	12/01/17	A3/P-1
2002A	Citigroup Financial Products, Inc.	Citigroup, Inc.	\$ 114,535,000	3.65%	70% of LIBOR	12/01/19	A3/P-1

The fair market value of the swap agreements associated with the 2001A and 2002A bonds was \$16.5 million and \$28.0 million less than book value as of December 31, 2009 and 2008, respectively. The fair market values take into consideration the prevailing interest rate environment and the specific terms and conditions of the transactions and were estimated using the zero-coupon discounting method. The fair market value of the 1995 swap agreement is currently in dispute between the PUD and the swap provider. Because the swap provider must pay the actual floating rate on the bonds, the fair market value of the swap will vary depending on the assumptions used, including assumptions regarding future market interest rates associated with tax-exempt variable rate demand bonds with features similar to the Series 1995 bonds, as determined weekly by the remarketing agent, and about the marketability of the swap. Depending on these assumptions, the fair value could range from zero to \$17.4 million less than book value. Prior to the dispute between the PUD and the swap provider, the swap provider provided to the PUD a market value based on cash flows that approximate a 67 percent of LIBOR swap. The PUD has opted to record this amount as it reflects a conservative measurement. The difference between the book value and fair market value has been recorded as a regulatory credit and a related deferred charge on the balance sheet. During 2009 and 2008, the net cash outflows for the swaps associated with the Series 2001A and 2002A bonds were \$9.6 and \$10.3 million, respectively. Net cash outflows for the swap associated with the Series 1995 bonds was \$3.6 million for 2009 and 2008. In the event that the credit rating of the guarantor of the Series 2001A and 2002A bonds drops below AA or Aa, the swap provider will be obligated to post collateral. In the event the long-term unsecured credit rating of the guarantor of the Series 1995 bonds falls below AA-/Aa3, the PUD may request collateral from that swap provider. As of December 31, 2009, none of the counterparties were required to post collateral. As of December 31, 2009, the PUD was not exposed to credit risk on the swaps associated with the Series 2001A and 2002A bonds because the swaps had fair values lower than book value. The amount of credit risk related to the swap associated with the Series 1995 bonds is currently unknown since the fair market value of the swap is in dispute.

The notional amounts of the swap agreements match the principal amounts of the associated debt. These interest rate swap agreements were entered into as a cash flow hedge to reduce the volatility related to variable interest rate debt. The swap agreements associated with the Series 2001A and 2002A bonds provide that the PUD pay a fixed percentage to the swap provider, and in return, receive a floating payment based on a percentage of LIBOR. This exposes the PUD to basis risk if the floating rate payment it receives is less than the actual variable rate it pays on the bonds. The swap agreement associated with the Series 1995 bonds is a cost of funds swap and does not expose the PUD to basis risk as it requires the PUD to pay a fixed percentage to the swap provider and in return receive the actual variable rate on the associated bonds.

The swap agreements may be terminated by either party if the other party fails to perform under the terms of the contract. Upon termination, a payment is due irrespective of causality based upon the fair market value of the swap. The swap agreements are coterminous with the terms of the Series 1995, 2001A and 2002A bonds. The structure of the variable interest rate payments the PUD receives from its swap agreements associated with the Series 2001A and 2002A bonds is based upon the

historical relationship between taxable and tax-exempt short-term interest rates. This presents tax risk to the PUD since a change in the tax code could fundamentally alter this relationship.

The PUD is obligated as part of its bond resolution to purchase for use in its Electric System all power available to the Electric System from the Generation System. The PUD is also unconditionally obligated by the bond resolution to set aside revenues in amounts sufficient to pay, to the extent not otherwise paid, all the debt service on the Generation System bonds on a parity of lien with the Electric System Senior bonds.

The Generation System is required to maintain a reserve account that approximates the amount required to be paid into the bond fund in any fiscal year with respect to principal and interest on the 2002B, 2001B and 1995 Series bonds outstanding. At December 31, 2009 and 2008, the PUD maintained the reserve requirement of \$28.4 million in the Generation System.

At December 31, 2009, \$26.0 million of the Series 1989 Generation System Revenue bonds and \$24.3 million of the Series 1986A Generation System Revenue Refunding bonds were considered defeased.

At December 31, 2009 and 2008, the fair value of the Generation System's long-term debt was \$289.1 million and \$316.6 million, respectively. The fair value of the Generation System's long-term debt is estimated based on quoted market prices for the same or similar issues. The carrying amounts for the 2002A and 2001A Adjustable Tender Revenue Refunding bonds, and the 1995 Adjustable Tender Revenue bonds approximate fair value as these are variable interest rate bonds which are adjusted to market interest rates on a weekly basis.

## Water System

A summary of principal outstanding on Water System long-term debt follows:

	December 31,	
	2009	2008
	(In thousands)	
2009 Revenue bonds, 2.50–4.38%, due 2011–2031, earliest call 2019	\$ 13,085	\$ –
2006 Revenue and Refunding bonds, 4.00–4.25%, due 2010–2026, earliest call 2016	5,745	6,185
2002 Revenue and Refunding bonds, 4.55–5.50%, due 2010–2022, bonds maturing in 2021 are currently callable, earliest call for all other bonds is 2012	11,900	12,620
Washington State Public Works Trust Fund loans		
Equal principal payments due annually through 2015	15	–
Equal principal payments plus 1% interest due annually through 2012	586	782
State of Washington Drinking Water Revolving Fund loans		
Equal principal payments plus 1.5% interest due annually through 2029	1,180	–
Equal principal payments plus 1.5% interest due annually through 2027	1,153	789
Equal principal payments plus 2.5% interest due annually through 2022	622	670
Note payable to Bayshore Forest Products		
Equal principal payments plus 5% interest due monthly through 2012	178	234
<b>Total Principal Outstanding on Long-Term Debt</b>	<b>\$ 34,464</b>	<b>\$ 21,280</b>

Changes in the Water System long-term debt during the years ended December 31, 2009 and 2008, follow (in thousands):

	2007	2008			2009		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	\$ 19,935	\$ –	\$ (1,130)	\$ 18,805	\$ 13,085	\$ (1,160)	\$ 30,730
Unamortized bond premiums	109	–	(5)	104	140	(11)	233
Unamortized bond discounts	(17)	–	4	(13)	–	4	(9)
Other notes payable	1,984	789	(298)	2,475	1,623	(364)	3,734
Total Debt	22,011	789	(1,429)	21,371	14,848	(1,531)	34,688
Current Portion of Long-Term Debt	1,423			1,502			1,567
<b>Total Long-Term Debt</b>	<b>\$ 20,588</b>			<b>\$ 19,869</b>			<b>\$ 33,121</b>

In November 2009, the PUD issued \$13.1 million of Series 2009 Water System Revenue bonds. The proceeds of the 2009 Series bonds are being used to finance a new Water System Operations Center and other capital improvements.

The Water System periodically enters into low-interest loan agreements with the Washington State Public Works Trust Fund and the State of Washington Drinking Water Revolving Fund. These funds have provided various loans to the PUD for the repair, replacement, rehabilitation and reconstruction of water facilities.

The Water System is required to maintain a reserve account of not less than the maximum annual interest requirement in any calendar year for the 2009, 2006 and 2002 Series bonds. The PUD maintained the reserve requirement of \$1.6 million and \$1.0 million at December 31, 2009 and 2008, respectively. The fair value of the Water System's long-term debt was \$34.5 million and \$21.8 million, respectively, at December 31, 2009 and 2008. The fair value of the Water System's long-term debt is estimated based on quoted market prices for the same or similar issues. The carrying amounts for the Washington State Public Works Trust Fund loans, the State of Washington Drinking Water Revolving Fund loans and the note payable to Bayshore Forest Products approximate fair value since such loans are exclusive and have no market.

## NOTE 5 RETIREMENT AND DEFERRED COMPENSATION PLANS

### Retirement Plan

Substantially all PUD full-time and qualifying part-time employees participate in the Washington Public Employees' Retirement System (PERS) administered by the Washington State Department of Retirement Systems (DRS). Copies of the DRS annual financial report may be obtained by writing to: Department of Retirement Systems, Communications Unit, PO Box 48380, Olympia, WA 98504-8380 or it may be downloaded from the DRS Web site at [www.drs.wa.gov](http://www.drs.wa.gov).

### Plan Description

PERS is a cost-sharing, multiple-employer retirement system, which includes three plans. Plan 1 and Plan 2 are defined benefit programs, while Plan 3 is a combination defined benefit and defined contribution program. Retirement benefits are financed from employee and employer contributions and investment earnings. Participants who joined the system by September 30, 1977, are Plan 1 members. Those joining thereafter were enrolled in Plan 2. Beginning September 1, 2002, participants have the option of choosing between Plan 2 and Plan 3.

Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, at age 60 with five years of service, or at age 55 with 25 years of service. The annual pension benefit is 2% of the average final compensation per year of service, capped at 60%. If qualified, after reaching age 66, a cost-of-living allowance is granted based on years of service credit and is capped at 3% annually.

Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at age 65 with five years of service. Plan 2 members who retire prior to age 65 receive reduced benefits. The annual pension benefit is 2% of the average final compensation per year of service. There is no cap on the years of service credit, and a cost-of-living allowance is granted, capped at 3% annually.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. Plan 3 retirement benefits are vested after an employee completes 5 or 10 years of service, based upon age requirements. Plan 3 members may retire at age 65, or at age 55 with 10 years of service. Plan 3 members who retire prior to age 65 receive reduced benefits. The annual pension benefit is 1% of the average final compensation per year of service. There is no cap on the years of service credit, and the cost-of-living allowance is granted, capped at 3% annually.

### ***Funding Policy***

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates needed to fully amortize the total costs of the plan. Employee contribution rates for Plan 1 are established by statute at 6% and do not vary from year to year. 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 the Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the state law. The methods used to determine the contribution requirements are established under state statute.

The required contribution rates expressed as a percentage of current covered payroll, as of December 31, 2009, were:

	<b>PERS Plan 1</b>	<b>PERS Plan 2</b>	<b>PERS Plan 3</b>
Employer	5.31%	5.31%	5.31%
Employee	6.00%	3.90%	5%–15%

Both the PUD and the employees made the required contributions. The PUD's required contributions for the years ended December 31, were:

	<b>PERS Plan 1</b>	<b>PERS Plan 2</b>	<b>PERS Plan 3</b>
	(In thousands)		
2009	\$ 197	\$ 4,487	\$ 783
2008	\$ 223	\$ 4,608	\$ 764

### **Post-Employment Health Care**

#### ***Defined Benefit Health Care Plan***

The PUD administers retiree self-insured medical and vision insurance and Health Reimbursement Arrangement (HRA) benefits for eligible retirees hired before July 1, 2009, and their dependents. Retiree benefit provisions are established by Commission resolution.

In general, the PUD pays a contribution toward the retiree's PUD group health plan premiums or to a Health Reimbursement Arrangement (HRA). For retirees and their dependents under age 65 who elect a PUD group medical plan, the PUD contribution is based on 75% of the premium for the most commonly elected retiree health plan during the prior year. Retirees and their dependents under age 65 who waive PUD group medical plan coverage receive a \$180 monthly contribution into their HRA. When a retiree or dependent becomes eligible for Medicare at age 65, the retiree is no longer eligible for the group medical plan; however, the PUD contributes \$180 a month to the retiree's HRA. In 2009 and 2008, the PUD contributed \$2.3 million and \$2.1 million to the plans, respectively. Plan members receiving benefits contributed \$0.4 and \$0.5 million in 2009 and 2008, respectively.

The PUD's annual Post-Employment Health care Benefit (PEHB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with GASB Statement 45. The ARC represents a level

of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded liabilities (or funding excess) over a 30-year period. The following table shows the components of the PUD's annual PEHB cost for the year ended December 31, 2009, the amount actually contributed to the plan and the changes in the PUD's net PEHB obligation (dollar amounts in thousands):

	<b>Electric</b>	<b>Generation</b>	<b>Water</b>
Annual required contribution (ARC)	\$ 5,093	\$ 77	\$ 170
Contributions made	<u>(2,239)</u>	<u>(34)</u>	<u>(75)</u>
Increase in net PEHB obligation	2,854	43	95
Net PEHB obligation – beginning of year	<u>5,240</u>	<u>81</u>	<u>171</u>
<b>Net PEHB obligation – end of year</b>	<b>\$ 8,094</b>	<b>\$ 124</b>	<b>\$ 266</b>

In 2009 and 2008, the PUD made contributions of \$1.3 million and \$1.0 million, respectively, to the net PEHB obligation. In addition, the Board of Commissioners approved an additional \$1.5 million contribution to the net PEHB obligation in 2010 beyond the annual current retiree costs.

As of December 31, 2009, the unfunded actuarial accrued liability (UAAL) was \$53.6 million. The annual payroll of active employees covered by the plan was \$80.1 million. Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual 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.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Actuarial assumptions include a rate of return on investments of 5.5%. The medical trend rate is estimated to gradually decrease from 10% in 2009 to 5.0% in 2019 and remain level thereafter.

#### ***Defined Contribution Health Care Plan***

Employees hired after July 1, 2009, are not eligible for the post-employment defined benefit health care plan but are instead eligible for a defined contribution health care plan. Under this plan, the PUD currently contributes \$50 per month into an employee's individual HRA account. These funds are available to the employee for qualified health care costs upon termination of employment from the PUD.

#### **Deferred Compensation Plans**

The PUD has an Internal Revenue Code Section 457 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 not available to employees until termination, retirement, death or an unforeseeable emergency. All plan assets are held in trust for the exclusive benefit of participants and their beneficiaries and as such are not included on the PUD's financial statements.

The PUD adopted a 401(k) Savings Plan (the Plan) effective May 1, 1985. Participation in the Plan is offered to eligible employees of the PUD as defined in the plan document. The Plan is a defined contribution plan, which provides that participants may make voluntary salary deferral contributions, on a pretax basis, up to a maximum amount as indexed for cost-of-living adjustments. The PUD makes matching contributions in an amount equal to 25% of the first 3% of a participant's compensation contributed as a salary deferral. The PUD made matching contributions of \$419,000 and \$393,000 in 2009 and 2008, respectively.

## **NOTE 6**

### **RELATED PARTY TRANSACTIONS**

The Generation System sells power to the Electric System at the cost of power produced including debt service and any other cash transactions. The Generation System sold \$59.0 million of power in 2009 and \$54.6 million of power in 2008 to the Electric System.

The Electric, Generation and Water Systems enter into various transactions to prudently and efficiently allocate resources and costs while treating each system as a stand-alone entity. Amounts due the Electric System from the Generation System for routine intercompany transactions at December 31 totaled \$431,000 in 2009 and \$809,000 in 2008. Amounts due the Generation System from the Electric System for routine intercompany transactions at December 31 totaled \$691,000 in 2009 and \$3.3 million in 2008. Amounts due the Electric System from the Water System for routine intercompany transactions totaled \$274,000 and \$356,000 at December 31, 2009 and 2008, respectively.

The Electric and Generation Systems periodically enter into loan transactions between the systems for various purposes including to defease Generation System Revenue bonds, to fund a portion of the Everett Cogeneration Project construction, and to fund the purchase and development of low-impact hydroelectric projects. These loans are assigned terms consistent with the associated asset acquired, and interest rates are set at tax-exempt bond market rates at the time of the loan.

The Electric System loans to the Generation System were \$102.8 million and \$100.0 million at December 31, 2009 and 2008, respectively. As of December 31, 2009 and 2008, the current portion of the intersystem loans was \$4.9 and \$4.6 million, respectively. The Generation System recorded interest expense on these loans of \$5.0 million in 2009 and 2008.

The Generation System loan to the Electric System was \$10.4 million and \$11.1 million at December 31, 2009 and 2008, respectively. As of December 31, 2009 and 2008, the current portion of the intersystem loan was \$0.7 million. The Electric System recorded interest expense on this loan of \$0.7 million in 2009 and 2008.

In 2008, the Electric System established a trust and purchased all of the outstanding Series 1995 Generation System Adjustable Tender Revenue bonds due to concerns surrounding the financial condition of the interest rate swap counterparty, bond insurer and bond liquidity provider. The Electric System includes this investment in special funds. In order to fund the purchase of the Series 1995 bonds, the Electric System issued \$58.2 million of Series 2008A Electric System Revenue notes at a stated interest rate of 3.75%, which matured on August 5, 2009. In July 2009, the Electric System refinanced these notes by issuing \$57.6 million of Series 2009B Electric System Revenue notes at a stated interest rate of 2.0%, which mature on August 5, 2010. The fair value of Electric System's note, which is estimated based upon quoted market prices, was \$58.2 million as of December 31, 2009.

In 2009, the Electric System established a trust and purchased all of the outstanding Series 2001A and 2002A Generation System Adjustable Tender Revenue Refunding bonds due to concerns surrounding the financial condition of the bond insurer and bond liquidity provider. The Electric System includes this investment in special funds. In order to fund the purchase of the Series 2001A and 2002A bonds, the Electric System issued \$174.9 million of Series 2009A Electric System Revenue notes at a stated interest rate of 2.0%, which mature on May 26, 2010. The fair value of Electric System's note, which is estimated based upon quoted market prices, was \$176.1 million as of December 31, 2009.

## **NOTE 7**

### **SELF-INSURANCE FUND**

The PUD maintains a comprehensive insurance program that includes liability insurance coverage of \$35 million in excess of a \$2 million self-insured retention per occurrence. This coverage insures against certain losses arising from property damage or bodily injury damage claims filed by third parties against the PUD. At December 31, 2009, the PUD's \$2 million self-insured retention was fully funded. Self-insurance funds are included in special funds at market value.



## **NOTE 8**

### **PURCHASED POWER CONTRACTS**

The PUD is a preference customer of BPA, from which it acquired approximately 75% and 77% of its energy purchases in 2009 and 2008, respectively. The PUD has entered into participation agreements in Energy Northwest's Nuclear Projects Nos. 1, 2 and 3. Additionally, the PUD has committed the Electric System to purchase the output of its Generation System at the cost of the power produced. The PUD also receives energy from various power supply agreements. Finally, the PUD enters into various short-term agreements for the sale and purchase of power.

#### **BPA Contracts**

The PUD purchases power from BPA under power supply contracts offered pursuant to the Pacific Northwest Electric Planning and Conservation Act. These contracts provide the PUD with the ability to purchase power in excess of its declared resources on an as-needed basis. The PUD entered into contracts with BPA to purchase approximately 75–80% of its power requirements from the federal agency through 2028.

#### **Energy Northwest Nuclear Projects Nos. 1, 2 and 3**

The PUD, Energy Northwest and BPA have entered into separate Net Billing Agreements with respect to Energy Northwest's Project No. 1, Project No. 2 and 70% ownership share of Project No. 3. The PUD is obligated to purchase from Energy Northwest, and BPA is obligated to purchase from the PUD, a maximum of approximately 20%, 15% and 19%, respectively, of the capability of Project Nos. 1 and 2 and Energy Northwest's 70% ownership share of Project No. 3. BPA is unconditionally obligated to pay Energy Northwest the PUD's pro rata share of the total annual costs of the projects, including debt service on revenue bonds issued to finance the projects. The effect of these net billing agreements is that the cost of power sold by BPA to all of its customers, including the PUD, includes the cost of these projects.

Notwithstanding the assignment of the PUD's share of the capability of a net billed project to BPA, the PUD remains unconditionally obligated to pay to Energy Northwest its share of the total annual costs of the projects to the extent payment is not received by Energy Northwest from BPA.

#### **Short-Term Power Supply Transactions and Open Market Purchases**

During 2009 and 2008, the PUD entered into various short-term power supply transactions to meet normal load requirements. As of December 31, 2009, the PUD has committed to purchase approximately 265,600 MWh of energy at various times during 2010 at a cost of approximately \$20.1 million.

In 2009 and 2008, respectively, the PUD purchased 9% and 11% of its total energy purchases through short-term power supply and open market purchases for a total cost of \$45.8 million and \$65.8 million.

## **NOTE 9**

### **CONTINGENCIES**

The PUD is involved in various claims arising in the normal course of business. The PUD does not believe that the ultimate outcome of these matters will have a material adverse impact on its financial position or results of operations.



## **NOTE 10 SUBSEQUENT EVENTS**

### **Kimberly-Clark Settlement Agreement**

The PUD and K-C have negotiated a settlement agreement regarding the Everett Cogeneration project. The agreement addresses a claim made by the PUD for power replacement costs resulting from a 2007 generator failure; it also clarifies the terms of the associated Operating Agreement. The terms of the agreement call for K-C to pay the PUD \$3 million for the cost of replacement power. The PUD will pay K-C \$7.5 million in settlement of claims made by K-C, and assigns the cost of decommissioning and remediation to K-C upon the December 31, 2016, termination date of the Operating Agreement. The \$7.5 million termination payment has been recorded by the Generation System as an accrued liability and a deferred charge as of December 31, 2009. The settlement agreement is expected to be signed in April, 2010.

### **AIG Financial Products Corp. Settlement Agreement**

Subsequent to year-end, the PUD entered into negotiations with AIG Financial Products Corp. (AIG-FP) to settle a dispute regarding the Interest Rate Swap Agreement associated with the PUD's Adjustable Tender Generation System Revenue Bonds, Series 1995. A settlement agreement is expected to be signed in April 2010.

The PUD has evaluated subsequent events through the report date, which is the date the financial statements are issued.

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## **APPENDIX B**

### **SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION**

The following summary is an outline of certain provisions of the Generation System Bond Resolution (the “Resolution”), is not to be considered a full statement thereof and is qualified by reference to the complete Resolution. Many of the capitalized words or phrases (other than those conventionally capitalized) used in this summary and elsewhere in this Official Statement are defined in the Resolution. Certain of those definitions are summarized below. For purposes of this Appendix, “Bonds” means Generation System Bonds.

#### **Certain Definitions**

“Annual Debt Service” for any Fiscal Year means the sum of the amounts required in such Fiscal Year to pay: (a) the interest due in such Fiscal Year on all Outstanding Bonds, excluding interest to be paid from the proceeds of sale of Bonds or other bonds; (b) the principal of all Outstanding Serial Bonds due in such Fiscal Year; (c) the sinking fund installment for Term Bonds, if any, for such Fiscal Year; and (d) any regularly scheduled District Payments adjusted by any regularly scheduled Reciprocal Payments during such Fiscal Year (See “Additional Indebtedness—Derivative Products” in this Appendix D). The Resolution specifies how debt service is calculated for Capital Appreciation Bonds, Deferred Income Bonds, Tender Option Bonds and Variable Interest Rate Bonds.

“Annual Debt Service of the Electric System” means “Annual Debt Service” as such term is defined in the Senior Electric System Bond Resolution. (See Appendix C—“SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Certain Definitions.”)

“Code” means the Internal Revenue Code of 1986, as amended, and applicable regulations.

“Generation System” means (i) the electric utility properties, rights and assets, real and personal, tangible and intangible, of the “Jackson Hydroelectric Project of Public Utility District No. 1 of Snohomish County, Washington,” the Everett Cogeneration Project and the Woods Creek Hydroelectric Project, and additions, improvements, betterments and extensions thereof and thereto, and (ii) any facilities or resources for the generation, transmission or conservation of power and energy including any incidental properties to be constructed or acquired in connection therewith, which facilities or resources are designated by resolution of the Commission as a part of the Generation System, and addition, improvements, betterments and extensions thereof and thereto. The Generation System shall not include any properties or assets of the Electric System except as heretofore or hereafter transferred and sold to the Generation System by resolution of the Commission or of any generating, conservation, transmission or distribution facilities acquired by the District as a separate electric utility system, the revenues of which are pledged to the payment of notes, bonds or other obligations issued to purchase, construct or otherwise acquire such separate electric utility system. Once the 1995 Generation System Bonds and the 2001 Generation System Bonds are no longer outstanding, the District may, by resolution, consolidate the Electric System and Generation System into a single system. Prior to consolidating the Electric System and Generation System, the District must obtain confirmation from each rating agency then rating the Bonds that the consolidation will not adversely impact the then current rating(s) on the Bonds. In addition, the District must obtain an opinion of bond counsel that the consolidation will not adversely affect the tax-exempt status of any Outstanding Bonds.

“Generation System Power Costs” has the meaning set forth under “SECURITY FOR THE 2010A BONDS—Payment of Generation System Power Costs as an Operating Expense of the Electric System.”

“Investment Securities” means the following to the extent the same are legal, from time to time, for investments of funds of the District: (a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed by, the United States, including obligations of any of the federal agencies set forth in clause (b) below to the extent unconditionally guaranteed by the United States; (b) obligations of the Export-Import Bank of the United States, the Government National Mortgage Association, the Federal National Mortgage Association to the extent guaranteed by the Government National Mortgage Association, the Federal Financing Bank, the Farmers Home Administration, the Federal Housing Administration, the Private Export Funding Corporation, the Federal Home Loan Bank, and the Federal Home Loan Mortgage Bank, or any agency or instrumentality of the Federal Government which shall be established for the purposes of acquiring the

obligations of any of the foregoing or otherwise providing financing therefor; (c) new housing authority bonds issued by the public agencies or municipalities and fully secured as to the payment of both principal and interest by a pledge of annual contributions under an annual contributions contract or contracts with the United States; or project notes issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States; (d) direct and general obligations of any State within the territorial United States, to the payment of the principal of and interest on which the full faith and credit of such State is pledged, provided, that at the time of their purchase, such obligations are rated in one of the two highest rating categories by Moody's and S&P (in the event S&P rates such obligations); (e) certificates of deposit, whether negotiable or nonnegotiable, issued by any bank, savings and loan association, or trust company, provided that such certificates of deposit shall be (i) continuously and fully insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or (ii) issued by a recognized qualified public depository of the State of Washington under RCW Chapter 39.58, as amended, or (iii) continuously and fully secured by such securities as are described above in clauses (a) or (b), which shall have a market value (exclusive of accrued interest) at all times at least equal to the principal amount of such certificates of deposit or (iv) certificates of deposit with domestic commercial banks which have a rating on their short-term certificates of deposit on the date of purchase of "A-1" or "A-1+" by S&P and "P-1" by Moody's; (f) any written repurchase agreement with any bank, savings institution or trust company which is insured by the Federal Deposit Insurance Corporation, or with any brokerage dealer with retail customers which falls under Securities Investors Protection Corporation protection, provided that such repurchase agreements are fully secured by direct obligations of the United States of America, or any agency thereof and provided further that (i) such collateral is held by the District or its agent or trustee during the term of such repurchase agreement, (ii) such collateral is not subject to liens or claims of third parties, (iii) such collateral has a market value (determined at least once weekly) at least equal to 100% of the amount invested in the repurchase agreement, (iv) the District or its agent or trustee has a perfected first security interest in the collateral, (v) the failure to maintain such collateral at the level required in (iii) above will require the District or its agent or trustee to liquidate the collateral; (g) Refunded Municipals rated Aaa by Moody's; (h) banker's acceptances with commercial banks that have a rating on their short-term certificates of deposit on the date of purchase of "A-1" or "A-1+" by S&P or "P-1" by Moody's, or in the event each of such rating agencies rates such obligations, by each of them, and that mature no more than 360 days after the date of purchase; and (i) notwithstanding any of the foregoing provisions any investments permitted under the laws of the State of Washington as amended from time to time.

"Net Revenues of the Electric System" means "Net Revenues" as such term is defined in the Senior Electric System Bond Resolution. (See Appendix C—"SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Certain Definitions.")

"Operating Expenses" means (i) all the District's expenses for operation and maintenance of the Generation System, and ordinary repairs, replacements and reconstruction of the Generation System not constituting a unit of property (as prescribed in the Uniform System of Accounts of FERC), including all costs of producing and delivering electric power and energy from the Generation System and payments (other than payments out of Bond proceeds) into reasonable reserves in the Revenue Fund for items of Operating Expenses and other costs without limiting the generality of the foregoing the payment of which is not immediately required, and shall include costs of transmission service, generating capacity reserve service and scheduled, emergency, economy or other interchange service, all other costs of purchased power (except costs under any purchased power contracts which secure the payment of debt issued to finance the facilities providing such power), 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 or payments in lieu of taxes, all to the extent properly allocable to the Generation System, (ii) any current expenses or obligations required to be paid by the District under the provisions of the Resolution or by law, all to the extent properly allocable to the Generation System, and (iii) the fees and expenses of the Trustee and Bond Registrar. Operating Expenses shall not include District Payments (as hereinafter defined), any costs or expenses for new construction or any allowance for depreciation and there shall be included in Operating Expenses of the Generation System only that portion of the total administrative and general expenses of the District that are properly allocable to the Generation System.

"Outstanding" when used with respect to Bonds means, as of any date, Bonds theretofore or thereupon issued pursuant to the Resolution except (i) any Bonds canceled by the Registrar or paid at or prior to such date; (ii) Bonds in lieu of or in substitution for which Bonds have been delivered; and (iii) Bonds deemed to be no

longer Outstanding under the Resolution.

“Parity Lien Obligations” means such term as it is defined in the Senior Electric System Bond Resolution. (See Appendix C—“SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Certain Definitions.”)

“Qualified Insurance” means any noncancellable municipal bond insurance policy or surety bond issued by any insurance company licensed to conduct an insurance business in any state of the United States (or by a service corporation acting on behalf of one or more such insurance companies) which insurance company or companies, as of the time of issuance of such policy or surety bond, are currently rated in one of the two highest rating categories by Moody’s Investors Service and Standard & Poor’s Ratings Services or their comparably recognized business successors.

“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 the Bonds, which institution maintains an office, agency or branch in the United States and as of the time of issuance of such letter of credit, is currently rated in one of the two highest rating categories by Moody’s Investors Service and Standard & Poor’s Ratings Services or their comparably recognized business successors.

“Resource Obligation” means such term as defined in the Senior Electric System Bond Resolution. (See Appendix C—“SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION—Certain Definitions.”)

“Revenues” means the income, revenues, and receipts derived by the District through the ownership and operation by it of the Generation System, but, except as provided in the Resolution, shall not include any income derived by the District through the ownership and operation by it of the Electric System or of any other generation, transmission and distribution facilities that may hereafter be purchased, constructed or otherwise acquired by the District as a separate electric utility system, or any Reciprocal Payments (as hereinafter defined). Once all Bonds Outstanding under the Resolution as of the date of issuance of the 2010B/C Bonds (but excluding the 2010B/C Bonds) are no longer Outstanding, Federal and state grant moneys received by the District in any Fiscal Year to pay or reimburse all or a portion of periodic payments of principal of and/or interest or redemption premium on the Bonds shall constitute Revenues if designated as such by the District.

“Serial Bonds” means Bonds that are not Term Bonds.

“Series” or “Series of Bonds” or “Bonds of a Series” means all Bonds designated as being of the same series issued and delivered on original issuance in a simultaneous transaction, and any Bonds thereafter delivered in lieu thereof or in substitution therefor pursuant to the Resolution.

“Term Bonds” means Bonds the retirement or the redemption of which shall be provided from money credited to the Term Bond Principal Account in the Bond Fund.

“Treasurer” means the Treasurer of the District as designated, from time to time, by resolution of the Commission.

“Value of Investment Securities” means the total market value of such Investment Securities (inclusive of any accrued interest not subject to rebate to the United States Treasury) except for securities that mature within six months from their date, which shall be valued at the par value thereof.

### **Authorization of Issuance of Bonds**

The Resolution continues and confirms an issue of Bonds of the District to be issued in series and provides for the issuance of the initial Series of Bonds subsequent to the adoption of the Resolution. The Bonds of each Series issued under the Resolution shall be equally and ratably payable and secured under the Resolution without priority by reason of date of adoption of the Supplemental Resolution providing for their issuance or by reason of their series, number or date of sale, issuance, execution or delivery, and by the liens, pledges, charges, trusts, assignments and covenants made by the Resolution, except as otherwise expressly provided or permitted by the Resolution and except as to insurance which may be obtained by the District to insure the repayment of one or more Series or maturities within a Series.

## **Additional Indebtedness**

### *Additional Bonds*

Additional Bonds (other than Refunding Bonds) may be issued in one or more Series to pay the Generation System Costs (as defined in the Resolution) or the costs of the reconstruction or replacement of the Generation System, or any portion thereof, to the extent any money received as a result of any transfer by operation of law or any insurance proceeds received as a result of any loss or damage thereto are insufficient for such purpose or for any other lawful purpose only if at the time of the delivery of each Series of Bonds:

(1) There shall have been adopted by the Commission a Supplemental Resolution authorizing the issuance of such Series of Bonds and providing for compliance with the requirements of the Resolution with respect to the Debt Service Reserve Account;

(2) There shall have occurred no default in the payment of debt service on any Bond nor shall the District be in default in performance of any covenants in the Resolution or if such default exists, an opinion of Bond Counsel shall be provided that any such default does not deprive any Bondowner of the security provided by the Resolution in any material respect; and

(3) There has been filed with the Secretary of the Commission either:

(a) a certificate of the Treasurer stating that Net Revenues of the Electric System in any 12 consecutive months out of the most recent 24 months preceding the delivery of the Bonds then proposed to be issued (the "Base Period"), after deducting therefrom amounts paid in the Base Period to satisfy all Parity Lien Obligations (including projected maximum Annual Debt Service on the Bonds then proposed to be issued), were not less than 125% of maximum Annual Debt Service of the Electric System in any future Fiscal Year on all Outstanding Electric System Bonds (provided that (i) in the event that any adjustment in the rates, fees and charges for the services of the Electric System shall be effective at any time on or prior to the date of delivery of the Bonds then proposed to be issued or within sixty days subsequent to the delivery of such Bonds, the Treasurer shall reflect in his or her certificate the Net Revenues of the Electric System he or she calculates would have been collected in the Base Period if such new rates, fees and charges had been in effect for the entire Base Period and (ii) with respect to any Variable Interest Rate Bonds of the Electric System or Generation System Outstanding on the date such certificate is delivered, the Treasurer shall estimate the debt service on such Bonds in accordance with the Resolution), or

(b) a certificate of a Professional Utility Consultant stating that

(i) (taking into consideration such adjustments as he or she deems appropriate) the issuance of the additional Bonds then proposed to be issued will not result in the District's inability to comply with its rate covenants in the Resolution; and

(ii) if such additional Bonds are being issued to pay Generation System Costs incurred or to be incurred for additions, improvements, betterments and extensions to the Generation System which will increase the total installed capacity thereof or the total energy output thereof, the plan for such additions, improvements, betterments and extensions is consistent with sound utility power supply planning and will not materially adversely interfere with operation of the Generation System.

The District may contract with the entity providing a Qualified Letter of Credit or Qualified Insurance or other equivalent credit enhancement device for the Reserve Account that the District's reimbursement obligation to such entity ranks on a parity of lien with the Bonds. In the event that the District elects additionally to secure any issue of Variable Interest Rate Bonds or Tender Option Bonds through the use of a letter of credit or other credit enhancement device, the District may contract with the entity providing such 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 additional Bonds and assuming that such credit enhancement device were to be drawn upon for the full amount available, such Bonds could be issued in compliance with the provisions described above for issuing additional Bonds.

### *Obligations Payable From Electric System Revenues*

The District may issue bonds or other evidences of indebtedness, other than bonds or other evidences of indebtedness issued in anticipation of permanent financing, for any lawful purpose of the District, payable from Electric System Revenues on a parity with the payment of Generation System Power Costs, if the District complies with the provisions summarized in paragraph number three in the preceding section entitled “Additional Bonds.”

### *Refunding Bonds*

The District may issue one or more Series of Bonds for the purpose of refunding any Bonds then outstanding if there is on file with the Secretary of the Commission either (1) a certificate of the chief financial officer of the District that immediately after the issuance of such Bonds the aggregate amount of principal and interest becoming due in any Fiscal Year with respect to all Series of Bonds Outstanding shall not be greater than that becoming due immediately prior to such issuance or (2) a certificate of the Professional Utility Consultant that the issuance of such Bonds will not result in a reduction of the Revenues and Electric System Revenues below the amount covenanted in the Resolution to be maintained by the District. In the event that simultaneously with the issuance of such Bonds, the District is also issuing Bonds for other purposes, the computations referred to immediately above shall be made without reference to such Bonds issued for other purposes.

### *Subordinate Lien Obligations Payable from Revenues*

The District may incur indebtedness and issue bonds or other evidences of indebtedness for any corporate use or purpose of the District payable from Revenues subject and subordinate to the payments required to be made from the Revenue Fund for Operating Expenses and the deposits from the Revenue Fund into the Bond Fund and may secure such bonds or other evidences of indebtedness and the payment thereof by a lien and pledge on the Revenues junior and inferior to the lien and pledge on the Revenues created by the Resolution.

### *Subordinate Lien Obligations Payable from Electric System Revenues*

The District may incur indebtedness and issue bonds or other evidences of indebtedness for any corporate use or purpose of the District payable from Electric System Revenues subject and subordinate to the deposits and payments required to be made from the Electric System Revenues into the Revenue Fund for the payment of Generation System Power Costs and may secure such bonds or other evidences of indebtedness and the payment thereof by a lien and pledge on Electric System Revenues junior and inferior to the lien and pledge on Electric System Revenues created by the Resolution.

### *Separate System Bonds*

Nothing in the Resolution will prevent the District from issuing bonds or other 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, which facilities shall be a separate system and which bonds or other evidences of indebtedness shall be payable solely from the revenues or other income derived from the ownership or operation of such separate utility system.

### *Derivative Products*

To the extent permitted by state law the District may enter into Derivative Products on a parity with the Bonds subject to the conditions set forth in the Resolution and summarized below. The following terms have the following meanings:

(1) “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.

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

(3) “Derivative Product” means a written contract or agreement between the District and a third party

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 (the “Reciprocal Payor”) (who, if the District’s Bonds are rated by Moody’s Investors Service, must have a rating as high as that of the District), 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 Revenues on an equal and ratable basis with the Outstanding Bonds;

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

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

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

(4) “District Payment” means any payment (designated as such by a Supplemental 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.

(5) “Reciprocal Payment” means any payment (designated as such by a Supplemental Resolution) to be made to, or for the benefit of, the District under a Derivative Product by the Reciprocal Payor.

(6) “Reciprocal Payor” means a party to a Derivative Product that is obligated to make one or more Reciprocal Payments thereunder.

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

(1) General Parity Tests. The Derivative Product must satisfy the requirements for additional Bonds described in the Resolution, taking into consideration regularly scheduled District Payments and regularly scheduled Reciprocal Payments under the Derivative Product.

(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 Resolution or the applicable provisions of any Supplemental Resolution and will not adversely affect the excludability for federal income tax purposes of the interest on any Outstanding 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 Supplemental 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 Resolution.



## **Application of Bond Proceeds**

The proceeds derived from each Series of Bonds issued to pay Generation System Costs shall be deposited:

(1) to the Interest Account in the Bond Fund in an amount equal to the accrued interest on such Series of Bonds paid by the initial purchasers thereof and such additional amount as the Commission determines in the Supplemental Resolution authorizing such Series of Bonds to be credited thereto to provide for the payment of interest on Bonds which is defined as a Generation System Cost;

(2) to the Debt Service Reserve Account in the Bond Fund, in an amount which, together with amounts insured by Qualified Insurance or guaranteed by a Qualified Letter of Credit, shall equal the Debt Service Reserve Requirement, as defined above;

(3) in the Revenue Fund such amount, if any, as the Commission determines in the Supplemental Resolution authorizing such Series of Bonds to be deposited thereto to provide a working capital reserve; and

(4) in the Construction Fund the balance of such Bond proceeds to be applied to the payment of Generation System Costs.

The District is authorized and directed to make disbursements from the Construction Fund to pay Generation System Costs. The District shall prepare and keep in its files in respect of each disbursement from the Construction Fund a written requisition signed by the General Manager or by another Authorized Officer with respect to each payment made or to be made.

In the event a Series of Bonds is issued to pay the costs of additions, improvements, repairs, renewals and replacements to the Generation System which are not Operating Expenses, if the Construction Fund no longer exists, the District shall create a new construction fund, to be held and administered by the District substantially in accordance with the Resolution.

## **Revenues and Flow of Funds**

To secure the payment of the Bonds, the Resolution continues in existence the previously created Revenue Fund and Construction Fund to be held and administered by the District and creates the Bond Fund, which is comprised of the Interest Account, the Serial Bond Principal Account, the Term Bond Principal Account and the Debt Service Reserve Account, to be held and administered by the District.

### *Revenue Fund*

The District will pay into the Revenue Fund all of the Revenues and other money required to be paid into the Revenue Fund (other than the Revenues and other amounts expressly required or permitted to be credited to, or deposited in, any other fund or account). The District shall make monthly payments into the Revenue Fund in an amount, together with amounts then on deposit in the Revenue Fund and available for such purpose, which is equal to Generation System Power Costs for that month then unpaid plus estimated Generation System Power Costs for the next month provided power or energy or other goods and services from the Generation System was made available to the Electric System during such month pursuant to the Resolution. In any month in which no power and energy or other goods or services of the Generation System were made available to the Electric System, the District shall pay into the Revenue Fund out of Electric System Revenues, after payment of operation and maintenance expenses of the Electric System, an amount sufficient to pay estimated Generation System Power Costs for the next succeeding month and to pay any deficiencies in the payment of Generation System Power Costs for the then current or any prior month. The District will apply money in the Revenue Fund first to the payment of Operating Expenses for such month and second to the deposit in the Bond Fund of the amounts required, if any, and, in the event that any Derivative Product exists on a parity of lien with the Bonds, to make regularly scheduled District Payments as adjusted by regularly scheduled Reciprocal Payments and to make payments required by a reimbursement agreement which is on a parity of lien with the Bonds. There will be retained in the Revenue Fund, after amounts are applied to Operating Expenses and the amounts required to be deposited in the Bond Fund have been so deposited, any balance of the Revenues. Such money may, in the discretion of the District, be used (1) to pay principal, premium, if any, and interest on the Bonds; (2) for transfer to any other fund or account created by the Resolution; (3) for the purchase or redemption of any Bonds; (4) to pay any subordinated indebtedness of the Generation System; or (5) for any lawful corporate purpose of the District.

### *Bond Fund*

At the times provided below, after payment of Operating Expenses the District shall withdraw from the Revenue Fund and transfer to the Bond Fund, amounts as follows and in the following order of priority:

(1) Interest Account. In the case of all Bonds other than Variable Interest Rate Bonds, not later than the day prior to the date on which an installment of interest falls due on the Bonds of a Series, the District shall transfer to the Interest Account an amount equal to the installment of interest then falling due on all Bonds of such Series. In the case of Variable Interest Rate Bonds, the District shall make transfers to the Interest Account at such times and in such amounts as shall be specified in the Supplemental Resolution authorizing the Series of Variable Interest Rate Bonds. Any amounts credited to the Interest Account representing accrued interest received on the sale of Bonds, interest capitalized from the proceeds of the Bonds of a Series and any other transfers and credits otherwise made or required to be made to the Interest Account shall be taken into consideration and allowance made with respect to the full amount of such transfers and credits.

(2) Serial Bond Principal Account and Term Bond Principal Account. Not later than the day prior to the date upon which an installment of principal on Serial Bonds or Term Bonds falls due, the District shall transfer to the Serial Bond Principal Account or the Term Bond Principal Account, as appropriate, an amount equal to such installment.

Not later than the day prior to the date upon which a sinking fund installment on Term Bonds falls due, the District shall transfer to the Term Bond Principal Account an amount equal to such installment.

The District shall apply the money credited to the Term Bond Principal Account as sinking fund installments to the retirement of the Term Bonds of such Series by redemption in accordance with the Supplemental Resolution providing for the issuance of such series of Bonds (a) on each date upon which a sinking fund installment is due with respect to a particular series of Bonds, or (b) on the first day of any month prior to such date, in respective principal amounts credited to the Term Bond Principal Account on such dates for such Term Bonds, so that the aggregate amounts so applied will equal the respective principal amounts required to be credited to the Term Bond Principal Account on such sinking fund installment dates by the Supplemental Resolution providing for their issuance; provided that if the last sinking fund installment for such Term Bonds falls due on the stated maturity date thereof, the amount of such installment shall be applied to the payment thereof at such maturity date. The District shall apply the money credited to the Term Bond Principal Account as sinking fund installments for the retirement of the Term Bonds of a particular Series to the purchase of such Bonds, at a purchase price (including accrued interest and any brokerage or other charge) not to exceed the redemption price then applicable upon the redemption of such Bonds from sinking fund installments, plus accrued interest, in which event the principal amount of such Bonds required to be redeemed on the next sinking fund installment date shall be reduced by the principal amount of the Bonds so purchased; provided, however, that no Bonds of such Series shall be purchased during the interval between the date on which notice of redemption of such Bonds from sinking fund installments is given and the date of redemption set forth in such notice, unless the Bonds so purchased are Bonds called for redemption in such notice or are purchased from money other than that credited to the Term Bond Principal Account with respect to such sinking fund installments. Money in the Term Bond Principal Account, other than money credited thereto as sinking fund installments, may be applied to the purchase or redemption of a Series of Bonds. The price payable on any such purchase shall not exceed the highest redemption price applicable at the time or any time thereafter with respect to such Series of Bonds.

In the event of the purchase or redemption of Term Bonds of a particular Series, except from money credited to the Term Bond Principal Account as sinking fund installments, the principal amount of Term Bonds of such Series so purchased or redeemed shall be credited to future sinking fund installments for the Term Bonds of such Series in such manner as the District shall determine.

Any purchase of Bonds may be made with or without tenders of Bonds and at either public or private sale, as shall be determined by the District. The accrued interest to be paid on the purchase or redemption of such Bonds shall be paid from the Interest Account.

(3) Debt Service Reserve Account. To the extent permitted under the Code, there shall be deposited from the proceeds of each Series of Bonds into the Bond Fund for credit to the Debt Service Reserve Account an

amount so that there will be on deposit therein money and Value of Investment Securities equal to the Debt Service Reserve Requirement. If with respect to any Series of Bonds the amount of proceeds of such Series of Bonds permitted by the Code to be deposited into the Bond Fund for credit to the Debt Service Reserve Account is less than the Debt Service Reserve Requirement allocable to such Series of Bonds, the Supplemental Resolution providing for the issuance of such Series of Bonds shall provide for further and additional payments into the Bond Fund for credit to the Debt Service Reserve Account from money in the Revenue Fund in such amounts and at such times so that by no later than five years from the date of issuance of such additional Series of Bonds or by the final maturity thereof, whichever occurs first, there will be credited to the Debt Service Reserve Account an amount equal to the Debt Service Reserve Requirement. Notwithstanding the foregoing provisions, any Supplemental Resolution authorizing the issuance of Bonds may provide for the District to obtain Qualified Insurance or a Qualified Letter of Credit for specific amounts required by the Resolution to be paid out of the Debt Service Reserve Account. The face amount of any such Qualified Insurance or a Qualified Letter of Credit shall be credited against the amounts required to be maintained in the Debt Service Reserve Account to the extent that such payments and credits to be made are insured by an insurance company, or guaranteed by a letter of credit from a financial institution. Such Qualified Letter of Credit or Qualified Insurance shall not be cancelable on less than three years notice. In the event of any cancellation, the Debt Service Reserve Account shall be funded in accordance with the provisions of the Resolution providing for payments to the Debt Service Reserve Account in the event of a deficiency therein, provided that the deficiency shall be funded in equal monthly installments over the period remaining until such cancellation becomes effective.

A determination as to the money and Value of Investment Securities in the Debt Service Reserve Account shall be made by the District as of January 1 and July 1 of each year and immediately following any withdrawal of amounts in the Debt Service Reserve Account as required by the Resolution. If the money and Value of Investment Securities in the Debt Service Reserve Account shall be less than the Debt Service Reserve Requirement as of the date of any valuation thereof, the District shall so notify any insurer of Bonds and shall then, beginning with last day of the month next succeeding such date, after paying Operating Expenses and making the transfers to the Bond Fund for credit to the Interest Account, the Serial Bond Principal Account and the Term Bond Principal Account, make monthly transfers from the Revenue Fund to the Bond Fund for credit to the Debt Service Reserve Account equal to one-sixth of the amount as originally determined by which the money and Value of Investment Securities in the Debt Service Reserve Account is less than the Debt Service Reserve Requirement, until there shall be on deposit in the Debt Service Reserve Account money and Value of Investment Securities equal to the Debt Service Reserve Requirement based upon the most recent valuation of that account; provided that if a Series of Bonds is issued during a period in which a deficiency exists in the Debt Service Reserve Account, to the extent permitted under the Code, the District shall deposit proceeds of such Series in the Bond Fund for credit to the Debt Service Reserve Account sufficient to make up any of the deficiency in the Debt Service Reserve Account at the time of such issuance, based upon the most recent valuation of that account.

If, as of the first business day of any Fiscal Year or as of a date upon which there is a withdrawal from the Debt Service Reserve Account (other than earnings on Investment Securities), the money and Value of Investment Securities as of the last date of calculation thereof, in the Debt Service Reserve Account shall exceed the Debt Service Reserve Requirement, the amount of such excess may be transferred as of such date to the Revenue Fund.

When a Series of Bonds is refunded in whole or in part, money may be withdrawn from the Debt Service Reserve Account to provide for the payment of refunded Bonds; provided that after such withdrawal there shall be on credit to the Debt Service Reserve Account money and Value of Investment Securities in an amount equal to the Debt Service Reserve Requirement.

In the event amounts in the Interest Account, the Serial Bond Principal Account or the Term Bond Principal Account shall be insufficient for the purposes of such payment, the District shall promptly make up such deficiency from the Debt Service Reserve Account by the withdrawal of cash therefrom and by the sale or redemption of Investment Securities held in the Debt Service Reserve Account, if necessary, in such amounts as will provide cash in the Debt Service Reserve Account sufficient to make up any such deficiency. If a deficiency still exists immediately prior to an interest payment date and after the withdrawal of cash, the District shall then draw from any Qualified Letter of Credit, Qualified Insurance, or other equivalent credit facility in sufficient amount to make up the deficiency. Such draw shall be made at such times and under such conditions as the Resolution and the agreement for such Qualified Letter of Credit or such Qualified Insurance shall provide. Any deficiency created

in the Debt Service Reserve Account by reason of any withdrawal therefrom for payment into the Interest Account, the Serial Bond Principal Account or the Term Bond Principal Account shall be made up from money in the Revenue Fund first available after providing for the required payments into such Interest, Serial Bond Principal and Term Bond Principal Accounts and after providing for payments under a reimbursement agreement entered into by the District pursuant to the Resolution.

Whenever the amount in the Debt Service Reserve Account, together with the amount in the Interest Account, the Serial Bond Principal Account and the Term Bond Principal Account, is sufficient to pay in full all Outstanding Bonds in accordance with their terms, the funds on deposit in the Debt Service Reserve Account shall be transferred to the Interest Account, the Serial Bond Principal Account and the Term Bond Principal Account as appropriate. Prior to the transfer, investments held in the Debt Service Reserve Account shall be liquidated to the extent necessary in order to provide for the timely payment of principal or redemption price of and interest on Bonds.

Notwithstanding any provision of the Resolution requiring the deposit of any earnings or other money in the Bond Fund, any such earnings that are subject to any rebate or other payment requirement pursuant to applicable provisions of the Code and applicable regulations thereunder may be withdrawn from the Bond Fund for deposit into a separate fund or account created for that purpose. Any amounts required at any time to be withdrawn from the Debt Service Reserve Account or other accounts in the Bond Fund in order to preserve the tax-exempt status of the Bonds shall be withdrawn and deposited in the Revenue Fund.

#### *Investment of Money in Funds*

Money on deposit in the Construction Fund and the Revenue Fund shall be invested by the District, to the fullest extent reasonable and practicable, in Investment Securities (as defined in the Resolution) maturing in such amounts and at such times as is anticipated by the District that such money will be required to pay the Generation System Costs to be satisfied from the Construction Fund and to make the payments contemplated to be made from the Revenue Fund, as the case may be.

Money in the Bond Fund shall be invested by the District to the fullest extent reasonable and practicable, in Investment Securities maturing in such amounts and at such times as the District determines so that payments required to be made from the Bond Fund may be made when due, provided that the money on credit to the Debt Service Reserve Account shall be invested in Investment Securities maturing no later than the final maturity date of all Bonds then Outstanding.

All earnings and income derived from investment of money in the funds, other than earnings and income required by the Resolution to be segregated to protect the federal tax exemption of interest in the Bonds, shall, at the option of the District, be deposited in the Construction Fund or the Revenue Fund, provided that all earnings and income derived from investment of money in the Debt Service Reserve Account shall be retained in such account to the extent necessary to satisfy the Debt Service Reserve Requirement.

#### **Covenants To Purchase Electric Power and Energy of the Generation System**

The District covenants that the Generation System will sell, and the Electric System will purchase, and by the terms of the Resolution the Generation System does thereby sell and the Electric System does thereby purchase, in each month all of the electric power and energy or other goods and services of the Generation System available in such month for use in the Electric System.

#### **Additional Covenants**

The District has covenanted as follows:

##### *To Maintain the Generation System*

The District will (1) at all times operate the properties of the Generation System and the business in connection therewith in an efficient manner and at reasonable cost, (2) maintain, preserve and keep the properties of the Generation System in good repair, working order and condition, and (3) make all necessary and proper repairs, renewals, replacements, additions, improvements and betterments thereto and extensions thereof, so that the

business carried on in connection therewith shall be properly and advantageously conducted. The District will take all lawful measures required to issue and sell Bonds to the extent required to enable the District to pay Generation System Costs.

*To Comply With Licenses*

The District will use its best efforts to comply with the terms and conditions of any federal, state or local governmental permit or license for the Generation System and with any federal, state or local law or regulation applicable to the operation, maintenance and repair of the Generation System, including the FERC License for the Jackson Project; provided that the District may, in good faith, contest by appropriate proceedings, duly prosecuted, the applicability or validity of any such permit, license, law, regulation or approval, if and so long as such contest or proceeding does not impair the security for or the payment of the Bonds.

*Not to Render Service Free of Charge; Enforcement of Accounts Owning*

Except as required or expressly permitted by statute, so long as any Bonds are Outstanding, the District will not furnish or supply electric power or energy or any other commodity, service or facility furnished by or in connection with the Generation System free of charge to any other system of the District or to any person, firm or corporation, public or private, and the District will promptly enforce the payment of any and all accounts owing to the District by reason of the Generation System.

*Disposition of All or Part of the Generation System*

The District will not sell, mortgage, lease or otherwise dispose of or encumber all or any portion of the Generation System except that:

(1) The District may sell, lease or otherwise dispose of all or substantially all of the Generation 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 any part of the Generation 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 Resolution; or

(b) provision is made for the payment, redemption or other retirement of a principal amount of 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 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 Revenues attributable to the part of the Generation System sold or disposed of for the 12 preceding months bears to the total Revenues for such period; or

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

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

(4) In the event that the ownership of the properties of the Generation System, or any part thereof, shall be transferred from the District through the operation of law, the District shall proceed to reconstruct or replace the portion of the Generation System so transferred and any money received by the District as a result of such transfer shall be applied to the payment of the costs of such reconstruction or replacement, unless the Commission shall determine by resolution that the same is not in the best interests of the District and the Bondowners. Pending the application of any money received by the District as a result of such transfer to the payment

of the costs of such reconstruction or replacement, such money shall be held by the District in a special account and invested in Investment Securities maturing no later than such times as is anticipated by the District that such money will be required to pay the costs of such reconstruction or replacement. The earnings on any money held in such special account shall be credited thereto. Any money received by the District as a result of such transfer or the balance in any such special account not required to be applied to reconstructing or replacing the portion of the Generation System so transferred shall be deposited in the Revenue Fund.

The above provisions with respect to the disposition of part or all of the Generation System shall also be applicable to any disposition of part or all of the Electric System.

#### *Insurance*

The District shall either self-insure in such manner and to such extent as the District shall determine to be necessary and appropriate or, as needed, and, to the extent available at reasonable cost, shall keep the Generation System and the operation thereof insured with responsible insurers with policies payable to the District against risks of direct physical loss, damage to or destruction of such properties, and against accidents, casualties or negligence, including liability and employer's liability insurance, at least to the extent that similar insurance is usually carried by electric utilities operating like properties. In the event of any loss or damage to the properties of the Generation System covered by such insurance, the District shall reconstruct or replace the portion of the Generation System suffering such loss or damage and any such insurance proceeds received by the District as a result of such loss or damage shall be applied to pay the costs of such reconstruction or replacement unless the Commission shall determine by resolution that such reconstruction or replacement is not in the best interests of the District and the Bondowners. Any insurance proceeds received as a result of such loss or damage not required to be applied to reconstructing or replacing the portion of the Generation System suffering such loss or damage shall be deposited in the Revenue Fund for use and application to the purchase or redemption of Bonds. In the case of loss, including the loss of revenue, caused by delay in completion of, or by suspension or interruption of generation or transmission of power and energy by the Generation System, the proceeds of any insurance covering such loss shall be paid into the Revenue Fund.

#### *Books of Account; Annual Audit*

The District will keep proper books of account, which will be audited annually by a Certified Public Accountant or by the Washington State Auditor's office. Any bondowner may obtain at the office of the District copies of the District's balance sheet and statement of income and retained earnings showing in reasonable detail the financial condition of the Electric System as of the close of each Fiscal Year.

#### *Professional Utility Consultant*

The District shall retain, as Professional Utility Consultant, independent persons or firms (which may but need not be engineering firms) having a favorable reputation for skill and experience in analyzing the operations of electric utility systems, preparing rate analyses, forecasting the loads and revenues of electric utility systems, and the marketing of power and energy therefrom who shall be available to advise the District upon request and render opinions to the District upon request on matters relating to electric power generation, transmission, power supply, electric utility operations, rates and charges, electric utility economics and financing, and budgets, and to make such investigations and determinations as may be necessary under the Resolution.

#### *To Make Economically Sound Improvements and Extensions*

The District will not expend any Revenues or the proceeds of Bonds for any renewals, replacements, capital additions, improvements, betterments or extensions which are not economically sound or which will not properly and advantageously contribute to the conduct of the business of the Generation System in an efficient and economical manner unless required to do so by or pursuant to law so as to permit the continued operation of the Generation System.

#### *To Pay Principal, Premium and Interest on Bonds*

The District will duly and punctually pay, or cause to be paid, solely from the Revenues, Electric System Revenues and other moneys pledged in the Resolution to the payment thereof, the principal, premium, if any, and interest on

each and every Bond on the date and at the places and in the manner provided in the Bonds, according to the true intent and meaning thereof, and will faithfully do and perform and fully observe and keep any and all covenants, undertakings, stipulations and provisions contained in the Bonds and in the Resolution.

#### *Protection of Security*

The District is duly authorized under all applicable laws to create and issue the Bonds and to adopt the Resolution and to pledge the Revenues, amounts of Electric System Revenues and other moneys, securities and funds purported to be pledged by the Resolution in the manner and to the extent provided in the Resolution. The Revenues, amounts of Electric System Revenues and other moneys, securities and funds so pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Resolution, except as otherwise expressly provided therein, and all corporate action on the part of the District to that end has been duly and validly taken. The Bonds and the provisions of the Resolution are and will be valid and legally enforceable obligations of the District in accordance with their terms and the terms of the Resolution. The District shall at all times, to the extent permitted by law, defend, preserve and protect the pledge of the Revenues, amounts of Electric System Revenues and other moneys, securities and funds pledged under the Resolution and all the rights of the Bondowners under the Resolution against all claims and demands of all persons whomsoever.

#### *Authority of District to Acquire and Construct the Generation System, to Provide for the Operation and Maintenance of the Generation System and to Fix and Collect Rates and Charges*

The District has good, right and lawful power to acquire and construct the Generation System and to provide for the operation and maintenance of the Generation System and to fix, establish, maintain and collect rates and charges for the Generation System electric power and energy and other services, facilities and commodities sold, furnished or supplied through the facilities of the Generation System.

#### *Payment of Taxes, Assessments and Other Governmental, Charges and Payments in Lieu Thereof; Payment of Claims*

The District shall, from time to time, duly pay and discharge, or cause to be paid or discharged, all taxes, assessments or other governmental charges, or payments in lieu thereof, lawfully imposed upon the Generation System, or on the revenues, income, receipts, profits or other moneys derived by the District therefrom when the same shall become due, and all lawful claims for labor and materials and supplies that, if not paid, might become a lien or charge upon such properties, or any part thereof, or upon the Revenues and other moneys derived by the District directly or indirectly from the Generation System, or that might in any way impair the security of the obligations issued by the District payable from the Revenues and other moneys, except those assessments, charges or claims that the District shall in good faith contest by proper legal proceedings.

#### *Taking Any Further Action Necessary*

The District shall, at any and all times, insofar as it may be authorized to do so by law, pass, adopt, make, do, execute, acknowledge, deliver, register, file and record all and every such further resolutions, acts, deeds, conveyances, assignments, recordings, filings, transfers and assurances as may be necessary or desirable for the better assuring, conveying, granting, pledging, assigning and confirming all and singular the rights, Revenues and other moneys pledged or assigned to the payment of Bonds or intended so to be.

#### *Employees' Fidelity Bonds*

The District shall require of agents of the District, and shall obtain for employees of the District collecting or handling money, fidelity bonds with a responsible surety company or companies as surety in reasonable amounts usually obtained by public agencies operating like properties, to protect the District from loss.

#### *Non-Acceleration of Certain Obligations*

The District shall not enter into any contract, obligation or evidence of indebtedness requiring the payment of money, described in the provisions of the Electric System Resolution regarding "Separate System Bonds; Resource Obligations" or described in the provisions of the Resolution regarding "Additional Indebtedness – Separate System

Bonds” pursuant to which the obligation of the District to make payments of money may be accelerated (upon occurrence of a default) from the regularly scheduled dates of such payments.

*Compliance with Senior Electric System Bond Resolution; Amendment Thereof*

Until the obligations of the District under the Senior Electric System Bond Resolution have been discharged in accordance with the terms thereof, the District shall comply with the provisions, covenants and agreements contained in the Senior Electric System Bond Resolution. The District will not consent to or agree to any amendment or modification of the Senior Electric System Bond Resolution which would impair the ability of the District to comply with the covenants set forth in the Resolution.

**Amendments**

The District, without the consent or concurrence of any owner of any Bond, may adopt a resolution amending or supplementing the Resolution (1) to provide for the issuance of Bonds; or (2) if the provisions of such Supplemental Resolution shall not adversely affect the rights of the owners of the Bonds then Outstanding, to make any changes or corrections in the Resolution as to which the District shall have been advised by its Counsel that the same are technical wording corrections or changes or are required for the purpose of curing or correcting any ambiguity or defective or inconsistent provision or omission or mistake or manifest error contained in the Resolution, or to insert provisions clarifying matters or questions arising under the Resolution as are necessary or desirable; to add additional covenants and agreements of the District to further secure the payment of the Bonds; to surrender any right, power or privilege reserved to or conferred upon the District by the terms of the Resolution; to confirm as further assurance any lien, pledge or charge, or the subjection to any lien, pledge or charge, created or to be created by the Resolution; to grant to or confer upon the owners of the Bonds any additional rights, remedies, powers, authority or security that lawfully may be granted to or conferred upon them, or to grant to or confer upon the Trustee for the benefit of the holders of the Bonds any additional rights, duties, remedies, power or authority; and to modify any of the provisions of the Resolution in any other respects; provided that if such modification materially adversely affects the owners of any Bonds, such modification shall not be effective until after the Bonds Outstanding at the time such Supplemental Resolution is adopted shall cease to be Outstanding, in which case any Bonds issued subsequent to any such modification shall contain a specific reference to the modifications contained in such Supplemental Resolution, or until the owners of the Bonds Outstanding at the time such Supplemental Resolution is adopted shall consent thereto.

With the consent of the owners of not less than 60% in aggregate principal amount and Accreted Value, if any, of the Bonds then Outstanding, the District may adopt a resolution amending or supplementing the Resolution to add any provisions to, or change in any manner or eliminate any of the provisions of, the Resolution, or modify or amend the rights and obligations of the District and the Trustee thereunder, or modify in any manner the rights of the owners of the Bonds and coupons then Outstanding; provided that, without the specific consent of the owner of each such Bond which would be affected thereby, no such Supplemental Resolution shall: (1) change the fixed maturity date for the payment of the principal of any Bond or the date for the payment of interest thereon or the terms of the redemption thereof, or reduce the principal amount of any Bond or the rate of interest thereon or the redemption price (or the redemption premium) payable upon the redemption or prepayment thereof, (2) reduce the aforesaid percentage of Bonds, the owners of which are required to consent to any Supplemental Resolution amending or supplementing the provisions of the Resolution; (3) give to any Bond or Bonds any preference over any other Bond or Bonds; (4) authorize the creation of any pledge of the Revenues and other money prior, superior or equal to the pledge of and lien and charge for the payment of the Bonds; or (5) deprive any owner of the Bonds of the security afforded by the Resolution.

**Stand-by Trustee**

U.S. Bank National Association or its successor is appointed to act as stand-by Trustee (the “Trustee”) for the owners of all Bonds in the event of default. The Trustee may resign by notice in writing to be given to the District and mailed to each Bondowner by the Trustee or published once by the Trustee, in a daily newspaper of general circulation or a financial journal published in New York, New York, not less than 45 days before such resignation is to take effect. Such resignation shall take effect immediately upon the appointment of a new Trustee, if such new Trustee is appointed and accepts the trust before the time stated in such notice.



The Trustee may be discharged by the District at any time as long as an Event of Default has not occurred and is not continuing or at any time by the owners of a majority in aggregate principal amount of the Bonds then Outstanding.

If at any time the Trustee resigns, is discharged, or if the position of Trustee becomes vacant for any other reason, the District must appoint a Trustee to fill such vacancy. The District shall mail notice of any such appointment to each Bondowner or shall publish notice thereof once, in a daily newspaper of general circulation or a financial journal published in New York, New York, within 20 days after such appointment. At any time within one year after such appointment, the owners of a majority in aggregate principal amount of the Bonds then Outstanding may appoint a successor Trustee, which shall supersede any Trustee theretofore appointed by the District.

Once the 1995 Generation System Bonds and the 2001 Generation System Bonds are no longer Outstanding, the District is not required to appoint a Stand-by Trustee. The Bondowners may appoint a Bondowners' Trustee in an Event of Default. See "Events of Default and Remedies – Bondowners' Trustee."

### **Events of Default and Remedies**

Under the Resolution, each of the following constitutes an "Event of Default": (1) if payment of the principal and premium, if any, on any Bond is not made when due and payable, whether at maturity or by proceedings for redemption or otherwise; or (2) if payment of any installment of interest on any Bond is not made when due and payable; or (3) if the provisions of any Supplemental Resolution with respect to mandatory sinking fund installments or the retirement of Term Bonds is not complied with at the time and in the manner specified in such Supplemental Resolution; or (4) default under any agreement executed by the District with respect to a Qualified Letter of Credit or Qualified Insurance, or any letter of credit or other credit enhancement device providing additional security for any Variable Interest Rate Bonds which default results in the suspension, expiration or termination of the payment obligations of the issuer thereof, or (5) the occurrence of an Event of Default as defined in the Senior Electric System Bond Resolution: or (6) if the District violates or fails to perform any of its other obligations under the Resolution or any Supplemental Resolution for 60 days after written notice of default is given to the District by the Trustee or by the owners of not less than 66% in aggregate principal amount and Accreted Value, if any, of the Bonds then Outstanding, provided the violation by the District of any provision of, or the failure of the District to perform any of its obligations (other than a failure constituting an Event of Default described in clauses (1) through (3) above) under the Resolution or any Supplemental Resolution shall not constitute an Event of Default if, prior to or within such 60-day period, the District commences appropriate action in good faith to cure such violation or failure and diligently prosecutes such action to completion, notwithstanding that the period required to effect such cure shall extend beyond such 60-day period, or (7) if a court having jurisdiction enters a decree or order for relief adjudging the District a bankrupt or insolvent, or approving as properly filed a petition seeking reorganization or arrangement of the District under any applicable bankruptcy, insolvency or other similar law, and such decree or order continues undischarged or unstayed for 40 days, or if a court having jurisdiction enters a decree or order appointing a receiver, liquidator, assignee, custodian, trustee or sequestrator of the District or any substantial part of its property, or ordering the winding-up or liquidation of the District, and such decree or order remains undischarged or unstayed for 60 days; or (8) if the District institutes voluntary proceedings to be adjudicated insolvent or bankrupt under any applicable bankruptcy, insolvency or other similar law or consents to the filing of a bankruptcy proceeding against it, or to the entry of an order for relief in an involuntary proceeding against it under any such law, or files a petition or answer or consent seeking reorganization or arrangement under any such law, or consents to the filing of any such petition, or consents to the appointment of a receiver, liquidator, trustee, assignee, custodian or sequestrator of the District or any substantial part of its property, or makes an assignment for the benefit of creditors, or admits in writing its insolvency or inability to pay its debts generally as they become due, or takes any action in furtherance of any of the foregoing.

If an Event of Default shall have happened and shall not have been remedied, the District upon demand of the Trustee shall pay over, and the District covenants that upon demand of the Trustee it shall pay over, to the Trustee only to the extent necessary to cure such Event of Default (i) forthwith, all moneys, securities and funds then held by the District and pledged under the Resolution, and (ii) as promptly as practicable after receipt thereof, all Revenues.

During the continuance of an Event of Default as defined under the Resolution or of any other Event of Default resulting in an Event of Default as defined in the Resolution, the Revenues received by the Trustee shall be applied by the Trustee, first, to the payment of all necessary and proper Operating Expenses and all other proper disbursements or liabilities made or incurred by the Trustee and, second, to the then due and overdue payments into the Bond Fund, including the making up of deficiencies therein.

In the event that at any time the funds held by the Trustee pursuant to the Resolution shall be insufficient for the payment of the principal (including any mandatory sinking fund installments), premium, if any, and interest then due on the Bonds, such funds (other than funds held for the payment or redemption of particular Bonds) and all Revenues shall be applied as follows: first, to the payment of all necessary and proper Operating Expenses and all other proper disbursements or liabilities made or incurred by the Trustee; second, to the payment, pro rata, to the persons entitled thereto of all installments of interest then due (including any interest on overdue principal) or any District Payments; third, to the payment, pro rata, to the persons entitled thereto of the principal (including any mandatory sinking fund installments) and premium, if any, due and unpaid upon the Bonds at the time of such payment; fourth, to the payment pro rata, to the persons entitled hereto by reason of a pledge of Revenue subordinate to the lien of the Bonds, and fifth, for any other lawful purpose as provided in the Resolution concerning the application of any balance of the Revenues in the Revenue Fund.

If an Event of Default happens and is not remedied, the Trustee, either in its own name or as trustee of an express trust, or as attorney-in-fact for the owners of the Bonds is empowered to proceed forthwith to institute such suits, actions and proceedings at law or in equity for the collection of all sums due in connection with the Bonds and to protect and enforce its rights and the rights of the owners of the Bonds under the Resolution for the specific performance of any covenant contained in the Resolution, or in aid of the execution of any power granted in the Resolution, or for an accounting against the District as trustee of any express trust, or in the enforcement of any other legal or equitable right as the Trustee, being advised by counsel, deems most effectual to enforce any of its rights, or to perform any of its duties, under the Resolution. The owners of not less than 66% in aggregate principal amount and Accreted Value, if any, of the Bonds at the time Outstanding shall be authorized and empowered (1) to direct the time, method, and place of conducting any proceeding for any remedy available to the owners of the Bonds or to the Trustee therefor, or of exercising any trust or power conferred upon the Trustee under the Resolution or (2) on behalf of the owners of the Bonds then Outstanding, to consent to the waiver of any Event of Default except an Event of Default defined in clauses (1) through (3) of the definition of "Events of Default" above or its consequences, and the Trustee shall waive any Event of Default and its consequences upon the written request of the owners of such 66%; provided that the Trustee shall be provided with adequate security and indemnity. No waiver shall extend to any subsequent or other default, or impair any right consequent thereon. The Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Bondowners not party to such direction.

No remedy by the terms of the Resolution conferred upon or reserved to the Trustee or the owners of the Bonds is intended to be exclusive of any other remedy given thereunder to the Trustee or to the owners of the Bonds or now or thereafter existing at law or in equity or by statute.

#### *Bondowners' Trustee*

Once the 1995 Generation System Bonds and the 2001 Generation System Bonds are no longer outstanding, 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 Bonds Outstanding. Any Bondowners' Trustee must be a bank or trust company organized under the laws of the State of New York or a national banking association. The bank or trust company acting as Bondowners' Trustee may be removed at any time, and a successor Bondowners' Trustee may be appointed, by the registered owners of a majority in principal amount of 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 appointed in the manner provided in the Resolution, and each successor thereto, will be a trustee for the owners of all Bonds Outstanding and is empowered to exercise all the rights and powers conferred on the Bondowners' Trustee.

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

first, to the payment of the charges, expenses, advances and compensation of the Bondowners' Trustee and the charges, expenses, counsel fees, disbursements and compensation of its agents and attorneys; and

second, to the payment to the persons entitled thereto, first of required interest and then, of unpaid principal amounts on any Bonds which shall have become due (other than Bonds previously called for redemption for the payment of which money is held pursuant to the provisions of the Resolution), whether at maturity or by proceedings for redemption or otherwise, in the order of their due dates and, if the amount available 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 Bonds shall have any right to institute any action, suit or proceeding at law or in equity for the enforcement of same unless: (i) an Event of Default has happened and is continuing; and (ii) a Bondowners' Trustee has been appointed; and (iii) such owner previously shall have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted; and (iv) the owners of 25% in principal amount of the Bonds Outstanding, after the occurrence of such Event of Default, has made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; and (v) there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and (vi) the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time; provided that the limitations in subsections (ii) through (iv) shall not apply if a Bondowner's Trustee is not appointed within 30 days following the occurrence of such Event of Default.

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

#### **Defeasance; Discharge of Liens And Pledges**

The obligations of the District and the liens, pledges, charges, trusts, assignments, covenants and agreements of the District made or provided for in the Resolution shall be fully discharged and satisfied as to any Bond and such Bond shall be deemed to be no longer Outstanding under the Resolution: (1) when such Bond shall have been cancelled, or shall have been surrendered for cancellation or is subject to cancellation or; (2) when payment of the principal of and premium, if any, on such Bond, plus interest on such principal to the due date thereof (whether such due date be by reason of maturity or upon redemption through the application of mandatory sinking fund installments or optional redemption or prepayment or otherwise), either (a) shall have been made or caused to be made in accordance with the terms thereof, or (b) shall have been provided by depositing with the Escrow Trustee, in a special trust account, and appropriating and setting aside exclusively for such payment, either (i) money sufficient to make such payment or (ii) Governmental Obligations maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient money to make such payment, or (iii) a combination of both such money and such Governmental Obligations, whichever the District deems to be in its best interest.

At such time as a Bond shall be deemed to be no longer Outstanding, such Bond, except for the purpose of any such payment from such money or Governmental Obligations, shall no longer be secured by or entitled to the benefits of the Resolution. In the case of a Bond which is to be redeemed or otherwise prepaid prior to its stated maturity, no deposit described under clause (2)(b) above shall constitute such payment, discharge and satisfaction as aforesaid until such Bond shall have been irrevocably designated for redemption or prepayment. If money or Governmental Obligations have been deposited with the Escrow Trustee for the payment of a specific Bond and such Bond shall be deemed to have been paid and be no longer Outstanding, but such Bond shall not have in fact been actually paid in full, no amendment to the provisions summarized above shall be made without the consent of the owner of each Bond affected thereby.

If the 1995 Generation System Bonds are defeased pursuant to the Resolution, only the following securities may be used for such defeasance: (1) Cash, (2) U.S. Treasury Certificates, Notes and Bonds (including State and Local Government Series -- "SLGS"), (3) Direct obligations of the Treasury which have been stripped by the Treasury itself, CATS, TIGRS and similar securities, (4) Resolution Funding Corp. (REFCORP). Only the interest component of REFCORP strips which have been stripped by request to the Federal Reserve Bank of New York in book entry

form are acceptable, (4) Pre-refunded municipal Bonds rated “Aaa” by Moody’s and “AAA” by S&P. If however, the issue is only rated by S&P and not by Moody’s, then the pre-refunded Bonds must have been pre-refunded with cash, direct U.S. or U.S. guaranteed obligations, or AAA rated pre-refunded municipals to satisfy this condition, (5) Obligations issued by the following agencies which are backed by the full faith and credit of the U.S.: (a) Direct obligations or fully guaranteed certificates of beneficial ownership of the U.S. Export-Import Bank (Eximbank); (b) Certificates of beneficial ownership of Farmers Home Administration (FmHA); (c) Federal Financing Bank; (d) Participation certificates of the General Services Administration; (e) Guaranteed Title XI financing of U.S. Maritime Administration; (f) Project Notes, Local Authority Bonds, New Communities Debentures - U.S. government guaranteed debentures, and U.S. Public Housing Notes and Bonds - U.S. government guaranteed public housing notes and Bonds of the U.S. Department of Housing and Urban Development (HUD); and (g) Any other securities approved by the Insurer and permitted by state law.

If the District defeases the 2001 Generation System Bonds pursuant to the Resolution, only Acquired Obligations (as defined in the Resolution) shall be used to effect the defeasance or refunding of the 2001 Generation System Bonds.

## **APPENDIX C**

### **SUMMARY OF CERTAIN PROVISIONS OF THE SENIOR ELECTRIC SYSTEM BOND RESOLUTION**

The following summary is an outline of certain provisions of the Senior Electric System Bond Resolution, is not to be considered a full statement thereof and is qualified by reference to the complete Senior Electric System Bond Resolution. All capitalized words or phrases (other than those conventionally capitalized) used in this summary are defined in the Senior Electric System Bond Resolution. Certain of those definitions are summarized below. For purposes of this Appendix, "Bonds" means Senior Electric System Bonds.

#### **Certain Definitions**

"Annual Debt Service" for any Fiscal Year means the sum of the amounts required to be paid in such Fiscal Year to pay: (a) the interest due in such Fiscal Year on all Outstanding Bonds, excluding interest to be paid from the proceeds of sale of Bonds or other bonds; and (b) the principal of all Outstanding Serial Bonds due in such Fiscal Year; and (c) the Sinking Fund Requirement, if any, for such Fiscal Year. The Senior Electric System Bond Resolution specifies how debt service is calculated for Capital Appreciation Bonds, Deferred Income Bonds, Tender Option Bonds and Variable Interest Rate Bonds.

"Code" means the Internal Revenue Code of 1986 as amended, and applicable regulations.

"Electric System" means the electric utility 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 or conservation of power and energy 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 properties, rights and assets and declared by the Commission to be included in the Electric System, but shall not include the Generation System or any other properties, rights or assets, real or personal, tangible or intangible that hereafter may be purchased, constructed or otherwise acquired by the District as a system that is declared by the Commission 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 system or otherwise may be pledged to the payment of the bonds of another such separate system of the District. Once the Electric System 1999 Bonds, the 1995 Generation System Bonds and the 2001 Generation System Bonds are no longer Outstanding, the District may, by resolution, combine the Generation System and the Electric System into a single system.

Upon consolidation of the Electric System and Generation System, the Bonds shall have a lien on revenues of the consolidated System equal to the lien thereon of any then outstanding senior lien revenue bonds of the Generation System and subject to the lien thereon of the costs of operation and maintenance of the consolidated System. Prior to consolidating the Electric System and the Generation System, the District must obtain confirmation from each rating agency then rating the Bonds that the consolidation will not adversely impact the then current rating(s) on the Bonds. In addition, the District must obtain an opinion of bond counsel that the consolidation will not adversely affect the tax-exempt status of any Outstanding Bonds.

"Electric System Costs" means costs of additions, betterments, extensions, renewals, repairs, replacements and extraordinary operating expenses of the Electric System and all costs incident thereto, including but not limited to engineering, financing, or legal costs.

"Net Revenues" means, for any period, the excess of Revenues over Operating Expenses for such period excluding from the computation of Operating Expenses any expenses paid from insurance proceeds and excluding from the computation of Revenues (a) any profit or loss derived from the sale or other disposition, not in the ordinary course of business, of investments or fixed or capital assets of the Electric System, or resulting from the early extinguishment of debt; and (b) any other extraordinary, nonrecurring income or donation other than the proceeds of insurance intended to replace Revenues.

“Operating Expenses” means all the District’s expenses for operation and maintenance of the Electric System, including all operation and maintenance expenses as defined by generally accepted accounting principles and shall include, without limiting the generality of the foregoing, (a) all amounts required to be paid to the United States with respect to the Bonds pursuant to Section 148 of the Code; (b) Resource Obligations for any month in which any power and energy or other goods and services from such Resource Obligation were made available to the Electric System during such month (regardless of whether or not the Electric System actually scheduled or received energy from the Resource Obligation during such month); and (c) so long as any Generation System Bond is Outstanding, the amounts covenanted in the Generation System Resolution to be paid into the Generation System Revenue Fund with respect to Generation System Power Costs on or prior to the last day of any month during which any power and energy or other goods and services from the Generation System were made available to the Electric System during such month (regardless of whether or not the Electric System actually scheduled or received energy from the Generation System during such month). Operating Expenses shall not include any extraordinary, nonrecurring expenses of the Electric System, any judgments or amounts to be paid in settlement of claims against the Electric System, any costs or expenses for new construction for the Electric System, interest on bonds or other obligations of the Electric System, amortization or any allowance for depreciation.

“Outstanding” when used with respect to Bonds means, as of any date, Bonds theretofore or thereupon issued pursuant to the Electric System Resolution except: (i) any Bonds cancelled by the Registrar or paid at or prior to such date; (ii) Bonds for which other Bonds have been substituted; and (iii) Bonds that have been defeased.

“Parity Lien Obligations” means all charges and obligations against Revenues ranking on a parity of lien with the Bonds, including but not limited to Generation System Power Costs or Resource Obligations for any month such Costs or such Obligations are not eligible for payment as Operating Expenses. “Parity Lien Obligations” does not include Bonds.

“Permitted Investments” means the following to the extent the same are legal for investments of funds of the District: (a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed by, the United States, including obligations of any of the federal agencies set forth in clause (b) below to the extent unconditionally guaranteed by the United States; (b) obligations of the Export-Import Bank of the United States, the Government National Mortgage Association, the Federal National Mortgage Association to the extent guaranteed by the Government National Mortgage Association, the Federal Financing Bank, the Farmers Home Administration, the Federal Housing Administration, the Private Export Funding Corporation, the Federal Home Loan Bank, and the Federal Home Loan Mortgage Bank, or any agency or instrumentality of the Federal Government which shall be established for the purposes of acquiring the obligations of any of the foregoing or otherwise providing financing therefor; (c) new housing authority bonds issued by the public agencies or municipalities and fully secured as to the payment of both principal and interest by a pledge of annual contributions under an annual contributions contract or contracts with the United States; or project notes issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States; (d) direct and general obligations of any State within the territorial United States, to the payment of the principal of and interest on which the full faith and credit of such State is pledged, provided, that at the time of their purchase, such obligations are rated in one of the two highest rating categories by either Moody’s Investors Service (“Moody’s”) or Standard & Poor’s Ratings Services (“S&P”) or in the event each of such rating agencies rates such obligations, by each of them; (e) certificates of deposit, whether negotiable or nonnegotiable, issued by any bank, savings and loan association, or trust company, provided that such certificates of deposit shall be (i) continuously and fully insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or (ii) issued by a recognized qualified public depository of the State of Washington under RCW Chapter 39.58, as amended, or (iii) continuously and fully secured by such securities as are described above in clauses (a) or (b), which shall have a market value (exclusive of accrued interest) at all times at least equal to the principal amount of such certificates of deposit or (iv) certificates of deposit with domestic commercial banks which have a rating on their short-term certificates of deposit on the date of purchase of “A-1” or “A-1+” by S&P and “P-1” by Moody’s; (f) any written repurchase agreement with any bank, savings institution or trust company which is insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or with any brokerage dealer with retail customers which falls under Securities Investors Protection Corporation protection, provided that such repurchase agreements

are fully secured by direct obligations of the United States of America, and provided further that (i) such collateral is held by the District or its agent or trustee during the term of such repurchase agreement, (ii) such collateral is not subject to liens or claims of third parties, (iii) such collateral has a market value (determined at least once weekly) at least equal to 100% of the amount invested in the repurchase agreement, (iv) the District or its agent or trustee has a perfected first security interest in the collateral, (v) the agreement shall be for a term not longer than 270 days and (vi) the failure to maintain such collateral at the level required in (iii) above will require the District or its agent or trustee to liquidate the collateral; (g) Refunded Municipals; (h) banker's acceptances with commercial banks that have a rating on their short-term certificates of deposit on the date of purchase of "A-1" or "A-1 +" by S&P or "P-1" by Moody's, or in the event each of such rating agencies rates such obligations, by each of them, and that mature no more than 360 days after the date of purchase; and (i) any investments or investment agreements permitted under the laws of the State of Washington as amended from time to time.

"Qualified Insurance" means any municipal bond insurance policy or surety bond issued by a licensed insurance company that at the time of issuance of the policy or surety bond is rated in one of the two highest rating categories by Moody's Investors Service or Standard & Poor's Ratings Services, or if rated by both, by each of them.

"Reserve Account Requirement" means (a) with respect to a series of Bonds, the lesser of (i) 10% of the proceeds of such series of Bonds or (ii) the maximum amount of interest due in any Fiscal Year on such series of Bonds, calculated as of their date of issuance and (b) with respect to all Bonds, the sum of the Reserve Account Requirements for all series of Bonds. A Supplemental Resolution may establish a separate reserve account for Bonds or provide that Bonds be secured by a common reserve account other than the Reserve Account, in either of which case such Bonds shall not be secured by the Reserve Account created hereunder. If the District establishes a separate reserve account for a series of Bonds, "Reserve Account Requirement" means with respect to a series of Bonds, an amount set forth in the Supplemental Resolution authorizing such Bonds. The Senior Electric System Bond Resolution specifies how interest is calculated for Variable Interest Rate Bonds.

"Resource Obligation" means an obligation of the District to pay the following costs associated with a resource from 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 Revenues on a parity of lien with the Bonds and any other obligation required or permitted pursuant to the Senior Electric System Bond Resolution or any Supplemental Resolution to be paid on a parity of lien with the Bonds:

(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.

"Revenues" means all income, revenues, receipts and profits derived by the District through the ownership and 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, in connection with the ownership and operation of the Electric System, exclusive of insurance proceeds compensating the District for the loss of a capital asset and income derived from investments irrevocably pledged to the payment of any Bonds defeased or other bonds defeased, or the payment of which is provided for, under any similar provision of any other bond resolution of

the District, and exclusive of investment income earned on money in any fund or account created for the purpose of complying with the rebate provision of Section 148 of the Code.

“Serial Bonds” means Bonds falling due by their terms in specified years, for which no Sinking Fund Requirements are mandated.

“Sinking Fund Requirement” means, for any Fiscal Year, the principal amount and premium, if any, of Term Bonds required to be purchased, redeemed or paid at maturity or paid into any sinking fund account for such Fiscal Year as established by the Supplemental Resolution authorizing the issuance of such Term Bonds.

“Term Bonds” means Bonds of any principal maturity that are subject to mandatory redemption or for which Sinking Fund Requirements are mandated.

## **Funds and Accounts**

### *Revenue Fund*

The District has pledged to pay all Revenues into the Revenue Fund except as specifically provided in the Senior Electric System Bond Resolution. The Revenue Fund consists of the General Account and the Rate Stabilization Account. All Electric System Revenues paid into the Electric System Revenue Fund are first to be credited to the General Account and applied as follows:

First, to pay Operating Expenses of the Electric System;

Second, to pay amounts as follows equally and without priority: (i) to deposit in the interest account, principal account and reserve account in the bond fund for the Electric System the amounts required by the Senior Electric System Bond Resolution in the order of priority established by the Senior Electric System Bond Resolution; (ii) to pay all Parity Lien Obligations (as defined in the Senior Electric System Bond Resolution) including, so long as any Generation System Bond is outstanding, the obligation to deposit in the Revenue Fund the amounts required by the Generation System Resolution to be paid on or prior to the last day of each month with respect to Generation System Power Costs; and (iii) in the event the District has entered into a reimbursement agreement pursuant to the Senior Electric System Bond Resolution that ranks on a parity of lien with the Bonds, to make all payments required to be made pursuant to such reimbursement agreement in connection with a qualified letter of credit, qualified insurance, or other credit facility, provided that if there is not sufficient money to make all payments under more than one reimbursement agreement, the payments shall be made on a pro rata basis;

Third, to make all payments required to be made into any junior lien fund or account in the order of priority, if any, set forth in the resolution of the Commission creating such junior lien fund or account; and

Fourth, to make additions, betterments, extensions, renewals, replacements and other capital improvements to the Electric System.

To the extent that Electric System Revenues remain after the payments required to be made out of the General Account in the Electric System Revenue Fund, the District may credit the full amount of such surplus to the Rate Stabilization Account in the Electric System Revenue Fund to be applied as set forth in the Senior Electric System Bond Resolution.

After all the above payments and credits have been made, amounts remaining in the Electric System Revenue Fund may be used for any other lawful purpose of the District, including the purchase of outstanding Bonds for retirement only.

### *Bond Fund*

The District has covenanted, as long as any Bonds are Outstanding, to make payments as follows:



(1) Into the Interest Account, not later than the day prior to the day on which any installment of interest falls due, an amount sufficient to pay such installment of interest falling due.

(2) Into the Principal Account, not later than the day prior to the day on which any installment of principal on Serial Bonds or any Sinking Requirement on Term Bonds falls due, an amount sufficient to pay such installment of principal or such Sinking Fund Requirement.

(3) Into the Reserve Account from money received upon the delivery of each series of Bonds (but not to exceed the amount permitted by the Code), the amount that together with other money meets the Reserve Account Requirement. The District has reserved the rights to substitute Qualified Insurance or a Qualified Letter of Credit (as defined in the Senior Electric System Bond Resolution) to satisfy the Reserve Account Requirement for any Bonds provided that the letter of credit or insurance is not cancelable on less than five years notice. If the amount in the Reserve Account is less than the Reserve Account Requirement, the District shall have 12 months to restore the Reserve Account to the Reserve Account Requirement. Money in the Reserve Account is to be applied to make up a deficiency in the Interest Account or the Principal Account.

Money in the Bond Fund shall be invested in Permitted Investments (as defined in the Senior Electric System Bond Resolution).

#### *Construction Fund*

The proceeds from the sale of the Bonds (other than any accrued interest received and amounts deposited into the Reserve Account) issued to pay Electric System Costs or to repay advances for Electric System Costs are to be deposited in the Construction Fund.

#### **Additional Indebtedness**

##### *Additional Bonds*

Additional series of Bonds may be issued for a lawful corporate purpose of the District only if at the time of the delivery of each series of Bonds to the initial purchasers:

(1) There is no deficiency in the Bond Fund or in any of the accounts therein, provision has been made to meet the Reserve Account Requirement with respect to such series of Bonds and no Event of Default has occurred and is continuing; and

(2) One of the two following certificates has been filed with the Secretary of the Commission;

(a) a certificate of the Treasurer stating that Net Revenues in any 12 consecutive months out of the most recent 24 months preceding the delivery of the Bonds then proposed to be issued (the "Base Period"), after deducting amounts paid in the Base Period to satisfy all Parity Lien Obligations and, for so long as the Reserve Policy is in effect, to pay all Policy Costs, were not less than 125% of maximum Annual Debt Service in any future Fiscal Year on all Outstanding Bonds and the Bonds then proposed to be issued (provided that (i) in the event that any adjustment in the rates, fees and charges for the services of the Electric System will be effective at any time on or prior to the date of delivery of the Bonds then proposed to be issued or within 60 days subsequent to the delivery, the Treasurer shall reflect in his or her certificate the Net Revenues he or she calculates would have been collected in the Base Period if such new rates, fees and charges had been in effect for the entire Base Period and (ii) with respect to any Variable Interest Rate Bonds Outstanding on the date such certificate is delivered, the Treasurer must estimate the debt service on such Bonds in accordance with the Senior Electric System Bond Resolution), or

(b) a certificate of the Professional Utility Consultant setting forth:

(i) the amount of the Adjusted Net Revenues computed as provided in the Senior Electric System Bond Resolution, after deducting amounts paid from Revenues in the Base Period to satisfy all Parity Lien Obligations; and

(ii) the amount of maximum Annual Debt Service in any Fiscal Year thereafter on account of all Bonds to be Outstanding in such Fiscal Year, including the Bonds proposed to be issued, and stating that the amount shown in (i) above is not less than 125% of the amount shown in this paragraph (ii).

The District may contract with the entity providing a Qualified Letter of Credit or Qualified Insurance for the Reserve Account that the District's reimbursement obligation to such entity ranks on a parity of lien with the Bonds. In the event that the District elects additionally to secure any issue of Variable Interest Rate Bonds or Tender Option Bonds through the use of a letter of credit or other credit enhancement device, the District may contract with the entity providing such 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 additional Bonds and assuming that such credit enhancement device were to be drawn upon for the full amount available, such Bonds could be issued in compliance with the provisions described above for issuing additional Bonds.

#### *Refunding Bonds*

The District may issue Refunding Bonds if it complies with the requirements set forth in paragraph (2) above or if there is on file a certificate of the Treasurer of the District stating that immediately after the issuance of such Refunding Bonds the Annual Debt Service in any Fiscal Year that Bonds (other than such Refunding Bonds) are then Outstanding shall not be increased by more than \$5,000 by the issuance of such Refunding Bonds.

#### *Junior Lien Bonds*

The District may issue bonds, notes, certificates or other evidences of indebtedness for any corporate use or purpose of the District payable from Revenues subordinate to the payments required to be made from the Revenue Fund into the Bond Fund for the Bonds.

#### *Generation System Bonds*

The District may issue Generation System Bonds in accordance with the requirements of the Generation System Resolution. See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM RESOLUTION—Additional Indebtedness."

#### *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 any 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 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; and

(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, provided that the Professional Utility Consultant shall for purposes of such estimate include all Generation System Power Costs and Resource Obligations in 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 the District and all other parties to the contract, respectively, which respective 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.

### **Defeasance of Bonds**

The District may refund or defease all or a portion of the then Outstanding Bonds by setting aside in a special fund money, Government Obligations and/or Refunded Municipals sufficient, together with known earned income, to accomplish the refunding or defeasance. In that case all rights of the owners of the defeased or refunded Bonds in the benefit or security of the Senior Electric System Bond Resolution will cease, except that such owners will have the right to receive payment of the principal of, premium, if any, and interest on their Bonds.

### **Certain Covenants**

#### *Rate Covenants*

General. The District has covenanted to establish, maintain and collect rates and charges for services, facilities and commodities sold, furnished or supplied through the facilities of the Electric System that shall be adequate to provide Revenues sufficient for the proper operation and maintenance of the Electric System, including payment of all Generation System Power Costs required by the Generation System Resolution to be paid as an Operating Expense of the Electric System and all Resource Obligations required to be paid as an Operating Expense of the Electric System and all necessary repairs, replacements and renewals of the Electric System, including the payment of all taxes, assessments or other governmental charges lawfully imposed on the Electric System or the revenues therefrom, or payment in lieu thereof, for the punctual payment of the principal of, premium, if any, and interest on the Bonds for which payment has not otherwise been provided, for all other payments that the District is obligated to make into the Bond Fund, for the payment of Parity Lien Obligations, for the payment of amounts required to repay draws under the Reserve Policy and related expenses for so long as the Reserve Policy is in effect and for the payment of all other amounts that the District may now or hereafter become obligated to pay from the Revenues by law or contract.

Debt Service Coverage. The District has also covenanted to establish, maintain and collect rates and charges that shall be adequate to provide in each Fiscal Year Net Revenues (after deducting therefrom amounts paid in such Fiscal Year to satisfy all Parity Lien Obligations and amounts transferred to the Rate Stabilization Account from the General Account and adding thereto amounts transferred to the General Account from the Rate Stabilization Account during such Fiscal Year) in an amount equal to at least 1.25 times the Annual Debt Service on the then Outstanding Bonds in such Fiscal Year.

### *Maintenance and Repair of Electric System*

The District has covenanted in the Senior Electric System Bond Resolution to operate the properties and business of the Electric System in an efficient manner and at reasonable cost; to maintain, preserve, and keep the properties of the Electric System in good repair, working order and condition; and to make all necessary and proper repairs, renewals, replacements, additions, improvements, betterments and extensions of and to the Electric System.

### *No Free Service; Enforcement of Accounts Owning*

Except as permitted by statute, the District will not supply electric power or energy free of charge to any other system of the District or to any person or entity and the District will promptly enforce the payment of all accounts owing to the District by reason of the Electric System.

### *Disposition of All or Part of the Electric System*

The District will not, nor will it permit others to, sell, mortgage, lease or otherwise dispose of or encumber all or any portion of the Electric System except:

(1) The District may dispose of all or substantially all of the Electric System, provided that simultaneously 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 the Professional Utility Consultant stating that such disposition will not impair the ability of the District to comply with the rate covenants previously set forth under this heading; or

(b) provision is made for the payment, redemption or other retirement of a principal amount of 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 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 Revenues attributable to the part of the Electric System sold or disposed of for the 12 preceding months bears to the total Revenues for such period; or

(ii) An amount which will be in the same proportion to 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.

(3) 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 use in the operation of the Electric System.

(4) If the ownership of all or part of the Electric System is transferred from the District through the operation of law, the District shall reconstruct or replace the portion using any proceeds of the transfer unless the Commission determines that such reconstruction or replacement is not in the best interests of the District and the bondowners, in which case any proceeds shall be used to retire Bonds prior to maturity.

### *Insurance*

The District will either insure or self-insure the Electric System against risks, accidents or casualties, at least to the extent that insurance is usually carried by municipal corporations operating like properties.

### *Books of Account*

The District will keep proper books of account, which will be audited annually by a Certified Public Accountant or by the Washington State Auditor's office. Any bondowner may obtain at the office of the District copies of the District's balance sheet and statement of income and retained earnings showing in reasonable detail the financial condition of the Electric System as of the close of each Fiscal Year.

### *To Make Economically Sound Improvements and Extensions*

The District will not expend any of the revenues derived by it from the operation of the Electric System or the proceeds of Bonds for any renewals, replacement, capital additions, improvements, betterments or extensions that are not economically sound or that will not properly and advantageously contribute to the conduct of the business of the Electric System in an efficient and economical manner unless required to do so by or pursuant to law so as to permit the continued operation of the Electric System. Nothing in this section shall prohibit or be construed to prohibit the District from transferring revenues of the Electric System to any fund or account created by the Generation System Resolution or by any resolution creating any other separate system of the District in accordance with the provisions thereof.

### *To Pay Principal, Premium and Interest on Bonds*

The District will duly and punctually pay, or cause to be paid, solely from the Revenues and other moneys pledged herein to the payment thereof, the principal, premium, if any, and interest on each and every Bond on the date and at the places and in the manner provided in the Bonds, according to the true intent and meaning thereof, and will faithfully do and perform and fully observe and keep any and all covenants, undertakings, stipulations and provisions contained in the Bonds and in the Resolution.

### *Protection of Security.*

The Revenues and other moneys, securities and funds pledged by the Resolution are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Resolution, except as otherwise expressly provided in the Resolution, and all corporate action on the part of the District to that end has been duly and validly taken. The Bonds and the provisions of the Resolution are and will be valid and legally enforceable obligations of the District in accordance with their terms and the terms of the Resolution. The District shall at all times, to the extent permitted by law, defend, preserve and protect the pledge of the Revenues, other moneys, securities and funds pledged under the Resolution and all the rights of the bondowners under the Resolution against all claims and demands of all persons whomsoever.

### *Authority of District to Provide for the Operation and Maintenance of the Electric System and to Fix and Collect Rates and Charges*

The District has good, right and lawful power to provide for the operation and maintenance of the Electric System and to fix, establish, maintain and collect rates and charges for the power and energy and other services, facilities and commodities sold, furnished or supplied through the facilities of the Electric System.

### *Payment of Taxes, Assessments and Other Governmental Charges and Payments in Lieu Thereof; Payment of Claims*

The District shall, from time to time, duly pay and discharge, or cause to be paid or discharged, all taxes, assessments or other governmental charges, or payments in lieu thereof, lawfully imposed upon the Electric System, or on the revenues, income, receipts, profits or other moneys derived by the District therefrom when the same shall

become due, and all lawful claims for labor and materials and supplies that, if not paid, might become a lien or charge upon such properties, or any part thereof, or upon the Revenues and other moneys derived by the District directly or indirectly from the Electric System, or that might in any way impair the security of the obligations issued by the District payable from the Revenues and other moneys, except those assessments, charges or claims that the District shall in good faith contest by proper legal proceedings.

#### *Merger, Consolidation or Dissolution*

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

#### **Trustee**

U.S. Bank National Association is appointed to act as Stand-by Trustee for the owners of all Bonds for the purposes set forth in the Senior Electric System Bond Resolution. The Stand-by Trustee may resign upon 45 days' notice mailed to each bondowner or published once. Such resignation shall take effect upon the appointment of a new Stand-by Trustee. The Stand-by Trustee may be discharged by the District as long as an Event of Default has not occurred and is continuing or by the owners of a majority of the Outstanding Bonds. If the Stand-by Trustee resigns or is discharged the District shall appoint a new Stand-by Trustee. At any time within one year after such appointment, the owners of a majority in principal amount of the Bonds then Outstanding may appoint a successor Stand-by Trustee, which shall supersede any Stand-by Trustee appointed by the District. Once the Electric System 1999 Bonds are no longer Outstanding, the District is not required to appoint a Stand-by Trustee. The Bondowners may appoint a Bondowners' Trustee in an Event of Default. See "Events of Default and Remedies – Bondowners' Trustee."

#### **Events of Default and Remedies**

##### *Events of Default*

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

- (1) Default in the due and punctual payment of the principal of any of the Bonds within five days when the same becomes due;
- (2) Default in the due and punctual payment of interest on any of the Bonds within five days when the same becomes due;
- (3) Failure to provide for any required Sinking Fund Requirements within five days when the same becomes due;
- (4) Default under any agreement with respect to a Qualified Letter of Credit or Qualified Insurance or other credit enhancement device providing security for the Bonds, which results in suspension, expiration or termination of the payment obligation of the issuer of the device and the District within ten days of such suspension, expiration or termination of payment obligations fails to obtain a substitute credit enhancement device or take other measures to remedy such default;
- (5) Default in the observance of any other of the covenants, conditions and agreements in the Senior Electric System Bond Resolution and such default continues for 90 days after the District receives from the Stand-by Trustee or from the owners of not less than 66% in principal amount of any series of Bonds Outstanding a written notice specifying and demanding the cure of such default; or
- (6) If the District shall admit in writing its inability to pay its debts as they become due, file a petition in bankruptcy, make an assignment for the benefit of its creditors, or consent to the appointment of a receiver for the Electric System.

### *Payment of Funds to Stand-by Trustee*

If an Event of Default is not remedied, the District, upon demand of the Stand-by Trustee, shall pay to the Stand-by Trustee only to the extent necessary to cure the Event of Default all funds held by the District and pledged under the Senior Electric System Bond Resolution and Revenues upon receipt. The Stand-by Trustee shall apply the funds in accordance with the Senior Electric System Bond Resolution.

### *Application of Funds by Stand-by Trustee*

During the continuance of an Event of Default the Revenues received by the Stand-by Trustee pursuant to the Payment of Funds to Stand-by Trustee provisions above shall be applied by the Stand-by Trustee, first, to the payment of the reasonable and proper charges, expenses and liabilities paid or incurred by the Stand-by Trustee (including the cost of securing the services of any engineer or firm of engineers selected for the purpose of rendering advice with respect to the operation, maintenance, repair and replacement of the necessary to prevent any loss of Revenues, and with respect to the sufficiency of the rates and charges for power and energy sold, furnished or supplied by the Electric System), and second, in accordance with the provisions of this section concerning Application of Funds by Stand-by Trustee.

In the event that at any time the funds held by the Stand-by Trustee and the Paying Agent for the Bonds shall be insufficient for the payment of the principal of, premium, if any, and interest then due on the Bonds, such funds (other than funds held for the payment or redemption of particular Bonds which have theretofore become due at maturity or by call for redemption) and all Revenues and other moneys received or collected for the benefit or for the account of owners of the Bonds by the Stand-by Trustee shall be applied as follows: First, to the payment to the persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, earliest maturities first, and, if the amount available shall not be sufficient to pay in full any installment or installments or interest maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the persons entitled thereto, without any discrimination or preference; and Second, to the payment to the persons entitled thereto of the unpaid principal and premium, if any, of any Bonds that shall have become due, whether at maturity or by call for redemption, in the order of their due dates, earliest maturities first, and, if the amount available shall not be sufficient to pay in full all the Bonds due on any date, then to the payment thereof ratably, according to the amounts of principal and premium, if any, due on such date, to the persons entitled thereto, without any discrimination or preference.

### *Remedies*

The Stand-by Trustee may, if an Event of Default is not remedied, take such steps and institute such proceedings as it deems appropriate to collect all sums owing and to protect the rights of bondowners. The owners of the Bonds shall be deemed to irrevocably appoint the Stand-by Trustee as the lawful trustee of the bondowners. The owners of at least 66% of the Outstanding Bonds may, in certain circumstances, direct the time, method and place of conducting any proceedings for any remedy available to the Stand-by Trustee or exercising any power conferred upon the Stand-by Trustee.

No bondowner may institute any proceeding for the enforcement of the Senior Electric System Bond Resolution unless an Event of Default is continuing and the owners of not less than 66% of the Outstanding Bonds have given the District and the Stand-by Trustee written notice to institute such proceeding and the Stand-by Trustee has refused to comply.

### *Bondowners' Trustee*

Once the Electric System 1999 Bonds are no longer outstanding, 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 Bonds Outstanding. Any Bondowners' Trustee must be a bank or trust company organized under the laws of the State of New York or a national banking association. The bank or trust company acting as Bondowners' Trustee may be removed at any time, and a successor Bondowners' Trustee may be appointed, by the registered owners of a majority in principal amount of 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 appointed in the manner provided in the Senior Electric System Bond Resolution, and each successor thereto, will be a trustee for the owners of all Bonds Outstanding and is empowered to exercise all the rights and powers conferred on the Bondowners' Trustee.

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

first, to the payment of the charges, expenses, advances and compensation of the Bondowners' Trustee and the charges, expenses, counsel fees, disbursements and compensation of its agents and attorneys; and

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

Neither the registered owner nor the beneficial owner of any one or more of Bonds shall have any right to institute any action, suit or proceeding at law or in equity for the enforcement of same unless: (i) an Event of Default has happened and is continuing; and (ii) a Bondowners' Trustee has been appointed; and (iii) such owner previously shall have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted; and (iv) the owners of 25% in principal amount of the Bonds Outstanding, after the occurrence of such Event of Default, has made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; and (v) there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and (vi) the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time.

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

## **Supplemental Resolutions**

### *Supplemental Resolutions Without Consent of Bondowners*

The District may adopt a supplemental resolution authorizing the issuance of additional Bonds or a resolution amending or supplementing the Senior Electric System Bond Resolution (1) to add to the covenants and agreements of the District in the Senior Electric System Bond Resolution which will not adversely affect the interest of the bondowners or (2) to cure any ambiguities or correct any defective provisions in the Senior Electric System Bond Resolution or any supplemental resolution which shall not adversely affect the bondowners' interest.

### *Supplemental Resolutions With Consent of Bondowners*

With the consent of the owners of not less than 66% of the Outstanding Bonds, the District may adopt a resolution amending or supplementing the Senior Electric System Bond Resolution; provided, that, without the specific consent of the owner of each Bond that would be affected, no such supplemental resolution shall: (1) change the fixed maturity date for the payment of the principal of any Bond or the date for the payment of interest or the terms of the redemption thereof, or reduce the principal amount of any Bond or the rate of interest thereon or the redemption price (or the redemption premium) payable upon the redemption or prepayment thereof; (2) reduce the percentage of Bonds the owners of which are required to consent to any



Supplemental Resolution; (3) give to any Bond any preference over any other Bond; or (4) create any pledge of the Revenues superior or equal to the pledge of and lien and charge for the payment of the Bonds.

#### **Rights of Insurer**

Upon an Event of Default, the insurer for any series of Bonds shall be considered a Bondowner of all outstanding Bonds that it insures for purposes of the amendment provisions and remedies provisions of the Senior Electric System Bond Resolution so long as the bond insurance policy is in effect and the Insurer is not in default.

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**APPENDIX D**  
**PROPOSED FORM OF OPINION OF BOND COUNSEL**

[Closing Date]

Public Utility District No. 1 of  
Snohomish County, Washington  
Everett, Washington

Public Utility District No. 1 of Snohomish County, Washington  
Generation System Revenue Bonds, Series 2010B Taxable *Build America Bonds* (Direct Pay)  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the Public Utility District No. 1 of Snohomish County, Washington (the “District”) in connection with issuance of \$14,050,000 aggregate principal amount of Public Utility District No. 1 of Snohomish County, Washington Generation System Revenue Bonds, Series 2010B Taxable *Build America Bonds* (Direct Pay) (the “Bonds”), issued in accordance with Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington, Chapter 167 of the Laws of Washington, 1983, as amended and supplemented, constituting Chapter 39.46 of the Revised Code of Washington, and Resolution No. 3902 adopted by the Commission of the District (the “Commission”) on January 28, 1993 (the “Master Resolution”), as supplemented and amended, including as supplemented and amended by Resolution No. 5496, adopted by the Commission on April 20, 2010 (the “Eighth Supplemental Resolution”). The Master Resolution as amended and supplemented, including as amended and supplemented by the Eighth Supplemental Resolution is referred to herein as the “Resolution.” Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Resolution.

In such connection, we have reviewed the Resolution, the Tax Certificate of the District with respect to the Bonds, dated the date hereof (the “Tax Certificate”), opinions of counsel to the District, certificates of the District and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this opinion speaks only as of its date and is not intended to, and may not, be relied upon in connection with any such future actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to

update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the District. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution and the Tax Certificate. We call attention to the fact that the rights and obligations under the Bonds, the Resolution and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against public utility districts in the State of Washington. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or as subject to the lien of the Resolution or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such assets. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the District.

2. The Resolution has been duly adopted by, and constitutes the valid and binding obligation of, the District. The Resolution creates a valid pledge, to secure the payment of the principal of and interest on the Bonds, of Revenues and certain other funds and accounts as provided by the Resolution, subject to the provisions of the Resolution permitting the application thereof for the purposes, in the order of priority, and on the terms and conditions set forth therein.

3. The Bonds are special limited obligations of the District payable from and secured by Revenues, subject to the prior payment of Operating Expenses. The Bonds shall not in any manner or to any extent constitute general obligations of the District or the State of Washington, or of any political subdivision of the State of Washington. The Bonds are not a charge upon any general fund or upon any moneys or other property of the District or of the State of Washington, or of any political subdivision of the State of Washington, not specifically pledged thereto by the Resolution. Neither the full faith and credit nor the taxing power of the District, the State of Washington, or of any political subdivision of the State of Washington, are

pledged to the payment of the Bonds. The Bonds shall not constitute indebtedness of the District within the meaning of the constitutional and statutory provisions and limitations of the State of Washington.

4. Interest on the Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

**Circular 230 Disclaimer:**

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

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

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## APPENDIX E

### BOOK-ENTRY SYSTEM

*The following information (except for the final paragraph) 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 2010B Bonds. The 2010B 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 2010B Bond certificate will be issued for each maturity of the 2010B Bonds 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 Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non U.S. securities brokers and dealers, banks, and trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the 2010B Bonds under the DTC system, in denominations of \$5,000 or any integral multiple thereof within a maturity, must be made by or through Direct Participants, which will receive a credit for the 2010B Bonds on DTC's records. The ownership interest of each actual purchaser of each 2010B 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 2010B 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 2010B Bonds, except in the event that use of the book-entry system for the 2010B Bonds is discontinued.

To facilitate subsequent transfers, all 2010B 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 2010B Bonds with DTC and their

registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2010B Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2010B 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.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the 2010B 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 2010B Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments on the 2010B 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 (nor its nominee), the Bond Registrar, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. 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 2010B 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, 2010B 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, 2010B Bond certificates will be printed and delivered.

**So long as DTC acts as securities depository for the 2010B Bonds, 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 2010B Bonds with respect to (i) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any beneficial ownership interest in the 2010B Bonds; (ii) the delivery to any Participant or any other person, other than a bondowner as shown on the Books of Registry, of any notice with respect to the 2010B Bonds; (iii) the payment to any Participant or any other person, other than an Owner as shown on the Books of Registry, of any amount with respect to principal of or interest on the 2010B Bonds; (iv) any consent given action taken by DTC as registered owner; or (v) any other matter. The District and the Bond Registrar may treat and consider Cede & Co., in whose name each 2010B Bond is registered in the**



**Books of Registry, as the holder and absolute owner of such 2010B Bond for the purpose of payment of principal and interest with respect to such 2010B Bond, for the purpose of giving notices of other matters with respect to such 2010B Bond, for the purpose of registering transfers with respect to such 2010B 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 2010B Bonds.**

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## APPENDIX F

### FORM OF CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement (this “Disclosure Agreement”) dated as of May \_\_, 2010, is executed and delivered by Public Utility District No. 1 of Snohomish County, Washington (the “District”) and U.S. Bank National Association, as dissemination agent (the “Dissemination Agent”) for the benefit of the Owners and Beneficial Owners of the Bonds (each as defined below) in connection with the issuance of \$14,050,000 principal amount of Generation System Revenue Bonds, Series 2010B (the “Bonds”).

#### WITNESSETH:

WHEREAS, pursuant to Resolution No. 3902, adopted by the Board of Commissioners of the District (the “Commission”) on January 28, 1993 (the “Master Resolution”), as amended and supplemented by Resolution No. 5496, adopted by the Commission on April 20, 2010 (the “Eighth Supplemental Resolution” and together with the Master Resolution, the “Resolution”), the District has provided for the issuance of the Bonds;

NOW THEREFORE, the District covenants and agrees for the benefit of the Owners and Beneficial Owners of the Bonds as follows:

SECTION 1. Definitions. The following capitalized terms shall have the following meanings:

“Annual Report” shall mean any Annual Report provided by the District pursuant to, and as described in, Sections 3 and 4 of this Disclosure Agreement.

“Beneficial Owner” shall mean any person that (a) has or shares the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, or otherwise make investment decisions concerning ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

“Bond Register” shall have the meaning provided in the Resolution.

“Business Day” shall mean a day that is not a Saturday, Sunday or legal holiday on which banking institutions in the State of Washington or the State of New York are closed.

“Dissemination Agent” shall mean the U.S. Bank National Association, or any successor Dissemination Agent designated in writing by the District and that has filed with the District a written acceptance of such designation.

“Listed Events” shall mean any of the events listed in Section 5(a) of this Disclosure Agreement.

“Official Statement” shall mean the Official Statement with respect to the Bonds dated May 11, 2010.

“Owner,” whenever used herein with respect to a Bond, shall mean the Person in whose name the ownership of such Bond is registered on the Bond Register.

“Participating Underwriters” shall mean the original underwriters of the Bonds required to comply with the Rule in connection with offering of the Bonds.

“Person” shall mean an individual, corporation, firm, association, partnership, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

“Repository” or “MSRB” shall mean the Municipal Securities Rulemaking Board or any other entity designated or authorized by the SEC to receive reports pursuant to the Rule. Until otherwise designated by the MSRB or the SEC, filings with the MSRB are to be made through the Electronic Municipal Market Access (EMMA) website of the MSRB, currently located at <http://emma.msrb.org>.

“Rule” shall mean Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (the “1934 Act”), as the same may be amended from time to time.

“SEC” shall mean the Securities and Exchange Commission or any successor agency thereto.

“State” shall mean the State of Washington.

“Trustee” shall have the meaning provided in the Resolution.

SECTION 2. Purpose of the Disclosure Agreement. This Disclosure Agreement is being executed and delivered by the District and the Dissemination Agent for the benefit of the Owners and the Beneficial Owners of the Bonds and to assist the Participating Underwriters in complying with Section (b)(5) of the Rule.

SECTION 3. Provision of Annual Reports.

(a) The District shall, or shall cause the Dissemination Agent to, not later than nine months after the end of each fiscal year of the District, commencing with the fiscal year of the District ending December 31, 2010, provide to the Repository an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Agreement. The Annual Report must be submitted in electronic format, accompanied by such identifying information as is prescribed by the Repository, and may cross-reference other information as provided in Section 4 of this Disclosure Agreement; provided, that the audited financial statements of the District may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the District’s fiscal year changes, the District shall give notice of such change in the same manner as for a Listed Event under Section 5(f) of this Disclosure Agreement. The Annual Report shall be submitted on a standard form in use by industry participants or other appropriate form and shall identify the Bonds by name and CUSIP number.

(b) Not later than fifteen (15) Business Days prior to the date specified in Section 3(a) for providing the Annual Report to the Repository, the District shall provide the Annual Report to the Dissemination Agent (if the Dissemination Agent is other than the District). If by 15 Business Days prior to such date, the Dissemination Agent (if the Dissemination Agent is other than the District) has not received a copy of the Annual Report, the Dissemination Agent shall contact the District to determine if the District is in compliance with Section 3(a).

(c) If the Dissemination Agent is unable to verify that an Annual Report has been provided to the Repository by the date required in Section 3(a), the Dissemination Agent shall send a notice to the Repository in substantially the form attached hereto as Exhibit A.

(d) The Dissemination Agent (if the Dissemination Agent is other than the District) shall file a report with the District certifying that the Annual Report has been provided pursuant to this Disclosure Agreement, stating the date it was provided to the Repository.

SECTION 4. Content of Annual Reports. The District's Annual Report shall contain or include by reference the following:

- (a)
  - (i) The audited financial statements of the Electric System and the Generation System prepared in accordance with generally accepted accounting principles applicable to government entities, with regulations prescribed by FERC and substantially in accordance with the system prescribed by the Washington State Auditor pursuant to RCW 43.09.200 (or any successor statute); provided, that if the audited financial statements of the Electric System and Generation System are not yet available by the time the Annual Report is required to be provided to the Repository pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the Official Statement, and the audited financial statements shall be provided to the Repository in the same manner as the Annual Report when they become available;
  - (ii) The outstanding indebtedness of the Electric System, the Generation System and any other system of the District that provides power or capacity to either of these systems, to the extent not already included in the audited financial statements;
  - (iii) Electric System retail customers, energy sales, peak demand and revenues substantially in the form of the table "Electric System Customers, Energy Sales, and Peak Demand", to the extent not already included in the audited financial statements;
  - (iv) Electric System income statements, operating results and debt service coverage on the outstanding Electric System Bonds substantially in the form of the table "Electric System Operating Results", to the extent not already included in the audited financial statements;
  - (v) Electric System energy requirements, resources and purchased power costs substantially in the form of the tables "Electric System Purchased Power Costs" and "Electric System Energy Resources", to the extent not already included in the audited financial statements;
  - (vi) The aggregate amount and percentage of total energy sold and of retail revenues provided by the Electric System's ten largest customers, to the extent not already included in the audited financial statements; and
  - (vii) Generation System annual production and costs substantially in the form of the table under the caption "Generation System Net Project

and Annual Costs”, to the extent not already included in the audited financial statements.

(b) Any or all of the items listed in Section 4(a) may be set forth in one or a set of documents or may be incorporated by specific reference to documents, including official statements of debt issues of the District, that have been made available to the public on Repository’s website. The District shall clearly identify each such other document so included by reference.

The contents, presentation and format of the Annual Report may be modified from time to time as determined in the judgment of the District to conform to changes in accounting or disclosure principles or practices and legal requirements followed by or applicable to the District or to reflect changes in the business, structure, operations, legal form of the District or any mergers, consolidations, acquisitions or dispositions made by or affecting the District; provided, that any such modifications shall comply with the requirements of the Rule; provided further, that if the respective Annual Report is modified to conform to changes in accounting or disclosure principles, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting or disclosure principles and those prepared on the basis of the former accounting or disclosure principles.

#### SECTION 5. Reporting of Significant Events.

(a) The occurrence of any of the following events with respect to the Bonds shall be a Listed Event:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions or events affecting the tax status of the Bonds;
- (vii) modifications to rights of holders of the Bonds;
- (viii) Bond calls (other than mandatory scheduled redemptions, not otherwise contingent upon the occurrence of an event, including, but not limited to, sinking fund payments);
- (ix) defeasance;
- (x) release, substitution or sale of property securing repayment of the Bonds;  
or
- (xi) rating changes.

(b) The Dissemination Agent shall, promptly upon obtaining actual knowledge at the address listed in Section 12 of this Disclosure Agreement of the occurrence of any of the Listed Events, contact the District, inform the District of the event and request that the District promptly notify the Dissemination Agent in writing whether or not to report the event pursuant to subsection (f).

(c) Whenever the District obtains knowledge of the occurrence of a Listed Event, whether because of a notice from the Dissemination Agent pursuant to subsection (b) or otherwise, the District shall as soon as possible determine if such event would be material under applicable federal securities laws.

(d) If the District determines that knowledge of the occurrence of a Listed Event would be material under applicable federal securities laws, the District shall promptly notify the Dissemination Agent in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (f).

(e) If in response to a request under subsection (b), the District determines that the Listed Event would not be material under applicable federal securities laws, the District shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to Section 5(f).

(f) If the Dissemination Agent has been instructed by the District to report the occurrence of a Listed Event, the Dissemination Agent shall file a notice of such occurrence with the Repository in electronic format, accompanied by such identifying information as is prescribed by the Repository. Notwithstanding the foregoing, notice of the occurrence of a Listed Event described in Section 5(a)(viii) and (ix) need not be given under this Section 5(f) any earlier than the notice, if any, of the underlying event is given to Owners of affected Bonds pursuant to the Resolution, and notice of any other Listed Event is required only following the actual occurrence of the Listed Event.

(g) The Dissemination Agent may conclusively rely on an opinion of counsel that the District's instructions to the Dissemination Agent under this Section 5 comply with the requirements of the Rule.

SECTION 6. Termination of Reporting Obligation. The District's and the Dissemination Agent's obligations under this Disclosure Agreement shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the District shall give notice of such termination in the same manner as for a Listed Event under Section 5(f).

SECTION 7. Dissemination Agent. The District may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. Upon such discharge, however, a new Dissemination Agent must be appointed within 60 days. The Dissemination Agent may resign by providing 60 days' written notice to the District. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the District pursuant to this Disclosure Agreement. If at any time there is not any other designated Dissemination Agent, the District shall be the Dissemination Agent. The initial Dissemination Agent shall be U.S. Bank National Association.

SECTION 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Agreement, the District may amend this Disclosure Agreement, and any provision of this Disclosure Agreement may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of the obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Owners in the same manner as provided in the Resolution for amendments to the Resolution with the consent of Owners (other than amendments requiring the consent of every Owner affected), or (ii) does not, in the opinion of the Dissemination Agent or nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners.

In the event of any amendment or waiver of a provision of this Disclosure Agreement, the District shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the District. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(f), and (ii) the Annual Report for the year in which the change is made shall present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 9. Additional Information. Nothing in this Disclosure Agreement shall be deemed to prevent the District from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement. If the District chooses to include any information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is expressly required by this Disclosure Agreement, the District shall have no obligation under this Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

SECTION 10. Default. In the event of a failure of the District to comply with any provision of this Disclosure Agreement, the Dissemination Agent may (and, at the request of the Participating Underwriters or the Owners of at least 25% of aggregate principal amount of the Bonds then Outstanding, shall), or any Owner or Beneficial Owner of the Bonds may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the District to comply with its obligations under this Disclosure Agreement; provided, that any such action may be instituted only in a Washington State Court sitting in Snohomish County or in U.S. District Court for the Western District of Washington. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Resolution, and the sole remedy under this Disclosure Agreement in the event of any failure of the District to comply with this Disclosure Agreement shall be an action to compel



performance, and no Person shall be entitled to recover monetary damages under this Disclosure Agreement.

SECTION 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are expressly set forth in this Disclosure Agreement, and the District agrees, to the extent permitted by law, to indemnify and save the Dissemination Agent, or the employees and agents of the Dissemination Agent, harmless against any loss, expense and liabilities which the Dissemination Agent or such employees or agents may incur arising out of or in the exercise or performance of the Dissemination Agent's powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the District under this Section 11 shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

SECTION 12. Notices. Any notices or communications to or among any of the parties to this Disclosure Agreement may be given as follows:

To the District:

Public Utility District No. 1 of Snohomish County, Washington  
2320 California Street  
Everett, Washington 98201

To the initial Dissemination Agent:

U.S. Bank Corporate Trust Services  
1420 Fifth Avenue, 7th Floor  
Seattle, WA 98101  
Attention: Shirley Young  
Telephone: (206) 344-4686  
Fax: (206) 344-4630

Any person may, by written notice to the other persons listed above, designate a different address or telephone number(s) to which subsequent notices or communications should be sent.

SECTION 13. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the District, the Dissemination Agent, the Participating Underwriters and the Owners and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

SECTION 14. Governing Law. This Disclosure Agreement shall be governed by the laws of the State of Washington determined without regard to the principles of conflict of law.

IN WITNESS WHEREOF, the party hereto has caused this Disclosure Agreement to be executed by its proper officer thereunto duly authorized, as of the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1 OF  
SNOHOMISH COUNTY, WASHINGTON

By \_\_\_\_\_  
Authorized Representative

U.S. Bank National Association, as  
Dissemination Agent

By \_\_\_\_\_  
Authorized Signatory

**Exhibit A**

**NOTICE TO REPOSITORY OF FAILURE TO FILE ANNUAL REPORT**

Name of Issuer: Public Utility District No. 1 of Snohomish County, Washington (the "District")

Name of Issue: Generation System Revenue Bonds, Series 2010B

Date of Issuance: \_\_\_\_\_, 2010

NOTICE IS HEREBY GIVEN that the District has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Agreement, dated as of \_\_\_\_\_, 2010. [The District anticipates that the Annual Report will be filed by \_\_\_\_\_.]

Dated: \_\_\_\_\_

U.S. BANK NATIONAL ASSOCIATION,  
as Dissemination Agent

By \_\_\_\_\_  
Authorized Representative

cc: Public Utility District No. 1 of Snohomish County, Washington

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