

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2015 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. In the further opinion of Bond Counsel, interest on the 2015 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the 2015 Bonds. See “TAX MATTERS” herein.



\$140,920,000
PUBLIC UTILITY DISTRICT NO. 1
OF SNOHOMISH COUNTY, WASHINGTON
ELECTRIC SYSTEM REVENUE BONDS, SERIES 2015

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

The Electric System Revenue Bonds, Series 2015 (the “2015 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, 2015.

When issued, the 2015 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 2015 Bonds. Individual purchases will be made in book-entry form in authorized denominations, and purchasers of the 2015 Bonds will not receive certificates representing their interests in the 2015 Bonds. Payments of principal of and interest on the 2015 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 Trustee, Registrar and Paying Agent for the 2015 Bonds.

The 2015 Bonds are subject to redemption prior to maturity as described herein.

The 2015 Bonds are being issued (i) to finance additions, betterments and improvements to and renewals, replacements and extensions of the Electric System, (ii) to fund a deposit to the Reserve Account with respect to the 2015 Bonds and (iii) to pay costs of issuing the 2015 Bonds. See “PURPOSE AND APPLICATION OF 2015 BOND PROCEEDS.”

The 2015 Bonds are special limited obligations of the District payable from and secured solely by the Electric System Revenues subject to the prior payment of Operating Expenses of the Electric System. The 2015 Bonds are secured by a pledge of and lien and charge on Electric System Revenues equal to that of the Electric System Bonds (as defined herein) heretofore and hereafter issued pursuant to the Electric System Bond Resolution (as defined herein) and any Parity Lien Obligations (as defined herein).

The District is obligated to pay all costs of its Generation System (as defined herein, the “Generation System Power Costs”) (i) as Operating Expenses of the Electric System (and thus prior to payment of debt service on the Electric System Bonds) for any month in which any power and energy from the Generation System (as defined herein) is 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 as Parity Lien Obligations on a parity with the Electric System Bonds outstanding from time to time, including the 2015 Bonds. See “SECURITY FOR THE 2015 BONDS.”

The District has covenanted in the Generation System Bond Resolution (as defined herein) 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.

MATURITY SCHEDULE — See Inside Front Cover

The 2015 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 Electric 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 2015 Bonds.

This cover page is not intended to be a summary of all of the terms of, or security for, the 2015 Bonds. Investors are advised to read the entire Official Statement to obtain information essential to making an informed investment decision.

The 2015 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 Interim General Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, Foster Pepper PLLC, Seattle, Washington. Certain legal matters will be passed upon by Orrick, Herrington & Sutcliffe LLP, as Disclosure Counsel to the District. It is expected that delivery of the 2015 Bonds will be made through DTC in New York, New York, by Fast Automated Securities Transfer (FAST), on or about June 30, 2015.

Citigroup

BofA Merrill Lynch

Goldman, Sachs & Co.

MATURITY SCHEDULE

\$140,920,000

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON ELECTRIC SYSTEM REVENUE BONDS, SERIES 2015

\$24,660,000 Serial Bonds

Maturity Date <u>December 1</u>	Principal <u>Amount</u>	Interest <u>Rate</u>	<u>Yield</u> [*]	CUSIP <u>No. 833102</u> [†]
2016	\$ 3,935,000	5.00%	0.45%	YT7
2017	2,785,000	5.00	0.97	YU4
2018	2,445,000	5.00	1.31	YV2
2019	2,605,000	5.00	1.56	YW0
2020	2,935,000	5.00	1.82	YX8
2021	2,590,000	5.00	2.09	YY6
2022	2,420,000	5.00	2.30	YZ3
2023	1,730,000	5.00	2.48	ZA7
2025	3,215,000	5.00	2.78	ZB5

\$116,260,000 Term Bonds

\$43,135,000 5.00% Term Bonds due December 1, 2037 Priced to Yield 3.58%** (CUSIP No. 833102ZD1[†])

\$73,125,000 5.00% Term Bonds due December 1, 2040 Priced to Yield 3.68%** (CUSIP No. 833102ZC3[†])

* The yields have been provided by the Underwriters, and the District cannot and does not make any representations as to the accuracy thereof.

** Priced to a par call date of December 1, 2025.

[†] CUSIP® is a registered trademark of the American Bankers Association. CUSIP Global Services (CGS) is managed on behalf of the American Bankers Association by S&P Capital IQ. Copyright(c) 2015 CUSIP Global Services. All rights reserved. CUSIP® data herein is provided by CUSIP Global Services. This data is not intended to create a database and does not serve in any way as a substitute for the CGS database. CUSIP® numbers are provided for convenience of reference only. None of the District, the Underwriters or their agents or counsel assume responsibility for the accuracy of such 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 2015 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 2015 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.

The Underwriters have provided the following paragraph 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.

Certain statements contained in this Official Statement do not reflect historical facts but are forecasts, projections and "forward-looking statements." 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. No assurance is given that any future results discussed herein will be achieved, and actual results may differ materially from any forecasts or projections described herein. In this respect, the words such as "estimate," "project," "forecast," "anticipate," "expect," "intend," "plan," "believe" and similar expressions identify forward-looking statements. All projections, forecasts, assumptions, expressions of opinion and other forward-looking statements are expressly qualified in their entirety by the cautionary statements set forth in this Official Statement. 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
Kathleen Vaughn**

**VICE PRESIDENT
Tanya “Toni” Olson**

**SECRETARY
David Aldrich**

ADMINISTRATIVE MANAGEMENT

Anne Spangler, Interim Chief Executive Officer/General Manager

Kristin Hall, Interim General Counsel

Craig Collar, 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

Benjamin Beberness, Chief Information Officer—Information Technology Services

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Public Financial Management, Inc.

Trustee, Registrar and Paying Agent

U.S. Bank National Association

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



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OFFICIAL STATEMENT

\$140,920,000

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON

ELECTRIC SYSTEM REVENUE BONDS, SERIES 2015

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 Electric System, its Generation System and its proposed \$140,920,000 Electric System Revenue Bonds, Series 2015 (the “2015 Bonds”).

The 2015 Bonds are to be issued pursuant to Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington, and 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. 3602, adopted by the Commission of the District (the “Commission”) on May 16, 1991, as supplemented and amended (the “Master Electric System Bond Resolution”), including as supplemented by Resolution No. 5720, adopted by the Commission on May 26, 2015 (the “Ninth Supplemental Resolution”). The Master Electric System Bond Resolution, as amended and supplemented, including as supplemented by the Ninth Supplemental Resolution, is hereinafter collectively referred to as the “Electric System Bond Resolution.”

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

Under Washington State 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 Electric System, the Generation System, and the Water System. See “THE DISTRICT.”

The District’s Electric System currently has outstanding its Electric System Revenue Bonds, Series 2005 (the “2005 Bonds”), Electric System Revenue Bonds, Series 2010A, Electric System Revenue Refunding Bonds, Series 2011, and Electric System Revenue Refunding Bonds, Series 2012, which bonds, together with the 2015 Bonds and any future bonds issued under the Electric System Bond Resolution, are collectively referred to herein as the “Electric System Bonds.”

This Official Statement includes summaries and descriptions of the terms of the 2015 Bonds, the Electric System Bond Resolution and the Generation 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 forecasts and projections in this Official Statement, the District has made various assumptions with respect to conditions that may occur in the future. While the District believes these assumptions are reasonable for the purpose of the forecasts and projections, they depend upon future events, and actual conditions likely will differ from those assumed. The District does not represent or guarantee that actual results will replicate the forecasts and projections in this Official Statement. Potential purchasers of the 2015 Bonds should not rely on the forecasts and projections in this Official Statement as statements of fact, as they 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 2015 BOND PROCEEDS

The proceeds of the 2015 Bonds are to be used (i) to finance additions, betterments and improvements to and renewals, replacements and extensions of the Electric System, including, among other things, construction and upgrades relating to the District's electric distribution system, smart grid infrastructure, replacement and consolidation of the District's local offices and utility pole replacements, (ii) to fund a deposit to the Reserve Account with respect to the 2015 Bonds and (iii) to pay costs of issuing the 2015 Bonds.

The proceeds of the 2015 Bonds are estimated to be applied as follows:

Estimated Sources of Funds:

Par Amount of 2015 Bonds	\$ 140,920,000
Original Issue Premium	17,122,442
Total Sources	<u>\$ 158,042,442</u>

Estimated Use of Funds:

Deposit to Construction Fund	\$ 150,000,000
Deposit to Debt Service Reserve Account	7,046,000
Costs of Issuance ⁽¹⁾	996,442
Total Uses	<u>\$ 158,042,442</u>

⁽¹⁾Includes printing costs, Underwriters' discount, Trustee, rating agency, financial advisor and legal fees and other costs.

DESCRIPTION OF THE 2015 BONDS

The following is a summary of certain provisions of the 2015 Bonds. Reference is made to the Electric System Bond Resolution for more detailed descriptions of such provisions. A summary of certain additional provisions of the Electric System Bond Resolution is set forth in APPENDIX B—"SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION."

General

The 2015 Bonds will be issued pursuant to the Electric System Bond Resolution in the form of fully registered bonds of each maturity without coupons in authorized denominations and dated their date of delivery. The 2015 Bonds are being issued in the aggregate principal amount of \$140,920,000 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 2015 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, 2015, until maturity or prior redemption. The authorized denominations of the 2015 Bonds will be \$5,000 and any integral multiple of \$5,000 for each maturity.

Upon their initial issuance, the 2015 Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company (“DTC”). Purchases of beneficial interests in the 2015 Bonds will be made in book-entry form, without certificates. See APPENDIX E—“BOOK-ENTRY SYSTEM.”

If the book-entry only system for the 2015 Bonds is discontinued, (i) the principal of each 2015 Bond will be payable to the owner thereof by check or draft at maturity upon the presentation and surrender of each such 2015 Bond at the corporate office of the Registrar; (ii) interest on the 2015 Bonds will be payable by the Paying Agent on each interest payment date by check or draft mailed to each owner as of the Record Date, at the most recent address shown on the Bond Register; provided, that payment of interest to each owner who owns of record \$1,000,000 or more in aggregate principal amount of 2015 Bonds may be made to such owner by wire transfer to such wire address within the United States as that owner may request in writing prior to the Record Date; and (iii) the 2015 Bonds will be exchangeable for other fully registered certificated 2015 Bonds in any authorized denominations. The Paying Agent may impose a charge sufficient to reimburse the District for any tax, fee or other governmental charge required to be paid with respect to such exchange or any transfer of a 2015 Bond.

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

Redemption

Optional Redemption

The 2015 Bonds maturing on or after December 1, 2037 are subject to redemption prior to their stated maturity dates at the option of the District, in whole or in part, in authorized denominations, at any time on or after December 1, 2025, at a redemption price equal to 100% of the principal amount thereof, plus accrued but unpaid interest thereon, if any, to the date fixed for redemption.

Mandatory Redemption

The 2015 Bonds stated to mature on December 1, 2037 are term bonds subject to mandatory sinking fund redemption, in part, at a redemption price equal to 100 percent of the principal amount to be redeemed, plus accrued interest, if any, to the dated fixed for redemption, on December 1 in the years and in the amounts as set forth below:

Term Bond Maturing on December 1, 2037

Year (December 1)	Sinking Fund Redemption
2036	\$ 21,040,000
2037 [±]	22,095,000

[±] Final maturity.

The 2015 Bonds stated to mature on December 1, 2040 are term bonds subject to mandatory sinking fund redemption, in part, at a redemption price equal to 100 percent of the principal amount to be redeemed, plus accrued interest, if any, to the dated fixed for redemption, on December 1 in the years and in the amounts as set forth on the following page:

Term Bond Maturing on December 1, 2040

Year (December 1)	Sinking Fund Redemption
2038	\$ 23,195,000
2039	24,355,000
2040 [±]	25,575,000

[±] Final maturity.

Upon any partial optional redemption of such term bond, the amount of future mandatory sinking fund redemption with respect thereto will be reduced, as directed by the District, to take into account such partial optional redemptions.

Partial Optional Redemption of the 2015 Bonds

If less than all of the 2015 Bonds are called for optional redemption, such 2015 Bonds called for redemption are to be redeemed from such maturities in such order as shall be selected by the District, and by lot within any maturity subject to selection by the Registrar in such manner as the Registrar in its discretion may deem proper, in the principal amount designated to the Registrar by the District. Notwithstanding the provisions of the Ninth Supplemental Resolution described in the preceding sentence, while the 2015 Bonds are held as book-entry bonds, if fewer than all of the 2015 Bonds of a maturity are called for redemption, the selection of the 2015 Bonds within such maturity to be redeemed is to be made by DTC in accordance with its operational procedures as then in effect.

Notice of Redemption of the 2015 Bonds

In the case of an optional redemption, the notice and the notice to Bondowners may state (1) that redemption is conditioned upon the deposit of moneys, in an amount equal to the amount necessary to effect the redemption, with the Registrar no later than the date fixed for redemption and/or (2) that the District retains the right to rescind such notice on or prior to the date fixed for redemption (in either case, a "Conditional Redemption") and that such notice shall be of no effect if such moneys are not so deposited or if the notice is rescinded, in each case as described below.

The Registrar is required to give written notice of any redemption of 2015 Bonds by first class mail, postage prepaid, not less than 20 days nor more than 60 days before the date fixed for redemption to the registered owners of 2015 Bonds that are to be redeemed at their last addresses shown on the Bond Register. So long as the 2015 Bonds are in book-entry form, notice of redemption is to be given as provided in the DTC letter of representations.

Effect of Redemption of 2015 Bonds

Notice of redemption having been duly given, the 2015 Bonds or portions thereof so called for redemption (unless, in the case of Conditional Redemption, such notice is rescinded or any condition to redemption is not satisfied), shall become due and payable, and moneys for payment of the redemption price of, together with interest accrued to the date fixed for redemption on, the 2015 Bonds (or portions thereof) so called for redemption being held by the Registrar on the date fixed for redemption designated in such notice, interest on the 2015 Bonds so called for redemption will cease to accrue and said 2015 Bonds (or portions thereof) will cease to be entitled to any benefit or security under the Electric System Bond Resolution (except for payment of particular 2015 Bonds for which moneys are being held by the Registrar and which money shall be pledged to such payment), and the owners of said 2015 Bonds shall have no rights in respect thereof except to receive payment of said principal, premium, if any, and interest accrued to the date fixed for redemption.

Defeasance

The District may refund or defease all or a portion of the then outstanding Electric System 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 Electric System Bonds in the benefit or security of the 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 Electric System Bonds. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Defeasance of Bonds.”

Trustee

The District has appointed U.S. Bank National Association to serve as Trustee, Registrar and Paying Agent for the 2015 Bonds. U.S. Bank National Association may be removed or replaced as Trustee, Registrar and Paying Agent by the District as provided in the Electric System Resolution.

SECURITY FOR THE 2015 BONDS

Pledge of Electric System Revenues

Under Washington State 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 Electric System, the Generation System, and the Water System. See “THE DISTRICT.”

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 payment of the bonds of another such separate system of the District. See “—The District’s Ability to Consolidate the Electric System and the Generation System.”

The 2015 Bonds are special limited obligations of the District payable from and secured solely by the Electric System Revenues, subject to the prior payment of Operating Expenses of the Electric System (including Generation System Power Costs and Resource Obligations, each as described below). The 2015 Bonds are secured by a pledge of and lien and charge on Electric System Revenues equal to that of (i) Electric System Bonds heretofore or hereafter issued pursuant to the Electric System Bond Resolution and (ii) any Parity Lien Obligations.

“Electric System 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 Electric System 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.

Once the 2005 Electric System Bonds are no longer outstanding, the definition of “Electric System Revenues” will be amended to add the following: “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 of Electric System Bonds shall constitute Electric System Revenues if designated as such by the Commission.”

“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 Electric System 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 Bond 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). See “—Payment of Generation System Power Costs.” Operating Expenses do 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.

The Electric System Bond Resolution defines “Parity Lien Obligations” as all charges and obligations against Electric System Revenues ranking on a parity of lien with the Electric System 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 of the Electric System. “Parity Lien Obligations” do not include Electric System Bonds.

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

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. Such power and energy is required to be purchased by the Electric System at rates and charges sufficient to provide the Generation System with revenues sufficient for the timely payment of Generation System Power Costs. "Generation System Power Costs" are defined in the Generation System Bond Resolution as all costs in each month that are attributable to the Generation System, including (i) Generation System Operating Expenses, (ii) payments required to be made into the bond fund for the Generation System Bonds, (iii) costs of necessary repairs, renewals and replacements of the Generation System (not financed with bond proceeds) and (iv) all other charges or obligations payable by the District from Generation System Revenues (excluding depreciation, amortization and other non-cash charges).

The Electric System is obligated to pay Generation System Power Costs as Operating Expenses of the Electric System (and thus *prior* to the payment of debt service on the Electric System Bonds, including the 2015 Bonds) for any month during which any power and energy from the Generation System is made available to the Electric System (regardless of whether or not the Electric System actually scheduled or received such power or energy). In any month during which power and energy is *not* made available to the Electric System from the Generation System, Generation System Power Costs are payable from Electric System Revenues as Parity Lien Obligations after payment of Operating Expenses of the Electric System and on a parity with the Electric System Bonds, including the 2015 Bonds.

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 which, together with amounts then on deposit in the Generation System Revenue Fund and available for such purpose, 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.

Limitation of Liability

The 2015 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 Electric 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 2015 Bonds.

Rates and Charges

The District has covenanted in the Electric System Bond Resolution 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 will be adequate to provide Electric System 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 Bond Resolution to be paid as Operating Expenses of the Electric System and all Resource Obligations required to be paid as Operating Expenses 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 Electric System Revenues, or payment in lieu thereof, for the punctual payment of the principal of, premium, if any, and interest on the Electric System Bonds for which the 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 Policy Costs, and for the payment of all other amounts that the District may become obligated to pay from the Electric System Revenues by law or contract.

The District has covenanted in the Electric System Bond Resolution also to establish, maintain and collect rates and charges that will be adequate to provide in each fiscal year Net Revenues of the Electric System (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 Electric System Bonds in such Fiscal Year. For the definitions of certain capitalized terms used in this paragraph, see Appendix B—“SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Definitions.” As of December 31, 2014, the District had \$115.0 million in the Rate Stabilization Account.

The calculation of the coverage requirement, and District’s compliance with such requirement, may be made solely with reference to the Electric System Bond Resolution without regard to changes in generally accepted accounting principles since the District’s audited financials for the fiscal year ended December 31, 1990 (the “1990 Audited Financial Statements”) were prepared. If the District adopts changes in accounting principles for coverage calculation purposes, such changes are to be applied consistently thereafter. The Electric System Bond Resolution provides that, if the District changes one or more of the accounting principles used in the preparation of its financial statements because of a change in generally accepted accounting principles or otherwise, and does not adopt the change for coverage calculation purposes, then an event of default relating to this coverage requirement shall not be considered an Event of Default if the coverage requirement ratio would have been complied with had the District continued to use those accounting principles employed in preparing the 1990 Audited Financial Statements. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Definitions” for the definitions of capitalized terms used above.

Flow of Funds

Pursuant to the Electric System Bond Resolution, the District created a special fund known as the Revenue Fund (the “Electric System Revenue Fund”), and within the Electric System Revenue Fund, the General Account and the Rate Stabilization Account. See APPENDIX B – “SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION – Funds and Accounts – *Revenue Fund*.” The District has covenanted in the 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 Electric System Bond Resolution to be deposited into the Electric System Revenue Fund. The Electric System Bond Resolution provides for the disbursement of Electric System Revenues in the following order of priority:

(a) First, for the payment of Operating Expenses of the Electric System, including Generation System Power Costs, as appropriate (see “—Payment of Generation System Power Costs” above);

(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 Electric System Bonds, and for deposit into a reserve fund securing any Electric System Bonds, according to the priority set forth in the Electric System Bond Resolution; (ii) for the payment of any Parity Lien Obligations, including Generation System Power Costs, as appropriate (see “—Payment of Generation System Power Costs” above); and (iii) for payment to any financial institution or insurance company providing any letter of credit, line of credit, or other credit or liquidity facility, including municipal bond insurance and guarantees, that secures the payment of principal of or interest on any Electric System Bonds;

(c) Third, for the payment of the principal of and interest and redemption premium, if any, on, and for deposit in any reserve fund securing, any Junior Lien Bonds (as defined below) and any other subordinate obligations of the Electric System;

(d) Fourth, to make additions, betterments, extensions, renewals, replacements and other capital improvements to the Electric System; and

(e) Fifth, for any other lawful purpose of the Electric System, in any order of priority that may be established by the District by resolution.

Any Electric System Revenues remaining after the District makes the payments and credits described in clauses (a) through (d) may be transferred by the District to the Rate Stabilization Account to be applied as set forth in the Electric System Bond Resolution.

The District may not withdraw moneys from the Electric System Revenue Fund in accordance with clause (e) described under this subheading unless the District first has made the payments and credits described in clauses (a) through (d) under this subheading.

Debt Service Reserve Account

The Electric System Bond Resolution established a Reserve Account in the Electric System Bond Fund (the “Debt Service Reserve Account”) to provide a reserve for the payment of the principal of, premium, if any, and interest on the Electric System Bonds. The Electric System Bond Resolution provides that there shall be deposited into such Debt Service Reserve Account an amount from the proceeds of each series of Electric System Bonds secured thereby sufficient, together with the other moneys and investments on deposit in the Debt Service Reserve Account to meet the Reserve Account Requirement for all series of Electric System Bonds secured thereby calculated immediately after the issuance of such Electric System Bonds. 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. See “APPENDIX B—SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Definitions” for the definition of Qualified Insurance and Qualified Letter of Credit.

“Reserve Account Requirement” means (a) with respect to a series of Electric System Bonds, the lesser of (i) 10% of the proceeds of such series of Electric System Bonds or (ii) the maximum amount of interest due in any Fiscal Year on such series of Electric System Bonds, calculated as of the date of issuance of such series of Electric System Bonds and (b) with respect to all Electric System Bonds secured by the Debt Service Reserve Account, the sum of the Reserve Account Requirements for all such series of Electric System Bonds. A Supplemental Resolution may establish a separate reserve account for one or more series of Electric System Bonds or provide that Electric System Bonds be secured by a common reserve account other than the Debt Service Reserve Account. In any such case, such Electric System Bonds would not be secured by the Debt Service Reserve Account. If the District establishes a separate reserve account for a series of Electric System Bonds, the Reserve Account Requirement will be as set forth in the Supplemental Resolution authorizing the series of Electric System Bonds.

Once the 2005 Bonds are no longer outstanding, the definition of “Reserve Account Requirement” will be amended to add at the end of clause (a) the phrase “and recalculated as of the date of issuance of any obligation of the District issued to refund any Bonds.”

The 2015 Bonds are to be secured by the Debt Service Reserve Account. The current Reserve Account Requirement for the outstanding Electric System Bonds secured by the Debt Service Reserve Account is \$18,244,226. Upon the issuance of the 2015 Bonds, the aggregate Reserve Account Requirements for all series of Electric System Bonds secured by the Debt Service Reserve Account will be

\$25,290,226. This amount is equal to the sum of the maximum annual interest on each such series of Electric System Bonds secured by the Debt Service Reserve Account as of their respective dates of issuance, and includes \$7,046,000 with respect to the 2015 Bonds, which amount is equal to the maximum annual interest on the 2015 Bonds as of their date of issuance. Upon the issuance of the 2015 Bonds, the District expects to deposit proceeds in the amount of \$7,046,000 into the Debt Service Reserve Account. If the District defeases or redeems all of the 2005 Bonds, the new Debt Service Reserve Requirement will be \$18,816,015, and the District expects that approximately \$6,474,211 will be released from the Debt Service Reserve Account.

Of amounts currently on deposit in the Debt Service Reserve Account, \$9,543,686 is invested pursuant to a forward delivery investment agreement (as amended, the "Forward Delivery Agreement") between the District and Bank of America, N.A. ("Bank of America"). The Forward Delivery Agreement, which pays 4.3152% and will mature on December 1, 2018, 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. As of December 31, 2014, Bank of America's long-term senior unsecured debt was rated "A" by Standard & Poor's and "A2" by Moody's.

The Debt Service Reserve Account is held in trust by the District for the benefit of the owners of the Electric 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, is to be used for the purpose of paying the principal of or interest on any Electric System Bonds secured thereby in the event that money in other accounts in the Electric System 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 Electric System Bond Resolution. See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Revenues and Flow of Funds—Debt Service Reserve Account."

The Electric System Bond Resolution requires that the District make a valuation of the amount credited to the Debt Service Reserve Account as of the close of business on each December 31 (or on the next preceding business day if December 31 does not fall on a business day) and after any withdrawal to pay when due debt service on any Electric System Bonds and provides that a valuation may be made on each June 30 (or the next preceding business day of June 30 is not a business day). For purposes of determining the amount credited to the Debt Service Reserve Account, obligations in which moneys have been invested are to be valued at the "market value" thereof. The Electric System Bond Resolution provides that if the amount in the Debt Service Reserve Account is less than Reserve Account Requirement, the District shall have 12 months within which to transfer to the Debt Service Reserve Account in amounts sufficient to restore the Debt Service Reserve Account to the Reserve Account Requirement, such transfers to come, first, from moneys in the Electric System Revenue Fund (after making provision for the Operating Expenses for the required payments into the Interest and Principal Accounts), and, second, from moneys in the Construction Fund.

Additional Indebtedness

Electric System Bond Resolution

Under the 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 Electric System Bonds (other than Generation System Bonds and Resource Obligations). The District may issue additional 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 Electric System Bond Resolution. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Additional Indebtedness—Additional Bonds.”

As of December 31, 2014, the Electric System Bonds were outstanding in the aggregate principal amount of \$317,900,000, and after giving effect to the issuance of the 2015 Bonds, the Electric System Bonds are expected to be outstanding in the aggregate principal amount of \$458,820,000.

The District currently expects to redeem the outstanding 2005 Bonds with funds on deposit in the Debt Management Reserve in 2015; however, no assurance can be given that the District will redeem the 2005 Bonds in 2015. See “ELECTRIC SYSTEM FINANCIAL INFORMATION—Financial Condition and Liquidity—Reserve Policy” and “—Projected Financial Results.”

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 C—“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Additional Indebtedness.”

As of December 31, 2014, the Generation System Bonds were outstanding in the aggregate principal amount of \$166,770,000. See “THE GENERATION SYSTEM—Small Hydroelectric Generation Projects—*Other Low Impact Hydroelectric Projects*.”

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 C—“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Additional Indebtedness—Obligations Payable from Revenues.”

Junior Lien Bonds and Other Electric System Subordinate 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 Electric System Bonds.

As of December 31, 2014, the District had no outstanding bonds having a lien on and charge against Electric System Revenues junior to the Electric System Bonds (“Junior Lien Bonds”).

Derivative Products

The Electric System Bond Resolution does not permit the District to enter into interest rate swap agreements payable from or secured by Electric System Revenues on a parity with the Electric System Bonds. The Generation System Bond Resolution, however, permits the District to enter into “Derivative Products” secured by a pledge of and lien on Generation System Revenues on a parity with the Generation System Bonds. 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. Derivative Products could also include currency or commodity swap agreements. As such, they would be payable from Electric System Revenues as a part of Generation System Power Costs either prior to or on a parity with the Electric System Bonds. Execution of any Derivative Product is subject to the satisfaction of certain conditions set forth in the Generation System Bond Resolution. See APPENDIX C —

“SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION – Additional Indebtedness—Derivative Products.”

The District has previously been a party to interest rate swap agreements (that is, Derivative Products) pursuant to the Generation System Bond Resolution. The District, however, is no longer a party to any such Derivative Products and does not currently expect to enter into any such agreements. The District from time to time may enter into certain hedge agreements, such as commodity or currency swaps, in the ordinary course of business. Payments made or received by the District under such agreements would be applied for purposes of the flow-of-funds provisions of the Electric System Bond Resolution consistent with applicable accounting rules.

Resource Obligations

If the District complies with certain requirements in the Electric System Bond Resolution, then the District may (1) enter into contracts for the purchase of energy, capacity, capability or reserves, or (2) acquire or construct a facility for the generation of power and energy as a separate system of the District, and in each case declare the costs of such contract or facility (including debt service on bonds) to be a “Resource Obligation” of the Electric System. Such costs would then be paid (a) as Operating Expenses of the Electric System for any month in which power and energy from such contract or facility was made available to the Electric System during such month (*regardless of whether or not the Electric System actually scheduled or received such power or energy during such month*), and (b) on a parity with the Electric System Bonds as a Parity Lien Obligation for any month in which power and energy from such contract or facility was *not* made available to the Electric System during such month. The requirements under the Electric System Bond Resolution include the delivery of a report of a Professional Utility Consultant to the effect that the District would continue to satisfy the Electric System rate covenant, described above, for the second full Fiscal Year following (i) the first delivery of energy, capacity, capability or reserves pursuant to such contract, or (ii) the date of commercial operation such facility constituting such a separate system of the District. The District has not declared costs associated with any contract or any separate system of the District to be a Resource Obligation, and the District has no current plans to do so. In practical effect, however, costs of the Generation System are paid from Electric System Revenues as if such costs were Resource Obligations of the Electric System. See APPENDIX B — “SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Additional Indebtedness—Separate System Bonds; Resource Obligations.”

Except as described in the preceding paragraph, the District is prohibited under the Electric System Bond Resolution from entering into a contract or other similar arrangement with a third party for the purchase of energy, capacity, capability or reserves from a new or existing generating facility, payments under which contract or arrangement are payable as Operating Expenses of the Electric System, if: (a) such payments are pledged directly to secure the payment of bonds or other indebtedness issued or incurred to finance such facility, and (b) such payments are due regardless of whether the District takes delivery of any power or such facility or resource is producing or is capable of producing any power.

Other Covenants

The District has covenanted in the Electric System Bond Resolution to maintain, preserve and keep the properties of the Electric 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 Electric System in an efficient manner and at a reasonable cost. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Certain 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 of the Generation System or Operating Expenses, 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 or the Electric System Bonds, including the 2015 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 Electric System Bonds, as applicable. Other such payments also may be payable on a parity with the Electric System Bonds or the Generation System Bonds subject to the satisfaction of certain conditions precedent. See “—Derivative Products” and “THE ELECTRIC SYSTEM POWER SUPPLY—Wholesale Power Market Purchases, Sales and Trades—*Dodd Frank Act*.”

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 Wheat Field Wind Power Project, LLC (“Wheat Field”) 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 Wheat Field. See “ELECTRIC SYSTEM POWER SUPPLY—Bonneville Power Administration—*The Bonneville Power Purchase Agreement—Slice Product*” and “ELECTRIC SYSTEM POWER SUPPLY—Long-Term Third-Party Power Purchase Contracts,” respectively. In addition, the District has entered into a reimbursement agreement with Bank of America pursuant to which Bank of America has issued to Bonneville a letter of credit with an available principal amount of approximately \$3.1 million and with an expiration date of July 1, 2015 to secure the District’s payment obligations for participation in the 2008 Network Open Season Precedent Transmission Service Agreement. The District intends to renew until July 1, 2017 the Letter of Credit issued to Bonneville in the amount of approximately \$2.3 million. See “ELECTRIC SYSTEM POWER SUPPLY—Bonneville Power Administration—*Bonneville’s Transmission Service Contracts*.”

The District’s Ability to Consolidate the Electric System and the Generation System

The District may combine the Electric System and the Generation System into a single system for accounting and financing purposes, subject to the satisfaction of certain conditions in the Electric System Bond Resolution and in the Generation System Bond Resolution. 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 Electric System Bonds, including the 2015 Bonds, and the operating expenses, capital costs and

other obligations of both Systems would be payable from the revenues of both Systems. Upon such consolidation of the Electric System and the Generation System, the Electric System Bonds and the Generation System Bonds would have an equal lien on revenues of the consolidated system, subject to the prior payment of the costs of operation and maintenance of the consolidated system.

As a condition to the consolidation of the Electric System and the Generation System, the District is required to provide (i) written confirmation from each Rating Agency then rating the Electric System Bonds and the Generation System Bonds that such consolidation would not cause a reduction or withdrawal of the then-current rating(s) on the Electric System Bonds and the Generation System Bonds and (ii) an opinion of Bond Counsel that such consolidation would not adversely affect the exclusion of interest on any tax-exempt Electric System Bonds or Generation System Bonds from gross income for federal income tax purposes. The District currently does not have any plans, nor does it expect, to consolidate these Systems.

Authorized Investments

All moneys in any of the funds and accounts held and established pursuant to the Electric 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 Electric System Bond Resolution, payment of the principal of and accrued interest on the Electric 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 Electric System Bonds upon an Event of Default could give rise to varying interests between holders of earlier and later maturing Electric 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 Electric 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 State law. The District has never defaulted in the payment of principal or interest on any of its bonds. See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Events of Default and Remedies."

OUTSTANDING DEBT OF THE ELECTRIC SYSTEM AND GENERATION SYSTEM

The table below presents the District's outstanding long-term indebtedness of the Electric System and the Generation System as of December 31, 2014. The table below does not reflect the 2015 Bonds. See "SECURITY FOR THE 2015 BONDS—Additional Indebtedness—Generation System Bond Resolution."

Outstanding Debt of the Electric System and the Generation System as of December 31, 2014 (\$000)

Series of	Final Maturity Date	Original Principal Amount	Amount Outstanding
<u>ELECTRIC SYSTEM BONDS</u>			
2005 ⁽¹⁾	12/1/2024	\$120,980	\$99,100
2010A	12/1/2035	128,075	128,075
2011	12/1/2024	47,970	35,115
2012	12/1/2028	<u>55,610</u>	<u>55,610</u>
<u>Total Electric System Bonds</u>		<u>\$352,635</u>	<u>\$317,900</u>
 <u>GENERATION SYSTEM BONDS</u>			
2010A	12/1/2024	\$212,465	\$152,720
2010B	12/1/2040	<u>14,050</u>	<u>14,050</u>
<u>Total Generation System Bonds</u>		<u>\$226,515</u>	<u>\$166,770</u>
<u>Total Outstanding Debt</u>		<u>\$579,150</u>	<u>\$484,670</u>

⁽¹⁾ The District currently expects to redeem the outstanding 2005 Bonds with funds on deposit in the Debt Management Reserve in 2015; however, no assurance can be given that the District will redeem the 2005 Bonds in 2015. See "SECURITY FOR THE 2015 BONDS—Additional Indebtedness—Electric System Bond Resolution" and "ELECTRIC SYSTEM FINANCIAL INFORMATION—Financial Condition and Liquidity—Reserve Policy" and "—Projected Financial Results."

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DEBT SERVICE

The following table shows the debt service requirements on the outstanding Generation System Bonds, the outstanding Electric System Bonds and the 2015 Bonds.

Generation System Bonds and Electric System Bonds Debt Service Requirements

Fiscal Year	Outstanding Generation System Bonds	Outstanding Electric System Bonds		2015 Bonds		Total Electric System Bonds Debt Service ⁽¹⁾
		Principal	Interest	Principal	Interest	
2015	\$ 31,016,346	\$ 14,220,000	\$ 16,335,647	-	\$ 2,955,406	\$ 19,291,053
2016	31,015,146	13,345,000	15,642,647	\$ 3,935,000	7,046,000	26,623,647
2017	31,012,396	15,340,000	14,995,397	2,785,000	6,849,250	24,629,647
2018	31,017,471	16,555,000	14,265,348	2,445,000	6,710,000	23,420,348
2019	31,012,921	17,285,000	13,492,890	2,605,000	6,587,750	22,685,640
2020	7,369,946	17,400,000	12,667,489	2,935,000	6,457,500	22,059,989
2021	7,346,778	18,230,000	11,827,484	2,590,000	6,310,750	20,728,234
2022	7,330,321	19,065,000	10,973,252	2,420,000	6,181,250	19,574,502
2023	7,310,814	20,815,000	10,037,815	1,730,000	6,060,250	17,828,065
2024	7,292,769	24,300,000	8,998,236	-	5,973,750	14,971,986
2025	1,200,422	9,880,000	7,783,236	3,215,000	5,973,750	16,971,986
2026	1,191,788	10,320,000	7,266,036	-	5,813,000	13,079,036
2027	1,179,696	10,775,000	6,725,995	-	5,813,000	12,538,995
2028	1,166,468	11,260,000	6,162,363	-	5,813,000	11,975,363
2029	1,157,104	12,680,000	5,573,553	-	5,813,000	11,386,553
2030	1,146,320	13,140,000	4,866,009	-	5,813,000	10,679,009
2031	1,129,116	13,625,000	4,126,227	-	5,813,000	9,939,227
2032	1,115,776	14,120,000	3,359,140	-	5,813,000	9,172,140
2033	1,101,016	14,640,000	2,564,184	-	5,813,000	8,377,184
2034	1,089,836	15,175,000	1,739,952	-	5,813,000	7,552,952
2035	1,071,952	15,730,000	885,599	-	5,813,000	6,698,599
2036	1,057,648	-	-	21,040,000	5,813,000	26,853,000
2037	1,041,640	-	-	22,095,000	4,761,000	26,856,000
2038	1,023,928	-	-	23,195,000	3,656,250	26,851,250
2039	1,009,512	-	-	24,355,000	2,496,500	26,851,500
2040	988,108	-	-	25,575,000	1,278,750	26,853,750
Total ⁽¹⁾	<u>\$ 209,395,238</u>	<u>\$ 317,900,000</u>	<u>\$ 180,288,497</u>	<u>\$ 140,920,000</u>	<u>\$ 143,241,156</u>	<u>\$ 464,449,653</u>

⁽¹⁾ 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 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.

Under Washington State 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 Electric System, the Generation 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 Electric System and Generation System.

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:

Kathleen Vaughn, President

Ms. Vaughn began her first term as a Commissioner on January 1, 1995, and was last re-elected to the Commission in November 2012. 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, 2018.

Tanya "Toni" Olson, Vice President

Ms. Olson began her first term as Commissioner on January 1, 2005 and was re-elected to the Commission in 2010. 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, 2016.

David Aldrich, Secretary

Mr. Aldrich began his first term as a Commissioner on January 1, 2003, and was re-elected to the Commission in November 2014. 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 Washington State Attorney General's Office. Mr. Aldrich holds a Bachelor of Arts degree in history from the University of California, Berkeley, and completed work for a Bachelor of Arts degree in philosophy at California State University, Hayward. Mr. Aldrich's term expires on December 31, 2020.

Administration

The present administrative management of the District is as follows:

Anne Spangler, Interim CEO/General Manager

Ms. Spangler was appointed Interim Chief Executive Officer/General Manager effective May 1, 2015 following the retirement of Steve Klein, the previous Chief Executive Officer/General Manager. Prior to her appointment as Interim Chief Executive Officer/General Manager, she had served as General Counsel since May 2008. In that capacity, she advised the Commission, the General Manager and District staff and managed the Legal and Records and Information Management departments. Ms. Spangler's background includes practice with the Office of the Attorney General, representing the Washington 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. She has also been active in the Washington State Bar Association's Environmental and Land Use Section. Ms. Spangler has a Bachelor of Arts degree in anthropology from Reed College, a juris doctorate, *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.

Kristin Hall, Interim General Counsel

Ms. Hall was appointed Interim General Counsel effective May 1, 2015. Prior to her appointment as Interim General Counsel, Ms. Hall served as an Associate, then Assistant General Counsel at the

District since July 1992. She also served as Interim General Counsel for the District in 2002 and again in 2008. In her role as Interim General Counsel, she advises the Commission, the General Manager and District staff and manages the Legal and Records and Information Management departments. Ms. Hall's background prior to her employment at the District includes practice as a public finance attorney with Faegre & Benson (now Faegre Baker Daniels) and prior to that with Foster Pepper PLLC. Ms. Hall has a Bachelor of Arts degree in English, *magna cum laude*, from Carleton College and a juris doctorate, *cum laude*, from the University of Michigan Law School.

Craig Collar, Assistant General Manager – Power, Rates and Transmission Management

Mr. Collar joined the District in November 2006 and has served as the Assistant General Manager for Power, Rates and Transmission Management of the District since November 1, 2012. Prior to his appointment as Assistant General Manager for Power, Rates and Transmission Management, he served as Senior Manager, Energy Resource Development. Prior to joining the District, Mr. Collar held a number of engineering and operations leadership positions for Kimberly Clark Corporation and also served as a U.S. Navy submarine officer. Mr. Collar holds a Bachelor of Science degree in Mechanical Engineering from Montana State University, as well as a Masters of Business Administration from Colorado State University, and is a registered Professional Engineer.

Glenn McPherson, Assistant General Manager – Finance and Treasurer

Mr. McPherson was appointed Assistant General Manager-Finance and Treasurer in 1997. He joined the District in 1991 as controller and later became senior manager of budget and financial planning. Mr. McPherson's responsibilities at the District include accounting and financial reporting, cash and debt management, risk management, budget and financial planning and procurement and materials management. Before joining the District, Mr. McPherson served as controller for Scandia Down Corporation. Prior to that time, he spent nearly eight years serving public and private companies as a senior manager with KPMG Peat Marwick. Mr. McPherson holds a Bachelor of Science degree in business administration with an emphasis in accounting from California State University at Long Beach. He is a certified public accountant.

Christopher Heimgartner, Assistant General Manager – Distribution and Engineering Services

Mr. Heimgartner joined the District in May 2009. He has over 34 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.

Benjamin Beberness, Chief Information Officer – Information Technology Services

Mr. Beberness joined the District in February 2011 to lead the Information Technology division. Before joining the District, Mr. Beberness worked for Lockheed at NASA Johnson Space Center and developed software for the NASA Space Station and developed real-time data acquisition systems for NASA medical researchers. He also served as the Director of Applications for PacifiCorp in Portland and worked for Deloitte & Touche Consulting Group / DRT Systems. Mr. Beberness attended Portland State University where he graduated with a Bachelor of Science degree in Computer Science.

Jim West, Assistant General Manager – Customer and Energy Services

Mr. West joined the District in February 2009. Prior to joining the District, Mr. West was Director of Product Management at CURRENT Group, LLC, a smart grid solutions provider based in Washington, D.C. Previously he spent 29 years at the Tennessee Valley Authority, serving in a variety of roles relating to multiple aspects of energy efficiency and renewable energy. Mr. West also held management positions in human resources and in research and development, where he managed the Tennessee Valley Authority's technology planning process. Mr. West holds a Masters of Business Administration and a Bachelor of Science degree in Economics from the University of Tennessee.

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 ending December 31, 2014, the Electric System served an average of 332,516 retail customers and had energy sales of 8,812,294 megawatt-hours ("MWh") and operating revenues of \$628,582,000. In 2014, the District purchased approximately 82% of its power from Bonneville, approximately 7% from long-term power contracts, approximately 6% from the Henry M. Jackson Hydroelectric Project (the "Jackson Project"), Youngs Creek Hydroelectric Project (the "Youngs Creek Project") and the Woods Creek Hydroelectric Project (the "Woods Creek Project"), and approximately 5% from the wholesale power market. The District makes short-term purchases in the wholesale power market to balance seasonal and daily variations in its customer loads and owned and contracted-for resources. The Electric System is primarily a distributor of power at retail rates. As of December 31, 2014, the total assets of the Electric System were \$1,711,204,000 and its long-term debt, net of unamortized premiums and discounts, was \$320,877,000. See "THE ELECTRIC SYSTEM," "ELECTRIC SYSTEM POWER SUPPLY" and "ELECTRIC SYSTEM FINANCIAL INFORMATION."

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 Jackson Project, the Youngs Creek Project and the Woods Creek Project. The District is developing, and seeking licenses from the Federal Energy Regulatory Commission ("FERC") for, two additional low-impact hydroelectric projects, as well as investigating other generating projects. See "THE GENERATION SYSTEM—Small Hydroelectric Generation Projects—*Other Low Impact Hydroelectric Projects*" and "THE ELECTRIC SYSTEM POWER SUPPLY—The District's Future Power Supply Strategy." The Generation System could include any other electric generating, transmission and/or conservation facilities undertaken by the District in the future. The District does not currently expect to include conservation facilities in the Generation System.

The Jackson Project is an operating hydroelectric generating facility with a nameplate capacity of 111.8 megawatts ("MW"). The Youngs Creek Project is a hydroelectric generating facility with a nameplate capacity of 7.5 MW. The Woods Creek Project is a small hydroelectric project with a nameplate capacity of 0.65 MW. See "THE GENERATION SYSTEM—The Jackson Project" and "—Small Hydroelectric Generation Projects."

As of December 31, 2014, the total assets of the Generation System were \$237,928,000, and its long-term debt, net of unamortized premiums and discounts, was \$157,754,000. See "THE GENERATION SYSTEM" and see "SECURITY FOR THE 2015 BONDS" for a discussion of the obligations of the Electric System to the Generation System.

The Water System

The District's Water System was formed through the merger of the District's former Lake Stevens Water System and its former Sunnyside Water System and became operational in 1946. For the year ending December 31, 2014, the Water System served an average of 19,185 customers. The Water System is operated, financed, and accounted for separately from the Electric System and the Generation System. 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, and the revenues of the Water System are not pledged to the payment of the expenses and obligations of the Electric System or the Generation System. As of December 31, 2014, the total assets of the Water System were \$129,003,000, and its long-term debt was \$25,616,000.

Labor Relations

The District had the full-time equivalent of approximately 1,018 employees as of December 31, 2014. Of those, 587 employees are covered by a three-year collective bargaining agreement with the International Brotherhood of Electrical Workers, Local #77 (the "IBEW"), which will expire on March 31, 2017. The District strives to promote sound labor relations policies that are beneficial to the District, its employees and its customers. The District has not experienced any work stoppages in over 30 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 property coverage has a sublimit of \$100 million for earth movement. 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, 2014, was approximately \$12.6 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 currently uses the FERC uniform system of accounts for class A electric systems. The District is in the process of implementing new financial accounting systems that will feature a standard chart of accounts, but the system is being developed to allow the District to continue to report on a FERC system of accounts basis as well. 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 – "INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013," Note 1.

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

The District requests proposals from national and large regional accounting and auditing firms every five years and selects its financial statement auditors based on industry expertise, reputation and cost. Following such a request for proposals, the District selected Baker Tilly as its independent auditors for the fiscal years ended December 31, 2010 through 2014. The District currently expects to extend the contract with Baker Tilly for an additional year through 2015.

Pension and Other Post-Employment Benefits

Pension Plans

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

The following information regarding PERS was derived from the 2013 Valuation Report and 2012 Valuation Report (each mentioned below) and from the Comprehensive Annual Financial Report for the Washington State Department of Retirement System Funds of the State of Washington for the fiscal year ended June 30, 2014 (the "2014 Retirement Fund Audit"). *The District has obtained certain information in this section from the State of Washington. The District believes such information to be reliable, but the District does not guarantee the accuracy or completeness of such information.*

PERS Plans 1, 2 and 3. PERS is a multiple-employer, cost-sharing public employee retirement system operated by the State. PERS is comprised of three separate plans for membership and benefit purposes ("PERS 1," "PERS 2" and "PERS 3"). See Note 7 in the District's audited financial statements in APPENDIX A for a description of PERS benefits and eligibility requirements for these plans.

PERS 1 is closed to employees hired after September 30, 1977. Eligible employees hired after that date are members of PERS 2 or PERS 3. Eligible employees hired after August 31, 2002, are members of PERS 2 unless they elect irrevocably to join PERS 3. The District is one of almost 1,200 governmental employers that participate in PERS. As of June 30, 2013, approximately 85,000 retirees and beneficiaries were receiving benefits under PERS, approximately 31,000 terminated plan members were entitled to but not yet receiving benefits and approximately 150,000 were active plan members. Benefits for active members in PERS 1 or PERS 2 vest after five years of service, and in PERS Plan 3 after 10 years unless they qualify for early vesting after five years.

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

Employers are not liable directly for and do not guarantee the obligations of PERS, but as described below employer contribution rates for defined benefit plans may increase if assets are, or are projected to be, insufficient to pay promised benefits. The WSIB directs the investment of retirement system assets and invests all retirement funds in a single pool. Although in general the assets of one plan

may not be used to fund benefits from another plan, the assets of PERS 2 and the defined benefit component of PERS 3 are accounted for in the same fund and all such assets may be used to pay defined benefits of PERS 2 or PERS 3 members.

Actuarial Valuation, Funding Policy and Assumptions

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

In September 2014, the OSA released an actuarial valuation for June 30, 2013 (the “2013 Valuation Report”). The primary purposes of the 2013 Valuation Report are to determine contribution rates that would be sufficient to fund the State’s retirement plans, including PERS, under the funding policy established by the Legislature and to provide information on the funding progress and developments in the plans over the State fiscal year ended June 30, 2014. Washington statutes require that valuation reports that are used in determining contribution rates be audited by independent actuaries selected by the PFC. The 2014 Valuation Report was audited by Milliman, which released its report in October 2014.

Funding Policy. The State’s funding policy and methods for determining the contribution rates are set forth in Chapters 41.40 and 41.45 RCW (collectively, the “Pension Act”). In 2009, the Pension Act was amended to provide for the amortizing in full of the unfunded accrued actuarial liability (the “UAAL”) of PERS 1 over a rolling-10-year period, using methods and assumptions that balance the needs for increased benefit security, decreased contribution rate volatility and affordability of contribution rates. The Pension Act also requires that to the extent feasible all benefits for PERS 2 and PERS 3 members be funded over the working lives of those members. In preparing valuations and making recommendations regarding contribution rates, the OSA uses valuation methods, economic and demographic assumptions, including rates of retirement, rates at which members become disabled, turnover rates and mortality rates, and other assumptions, including assumptions about plan benefits.

Assumptions. Demographic assumptions are based on experience studies, which are generally released every seven years. The most recent experience study for the period 2007-2012 was released in November 2014. Economic assumptions are adopted by the PFC and/or prescribed by the Legislature. In August 2011, OSA recommended that the PFC adopt new long-term assumptions about system membership growth and new economic assumptions and that the PFC phase in the changes over the following five biennia. OSA’s recommended changes to the economic assumptions include reducing the assumed rate of inflation from the current 3.5% to 3.0%; reducing the assumed annual investment return from the current 8.0% to 7.5%; reducing the 10-year membership growth from the current 1.25% to 0.95%; and reducing the general salary growth assumption from the current 4.0% to 3.75%. In late 2011, the PFC adopted lower economic assumptions. In addition, in 2012 the Legislature enacted a schedule to decrease the investment rate of return assumption for all plans, assuming a rate of return of 7.9% for the 2013-2015 biennium, 7.8% for the 2015-2017 biennium and 7.7% for the 2017-2019 biennium. For the 2013 Valuation Report, the OSA assumed the following: a rate of inflation of 3.0%; an assumed annual investment return of 7.8%; a 10-year membership growth rate of 0.95%; and a general salary growth assumption of 3.75%.

Actuarial Funded Status. For purposes of determining the plans’ funded status on an actuarial basis (but not to determine contribution requirements), the OSA determines the ratio of the actuarial value of assets (the “AVA”) to the cost of plan benefits. The annual cost of benefits is comprised of (i) the

“normal cost” of future benefits that will accrue in the subsequent year for current plan members, and (ii) the amount required to amortize the UAAL over a specified period. The UAAL is the difference between a plan’s actuarial accrued liability (“AAL”) and the actuarial value of the plan’s assets. The AAL represents the present value of future benefits that have accrued as of the valuation date.

To determine a plan’s AVA, the OSA determines the current Market Value of Assets (the “MVA”). To limit fluctuations in contribution rates and plan funded status, the OSA “smoothes” the inherent volatility in the MVA by deferring a portion of annual investment gains or losses over a period of not to exceed eight years. To help ensure that the AVA maintains a reasonable relationship to the MVA, any valuation of the AVA may not exceed 130% of, nor drop below 70% of, the MVA.

As of June 30, 2013, the funded status for PERS 1 on an actuarial basis was 63% and for PERS 2/3 was 102%.

**PERS PUC Liability and Funded Ratio on an Actuarial Basis
(\$millions)**

	<u>June 30, 2011</u>		<u>June 30, 2012</u>		<u>June 30, 2013</u>	
	<u>PERS 1</u>	<u>PERS 2/3</u>	<u>PERS 1</u>	<u>PERS 2/3</u>	<u>PERS 1</u>	<u>PERS 2/3</u>
Actuarial Liability	\$12,567	\$18,815	\$12,368	\$20,347	\$12,884	\$23,798
Valuation Assets	<u>8,883</u>	<u>20,997</u>	<u>8,521</u>	<u>22,653</u>	<u>8,053</u>	<u>24,335</u>
Unfunded Liability	\$ 3,684	(\$2,182)	\$ 3847	(\$2,306)	\$ 4,831	(\$537)
Funded Ratio	71%	112%	69%	111%	63%	102%

Source: Office of the State Actuary; 2013 Valuation Report, and actuarial valuation for June 30, 2012 (the “2012 Valuation Report”).

Contribution Rates. The employee contribution rate for PERS 1 is established by statute at 6% of covered payroll for local government unit employees. The employee contribution rate for PERS 2, which is determined by the PFC, increased to 4.92% of covered payroll as of September 1, 2013. Effective as of July 1, 2015, the employee contribution rate for PERS 2 will increase to 6.12% of covered payroll. Employee contribution rates for the defined contribution component of PERS 3 are determined by the Director of the Department of Retirement Systems and range from a minimum of 5.0% of covered salary to a maximum of 15.0%. Employees are not required to contribute to the defined benefit component of PERS 3.

Employer contribution rates for the upcoming biennium (the State’s two-year period ending on June 30 of an odd-numbered year) are adopted during even-numbered years according to a statutory rate-setting process. Based upon the statutory funding policy, the same contribution rate is charged to employers regardless of the plan in which employees hold membership. In even-numbered years, the OSA provides recommended contribution rates to the SCPP and to the PFC. The PFC, based on the recommendations of the OSA and the SCPP, adopts contribution rates. The rates adopted by the PFC are subject to revision by the Legislature. In several of the past 14 years, the Legislature has adopted contribution rates that are *lower* than those recommended by the OSA and adopted by the PFC. All employers are required to contribute at the levels established by the Legislature.

In 2010, the Legislature amended the Pension Act to (i) suspend the minimum contribution rates adopted in 2009, (ii) adopt, for all PERS plans, rate ceilings effective through 2015 for the portion of the employer contributions rates designed to amortize the UAAL for PERS 1, and (iii) establish a minimum UAAL rate of 5.25% beginning July 1, 2015. In 2011, the Legislature amended the Pension Act again to, among other things, reduce the minimum UAAL rate to 3.5% beginning July 1, 2015.

As of September 1, 2013, the employer contribution rate for all PERS plans is 9.21% of covered payroll, which includes the amortization of the PERS 1 UAAL, and effective as of July 1, 2015, the rate will increase to 11.18%.

The District does not have any control over the determination of the employer contribution rates or the process for setting such rates. Employee and employer contribution rates are expected to increase over the next several years, and those increases may be significant.

District Contributions. For the year ended December 31, 2014, the District's total payroll for employees was \$ 99.3 million, and virtually all of that was covered by PERS. Both the District and its employees made their required contributions to PERS in 2014, with the District contributing \$9,144,000, consisting of \$155,000 to PERS 1, \$7,627,000 to PERS 2 and \$1,362,000 to PERS 3.

Other Post-Employment Benefits

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 ("UAAL") for these benefits as of December 31, 2014 was \$49.7 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 \$10.3 million as of December 31, 2014. In addition, the District made an additional contribution of \$2.0 million to the net post-employment obligation in 2015. For a description of the post-employment related disclosures, see APPENDIX A—"INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013," Note 7.

Deferred Compensation Plans

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.

Investment Policy

The District invests its available funds pursuant to an investment policy adopted by the Commission that emphasizes compliance with state and local statutes governing the investment of public funds, preserving principal, maintaining necessary liquidity, matching investment maturities to estimated cash flow requirements, and achieving yields consistent with financial market indices. The District last updated its investment policy in April 2015. Eligible investments include obligations of the U.S. government including U.S. Treasury bonds, notes, and bills; obligations of U.S. government agencies wholly owned by the government or any Governmental Sponsored Enterprises (GSE's); highly rated banker's acceptances; highly rated commercial paper; certificates of deposit; liquid overnight funds held at national financial institutions that are under the Washington State Public Depository Protection Commission (PDPC); the State of Washington Local Government Investment Pool; 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 of Washington, including the District.

The District's investment policy also establishes maximum investment levels and other guidelines for various types of these investments. As of December 31, 2014, the District's major portfolio holdings include the Washington State Local Government Investment Pool (11.9%), Federal Home Loan Bank Notes (25.1%), Federal Home Loan Mortgage Corporation ("Freddie Mac") Notes (16.4%), Federal National Mortgage Association ("Fannie Mae") Notes (20.1%), Federal Farm Credit Bank Notes (9.1%), Federal Agriculture Mortgage Corporation ("Farmer Mac") Notes (1.5%), United States Treasury Notes (8.0%) and various bank deposits (7.9%). Freddie Mac and Fannie Mae remain under the conservatorship of the U.S. Government. The Electric System Bond Resolution provides that money in the Electric System Bond Fund be invested in any obligations or investments in which the District may legally invest its funds. The investment policy of the District may be amended at any time. See APPENDIX A—"INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013," Note 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 or the Electric System Bonds, including the 2015 Bonds.

Seismic Risk

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 earthquake reportedly caused more than \$2 billion in damage in the region, but caused minimal damage within the District's service area and to District facilities. The largest known earthquake in the region reportedly 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 reportedly estimated to occur in the region every 400 to 600 years, according to the Pacific Northwest Seismic Network. 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 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, 2014, the District had approximately 319.61 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, 87 substations with a combined capacity of 2,899,475 kVA, distribution transformers, meters, and secondary lines and services, both overhead and underground. As of December 31, 2014, these facilities included 3,306 miles of overhead lines and 2,713 miles of underground lines. In addition, the District has three mobile transformer units with a combined capacity of 75,000 kVA. 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 – Financial Condition and Liquidity – *Capital Expenditures*.”

The District and Frontier Communications (“Frontier”) are parties to a Joint Pole Ownership Agreement (the “Frontier Joint Pole Ownership Agreement”) covering approximately 60% of the District’s distribution pole plant. The Frontier Joint Pole Ownership Agreement became effective October 1, 2009 and had an initial term of five years, which has been extended for an additional five-year term ending on September 30, 2019, and which may be extended for additional five year terms upon mutual agreement of the parties.

Electric Rates

The District is required and empowered under Washington State law to establish, maintain and collect rates or charges for electric energy that 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, construction and resource plans, 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.

During the western power market crisis resulting from the unprecedented increase in the market price of power in 2001, the District was able to raise rates by 35% within two days and by an additional 18% within the following 10 months. 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 sharp increases in price for that power had a significant impact on the District’s total costs.

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

<u>Effective Date</u>	<u>Average Increase</u>
April 1, 2009	3.5%
October 1, 2009	2.9%
October 1, 2011	0.9%
April 1, 2012	2.9%
April 1, 2013	2.3%
October 1, 2013	2.7%
April 1, 2015	1.9%

The District enacted general rate increases of 3.5%, effective April 1, 2009, 2.9%, effective April 1, 2012, 2.3% effective April 1, 2013, and 1.9% effective April 1, 2015. Because the District contracts for a majority of its power supply from Bonneville, changes Bonneville makes to its power and transmission rates could potentially have a significant effect on the District’s overall power supply costs. In July 2009, the Commission adopted a policy providing for a review and pass-through of any adjustments to the costs of wholesale energy or transmission services charged by Bonneville, subject to the discretion of the Commission. The District has enacted rate increases of: 2.9%, effective October 1, 2009; 0.9%, effective October 1, 2011, and 2.7%, effective October 1, 2013, with each such increase consisting solely of a pass-through of the increased costs of power and transmission 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. 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 average rates in cents per kWh and monthly bills for selected levels for typical residential, commercial and industrial customers of the District as of April 1, 2015.

Electric System Typical Rates and Monthly Bills

	Average Rate (¢/kWh)	Monthly Bill
Residential⁽¹⁾		
1,000 kWh per month	9.451	\$95
2,000 kWh per month	9.451	\$189
Commercial⁽¹⁾		
1,500 kWh per month (12 kW demand)	9.030	\$135
9,000 kWh per month (30 kW demand)	8.493	\$764
Industrial		
150,000 kWh per month (400 kW demand)	7.795	\$11,692
400,000 kWh per month (1,000 kW demand)	7.674	\$30,697
Large Industrial		
1,800,000 kWh per month (5,000 kW demand)	6.389	\$115,010

⁽¹⁾ The District’s rates for residential and certain commercial customers do not include a customer or base charge. Although the figures are presented for monthly bills, the District reads meters and bills residential and certain commercial customers on a bi-monthly basis.
Source: The District.

The District’s accounts receivable write-offs in 2014 were approximately 0.39% 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 April 1, 2015⁽¹⁾

	Residential 1,000 kWh	Commercial 30 kW & 9,000 kWh Use	Industrial 400 kW & 150,000 kWh Use
The District	\$ 95	\$ 764	\$ 11,692
Washington Cities			
City of Seattle ⁽²⁾	93	719	10,406
City of Tacoma	82	728	8,885
Investor-Owned Utilities			
AVISTA	86	950	13,460
Pacific Power	84	753	10,143
Portland General Electric Co.	117	818	11,393
Puget Sound Energy	100	801	12,496
Western Washington Public Utility Districts			
PUD No.1 of Cowlitz County	83	746	10,272
PUD No.1 of Clark County	94	718	9,876

⁽¹⁾ Computed from the published rate schedules of the utilities listed. There may be some variations in rate schedules and/or rate classifications among the utilities. Although the figures are presented for monthly bills, the District reads meters and bills residential and certain commercial customers on a bi-monthly basis.

⁽²⁾ The City of Seattle rate structure includes seasonal differences in its summer and winter block rates, which affect monthly bills. For purposes of this table, the District has used an average of these block rates.

Source: The District and individual utilities.

Largest Customers

The Electric System's ten largest customers in terms of revenues accounted for approximately 11% of total retail MWh energy sales and 9% of retail energy sales revenue in 2014. The top two customers accounted for 6% of total retail MWh energy sales and 5% of retail sales revenue for the year ended December 31, 2014. The District's ten largest customers in alphabetical order for calendar year 2014 in terms of retail energy sales revenue were: The Boeing Company, City of Everett, Fred Meyer, Inc., Frontier Communications, Providence Medical Center, Safeway Stores, Snohomish County, State of Washington, Tulalip Tribes Inc., and the U.S. Navy.

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 2010 through 2014.

Electric System Customers, Energy Sales, and Peak Demand

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Average Number of Customers					
Residential	290,327	292,032	294,178	297,175	301,639
Commercial	29,626	29,823	30,011	30,280	30,524
Industrial	77	78	79	77	76
Other ⁽¹⁾	307	295	313	339	277
Total Customers	<u>320,337</u>	<u>322,228</u>	<u>324,581</u>	<u>327,871</u>	<u>332,516</u>
Retail Energy Sales (MWh)					
Residential	\$3,493,641	\$3,598,932	\$3,531,333	\$3,557,593	\$3,502,748
Commercial	2,371,690	2,391,539	2,364,872	2,390,699	2,390,801
Industrial ⁽²⁾	829,188	864,692	610,717	569,021	565,246
Other	26,661	26,583	28,662	27,395	27,314
Total Retail Energy Sales (MWh)	<u>6,721,180</u>	<u>6,881,746</u>	<u>6,535,584</u>	<u>6,544,708</u>	<u>6,486,109</u>
Energy Losses and Electric System Usage (MWh)	184,369	321,990	274,366	282,240	210,701
Wholesale Power Sales (MWh)	<u>1,352,152</u>	<u>2,152,735</u>	<u>2,658,970</u>	<u>1,976,233</u>	<u>2,326,185</u>
Total System Energy Requirements	<u>8,257,701</u>	<u>9,356,471</u>	<u>9,468,920</u>	<u>8,803,181</u>	<u>9,022,995</u>
Peak Demand (MW)	<u>1,490</u>	<u>1,375</u>	<u>1,324</u>	<u>1,444</u>	<u>1,465</u>

⁽¹⁾ Includes non-revenue MWh used internally by the Electric System, line losses and energy unbilled at the end of the period.

⁽²⁾ Decrease in Industrial Retail Energy Sales beginning in 2012 reflects closure of a large industrial customer.

The District's average number of customers increased by 12,179 from 2010 to 2014, reflecting a compound annual rate of 0.8%. During this period, average residential customers increased at a compound annual rate of 0.8%, average commercial customers increased at a compound annual rate of 0.6%, and average industrial customers decreased slightly by a compound annual rate of 0.3%.

Residential energy sales between 2010 and 2014 increased from 3,493,641 MWh to 3,502,748 MWh, a compound annual rate of 0.05%. Commercial sales increased from 2,371,690 MWh in 2010 to 2,390,801 MWh in 2014, a compound annual rate of 0.2%. Industrial sales declined at a compound annual rate of 7.4% from 2010 to 2014 as a result of the closure of a large industrial customer in 2011.

The amount of wholesale power sales typically varies year-to-year due to changes in annual hydrological conditions, retail customer demand and the initiation and expiration of power supply contracts. Wholesale power sales were higher in 2011, 2012 and 2014 due to weather conditions leading to strong hydroelectric generation in the Pacific Northwest.

ELECTRIC SYSTEM POWER SUPPLY

Overview

In 2014, over 82% of the District's long-term energy resources came from Bonneville, over 6% from the District's owned hydro resources (Jackson Project, Youngs Creek Project, Woods Creek Project),

7% from the long-term Renewable Energy Contracts, and approximately 5% from short-term market purchases. The District purchases and sells power in the short-term wholesale 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 2010 through 2014.

Electric System Energy Resources (Megawatt Hours)					
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Long-Term Energy Resources:					
Bonneville	6,397,575	7,620,284	8,162,912	7,421,283	7,424,006
Jackson Project	382,612	485,784	520,255	452,063	519,531
Cogeneration Project ⁽¹⁾	219,948	170,633	-	-	-
Renewable Energy Contracts ⁽²⁾	494,921	540,781	502,312	528,244	537,398
Small Hydroelectric Generation Projects ⁽³⁾	1,830	4,883	23,796	20,652	23,858
Other ⁽⁴⁾	93,808	101,703	22,813	18,940	25,143
Total Long-Term Energy Resources	<u>7,590,694</u>	<u>8,924,068</u>	<u>9,232,088</u>	<u>8,441,182</u>	<u>8,529,936</u>
Short-Term Energy Purchases ⁽⁵⁾	<u>667,007</u>	<u>432,403</u>	<u>236,832</u>	<u>361,999</u>	<u>493,059</u>
Total Energy Resources	8,257,701	9,356,471	9,468,920	8,803,181	9,022,995
Wholesale Power Sales ⁽⁶⁾	<u>(1,352,152)</u>	<u>(2,152,735)</u>	<u>(2,658,970)</u>	<u>(1,976,233)</u>	<u>(2,326,185)</u>
Total Net Energy Resources	<u>6,905,549</u>	<u>7,203,736</u>	<u>6,809,950</u>	<u>6,826,948</u>	<u>6,696,810</u>

⁽¹⁾ Pursuant to an operating agreement between Kimberly-Clark and the District, Kimberly-Clark was required to operate and produce output from the Cogeneration Project through December 31, 2016. Pursuant to a termination agreement, the operating agreement was terminated and Kimberly-Clark ceased producing energy effective September 30, 2011. See "THE GENERATION SYSTEM—The Cogeneration Project."

⁽²⁾ Renewable Energy Contracts include (i) a landfill gas contract with Public Utility District No. 1 of Klickitat County, Washington ("Klickitat County PUD") that began in November 2008 (the "Klickitat County PUD Landfill Gas Agreement"), (ii) a power purchase contract for 10% of the output from the White Creek Wind Project, which became effective in January 2008 (the "White Creek Wind Agreement"), (iii) two power purchase contracts, each for 50% of the output from the Hay Canyon Wind Project, which became effective in March 2009 (together, the "Hay Canyon Wind Agreements"), (iv) a power purchase contract for 100% of the output from the Wheat Field Wind Project, which became effective in April 2009 (the "Wheat Field Wind Agreement"), (v) a power purchase contract for output from the Hampton Lumber Mill Co-Generation Project, which became effective August 2006, and was amended in December 2011 (collectively, the "Hampton Lumber Mill Agreement"), and (vi) a power purchase contract for output from the Qualco Energy Biodigester Project, which became effective in January 2014 (the "Qualco Energy Agreement"). See "—Long-Term Third-Party Power Purchase Contracts."

⁽³⁾ Small Hydroelectric Generation Projects include the District-owned and operated Youngs Creek and Woods Creek hydroelectric projects, and the customer-owned 97 kilowatt Ebey Hill project from which the District purchases power under a small power production rate schedule.

⁽⁴⁾ Other includes (i) a power sales agreement for 100% of the output from the Packwood Hydroelectric Project, which expired September 2011 (the "2008-2011 Packwood Agreement"), (ii) a power sales agreement for 20% of the output from the Packwood Hydroelectric Project, which was amended and restated in October 2011 (the "2011 Packwood Agreement"). See "—Long-Term Third-Party Power Purchase Contracts."

⁽⁵⁾ Short-Term Energy Purchases represent energy purchases made daily to balance customer demand with power resource availability.

⁽⁶⁾ Wholesale Power Sales include energy sales made daily to balance customer demand with power resource availability.

The table on the following page presents purchased power costs for the Electric System for 2010 through 2014:

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

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Long-Term Energy Purchases:					
Bonneville ⁽¹⁾	\$ 175,759	\$ 185,648	\$ 213,008	\$ 210,095	\$ 213,296
Jackson Project	33,454	36,461	26,192	20,676	19,285
Cogeneration Project ⁽²⁾	13,848	19,418	11,770	10,308	9,125
Small Hydroelectric Generation Projects ⁽³⁾	716	457	2,372	2,479	2,577
Other Generation System Costs ⁽⁴⁾	12,188	2,285	12,041	18,728	18,132
Renewable Energy Contracts ⁽⁵⁾	36,549	39,291	37,405	39,421	40,493
Other ⁽⁶⁾	5,760	5,643	3,828	3,825	3,860
Total Long-Term Energy Purchases	<u>278,274</u>	<u>289,203</u>	<u>306,616</u>	<u>305,532</u>	<u>306,768</u>
Short-Term Energy Purchases:					
Market Purchases	36,988	15,625	5,729	13,671	21,218
Other Short-Term Purchases	4,786	3,965	4,956	4,369	4,388
Total Short-Term Energy Purchases	<u>41,774</u>	<u>19,590</u>	<u>10,685</u>	<u>18,040</u>	<u>25,606</u>
Total Purchased Power Costs ⁽⁷⁾	320,048	308,793	317,301	323,572	332,374
Wholesale Power Sales	(38,902)	(45,715)	(49,178)	(48,758)	(59,257)
Net Cost of Energy Purchased	<u>\$ 281,146</u>	<u>\$ 263,078</u>	<u>\$ 268,123</u>	<u>\$ 274,814</u>	<u>\$ 273,117</u>
Total Energy Purchases (MWh)	8,257,701	9,356,471	9,468,920	8,803,181	9,022,995
Less: Wholesale Power Sales	(1,352,152)	(2,152,735)	(2,658,970)	(1,976,233)	(2,326,185)
Net Energy Purchases (MWh)	<u>6,905,549</u>	<u>7,203,736</u>	<u>6,809,950</u>	<u>6,826,948</u>	<u>6,696,810</u>
Total Purchased Power (cents/kWh) ⁽⁷⁾	3.9¢	3.3¢	3.4¢	3.7¢	3.7¢
Net Purchased Power (cents/kWh) ⁽⁷⁾	4.1¢	3.7¢	3.9¢	4.0¢	4.1¢

⁽¹⁾ On October 1, 2011, the District began purchasing power from Bonneville under a new 17-year contract (as further defined below, the "Power Purchase Agreement"), pursuant to which the District may purchase up to 811 average annual megawatts ("aMW") at cost, or the "Tier 1 Rate." The amount of energy the District purchased under the Power Purchase Agreement beginning in October 2011 increased to 786 aMW from 706 aMW purchased under its prior contract with Bonneville. See "—Bonneville Power Administration—*The Bonneville Power Purchase Agreement*." During the five-year period presented, expenditures for Bonneville power purchases were reduced by a credit related to Bonneville's readjustment of the level of Residential Exchange benefits provided to investor-owned utilities as a result of a legal challenge and subsequent court decision regarding those benefits. This credit was \$9.4 million in 2010, \$8.0 million in 2011, \$8.8 million in 2012, \$8.8 million in 2013 and \$8.6 million in 2014. See "—Bonneville Power Administration—*Bonneville Residential Exchange Program*."

⁽²⁾ Operations at the Cogeneration Project were terminated effective September 30, 2011. Costs incurred after the project termination represent intersystem debt service costs related to the project that will be satisfied in 2016. See "THE GENERATION SYSTEM—*The Cogeneration Project*."

⁽³⁾ Includes costs that are charged to the Electric System from the Woods Creek Project, the Youngs Creek Project which began production in 2012, and design costs related to other low impact hydroelectric projects. See "— Small Hydroelectric Generation Projects."

⁽⁴⁾ Represents debt service on Generation System Bonds that is not directly related to current Generation System projects and other renewable generation costs.

⁽⁵⁾ Includes the White Creek Wind Agreement, the Hay Canyon Wind Agreements, the Wheat Field Wind Agreement, the Klickitat PUD Landfill Gas Agreement, the Hampton Lumber Mill Agreement, and the Qualco Energy Agreement. See "— Long-Term Third-Party Power Purchase Contracts."

⁽⁶⁾ Includes the 2008-2011 Packwood and 2011 Packwood Agreements, and other gas and small power production charges. See "— Long-Term Third-Party Power Purchase Contracts."

⁽⁷⁾ 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. The total and net purchased power costs per kWh vary annually as a result of changes in the District's resource portfolio, the impact of annual precipitation levels on hydroelectric power generation, and the additional power provided by Bonneville under the Power Purchase Agreement.

Bonneville Power Administration

Background

The Bonneville Power Administration was created by federal law in 1937, and is a revenue-financed federal agency under the United States Department of Energy (the “DOE”), 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. Bonneville markets power from resources having an expected aggregate output of approximately 11,078 average annual megawatts[±] (“aMW”) under average water conditions and approximately 8,300 aMW under critical water conditions. The federal hydroelectric projects and the related 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 supply. 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. It also owns and operates a high voltage transmission system comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest.

Bonneville is required by law to meet certain energy requirements in the region and is authorized to acquire power resources and take other actions to enable it to carry out these purposes. This includes the requirement for Bonneville to provide power to preference customers, like the District, so the utility can meet its total customer load and load growth, less its owned or purchased resources from non-federal generators. In doing so, Bonneville must give preference and priority to public body and cooperative utilities before offering to serve non-preference entities. Since 1937, Bonneville has always met its power marketing obligations to supply federal power to serve the firm power needs of its regional power customers.

On October 1, 2011, Bonneville’s customers began purchasing power from the agency under a new 17-year power contract under a tiered rate construct. Under this rate construct, a utility is eligible to purchase energy from Bonneville at a “Tier 1 Rate,” up to a pre-defined amount, or “High Water Mark.” The Tier 1 Rate is cost based and reflects the investment and operating costs of resources in the Federal System on October 1, 2011, the date the new 17-year contract went into effect.

Bonneville has agreed by contract to review and set the Tier 1 Rate every two years. The ratemaking process incorporates inputs from a number of public processes which include (i) the Integrated Program Review, which establishes Bonneville’s operating budgets and costs, (ii) the Capital Investment Review, which establishes the agency’s long-range capital plan, and (iii) the Rate Period High Water Mark process, through which the size of the Federal System and the total preference customer load is determined for the purpose of allocating costs under the tiered rates construct. At the conclusion of the ratemaking process, Bonneville submits its rates to FERC for approval. This review is to confirm Bonneville’s rates are sufficient to recover the agency’s costs.

Under the Power Purchase Agreement with Bonneville, the District’s High Water Mark for power it can purchase at the Tier 1 Rate is 811 aMW, which is 105 aMW higher than the District’s prior

[±] An average megawatt is the amount of electricity produced by the continuous production of one megawatt over a period of one year. The term average megawatt (or “aMW”) is also referred to as average annual megawatt, which defines power production in megawatt increments over time. There are 8,760 hours in a year, so an average megawatt (aMW) is equal to 8,760 megawatt-hours.

Bonneville contract amount of 706 aMW. In fiscal year 2014, the District purchased 751 aMW at the cost-based, Tier 1 Rate.

A utility may elect to purchase power from Bonneville for its customer loads that exceed its High Water Mark (“Tier 2 Power”), at a rate reflecting Bonneville’s incremental costs for additional resources. Alternatively, a utility may acquire power from other sources to serve loads above its High Water Mark. The District elected to use its own resources to serve any loads above its 811 aMW High Water Mark for fiscal years 2015 through 2019. In 2016, the District is required to provide notice to Bonneville of whether it intends to purchase Tier 2 Power from Bonneville for fiscal years 2020 through 2024, or rely on its own resources.

The Power Purchase Agreement

On December 1, 2008, the District executed a long-term power sales agreement with Bonneville (the “Power Purchase Agreement”), purchasing the “Block-Slice” product for the period October 1, 2011 through September 30, 2028. The Block-Slice product is a combination of two energy products: the Block component provides a set amount of energy delivered in flat monthly blocks; the Slice component represents a “slice” or percentage of the actual output of the Federal System.

Block Product. The Block product provides the District with power in flat monthly amounts that are determined based on the District’s average monthly load. In January 2014, for example, the Block product provided 441 aMW, while in June 2014, the amount was 308 aMW. In 2014, the District received 3,167,322 MWh from the Block product, at a total annual cost of \$97,868,754. For the period October 2013 through September 2014, the District received 3,127,320 MWh or 357 aMW of Block energy, at an average cost of \$31.14/MWh.

Slice Product. The Slice product provides the District with variable amounts of power that reflect the actual output of Bonneville’s resource portfolio. 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 Bonneville’s resources, and assumes the inherent risks. 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. If snowpack and water conditions that feed the Federal System are above average, the energy output from the Slice product will be above average. If snowpack and water conditions are low, then the output from the Slice product will be reduced.

The output of the Federal System can vary annually with changes in hydrological conditions. Regional weather patterns create the snowpack and precipitation levels that provide fuel for this expansive hydroelectric system. These weather patterns impact the five major water basins that feed the Federal System very differently. In 2015, for example, hydrological conditions west of the Cascade Mountains were impacted by above average temperatures and heavy precipitation at the start of the winter season, with no measurable build in snowpack, while conditions east of the Cascades, north into British Columbia, Canada, are experiencing near average conditions. This diversity in regional hydrological conditions is a result of the broad geographic footprint that encompasses rivers and major tributaries that extend from British Columbia, Canada, to the states of Washington, Oregon, Idaho and Montana. Columbia River water flows have been above average due to above average precipitation and early snowmelt due to warm weather, with 101% of average being observed at the Dalles Dam for the portion of the federal water year beginning October 1, 2014 through June 3, 2015, and current projections of 88% of average for the federal water year beginning October 1, 2014 and ending September 30, 2015, projected as of June 3, 2015.

As a purchaser of the Slice product, the District has an obligation to pay its *pro rata* share of Bonneville's actual operating costs for its Slice percentage. The District's Slice percentage is 5.454%, which is equivalent to 3,451,440 MWh or 394 aMW, under critical water conditions.

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 Bonneville's fiscal year 2014 True-Up Adjustment was a credit of \$8.35 million. Based on Bonneville's first quarter financial results for fiscal year 2015, the District's share of the Slice True-Up Adjustment is estimated to be a credit of approximately \$5.0 million.

The Slice portion of the Power Purchase Agreement 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 a factor of 0.12 multiplied by the District's total annual cost for Slice, or \$14 million. To date, the District has maintained ratings sufficient that it has not been required to provide collateral for this purpose.

Bonneville Residential Exchange Program

The Northwest Power Act of 1981 (the "Northwest Power Act") provides that a municipal or investor-owned utility may offer power to Bonneville, and Bonneville must purchase power from the utility, at the utility's average system cost. In exchange, Bonneville sells an equivalent amount of power to the utility for purchase by its residential and small farm customers at Bonneville's established Priority Firm ("PF") Exchange Rate. This is referred to as the "Residential Exchange Program." The PF Exchange Rate is established periodically by Bonneville as part of its rate case and is the lower rate Bonneville is required to provide to its municipal and electric cooperative utility customers. Benefits are settled financially with no energy exchanged.

Over the years there have been numerous legal challenges. In 2011, the parties reached a settlement agreement (the "2011 Settlement Agreement"), which provides an agreed basis and certainty for how the Residential Exchange Program is treated in Bonneville's rates through 2028.

The District has subsequently executed a Residential Purchase and Sale Agreement ("RPSA") with Bonneville for the period of October 1, 2011 through September 30, 2028. In accordance with the 2011 Settlement Agreement, the RPSA provides that the District may remain in or opt out of the Residential Exchange Program for future rate periods, depending upon its eligibility for participation. The District's residential customers were eligible to receive benefits in the form of rate credits totaling \$4.97 million during fiscal year 2012 and \$4.6 million during fiscal year 2013, but were not eligible for program benefits during fiscal years 2014 and 2015.

In June 2014, the District submitted its financial information to Bonneville to determine its eligibility to participate in the Residential Exchange Program for fiscal years 2016 and 2017. Bonneville's determination as to the amount of benefits the District's residential customers would be eligible to receive under this program, if any, is expected in July 2015.

Bonneville's Transmission Service Contracts

The District contracts with Bonneville for its firm transmission needs. The District currently contracts for 1,919 MW of transmission capacity on Bonneville's transmission network. Of this amount, 1,357 MW are designated for delivery to the District's service area. When the District requires more than 1,357 MW delivered to its service area, the staff formally requests Bonneville, through its Open Access

Same-Time Information System (the “OASIS”), to “redirect” contracted transmission capacity to other District interconnection points. The District also has rights to 97 MW of transmission associated with the long-term Wheat Field Wind Project power purchase agreement. The District can redirect this transmission capacity on a short-term basis, to the extent it is not needed to deliver wind output from the project.

The District also has contractual scheduling 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 Intertie network, and as a result of Congress’ requirement for nonfederal participation, Bonneville offered capacity ownership and scheduling 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.

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. (“Iberdrola”) Bonneville approved the assignment of the District’s Third AC capacity and scheduling rights to Iberdrola in March 2009.

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 assignment term, the Third AC capacity and scheduling rights will revert to the District. See “–Long Term Third-Party Power Purchase Contracts–Hay Canyon Wind Agreements.”

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 Washington State. 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 \$5.44 billion in outstanding bonds (as of September 30, 2013) for Energy Northwest’s Project No. 1, Project No. 2 (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 and refinance 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 Net Billed 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 "*—Long-Term Third-Party Power Purchase Contracts—Packwood Agreements.*"

Bonneville and Columbia River Treaty

The Columbia River Treaty (the "CRT") is an international treaty between Canada and the United States of America. Ratified in 1964, the CRT named two "entities" to implement the CRT — a "U.S. Entity" and a "Canadian Entity." The U.S. Entity, created by the President, consists of the Administrator of Bonneville (chair) and the Northwestern Division Engineer (member) of the U.S. Army Corps of Engineers. The Canadian Entity, appointed by the Canadian Federal Cabinet, is the British Columbia Hydro and Power Authority (B.C. Hydro). Canada and the United States each have the option to terminate many of the CRT provisions by providing a 10-year advance written notice.

The CRT called for the construction and operation of three large dams in the upper Columbia River basin in British Columbia, Canada, and gave the U.S. an option to build a fourth dam in Montana with a reservoir that extends into Canada. The operation of CRT dams was designed to provide flood control and hydropower benefits to both countries, which made other benefits possible. These benefits included dams that doubled the amount of Columbia River basin reservoir storage, which helped transform annual river and stream flows by storing the spring runoff for release during the fall and winter months, or even in subsequent years. This helped eliminate major flood damage for all but the most extreme events. The dams constructed in the Columbia River basin as a result of the CRT provided power generation, flood control, navigation and irrigation benefits.

The CRT flood control operations, which provide significant benefits to the United States, will expire in September 2024. Terms and conditions for ongoing flood control will need to be renegotiated, regardless of whether or not the CRT is terminated. In addition, U.S. operations of the Columbia River system for fisheries management have significantly reduced the original downstream power benefits provided under the CRT.

Leading up to 2014, the U.S. Entity engaged in a multi-year effort and collaborated and consulted with the region's sovereign states, federally recognized tribes, and a variety of stakeholders to evaluate the regional cost and benefits of the CRT after 2024. At the conclusion of this effort, the U.S. Entity issued a Regional Recommendation to the United States Department of State in December 2013. This recommendation identified potential modifications to the CRT post 2024, and outlined a general set of principles. The recommendation requested that the U.S. government make a decision by mid-2014 to proceed with a renegotiation of the CRT with Canada and also requested that the U.S. government complete that effort no later than 2015. To date, the U.S. Interagency Policy Committee has completed their review of the Regional Recommendation, but there is no word on when the U.S. State Department will make a final decision on next steps. The long-term resolution of the CRT post-2024 is unknown at this time.

Bonneville's Over-Generation Conditions

Bonneville began in 2011 to implement policies to address a unique set of over-generation conditions. Over-generation conditions can occur during spring runoff periods when high water flows into the Federal System from melting snowpack combine with high generation levels from wind projects, resulting in generation levels that exceed the load needs inside the Bonneville footprint and export commitments. These policies include: the one-year Interim Environmental Redispatch and Negative Pricing Policies (the “ER Policy”) of 2011; the Oversupply Management Protocol I (“OMP I”) established in 2012 which replaced the ER Policy; and the Oversupply Management Protocol II (“OMP II”), which replaced OMP I in 2013, and is set to expire on September 30, 2015.

Under both the ER Policy and the OMPs, if the electricity supply in the Bonneville footprint exceeds demand, Bonneville will reduce the output of any non-federally owned generation that does not affect reliability, and substitute hydroelectric power from the Federal System to ensure Bonneville can meet its environmental, statutory and reliability responsibilities. The intent of the ER Policy and the OMPs is to move the high water flows through the Federal System to create energy, rather than spilling additional water from dams into the river and potentially harming fish. Bonneville then compensates the generators for certain costs related to the displacement. These “oversupply costs” are then allocated to the generators based on their scheduled use of transmission during the oversupply condition or event.

Under the ER Policy of 2011, Bonneville did not provide compensation to entities whose generation was displaced. Bonneville reported it displaced approximately 97,000 MWh between May and July 2011. A group of large wind generators/owners challenged the Bonneville ER Policy in a petition for review in the United States Court of Appeals for the Ninth Circuit (“Ninth Circuit”) in late 2011. In January 2014, Bonneville entered into a settlement with most, but not all of the petitioners in that case. Under the ER Policy Settlement, Bonneville agreed to pay a total of \$9 million, and the affected petitioners agreed to voluntarily dismiss their appeals. Bonneville plans to expense the \$9 million to its Transmission Services during the first quarter of fiscal year 2015. This settlement amount will draw down Bonneville’s Transmission Services’ reserves, with no direct out-of-pocket expense billed to the District.

Under the OMP I established in 2012, Bonneville employed a least cost displacement model that encouraged generators to submit costs for their facilities so that Bonneville could compensate them in the event their generation was displaced during an oversupply event with Federal hydropower. During 2012, Bonneville reported that it displaced approximately 49,000 MWh of regional generation, resulting in approximately \$2.7 million in displacement costs. Bonneville has determined through a formal rate case that it will allocate these displacement or “oversupply costs” to customers for both OMP I (for fiscal year 2012) and OMP II (for fiscal years 2013 through 2015), based on the generators’ use of transmission during the oversupply period. For OMP I, the District’s share of the oversupply costs was \$258,888, billed by Bonneville in December 2014. Bonneville did not have any oversupply events during fiscal years 2013 and 2014, so there currently are no OMP II displacement costs.

As a result of the ER Policy and OMP I, a small portion of the District’s contracted-for wind generation was displaced by Bonneville with an equivalent amount of hydro power being provided from the Federal System at zero cost in 2011 and 2012. Under the provisions of the District’s wind contracts, it is not required to pay for wind energy when Bonneville directs the wind projects to reduce their generation levels. During these periods, the District received replacement energy from Bonneville, but did not receive the renewable energy credits (“RECs”) or the associated environmental attributes that would have been produced if the wind projects had been allowed to generate. The number of RECs the District did not receive as a result of the ER Policy and the OMP I did not adversely affect the District’s ability to comply with its renewable energy portfolio requirements under Washington State law. See “—Long-Term Third-Party Power Purchase Contracts,” “—Wholesale Power Market Purchases, Sales and Trades—Renewable Energy Credits” and “—Washington State Energy Initiatives and Legislation—Washington State’s

Renewable Energy Portfolio and Conservation Standards.” Although there is a possibility that energy from the District’s contracted-for wind projects could be displaced in the remaining time period of OMP II, the District does not expect that such displacement or loss of RECs will adversely affect its continued compliance with renewable energy portfolio requirements under Washington State law.

Legal Proceedings - ER Policy

In response to a complaint filed by a group of wind generators and investor owned utilities with FERC in 2011, FERC issued an order (the “FERC ER Order”) concluding that the ER Policy resulted in non-comparable transmission service that was unduly discriminatory and preferential under the Federal Power Act and ordered Bonneville to submit a revised tariff within 90 days. The District and other parties appealed the FERC ER Order to the Ninth Circuit, which is currently pending. The arguments raised by the District and other petitioners relate to FERC’s jurisdiction over the ER Policy and the basis FERC used in making its determination. The District is not aware of any potential impacts the Ninth Circuit’s forthcoming decision on the appeal of the FERC ER Order will have on the ER Policy Settlement discussed above.

Since Bonneville’s ER Policy Settlement, the remaining petitioners also requested dismissal of their appeals. The Ninth Circuit subsequently issued orders granting dismissal of all appeals in the proceeding.

Legal Proceedings - OMP I and OMP II

Several parties have appealed both OMP I and OMP II to the Ninth Circuit. Some of these same parties have submitted requests for rehearing of FERC orders which (i) accepted OMP I and OMP II as in compliance with prior FERC orders and the Federal Power Act, and (ii) confirmed and approved the outcome of Bonneville’s formal rate proceeding on OMP under the Pacific Northwest Electric Power Planning and Conservation Act. On February 19, 2015, FERC denied the requests for rehearing. Parties are now allowed to appeal the FERC orders to a federal appellate court within sixty days.

The District cannot predict what impact the proceedings before FERC and the Ninth Circuit with respect to OMP I or OMP II may have on the District.

District-Owned Power Supply

The District receives power from three District-owned generation projects: the Jackson Project, the Woods Creek Project and the Youngs Creek Project. In addition, the District is in the process of developing several additional low-impact hydroelectric projects. See “THE GENERATION SYSTEM—Small Hydroelectric Generation Projects.”

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. The Jackson Project has a total nameplate capacity of 111.8 MW. 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. FERC issued a new 45-year license to the District, as sole licensee, in September 2011. In 2014, the Jackson Project produced 519,532 MWh. See “THE GENERATION SYSTEM – The Jackson Project – FERC License.”

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. This project is adjacent to Woods Creek, a tributary of the Skykomish River, with a powerhouse located above a natural impassable barrier to anadromous fish. In 2014, the Woods Creek Project produced 2,043 MWh, of which 1,546 MWh qualifies as incremental hydro under Initiative 937. See “THE GENERATION SYSTEM – Small Hydroelectric Generation Projects – *Woods Creek Project*.”

Youngs Creek Project

In 2008, the District acquired the lands, access rights and studies for the Youngs Creek Project located just south of the city of Sultan, Washington. An existing FERC license was successfully transferred to the District. The Youngs Creek Project was completed and commissioned in October 2011. The Youngs Creek Project has a nameplate capacity of 7.5 MW and produced 21,549 MWh in 2014. See “THE GENERATION SYSTEM—Small Hydroelectric Generation Projects—*Youngs Creek Project*.”

Long-Term Third-Party Power Purchase Contracts

The District has a number of long-term contracts for power supply. All of these contracts are take and pay agreements and are associated with acquiring the output from specific generating projects.

Hay Canyon Wind Agreements

The District executed two power purchase agreements in February 2009 with Hay Canyon 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, a subsidiary of Iberdrola, whose parent company is Iberdrola Renewables, one of the world’s largest wind developers with over 9,000 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 260,000 MWh. The District receives 50% of the project’s output under a 15-year power purchase agreement and 50% under an 18-year power purchase agreement. For the year ended December 31, 2014, the District purchased output totaling 228,535 MWh. 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 Power Administration—*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.”

Wheat Field Wind Agreement

The District executed a 20-year power purchase agreement with Wheat Field for 100% of the project’s 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, in conjunction with Horizon Wind Energy, LLC, which was rebranded in 2011 to EDP Renewables North America LLC. The project is owned and operated by Wheat Field. The District began receiving energy output under the agreement on April 1, 2009. The Wheat Field Wind Project has an estimated annual output of approximately 255,000 MWh, and qualifies as an eligible renewable resource under Initiative 937. For the year ended December 31, 2014, the District purchased output totaling 217,684 MWh. See “—Washington State Energy Initiatives and Legislation.”

White Creek Wind Agreement

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 Wind Project output is equivalent to 20 MW of wind capacity, with an average annual output of approximately 52,000 MWh. The project achieved commercial operation in November 2007, and the District began taking output under its contract in January 2008. For the year ended December 31, 2014, the District purchased output totaling 51,970 MWh. This wind project qualifies as an eligible renewable resource under Initiative 937. See “—Washington State Energy Initiatives and Legislation.”

Packwood Agreements

Energy Northwest owns and operates the Packwood Hydroelectric Project, located 20 miles south of Mount Rainier in Packwood, Washington. The Packwood Hydroelectric Project began operating in 1964 and has a nameplate capacity of 27.5 MW. The District currently contracts for a 20% share, or approximately 17,000 MWh of annual energy from the project. For the year ended December 31, 2014, the District's share was 25,143 MWh.

Klickitat County PUD Landfill Gas Agreement

The District secured a power purchase agreement effective November 1, 2008 with Klickitat County PUD, for approximately 17,500 MWh in annual energy and RECs from the H.W. Hill Landfill Gas Project, located in Klickitat County, Washington. This contract will expire October 31, 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 Agreement

In 2006, the District executed a 10-year power purchase agreement with Hampton Lumber Mills-Washington, Inc. for 100% of the electrical output of a cogeneration project located at the Hampton Lumber Mill in Darrington, Washington. In December 2011, the District amended its existing contract to include the purchase of the energy and the RECs associated with the full electrical output of the project and the option to extend the contract term in five year increments, by mutual agreement, beyond the 2016 expiration date. The project utilizes wood waste (biomass) and has a nameplate capacity of 4.5 MW and is recognized as an eligible renewable resource under Initiative 937. For the year ended December 31, 2014, the District purchased output totaling 18,993 MWh.

Qualco Energy Agreement

The District executed a five-year power purchase agreement with the Qualco Energy Corporation for 100% of the output and RECs from its 450 kilowatt bio-digester facility located in Monroe, Washington. Fuel for the project is provided through anaerobic digestion, which uses waste from local dairy operations and other bio-waste products such as restaurant trap grease and expired alcohol and beverages. This generator qualifies as an eligible renewable resource under Initiative 937. The project is owned and operated by Qualco Energy Corporation, a nonprofit partnership between Northwest Chinook Recovery, the Tulalip Tribes and the Sno/Sky Agricultural Alliance. The power purchase agreement began January 2014, and includes an option to extend the term in five year increments, by mutual agreement, beyond the 2018 expiration date. During 2014, the District purchased output totaling 3,127 MWh.

Conservation

The District has offered energy efficiency programs to its customers for over thirty years. These programs provide energy savings opportunities over a broad range of electric uses, from installing LED lighting to analyzing process improvements for industrial operation. In 2014, District programs enabled customers to reduce their annual energy consumption by approximately 87,000 MWh. On a cumulative basis, average electric loads in 2014 were more than 100 aMW lower than would have occurred without the existence of the District's long-standing programs.

Residential Programs

Programs currently available to residential customers promote energy efficiency improvements for space heating, water heating, lighting, appliances and consumer electronics. Customers can take advantage of upfront cash incentives for floor, wall, ceiling and duct insulation, high-efficiency heat pumps, and insulated windows. The District also offers rebates for efficient appliances, in addition to manufacturer buy-downs and rebates for LED bulbs and fixtures. Because the District works with others in the Pacific Northwest region, District customers benefit from regionally coordinated buy-downs for products including consumer electronics.

Commercial and Industrial Programs

Commercial and industrial customers receive technical assistance, incentives and rebates for energy efficiency measures, including lighting controls and fixtures, heating, ventilating, and air conditioning equipment, compressed air systems, motors, pumps and fans, refrigeration, heat recovery systems, and variable frequency drives. The District's executive account managers and energy engineers work closely together to identify custom efficiency solutions for large customers. For smaller businesses, the District has established standardized rebate amounts for lighting and commercial cooking equipment, similar to the strategy for measures in the residential sector.

The District offers incentives for residential and commercial new construction projects. These incentives enable staff to influence design decisions and encourage owners, builders and architects to incorporate efficiency technologies in new homes and buildings.

Customer Renewables Programs

The District implemented its *Solar Express* program in 2009 for residential and business customers who install solar photovoltaic or solar hot water systems in their homes and businesses. To date, the program has resulted in more than five hundred installations across the District's service area.

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 2014, the District sold 2,326,185 MWh and purchased 493,059 MWh in the short-term market. The short-term market purchases were made to serve customer loads during the winter months when peak demands (driven by space heating loads) 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 in 2014. All employees involved in the District's energy supply, energy 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.

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 creditworthy 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 allows 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 MWh 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 MWh. 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. The District has not entered into any such hedges.

Dodd Frank Act

In July 2010, the Dodd-Frank Wall Street Transparency and Accountability Act ("Dodd Frank") was signed into law. Dodd-Frank vastly expanded the role of the Commodity Futures Trading Commission ("CFTC") in regulating "swaps," which generally include energy and other commodity derivatives. The CFTC has implemented and continues to implement various provisions of Dodd-Frank through rulemakings. Significantly, Dodd-Frank and the CFTC rules thereunder generally exclude from the "swap" definition forward contracts in nonfinancial commodities that are intended to be physically settled. The District engages mostly in forward contracts for physical commodities that should qualify for that exclusion. Additionally, a CFTC interim final rule issued in April 2012 and a related 2013 CFTC no-action letter provide that qualifying commodity options ("trade options") are generally exempt from the relevant swap regulations, subject to certain specified conditions. The District also engages in such trade options. No final rule regarding trade options has yet been issued, but in May 2015 the CFTC proposed a rule that would, like the 2012 interim final rule and related 2013 CFTC no-action letter, generally exempt

trade options from the relevant swap regulations, subject to certain specified conditions. The District cannot predict whether this proposed rule will be finalized in its current form or how a final rule regarding trade options may affect the District. The District does not anticipate engaging in other transactions that would qualify as swaps subject to CFTC regulation. To the extent the District does engage in such transactions, certain of the more significant Dodd-Frank requirements should not apply to the District, as a non-financial end-user. For example, the District likely would qualify for the “end-user exception” from the Dodd-Frank requirement that certain swaps be executed on an exchange and centrally cleared. Nevertheless, certain other requirements, including reporting and recordkeeping, would apply, potentially raising costs for the District.

Renewable Energy Credits

Renewable Energy Credits, or 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 Washington State renewable portfolio standards (RPS). Initiative 937 (Chapter 19.285 of the Revised Code of Washington), applies to utilities with over 25,000 customers, and establishes a minimum target for the amount of renewable resources it must include in its power supply portfolio to serve its customers. The legislation provides three different methods by which a utility can demonstrate it is compliant for the target year. See “—Washington State Energy Initiatives and Legislation – *Washington State’s Renewable Portfolio and Conservation Standard.*”

As a matter of policy, the Commission approved the sale of up to 100% of RECs that are surplus to the District’s Initiative 937 needs. The proceeds from such sales have been earmarked to both reduce the cost of renewable energy resources the District invests in, and to 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 generated 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 2014, District revenue from the sale of surplus RECs was \$3.8 million.

The District’s Future Power Supply Strategy

For purposes of long-term resource planning, the District projects customer loads to grow by approximately 20% from 2015 to 2024, with a compound annual growth rate of 2% per year during that period. The District expects to meet this increased demand by pursuing a diverse mix of new conservation and renewable resources. The District expects that it will be able to meet forecast customer loads through 2023 with its current and committed resources, combined with new conservation achievements. The District utilizes more conservative assumptions for load growth in the financial plan, which assumes no projected residential load growth. See “Financial Plan—*Load Forecast.*”

District’s 2013 Integrated Resource Plan. Washington State law requires utilities with more than 25,000 customers in the State to develop and adopt an updated Integrated Resource Plan (“IRP”) at least every four years and provide a progress report at least every two years. The District’s 2013 Integrated Resource Plan (the “2013 IRP”) was formally adopted by the Commission in November 2013. See “—Washington State Energy Initiatives and Legislation—*Washington State Integrated Resource Planning Requirements.*” This planning document established the following policy and actions necessary to meet the District’s expected load growth: implement all cost-effective energy conservation measures; conduct a thorough situational scan of demand response technologies and applications; evaluate energy storage technologies and execute the Modular Energy Storage Architecture project; continue to evaluate geothermal development potential within Washington State; continue efforts to license and implement a tidal energy pilot demonstration project in Puget Sound; continue to identify and evaluate new small hydroelectric resources; participate in Initiative 937 rulemaking; continue to monitor new demand-side and

supply-side technologies and pursue where applicable; and actively participate in capacity planning efforts underway in the region.

The 2013 IRP also identified a winter planning standard and an action plan to ensure that enough resources would be available, at reasonable cost, to meet the District's future load growth. Energy efficiency, renewable power supplies, purchased power contracts, and District-owned resources are among the potential alternatives identified. The actual development of a resource is dependent on various factors.

In 2015, the District will provide a progress report on the 2013 IRP, incorporating the most recent information affecting forecast load growth, impacts to the planning environment in which the District operates, and changes in resource assumptions. The information will be used to develop a revised set of avoided costs, which serve as the basis for conducting a conservation potential assessment for the 2015 through 2028 planning horizon. The 2015 progress report will also inform the District's two-year conservation target for 2015 and 2016, and the 10-year conservation potential estimate for the 2015-2025 period. The District is scheduled to develop its next comprehensive IRP in 2017. See “—Washington State Energy Initiatives and Legislation—*Washington State's Renewable Portfolio and Conservation Standard.*”

Geothermal. The 2013 IRP identified the addition of 10 MW of geothermal energy on line by the year 2026 to meet forecast load growth needs post 2024. To that end the District had engaged in exploration of feasible geothermal sites with two independent geothermal consultants. After drilling a series of test wells, and evaluating sites with consultants, the District determined that the site at Garland Mineral Springs was the only one that warranted further exploration. In fall 2011, the District drilled a 5,000-foot deep well to establish temperature gradient profile below 700 feet (previous drill depth). The information gathered was valuable for researchers and provided additional experience in geothermal development. However, the temperatures and permeability conditions at this site did not warrant additional exploration. The District has broadened its assessment of geothermal potential beyond Snohomish County and is considering other sites in and around the Cascade Mountains for additional research.

Tidal Energy. The District took a leadership role in the research and development of tidal energy in the Pacific Northwest and submitted a Final License Application to FERC for the Admiralty Inlet pilot demonstration plant in March 2012. While the project was expected to be connected to the grid and generate only a modest amount of energy, the primary purpose of the project was to generate data to inform evaluation of the technical, economic and environmental viability of commercial tidal energy generation in Puget Sound. In fiscal year 2010, the Department of Energy (DOE) awarded the District a grant in the amount of \$10 million to advance the Admiralty Inlet pilot project. Initial site preparation was slated to begin in 2015, with deployment of the turbines into the water in summer 2016.

Since the preliminary permit filing with FERC in 2006, the cost of the materials needed to eventually build the project have risen and various entities have mandated an increasing amount of studies and monitoring requirements beyond installation of the tidal turbines. These all contributed to an increase in the estimated cost for the overall effort and as a result, the District has terminated activity on the Project.

While the Admiralty Inlet project will not move forward without additional research partner funds, a great deal of value has been derived from the study process over the past eight years. The information gained has greatly enhanced the collective knowledge of the environment and species that inhabit Puget Sound and the results have helped inform tidal energy researchers worldwide.

Energy Storage. The District, along with several project partners, is designing a new model of battery architecture, or Modular Energy Storage Architecture (MESA). MESA is a set of nonproprietary design and connectivity standards that provide a scalable approach for energy storage control system integration and optimization. The MESA project is aimed at standardizing software and communications

interfaces between battery storage unit components and a utility's IT systems, with the goal of driving down the costs of this flexible technology. The District has teamed up with 1Energy Systems, Alstom Grid, the University of Washington, Pacific Northwest National Labs and other private- and public-sector partners in order to develop and demonstrate the MESA standards. This first-generation effort includes two demonstration projects with a capacity of 2 MW and 2.2 MW. The first system was installed December 2014 at a District substation; the second installation is planned for 2015.

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 or more), has low operation and maintenance costs, and can produce relatively predictable output. The District is currently operating two such projects, the Woods Creek and the Youngs Creek projects. In 2010, the District purchased the lands, associated rights and studies to develop the Calligan Creek hydroelectric project (the "Calligan Creek Project") and the Hancock Creek hydroelectric project (the "Hancock Project") located adjacent to the District's service territory in north King County. The District currently expects these projects to come online in late 2016 or early 2017.

FERC issued a preliminary permit in March 2012 for the District to study and assess the run-of-the-river hydroelectric project known as the Sunset Fish Passage and Energy Project on the Skykomish River.

See "THE GENERATION SYSTEM—Small Hydroelectric Generation Projects—Other Low Impact Hydroelectric Projects."

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 the policy, the District, among other things, (i) commits that it 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.

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 Measure 937 ("Initiative 937"), codified as the Energy Independence Act, Chapter 19.285 RCW, requiring electric utilities with over 25,000 customers in the State to accomplish all cost-effective conservation and, by 2020, use certain eligible renewable resources to serve at least 15% of their retail loads. Specifically, Initiative 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) every two years, calculate and document 10-year conservation potential; (iii) produce detailed analyses of how energy will be conserved through end-user programs, production and distribution efficiencies, co-generation and/or distributed generation; (iv) use eligible renewable resources to serve 3%, 9% and 15% of the utility's retail loads by 2012, 2016 and 2020, respectively; and (v) beginning January 1, 2012, report

annual 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). 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 or renewable resource targets.

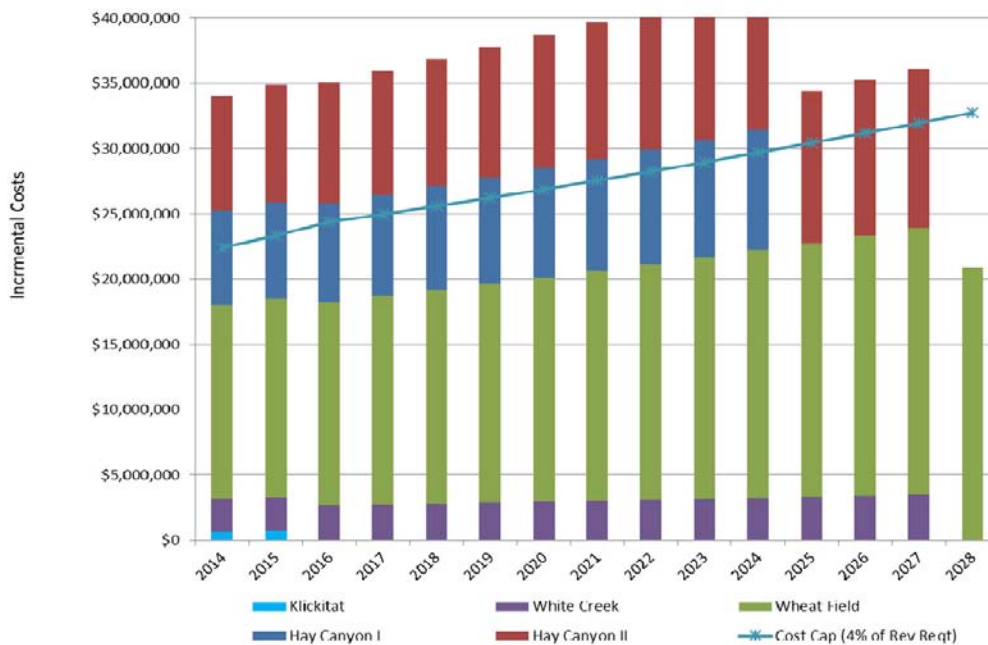
To satisfy the renewables target for a given compliance year, a qualifying utility may elect to serve an increasing percentage of its load with certain eligible renewable generation or RECs ("target method"). These targets are 3% of load served by renewables by 2012, 9% by 2016 and 15% by 2020. A utility may also "bank" or "carryover" the RECs generated by the renewable resources in its portfolio the year prior to, the year of, and the year after, the compliance target year. For example, a utility can apply the RECs generated in 2015 by its renewable resource to the utility's 2016 compliance requirement.

The District's renewables targets translate into approximately 24 aMW, 73 aMW and 127 aMW, for the compliance years 2014, 2016 and 2020, respectively. As of January 1, 2014, the District has acquired approximately 73 aMW of eligible renewable resources from its own resources or long-term power supply contracts, including the White Creek Wind Agreement, the Wheat Field Wind Agreement, the Hay Canyon Wind Agreements, the Hampton Lumber Mill Agreement, the Klickitat County PUD Landfill Gas Agreement, the District's Solar Express Program, incremental hydro from the District's Woods Creek Hydroelectric Project, and approximately 4 aMW of RECs from Bonneville's resource portfolio. The District is eligible to receive an allocation of RECs from Bonneville under its Block-Slice Power Purchase Agreement; the REC quantity is determined annually. For the year ending December 31, 2014, Bonneville's allocation of RECs to the District was 49,064 MWh.

Using the banking provisions under Initiative 937, which allows RECs to be applied to target year from the year prior or year after the compliance period, the District expects to meet its annual renewable resource target through approximately 2019.

Initiative 937 also includes an alternative compliance method for satisfying the renewables target known as the "cost cap" or financial path. Under this method, a utility has met its renewables target if it can demonstrate it has invested at least four percent of the utility's total annual retail revenue requirement in the incremental cost of certain renewable resources, when compared to the cost of an alternate, or non-renewable resource. Beginning in 2013, the District elected to meet its Initiative 937 renewables target using the financial path or cost cap method. Under the cost cap methodology, the District's incremental investment in renewable resources is expected to meet or exceed the four percent threshold through approximately 2027, as shown in the chart on the following page.

**District's Annual Forecast Incremental Cost of Renewable Resources
vs. 4% of Total Annual Retail Revenue Requirement**



In November 2013, the Commission adopted conservation targets for years 2014-2015 of 13.3 aMW, or 6.7 aMW per year, and set its 10-year conservation potential estimate at 73.1 aMW for the 2014-2023 period. The District subsequently filed the two-year target and 10-year potential estimate with the Washington State Department of Commerce in December 2013.

In accordance with Initiative 937 reporting requirements, the District submits its annual filings with the Washington State Department of Commerce by June 1 each year. This report consists of: (i) total owned and acquired renewable resources as of January 1 of the target year; and (ii) the actual conservation achievements for the two-year period, compared to the adopted target.

The Washington State Auditor's Office is responsible for auditing utility compliance with Initiative 937. In auditing the District's 2013 compliance year in 2014, the State Auditor's Office raised questions regarding the District's interpretation and application of the cost cap methodology for the renewables portion of the law. After a lengthy exchange of opinions about the proper interpretation of Initiative 937, the District submitted in December 2014, under protest, an alternate compliance document for the 2013 compliance year using the target method. The District has filed a declaratory judgment action in the Washington State superior court, requesting that the court validate the District's proposed use of the financial cost cap methodology for the 2013 compliance year.

Washington State Integrated Resource Planning Requirements

In 2006, the Washington State Legislature passed a law requiring electric utilities with more than 25,000 customers in the State (that are not full requirements customers of Bonneville) to develop an

Integrated Resource Plan or IRP. 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 criterion; (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.

Washington State Emissions Performance Standards

In 2008, legislation was adopted in Washington requiring reductions in greenhouse gas (“GHG”) emissions, initiating GHG reporting requirements, and requiring the Washington State Department of Ecology to make recommendations for the development of a market-based cap and trade system. Under the legislation, the State must reduce overall GHG emissions to 1990 levels by 2020; to 25% below 1990 levels by 2035; and to 50% below 1990 levels by 2050. The legislation also required the Washington State Department of Ecology to adopt rules requiring the reporting of GHG emissions. Subsequent legislation adopted in 2010 aligned the Washington State GHG reporting protocols with federal regulations promulgated by the Environmental Protection Agency. The Washington State Department of Ecology rules for the reporting of GHG emissions became effective on January 1, 2011. Mandatory reporting for facilities with annual GHG emissions of 10,000 metric tons CO₂ equivalent or greater began with 2012 emissions reported in 2013.

Related legislation provides that generation sources underlying power supply 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 Washington State Department of 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, Washington State Department of Commerce and Bonneville coordinated and adopted rules to implement and enforce these standards. In addition to compliance with such ceiling, owners of generation facilities were required to comply with certain mandatory reporting requirements beginning in 2013 (based on 2012 emission levels).

Voluntary Green Power Program Legislation

Since 2002, Washington State law has required that larger electric utilities in Washington State offer retail customers an option to purchase qualified alternative energy resources—often referred to as green power. Utilities have two options for providing customers with qualified green power: actual power from qualified green resources, or RECs. The law also requires electric utilities to maintain and make available upon request certain information and details regarding their green power programs. As a consumer-owned utility, the District provides this information annually to the Washington State Department of Commerce. See “—Wholesale Power Market Purchases, Sales and Trades—*Renewable Energy Credits*.”

The District’s Planet Power program provides all of its customers the opportunity to make voluntary contributions that are used to fund the development of small-scale solar generation projects within the utility’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 locally from renewable sources. The program exemplifies the District's efforts to develop and promote green energy sources throughout its service territory. As of December 31, 2014, the District's Planet Power program has funded 29 photovoltaic installations with a combined capacity of 165 kilowatts; 16 of these systems were installed on schools or colleges and include a strong educational component.

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 making a one-time purchase of a minimum of five green blocks or designating an amount of green blocks that they would like to purchase each month. The Green Blocks program is supplied with RECs from various wind projects throughout the Pacific Northwest.

Regional Transmission Planning

Regional Transmission Planning

Bonneville owns and operates a high voltage transmission system comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest. The District depends on Bonneville for the vast majority of its regional transmission needs and does not provide transmission services to others. While the District is not FERC jurisdictional and is not required to participate in joint regional planning, it is nonetheless interested in the development of a robust transmission network throughout the Pacific Northwest. The District is a member of ColumbiaGrid along with eight other private and public utilities, including Bonneville, Avista Corporation, Puget Sound Energy, Seattle City Light, Public Utility District No. 2 of Grant County, Washington, Public Utility District No. 1 of Chelan County, Washington, and Tacoma Power. ColumbiaGrid staff along with member utilities carry out transmission planning studies, coordinate and facilitate transmission expansion projects and develop new tools and processes for increasing the efficiency and utilization of the regional network.

Puget Sound Area Transmission Initiatives

Changing generation patterns and loads within the metropolitan Puget Sound area, regional transmission outages, and Bonneville's obligation to return energy to Canada under the CRT, have occasionally created transmission congestion which has impacted the District. Coordinated actions to re-dispatch local generation and a memorandum of understanding citing investment and cost-sharing responsibilities was signed by Bonneville, Seattle City Light and Puget Sound Energy in December 2011. These actions have averted the need to drop customer load in the Puget Sound area. The District is not a party to this agreement.

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 the District 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.

FERC Order 1000

In 2011, FERC issued Order 1000, which amended the transmission planning and cost allocation requirements established in Order 890. FERC issued Order 1000A in 2012, to include clarifications in response to petitions for rehearing filed on the original Order 1000. FERC subsequently issued Order 1000B, affirming its basic determinations in Order 1000 and Order 1000A in response to petitions for rehearing filed on Order 1000A. Collectively, these Orders are referred to as “Order 1000.” With respect to transmission planning, Order 1000 (i) requires that each jurisdictional utility transmission provider participate in a regional transmission planning process that produces a regional transmission plan; (ii) requires that each jurisdictional utility transmission provider amend its OATT to describe procedures that provide for the consideration of transmission needs driven by public policy requirements in the local and regional transmission planning process; (iii) removes from FERC-approved tariffs and agreements a federal right of first refusal for certain new transmission facilities; and (iv) improves coordination between neighboring transmission planning regions for new interregional transmission facilities.

Order 1000 also requires each jurisdictional utility transmission provider to participate in a regional transmission planning process that has (i) a regional cost allocation method for the cost of new transmission facilities selected in a regional transmission plan for purposes of cost allocation; and (ii) an interregional cost allocation method for the cost of certain new transmission facilities that are located in two or more neighboring transmission planning regions and are jointly evaluated by the regions in the interregional transmission coordination procedures required by Order 1000. Each cost allocation method must satisfy six cost allocation principles specified by FERC.

Participation in regional transmission planning efforts is voluntary for non-jurisdictional utility transmission providers. The District is not a jurisdictional utility nor is it a “transmission provider” for purposes of Order 890 or Order 1000. A potential impact to the District could occur if ColumbiaGrid adopted cost allocation principles for a regional transmission project under which a share of the project’s costs were made attributable to the District. The District has negotiated for provisions in the Order 1000 Functional Agreement that protect the District from costs it has not agreed to pay, and the District could further protect itself from an unacceptable cost allocation by terminating its membership in ColumbiaGrid. FERC has not yet approved the current version of the Order 1000 Functional Agreement. The District can refuse to execute the Agreement if the protective provisions are removed.

Several entities, including the Large Public Power Council, of which the District is a member, submitted petitions for review of Orders 1000 at the U.S. Court of Appeals for the District of Columbia which unanimously affirmed the Order 1000 reforms.

Transmission Reliability

In March 2007, FERC issued Order No. 693, which addresses mandatory reliability standards for utilities. The North American Electric Reliability Corporation (“NERC”) was tasked with developing reliability standards for the electric industry 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 Western Electricity Coordinating Council (“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. In both January 2012 and January 2015, WECC conducted a comprehensive audit of the District's compliance with the applicable NERC reliability requirements and found no violations.

FERC Order 764 - Variable Energy Resources

On June 22, 2012, FERC issued a final rule on the integration of variable energy resources (the "VERs Rule"). The VERs Rule requires transmission providers subject to FERC's jurisdiction to (i) offer 15-minute intra-hourly transmission scheduling or equivalent alternatives; and (ii) incorporate provisions into the pro forma Large Generator Interconnection Agreement requiring interconnection customers whose generating facilities are variable energy resources to provide meteorological and forced outage data to the transmission provider for the purpose of power production forecasting.

While not strictly subject to FERC jurisdiction, Bonneville implemented new protocols in 2014 to allow VERs to submit generation forecasts in 15-minute intervals, if so elected. Bonneville has also developed forecasting and scheduling protocols ranging from next hour to sub-hourly intervals. Because the accuracy of the VERs output increases with multiple scheduling intervals per hour, Bonneville further demonstrated it could reduce the amount of reserves it maintains to balance VERs output. Beginning in 2013, Bonneville offered a range of discounts to its balancing service rate assessed on generators that elect to forecast and schedule their VERs output with greater accuracy (shorter time intervals).

Changing the interval frequency in which VERs generation is scheduled as a result of the VERs Rule has the potential to change how energy is traded in the Pacific Northwest. Bonneville's scheduling protocols to date have allowed the existing hourly market structure to co-exist with the new 15-minute scheduling periods, lessening the potential for market disruption. The District cannot at this time assess how 15-minute scheduling has or will impact it financially or operationally.

Energy Imbalance Market

The District has participated in the Northwest Power Pool Market Assessment and Coordination Committee (the "Northwest Power Pool MC") since 2011. The goal of the Northwest Power Pool MC effort is to identify, analyze, and recommend approaches to addressing challenges in the region, including the growing number of variable energy resources being connected to the electrical grid. Potential solutions considered by the Northwest Power Pool MC have ranged from enhancements to existing bilateral markets and operational tools, to a centralized real-time energy imbalance market ("EIM"). A centralized EIM is the means by which imbalances in energy, which occur when generating resources or loads that have been forecast do not turn out as planned over the course of an hour, are served. To create a pool of resources available to serve this imbalance, market participants are encouraged to submit offer curves to provide output from their generating resource. If an offer is accepted, then the market participant is instructed to move their generation based on their offer, while reliability is maintained. The amount of increase or decrease in generation is paid for by the market participant requiring the imbalance energy.

Under the EIM being discussed in the Northwest, market participants would be able to offer resources voluntarily into the market, with a model economically dispatching the pool of resources based on an offer curve, to serve the energy imbalance every five minutes. Bonneville has been conducting a public process with its customers to examine the costs and benefits of their participation in an EIM. These discussions have also included what products and services Bonneville may offer customers to support the implementation of an EIM in the Northwest. At this time, the District cannot predict what impact the creation of an EIM or other tools the Northwest Power Pool MC is considering, will have on the District.

The District remains active in the Northwest Power Pool MC forums, including the Executive Committee, market design and resource sufficiency subcommittees.

Washington Initiative 502

Washington voters approved Initiative 502 (“I-502”) on marijuana reform in the November 2012 election. I-502 legalizes the recreational use of marijuana and marijuana-related products by adults, taxes those products, and designates the revenue for health-care and substance-abuse prevention and education. Possession by anyone younger than 21, possession of larger amounts, and the unlicensed or unregulated growing of marijuana remain illegal under State law. In addition, marijuana is still classified as a Schedule I controlled substance under federal law. Thus, the growing, possession and sale of marijuana are subject to federal prosecution, and could subject violators to confiscation of their assets.

I-502 has presented Washington local governments with numerous issues, including in particular as a result of the conflict between State and federal law. There is very limited guidance from the federal government available to date on how state and local governments can or should address this conflict. The U.S. Department of Justice has issued a number of memoranda making it clear that the distribution and sale of marijuana remains illegal under the Controlled Substances Act (CSA) and indicating that the Department of Justice expects that states and local governments “will implement strong and effective regulatory and enforcement systems” that are “effective in practice.” If they do not, the Department of Justice “may seek to challenge the regulatory structure itself.” And regardless of state law, the Department of Justice will prosecute persons or organizations “whose conduct interferes with any one or more of” the Department’s eight identified priorities in enforcing the CSA against marijuana-related conduct. These eight priorities include: preventing distribution to minors; preventing revenue from going to criminal enterprises, cartels or gangs; preventing the diversion of marijuana from states where it is legal to states where it is not; preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity; preventing violence and the use of firearms in the cultivation and distribution of marijuana; preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use; preventing the growth of marijuana on public lands and other environmental dangers; and preventing marijuana possession or use on federal property. The following is a brief summary of certain of the issues presented. The District does not believe that any of these issues will have a material adverse effect on the District.

Increased Loads. Marijuana, which is grown primarily indoors in the Pacific Northwest, requires significant amounts of power to produce. Energy uses include for high-intensity lights, dehumidification, space heating and cooling during certain periods, pre-heating of irrigation water, and ventilation and air-conditioning to remove waste heat. A recent report by the Northwest Power and Conservation Council estimated marijuana operations could increase electricity demand in the State between 60 MW and 160 MW over the next 20 years. According to the report, regional demand – from producers in Idaho, Montana, Oregon and Washington – could increase by almost 250 MW by 2035. Legal marijuana production was identified as one of three major categories of load growth in the region, along with data centers and electric vehicles. The State has already issued licenses for approximately 2.0 million square feet of marijuana production “canopy.” Based on the number of existing and pending permits applied for to date, the District’s estimates for marijuana production-associated load growth within its service territory during the next 5 to 10 years range from approximately 25 MW to as much as 80 MW, but the District also expects much of this potential production to shift to the east of the Cascade Mountains due to greater amounts of sunlight and lower electricity rates.

Energy Conservation Efforts. There are significant opportunities for energy conservation with marijuana producers, including in particular through the use of more energy-efficient lighting, such as LEDs. LED lighting, however, is significantly more expensive than traditional lighting methods which rely on high-pressure sodium and other high-intensity fixtures. Marijuana producers are thus unlikely to switch to LED lighting in the absence of financial incentives to do so from utilities. The District to date has not offered such incentives to marijuana producers. Electric utilities could face potential federal liability and other repercussions if they provide financial or other incentives to marijuana producers to

convert to more efficient lighting systems. However, it may be possible to offer such incentives upon the express condition that the guidance and nonenforcement conditions in the memoranda from the U.S. Department of Justice that are described above remain in effect and the District has not ruled out the possibility of doing so in the future, subject to further analysis of the associated risks and benefits.

Bonneville Power. The District purchases a substantial portion of its power supply from Bonneville, and is also the recipient of various federal grants and subsidies, including from Bonneville. The grant agreements typically include a requirement that the District comply with all applicable federal laws during the term of the grant agreement. To date, Bonneville has not provided any formal guidance to its utility customers as to Bonneville's ability or willingness to continue to deliver power to utility customers who provide electric service to marijuana producers. A recent U.S. Department of Energy memorandum on this topic provided to federal power marketing agencies ("PMAs"), including Bonneville, notes that the cultivation and distribution of marijuana is illegal under federal law and that "federally owned, controlled or administered resources may not be purposely provided to facilitate the commission of a federal offense." The memorandum also suggests, however, that wholesale power sales by PMAs to their utility customers "do not purposely facilitate the commission of a federal offense." Should the Department of Energy's guidance on this topic change in the future, the District has enough owned or contracted -for nonfederal resources to serve the existing and anticipated load associated with marijuana production within its service territory over the next 5 to 10 years, as more fully described above under "Washington Initiative 502 – Increased Loads."

ELECTRIC SYSTEM FINANCIAL INFORMATION

Financial Results

The table on the following page presents income statements of the Electric System for the five calendar years 2010 through 2014. Appendix A contains the audited financial statements for the District for 2014 and 2013. See "—Financial Condition and Liquidity" for a description of the District's cash balances and liquidity reserves.

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Electric System Operating Results
(\$000s)

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Operating Revenues					
Sales of Electric Energy					
Residential	\$ 282,648	\$ 291,077	\$ 297,937	\$ 311,773	\$ 319,720
Commercial	174,069	175,483	178,463	184,939	190,242
Industrial	47,984	50,132	37,038	35,440	36,289
Other	3,471	3,494	3,594	3,421	3,511
Sales for Resale	38,902	45,715	49,178	48,758	59,257
Unbilled Revenue	(5,000)	(5,000)	4,000	3,000	(5,000)
Total Sales of Electric Energy	<u>542,074</u>	<u>560,901</u>	<u>570,210</u>	<u>587,331</u>	<u>604,019</u>
Other Operating Revenues	<u>18,695</u>	<u>25,186</u>	<u>20,800</u>	<u>21,672</u>	<u>24,563</u>
Total Operating Revenues	<u>560,769</u>	<u>586,087</u>	<u>591,010</u>	<u>609,003</u>	<u>628,582</u>
Operating Expenses					
Purchased Power and Generation	320,049	308,793	317,301	323,572	332,375
Operations	152,053	155,404	149,089	159,589	173,035
Maintenance	20,860	20,201	27,751	23,366	25,681
Depreciation	40,313	42,242	43,854	45,968	48,336
Taxes	30,885	31,699	31,517	32,582	33,149
Total Operating Expenses	<u>564,160</u>	<u>558,339</u>	<u>569,512</u>	<u>585,077</u>	<u>612,576</u>
Net Operating Income	(3,391)	27,748	21,498	23,926	16,006
Interest and Other Income ⁽¹⁾	<u>33,245</u>	<u>11,412</u>	<u>17,251</u>	<u>10,269</u>	<u>2,313</u>
Interest Charges					
Interest	19,657	19,933	18,343	17,485	16,895
Other, Net of Capitalized Interest	(2,509)	(804)	(1,232)	(1,978)	(2,704)
Total Interest Charges	<u>17,148</u>	<u>19,129</u>	<u>17,111</u>	<u>15,507</u>	<u>14,191</u>
Capital Contributions	11,023	11,397	11,434	14,424	18,287
Net Income	<u>\$ 23,729</u>	<u>\$ 31,428</u>	<u>\$ 33,072</u>	<u>\$ 33,112</u>	<u>\$ 22,415</u>
Net Income Adjustments:					
Non-cash contributions	\$ (1,082)	\$ (1,747)	\$ (1,309)	\$ (2,520)	\$ (4,531)
Interest charges	15,054	19,129	17,111	15,507	14,191
Depreciation	40,313	42,242	43,854	45,968	48,336
Net (increase) decrease in the fair value of investments ⁽²⁾	436	368	(402)	379	591
Rate stabilization fund transfer ⁽¹⁾	(13,260)	13,260	-	-	-
Tidal project termination charge	-	-	-	-	6,939
Balance Available For Debt Service	<u>\$ 65,190</u>	<u>\$ 104,680</u>	<u>\$ 92,326</u>	<u>\$ 92,446</u>	<u>\$ 87,941</u>
Electric System Bonds Debt Service	\$ 22,396	\$ 24,271	\$ 32,850	\$ 30,667	\$ 30,643
Electric System Bonds Debt Service Coverage	2.9x	4.3x	2.8x	3.0x	2.9x

⁽¹⁾ In 2010, the District transferred \$13.3 million received as part of a litigation settlement into the Rate Stabilization Account, which was recorded as "interest and other income." As required by certain bond covenants, the amount transferred into the Rate Stabilization Account is excluded from the debt service coverage calculation. This amount was subsequently transferred to the Operating Reserve Fund in 2011. See APPENDIX B – "SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Additional Covenants."

⁽²⁾ The District typically holds investments to maturity. Generally Accepted Accounting Principles, however, 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.

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

Revenues from the District's annual sales of electric energy increased from \$542.1 million in 2010 to \$608.0 million in 2014, an increase of \$65.9 million over the period. Excluding sales for resale, sales of electric energy increased from \$503.2 million in 2010 to \$544.8 million in 2014, an increase of \$41.6 million, or 8%, over the period. The increase in retail energy sales revenue during this period reflects modest rate increases implemented during the past five years.

The District enacted general rate increases of 2.9%, 2.3% and 1.9% effective April 1, 2012, 2013 and 2015, respectively. In addition, the District enacted rate increases of 0.9% and 2.7% effective October 1, 2011 and 2013, respectively, to recover the cost of wholesale power increases from Bonneville.

The total average number of customers of the District's Electric System increased from 320,337 in 2010 to 332,516 in 2014, an increase of 4%. The growth in customers reflects the population growth rate in Snohomish County.

The District is not dependent on its large corporate customers for its retail sales revenue. In 2014, industrial customers represented only about 7% of the District's retail sales revenue, while residential and commercial customers made up 58% and 35% of retail sales, respectively. The District's two largest customers in terms of power consumption accounted for 5.0% of retail energy sales revenues in 2014. Retail sales of power to industrial customers declined in the second quarter of 2012, after Kimberly-Clark, then the District's largest customer, closed its Everett Mill. See "THE ELECTRIC SYSTEM—Customers, Energy Sales and Peak Demand."

Power received from the District's own generating resources and power purchase contracts, in particular its Bonneville Slice product, can exceed the District's retail power requirements during certain periods of the year, resulting in sales for resale (wholesale market sales). Annual fluctuations in resale revenues have resulted from changes in retail load, variations in annual hydrological conditions, changes in District resources and variations in wholesale power prices. Resale revenues of \$59.3 million in 2014 were \$10.5 million higher than in 2013 due to a slightly lower retail load, higher wholesale power prices, and more favorable hydrological conditions in 2014, resulting in more power available for resale.

Other operating revenues include proceeds from the sales of the District's transmission capacity, proceeds from the sale of RECs, reimbursements from Bonneville to fund conservation programs, lease revenue for use of District facilities and customer fees. These revenues increased from \$18.7 million in 2010 to \$24.6 million in 2014, due to a \$5.9 million increase in conservation reimbursements from Bonneville and the introduction and adjustment of various cost recovery customer fees resulting in \$5.2 million of additional revenue.

Operating expenses for the period 2010 to 2014 increased 9% from \$564.2 million to \$612.6 million. This increase is generally the result of the 4% growth in the number of customers and the costs to address this growth, increases in Bonneville wholesale power rates in 2011 and 2013, the impact of increased transmission costs and expanded energy efficient programs. In addition, the construction of electric system infrastructure has led to an increase in depreciation expense.

Purchased power and generation expenses increased from \$320.0 million in 2010 to \$332.4 million in 2014, an increase of 4%, with larger annual fluctuations during this period. From 2010 to 2011, purchased power and generation costs decreased from \$320.0 million to \$308.8 million, a decrease of \$11.2 million. The cause of this decrease was a \$21.4 million decline in wholesale market power purchases which was partially offset by a \$9.9 million increase in the cost of wholesale power from Bonneville. Purchased power and generation expenses were \$317.3 million in 2012, or \$8.5 million higher than 2011, due primarily to greater purchases from Bonneville under a new power purchase agreement. In

2013 and 2014, purchased power and generation expenses increased \$6.3 million to \$323.6 million and \$8.8 million to \$332.4 million, respectively, primarily as a result of a higher level of purchases from the wholesale power market. Operations expenses increased from \$152.1 million in 2010 to \$173.0 million in 2014, an increase of \$20.9 million or 14%. This increase in operations expenditures reflects a number of factors including a 4% increase in customers served by the District, a 4% higher number of distribution system line miles built and maintained, a \$15.1 million increase in costs charged by transmission and ancillary service providers, a \$4.4 million expansion of energy conservation programs, increases in commodity costs affecting essential materials such as copper and aluminum wire, transformers, wood poles and fuel, annual increases in wages and salaries, and higher pension and medical benefit costs.

Maintenance expenditures increased from \$20.9 million in 2010 to \$25.7 million in 2014, an increase of \$4.8 million, or 23%. Maintenance expenses are subject to annual fluctuations based on the level of restoration efforts necessary following periodic storms that impact the Pacific Northwest. In addition to storm restoration, maintenance expenses represent the costs to repair, refurbish and preserve the Electric System's transmission and distribution assets to appropriate operating levels, including regular maintenance of lines and stations. Maintenance expenditures also include programs such as tree and vegetation trimming around overhead lines, as well as upkeep of Electric System facilities, vehicles and equipment.

Depreciation expense increased from \$40.3 million in 2010 to \$48.3 million in 2014, an increase of \$8.0 million, or 20%. Higher depreciation expense over the five-year period reflects continued investments in electric system infrastructure, facilities and systems as the District continues to grow and expand to serve a growing customer base.

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.

Interest and other income was \$33.2 million in 2010 and decreased \$21.8 million to \$11.4 million in 2011. This decrease was primarily the result of a \$13.3 million litigation settlement received in 2010, and a \$5.1 million charge for termination of a geothermal exploration project recorded in 2011. Interest and other income increased \$5.9 million to \$17.3 million in 2012 due to the one-time geothermal project termination charge in 2011. Interest and other income declined to \$10.3 million in 2013, primarily due to the completion of smart grid and energy efficiency programs in 2012 that were funded by grants. Interest and other income declined further to \$2.3 million in 2014 as a result of a \$6.9 million charge related to the termination of the District's tidal energy research project.

Financial Condition and Liquidity

Cash and Temporary Investments and Special Funds

As of December 31, 2014, the Electric System's cash and temporary investments totaled \$237.3 million, and special funds totaled \$265 million. Cash and temporary investments represent bank deposits and highly liquid, short-term investments that are available for use in District operations. Special funds are limited-use funds established by the Commission and are restricted for specific purposes such as debt service, bond reserves, rate stabilization, qualifying capital expenditures, post-employment benefits, and other reserve requirements. Cash and temporary investments and special funds for each of the years 2010 through 2014 are summarized in the table on the following page.

Electric System
Cash, Temporary Investments and Special Funds
(\$000s)

<u>Year</u>	<u>Cash and Temporary Investments⁽¹⁾</u>	<u>Special Funds⁽²⁾</u>
2010	\$334,453	\$210,564
2011	396,346	180,398
2012	277,369	268,800
2013	270,947	262,574
2014	237,342	264,790

⁽¹⁾ Balance includes \$42.2 million and \$35.0 million in 2010 and 2011, respectively, of bond construction funds expected to be used to fund capital expenditures in the following year.

⁽²⁾ Balance includes the Rate Stabilization Account, which totaled \$128.3 million in 2010, and \$115.0 million in 2011 through 2012. In 2012, the District transferred \$100 million from cash and temporary investments to a Debt Management Reserve, which is treated as a special fund in 2012, 2013 and 2014.

Reserve Policy

In 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, 2014, the District's cash position exceeded reserves set forth in its financial policies. The Electric System had \$237.3 million in cash and temporary investments, including \$233.4 million related to its financial reserve policy. In addition, the Electric System had \$227.5 million in special funds related to its financial reserve policy at December 31, 2014, for total financial policy reserves of \$460.9 million.

Two types of reserve funds were established: (i) On-going Long-Term Reserves and (ii) Project-Specific Reserves.

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 Operating Reserve is to be maintained at a level that provides 90 days of non-power budgeted expenses in order to maintain adequate working capital during unforeseen events. The policy required a \$91 million balance at December 31, 2014, and the actual balance was \$95.9 million. 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 \$68.4 million as of December 31, 2014.

In 2012, the Commission established a Debt Management Reserve, funded by excess Operating Reserve resources. The Debt Management Reserve, which was established at \$100 million and remained at that level at December 31, 2014, is designed to be utilized to manage the District's debt levels by redeeming the \$99.1 million principal amount of 2005 Bonds that are callable on December 1, 2015, defeasing other future payments on outstanding debt, deferring expected capital financings or replenishing the Operating Reserve if it falls below the established policy levels at the end of any fiscal year. The District currently expects to redeem the outstanding 2005 Bonds with funds on deposit in the Debt Management Reserve in 2015; however, no assurance can be given that the District will redeem the 2005 Bonds in 2015.

Electric System Debt

As of December 31, 2014, the Electric System Bonds were outstanding in the aggregate principal amount of \$317,900,000. After giving effect to the issuance of the 2015 Bonds, the Electric System Bonds are expected to be outstanding in the aggregate principal amount of \$458,820,000. See "OUTSTANDING DEBT OF THE ELECTRIC SYSTEM AND GENERATION SYSTEM."

Capital Expenditures

Capital expenditures for the years 2010 through 2014 are presented in the following table.

Electric System Capital Expenditures (\$000s)	
Historical	
<u>Year</u>	<u>Amount</u>
2010	\$64,157
2011	68,552
2012	103,945
2013	94,250
2014	109,904

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.

Intersystem Loans

The Electric System and the Generation System periodically enter into loan transactions between the systems for various purposes. As of December 31, 2014, the aggregate outstanding principal amount of Electric System loans to the Generation System was \$64.2 million, and the aggregate outstanding principal amount of Generation System loans to the Electric System was \$6.2 million. See APPENDIX A “INDEPENDENT AUDITOR’S REPORT AND FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013,” Note 6.

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. No such loans have been made or are currently anticipated by the District.

Financial Plan

As part of its continuing planning efforts, the District prepares a five-year financial plan including projected operating results. Projected operating results are based on forecasts of retail loads, market prices for wholesale energy, District energy resources and energy contracts, and capital and operating expenditures. The District believes the underlying assumptions in the projected 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 projected operating results to certain factors which it believes could significantly affect its operating results, such as variations in load forecasts, the impact of annual precipitation levels on hydroelectric power generation and the cost of purchased power on the wholesale market.

The District has established financial guidelines developed for the Electric System in connection with a comprehensive financial study. The District has concluded that a minimum debt service coverage ratio of 1.75x on the 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 several scenarios of load growth. Trend and econometric analysis are used to predict new customer connections by type (such as single family with electric heating and new apartment complexes with gas heating), with key model inputs including 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 the District’s largest industrial customer, 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.

Resource Forecast

The District’s resources must meet its expected loads. Resource planning is an ongoing process and documented in the District’s adopted Integrated Resource Plan. The District currently has resources available and planned to meet its forecasted loads through 2022. See “ELECTRIC SYSTEM POWER SUPPLY – The District’s Future Power Supply Strategy – *District’s 2013 Integrated Resource Plan.*”

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 wholesale market 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, 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 the majority of its long-term power resource requirements from Bonneville, changes to Bonneville's wholesale power rates can significantly affect the District's purchased power costs. The District's projected financial results include Bonneville's most recent forecast for wholesale power costs. The Power Purchase Agreement with Bonneville provides the ability for Bonneville to adjust their power prices to the District for a variety of reasons, including changes in Bonneville's power production costs and financial results. The Slice product provides the District a variable amount of power generated by Bonneville's resource portfolio and obligates the District to pay a percentage of Bonneville's costs. See "THE ELECTRIC SYSTEM POWER SUPPLY—Bonneville Power Administration—The Bonneville Power Purchase Agreement."

Projected Capital Expenditures

Projected capital expenditures for the years 2015 through 2017 are presented in the following table.

Electric System Capital Expenditures (\$000s)	
Projected	
<u>Year</u>	<u>Amount</u>
2015	\$ 130,704
2016	124,547
2017	111,325

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 reserves, line extension fees, general rates, and bond proceeds. Other than the 2015 Bonds, the District does not currently expect to issue additional Electric System Bonds for purposes of financing improvements to the Electric System prior to 2018.

Projected Financial Results

In projecting the financial results for the Electric System, the District has made certain assumptions regarding various factors that affect financial performance, which the District believes are reasonable. Actual results, however, may differ from such assumptions, which could have material effects on the Electric System's projected 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 the impact of annual precipitation levels on hydroelectric power generation in the Federal System,

Bonneville power price adjustments, the effect of the distributed generation, conservation response or temperature variations on load forecasts and the cost of purchased power on the wholesale market.

The management of the District has prepared the prospective financial information set forth below to present the projected 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 projected financial information.

The weather conditions for 2015 have been above average temperatures through March, which have led to lower than expected residential heating loads. Through March 2015, residential customer loads have been lower than the corresponding period in 2014, which has been reflected in the projected financial results. The impact of the warmer weather is expected to decrease during the remainder of 2015 as the impact of heating loads on residential consumption decreases during warmer weather months. These weather conditions have also led to a decrease in purchases from the wholesale power market as the number of purchases to balance District resources with retail sales levels has been lower than expected.

The projected financial results for 2015 were prepared based primarily on the District's 2015 approved budget as modified by the results for January through March 2015 and reflect (i) a 1.9% general rate increase effective April 1, 2015; (ii) a 4.5% rate increase expected to be effective October 1, 2015 designed to recover an expected October 1, 2015 wholesale price increase from Bonneville; (iii) a lower level of customer loads as a result of the impact of warmer than normal weather on winter heating loads; (iv) higher purchased power costs from Bonneville as a result of the expected wholesale price increase; and (v) a lower volume of wholesale power purchases to balance loads. The 2015 approved budget was prepared based on lower than average precipitation levels, which led to lower wholesale sales, a decreased amount of power available from the BPA's Slice product, and higher wholesale market purchases than if average precipitation levels were planned.

The projected financial results for 2015 also reflect the District's current intent to redeem the outstanding 2005 Bonds with funds on deposit in the Debt Management Reserve in 2015; however, no assurance can be given that the District will redeem the 2005 Bonds in 2015. See "SECURITY FOR THE 2015 BONDS—Additional Indebtedness—Electric System Bond Resolution."

The 2016 and 2017 projected financial results were prepared based on the following assumptions: (i) less than 1% annual increase in retail loads, reflecting modest growth in customers and recent lower per capita residential consumption, modest increases in commercial consumption due to an improving economy, and expected production expansion by The Boeing Company, the District's largest customer; (ii) a 2.9% general retail rate increase projected for April 1, 2017 and a projected 2.1% rate increase to offset a forecasted Bonneville wholesale power price increase expected to be effective October 1, 2017; (iii) increased power purchase costs due to expected October 1, 2015 and 2017 wholesale price increases from Bonneville; and (iv) increased operating and maintenance costs, reflecting higher transmission and ancillary services costs, increased labor, materials, medical and pension costs, and upgrade and maintenance costs for certain District software systems.

The District's financial projections for 2016 and 2017 assume average water conditions at hydroelectric facilities. The projected financial results can be significantly impacted by wide-ranging actual water conditions.

The following table presents the projected Electric System financial results for the years ending December 31, 2015, 2016, and 2017.

**Electric System
Projected Financial Results
(Average Water Conditions)
(\$000s)**

	2015	2016	2017
Operating Revenues			
Retail Sales of Electric Energy ⁽¹⁾	\$ 557,789	\$ 590,354	\$ 613,391
Wholesale Sales of Electric Energy	42,342	53,510	51,148
Other Operating Revenues	19,785	19,989	20,320
Total Operating Revenues	619,916	663,853	684,859
Operating Expenses			
Purchased Power and Generation ⁽²⁾	330,087	351,207	350,962
Operations and Maintenance	210,947	218,663	224,475
Depreciation	49,069	49,560	50,056
Taxes	33,908	35,755	37,150
Total Operating Expenses	624,011	655,185	662,643
Net Operating Income (Loss)	(4,095)	8,668	22,216
Other Income ⁽³⁾	12,183	6,128	5,407
Contributions	20,005	21,529	24,264
Interest Charges	(15,847)	(14,471)	(14,085)
Net Income	12,246	21,854	37,802
Interest Charges	15,847	14,471	14,085
Depreciation	49,069	49,560	50,056
Other	(2,000)	(2,000)	(3,000)
Balance Available for Debt Service	75,162	83,885	98,943
Electric System Bonds Debt Service ⁽⁴⁾	29,678	27,697	27,366
Electric System Bonds Debt Service Coverage:	2.5x	3.0x	3.6x

⁽¹⁾ Retail Sales of Electric Energy reflect a 1.9% rate increase effective April 1, 2015, a projected 4.5% rate increase expected to be effective October 1, 2015, a projected 2.9% rate increase expected to be effective April 1, 2017 and a projected 2.1% rate increase expected to be effective October 1, 2017.

⁽²⁾ Purchased Power and Generation Costs reflect a 5.3% increase in the cost of wholesale power from Bonneville effective October 1, 2015 and a 2.2% increase in the cost of wholesale power from Bonneville effective October 1, 2017.

⁽³⁾ Other income includes \$5.8 million in grant funding in 2015.

⁽⁴⁾ Electric System Bonds Debt Service in 2015 reflects debt service on the 2005 Bonds through September 1, 2015, when the District expects to defease the 2005 Bonds, and projected debt service on the 2015 Bonds beginning July 1, 2015.

Sensitivity Analysis

The District tests the sensitivity of the projected numbers by analyzing the impacts of varying hydrological conditions. The projected financial results above are based on average water conditions, which represent hydroelectric production calculated based on historical average water. The District also calculates projected financial results, for planning purposes, on hydrological conditions at the midpoint between critical and average water conditions at hydroelectric facilities. In this scenario of water conditions, the District's operating results could be weaker, as seen in the table on the following page.

**Electric System
Projected Financial Results
(Lower than Average Water Conditions)
(\$000s)**

	<u>2015⁽¹⁾</u>	<u>2016</u>	<u>2017</u>
Total Operating Revenues	\$619,916	\$647,638	\$668,887
Total Operating Expenses	624,011	655,183	661,999
Net Operating Income (Loss)	(4,095)	(7,545)	6,888
Other Income, Interest Charges and Contributions	16,341	12,229	14,630
Net Income	12,246	4,684	21,518
Electric System Bonds Debt Service Coverage	2.5x	2.4x	3.1x

⁽¹⁾ The District utilizes the assumption of hydrological conditions at the midpoint between critical and average water conditions at hydroelectric facilities for annual budgeting purposes. As a result, the projected financial results for 2015 are the same for both scenarios.

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 Youngs Creek Project 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 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, 2008 and 2009 set out the rights and duties of the City and District to use water at the Jackson Project. Jackson Project storage is used to capture water during high runoff periods and to provide water during low precipitation periods for stream flows, City water demands and power production. Actual energy production varies substantially throughout the year and from year to year.

The following table shows Jackson Project production for the last 10 years.

Jackson Project Energy Production

<u>Year</u>	<u>MWh</u>	<u>Annual Precipitation (Inches)</u>	<u>Cost of Energy Produced (cents/kWh)</u>
2014	519,531	192	3.7
2013	452,063	142	4.6
2012	520,255	169	5.0
2011	485,784	170	7.5
2010	382,612	140	8.7
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

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 minimum instream 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. Under normal precipitation and stream flow conditions, the Jackson Project can generate approximately 50 aMW or 434,528 MWh.

FERC License

The District operates the Jackson Project under a 45-year license issued on September 2, 2011 by the FERC. The license generally conforms to the terms of a Settlement Agreement approved by federal, state and local agencies, the cities of Everett and Sultan, the Tulalip Tribes and American Whitewater that was filed with FERC on October 14, 2009. The District also negotiated a separate settlement agreement with the Tulalip Tribes that covers the proposed license term. The license does not contain conditions that substantially alter the physical characteristics of the Jackson Project or substantially increase the capital costs thereof. The license and settlement agreements require the District to complete certain capital improvement projects, fund habitat preservation and monitor certain functions, the aggregate costs of which are expected to total approximately \$85 million over the 45-year term of the license.

Endangered Species Issues

Fish listings that may affect Jackson Project operations include Puget Sound Chinook salmon, steelhead, and bull trout. Listed 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 Settlement Agreement does not substantially modify the fisheries conditions for the Jackson Project.

The U.S. Fish and Wildlife Service (the "USFWS") Western Washington field office website 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 four candidate species for listing, the fisher, North American wolverine, yellow-billed cuckoo and Oregon spotted frog, as possibly occurring in Snohomish County. Only the marbled murrelet (federal threatened species) is known to occur within the Jackson Project area. The Jackson Project Terrestrial Resources Management Plan protects and enhances habitat used by this species. Jackson Project operations that might affect this species such as road maintenance and repairs follow State Forest Practice guidelines and the Jackson Project Marbled Murrelet Habitat Protection Plan (“MMHPP”) to protect these species as appropriate. As part of the “ORDER ISSUING NEW LICENSE, September 2, 2011,” FERC approved the MMHPP with a requirement to update it every ten years in consultation with USFWS and the Washington State Department of Fish and Wildlife. The approved MMHPP will result in minimal changes to current operations; however, it is unclear whether or how management of this species will change during the license period. It is possible that changes will result in increased expenditures and staff time for the District.

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 and reliable continued operation. In 2006, an additional FERC-required exercise assessing the potential failure modes of Culmback Dam was conducted by the District and independent consultants. As part of these studies, previous analysis for a maximum credible earthquake was reviewed for consistency with FERC engineering guidelines. The maximum credible earthquake is the highest credible earthquake loading to which the dam would be subject, based on FERC standards. Such previous analysis includes a detailed review of both local crustal faults and larger regional or subduction events. Culmback Dam is estimated to be able to withstand all of the earthquake loads analyzed. The District again retained the same independent consultants for the 5-year 2011 inspections, and their final report did not indicate any major issues or concerns about Culmback Dam or the Jackson Project.

Small Hydroelectric Generation Projects

The District is currently operating and/or 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 has focused 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 2013 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 acquiring 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, although the exemption places certain restrictions on the operation of the Woods 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 annual operation and maintenance costs for this facility are approximately \$250,000.

Youngs Creek Project

The Youngs Creek Project is a FERC-licensed project located on an approximately 23-acre site just south of the city of Sultan, Washington. The District commissioned the Youngs Creek Project and began generating power on October 17, 2011. With a nameplate capacity of 7.5 MW, the powerhouse is located above a natural impassible barrier to anadromous fish on Youngs Creek, a tributary of Elwell Creek. The FERC license expires in April 2042.

Other Low Impact Hydroelectric Projects

In December 2010, the District acquired the project lands for the Calligan Creek and Hancock Creek Projects, and both filed and received preliminary permits for the projects from FERC in 2011. Each of these Projects has a capacity of 6.0 MW. Both of these Projects are “run-of-the-river” projects located in King County above Snoqualmie Falls, a natural impassible barrier to anadromous fish, and were originally licensed with FERC in 1993. The design and layout of these Projects is expected to be similar to that of the Youngs Creek Project. Construction costs for the Calligan Creek and Hancock Creek Projects are estimated to be approximately \$24 million and \$29 million, respectively. A 401 Water Quality certification has been granted by the Washington State Department of Ecology, and FERC issued its Environmental Assessment for both projects in December 2014. The District expects FERC licenses to develop and construct the Calligan Creek Project and the Hancock Creek Project to be issued in early June 2015, and the District currently has slated construction for mid-2015 through 2017, with the Projects’ commissioning anticipated in 2017. No assurance can be given that the District will receive the FERC licenses within such time frame, however, and if the District does not receive the FERC licenses by June 15, 2015, the commencement of construction of the Projects is expected to be delayed until 2016.

The Hancock Creek Project is located on Hancock Creek, a tributary of the North Fork Snoqualmie River in King County downstream from Lake Hancock. The Hancock Creek Project is expected to have a nameplate capacity of 6 MW, with expected output of approximately 2.5 aMW (approximately 22,100 MWh per year during average water year conditions). Construction costs for the Hancock Creek Project are estimated to be approximately \$29 million, with the cost of electric energy generated by the Hancock Creek Project (including annual debt service on any Generation System Bonds financing the Hancock Creek Project) expected to be \$77 to \$88/MWh.

The Calligan Creek Project is located on Calligan Creek, a tributary of the North Fork Snoqualmie River in King County downstream from Calligan Lake. The Calligan Creek Project is expected to have a nameplate capacity of 6 MW, with expected output of approximately 2.4 aMW (approximately 20,700 MWh per year during average water year conditions). Construction costs for the Calligan Creek Project are estimated to be approximately \$24 million, with the cost of the Calligan Creek Project (including annual debt service on any Generation System Bonds financing the Calligan Creek Project) expected to be \$77 to \$88/MWh.

The District is investigating the feasibility of a third project, the Sunset Fish Passage and Energy Project (the “SFPE Project”). In March, 2012, FERC issued a preliminary permit to the District to study the SFPE Project. The SFPE Project is a run-of-the-river project in east Snohomish County located on the South Fork of the Skykomish River at the base of a natural impassible barrier to anadromous fish. Project capacity could range from 27 to 30 MW. The District has met numerous times with federal and Washington State agencies and the Tulalip Tribes, and there do not appear to be any significant issues with these agencies or the Tulalip Tribes regarding development of the SFPE Project. Opposition has been expressed, however, by some members of the local community. As part of its due diligence, the District has completed 17 additional environmental studies throughout 2014, which are subject to stakeholder review and comment. Pending the study results and public comment, the District anticipates it could submit a draft license application to FERC for the project in fall 2015.

Other Projects

The District's review of other generating projects such as, tidal energy and geothermal energy 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.

The Cogeneration Project

In 1993, the District and Scott Paper Company, as the predecessor in interest to Kimberly-Clark, entered into certain agreements for the construction and operation of the Cogeneration Project as a renewable resource cogeneration facility. The District funded the Cogeneration Project's capital requirements up to an agreed amount of approximately \$115 million, and Kimberly-Clark assumed responsibility for construction and operation of the Cogeneration Project through December 31, 2016. As amended, the agreements required Kimberly-Clark to deliver at least 325,000 MWh annually and to pay replacement power costs for energy not delivered at market based rates in the event of a shortfall.

On August 22, 2011, the District and Kimberly-Clark terminated the agreements, and Kimberly-Clark paid the District \$26.5 million (representing the net present value of the reasonably-expected net benefits the District would have received under the agreements through December 31, 2016), assumed title to the Cogeneration Project assets and suspended operation of the Cogeneration Project on October 1, 2011.

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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 2010.

Generation System Annual Costs (\$000s)					
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Jackson Project	\$33,454	\$36,461	\$26,192	\$20,676	19,285
Cogeneration Project ⁽¹⁾	17,580	21,781	14,486	14,936	14,939
Small Hydroelectric Generation Projects ⁽²⁾	646	445	2,367	2,445	2,519
Net Project Costs ⁽³⁾	51,680	58,687	43,045	38,057	36,743
Other Costs ⁽⁴⁾	12,258	2,298	12,047	18,762	18,190
Net Annual Costs ⁽⁵⁾	<u>\$63,938</u>	<u>\$60,985</u>	<u>\$55,092</u>	<u>\$56,819</u>	<u>\$54,933</u>
Jackson Project Energy Output (MWh) ⁽⁶⁾	382,612	485,784	520,255	452,063	519,531
Cogeneration Project Energy Output (MWh)	219,948	170,633	-	-	-
Small Hydroelectric Generation Projects (MWh)	1,586	4,636	23,512	20,407	23,593
Total Energy Output (MWh)	<u>604,146</u>	<u>661,053</u>	<u>543,767</u>	<u>472,470</u>	<u>543,124</u>
Net Project Costs (\$/MWh) ⁽⁷⁾	\$86	\$89	\$79	\$81	\$68
Net Annual Costs (\$/MWh)	\$106	\$92	\$101	\$120	\$101

⁽¹⁾ Operations at the Cogeneration Project terminated effective September 20, 2011. Costs incurred after termination of the Cogeneration Project represent intersystem debt service costs related to the Cogeneration Project, which will be satisfied in 2016.

⁽²⁾ Small Hydroelectric Generation Projects costs include costs that are charged to the Electric System from the Woods Creek Project and the Youngs Creek Project. See “—Small Hydroelectric Generation Projects.”

⁽³⁾ 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.

⁽⁴⁾ Other Costs represents debt service expenditures on Generation System Bonds that are not directly related to current Generation System projects.

⁽⁵⁾ Excludes costs incurred by the Generation System for the research of potential renewable resources which are being funded by the District’s resource reinvestment reserve.

⁽⁶⁾ Jackson Project energy output varies annually based on the timing of precipitation received in the Sultan River basin.

⁽⁷⁾ Excludes Other Costs (see Note 3 above). Variations in unit costs per MWh are primarily due to the effects of annual precipitation on generation output.

Operations at the Cogeneration Project were terminated effective September 20, 2011. Costs incurred after the project termination represent intersystem debt service costs related to the project that will be satisfied in 2016.

As a result of the termination of the Cogeneration Project in 2011, as more fully described in “—The Cogeneration Project,” projected annual costs of the Generation System are expected to decrease approximately \$3 million to \$5 million per year beginning in 2012; however, approximately \$10 million of the annual costs of the Cogeneration Project will continue through 2016, representing the repayment of intersystem loans from the Electric System. Projected annual costs of the Jackson 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 for the Jackson Project is expected to vary annually based on the timing of the precipitation in the Sultan River Basin.

The Generation System had negative equity of \$36,818,000 at December 31, 2014. 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, such as depreciation, net of principal payment components of debt service. The negative equity is due also to the early retirement of Cogeneration Project assets. See “—The Cogeneration Project.”

Future Generation System Expenditures

Generation System expenditures related to the operations of the Jackson Project, the Youngs Creek Project and the Woods Creek Project consist of operating and maintenance, capital, taxes and debt service costs. These costs are expected to remain near historical levels, approximately \$30 million annually, for the period 2015 through 2016. Capital expenditures are expected to average \$2 to \$4 million per year, with no significant capital projects expected for 2015 through 2019.

Total Generation System costs are expected to increase through 2017 as the District permits, develops and constructs the Calligan Creek and the Hancock Creek projects, and identifies, develops, constructs or acquires geothermal, other low-impact hydroelectric sites, or other potential resources to meet future Electric System retail loads in accordance with the District’s most current IRP. The need for new resources and the associated capital requirements are assessed during the IRP planning process.

The current forecast, based on project development and permitting, calls for approximately \$65 million in expenditures for potential resources during the period 2015 through 2017, with \$15 million financed through the use of the District’s Resource Re-investment Reserves and/or other revenues generated. Remaining capital expenditures and any other future resources would likely be funded, in part, through future issues of Generation System Bonds. See “SECURITY FOR THE 2015 BONDS—Additional Indebtedness—Generation System Bond Resolution” and “ELECTRIC SYSTEM POWER SUPPLY—The District’s Future Power Supply Strategy.”

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. As shown in the following table, since 2010, the County’s population has grown by approximately 3.9%.

Population

<u>Year</u>	<u>Snohomish County</u>
2014	741,000 ⁽¹⁾
2013	730,500 ⁽¹⁾
2012	722,900 ⁽¹⁾
2011	717,000 ⁽¹⁾
2010	713,335

⁽¹⁾ Estimates.

Source: Washington State Office of Financial Management – Forecasting Division

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. The County has benefited from economic and population growth in western Washington over the last decade and an improvement in economic conditions since the financial crisis in 2008.

Boeing

As of December 2014, The Boeing Company ("Boeing") was the County's largest employer, with an estimated 40,000 workers in the County and approximately 80,000 employed State-wide. Boeing established an airplane manufacturing plant in south Everett in 1966. The plant was built to assemble wide-bodied 747 aircraft. In 1980, the plant was expanded for production of the 767, 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 what is reported to be 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 the 787 Dreamliner. The Everett facility includes a 787 line, as well as a 787 "surge" line, which Boeing has been employing (together with its plant in Charleston, South Carolina) to get production of the 787 Dreamliner up to 10 a month. In 2014, Boeing chose to assemble its newest 777X model in Snohomish County. It is expected that the 787 "surge" line will be switched over to initial production of the 777X in 2017. Boeing is also building a \$1 billion, 1.3 million square foot Composite Wing Center to fabricate the components for 235-foot carbon composite wings for the 777X. The new building is expected to be complete in 2016.

In February 2011, Boeing was awarded a contract to assemble 179 air refueling tanker planes for the U.S. Air Force. The KC-46 Air Force tanker program has reportedly experienced some delays, and the Pentagon is reportedly expected to make a decision regarding production in October 2015. The KC-46 Air Force tanker planes are expected to be assembled at the Boeing plants in Everett, Washington and in Kansas.

U.S. Navy

The U.S. Navy operates a homeport for a nuclear aircraft carrier battle group in Everett. Naval Station Everett is currently home to two destroyers and two Coast Guard cutters. A nuclear-powered aircraft carrier was moved in January 2015 to Naval Base Kitsap-Bremerton for 16 months of maintenance and modernization work.

There are approximately 6,000 sailors and civil service persons assigned to commands located at Naval Station Everett.

In April 2015, the Navy announced the names of three destroyers that will be based at the Everett Naval Station, all three of which are expected to arrive in 2016. These destroyers will replace three frigates that are being decommissioned. Each destroyer has approximately 300 crew members, resulting in a seven percent increase in Navy personnel from 3,956 to 4,235.

Snohomish County also is home to a Navy Support Complex approximately 11 miles north of the Naval Station.

Economic Indicators

Following are economic indicators for the County. The major private and public employers in the County as of December 2014 are shown on the following tables:

Major Private Employers

Employer	Product/Business	FTE 2014 Employment
The Boeing Company	Aircraft manufacturing	40,000
Providence Regional Medical Center	Medical services	3,500
Tulalip Tribes Enterprises	Real estate, retail, gaming	3,500
Everett Clinic	Health care	2,500
Premiera Blue Cross	Health insurer	2,400
Walmart	Retail	2,056
Philips Medical Systems	Ultrasound technology	2,000
Safeway	Retail - Grocery	1,700
Swedish/Edmonds Hospital	Health care	1,700
Fred Meyer	Retail - Grocery	1,600
Fluke Corporation (Danaher)	Electronic test and measurement	1,200
Aviation Technical Services	Aircraft repair, maintenance, parts	1,000

Major Public Employers

Employer	Product/Business	FTE 2014 Employment
Naval Station Everett	U.S. Navy	6,350
State of Washington	State government (includes colleges)	5,400
Snohomish County	County government	2,700
Edmonds School District	School district	1,865
Everett School District	School district	1,900
Marysville School District	School district	1,200
City of Everett	City government	1,136

Source: Economic Alliance of Snohomish County

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

<u>2014⁽¹⁾</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
\$8,520,995	\$11,172,618	\$10,341,319	\$9,742,664	\$9,735,984	\$9,614,803

⁽¹⁾ Data is through the first three quarters of 2014. Through the first three quarters of 2013, taxable retail sales were \$8,156,826,277.

Source: Washington State Department of Revenue.

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

<u>Collection Year</u>	<u>Valuation</u>
2015	\$88,260,208
2014	79,448,742
2013	72,621,623
2012	76,647,038
2011	85,710,608

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>
2013 ⁽¹⁾	\$34,858,553	\$46,733
2012	34,179,014	46,631
2011	32,389,731	44,829
2010	30,352,011	42,424
2009	29,936,807	42,385

⁽¹⁾ Most recent data available.

Source: U.S. Bureau of Economic Analysis.

According to the Office of Financial Management for the State of Washington, the preliminary estimated median household income in Snohomish County for 2013 is approximately \$64,740, and the projected median household income in Snohomish County for 2014 is \$65,454.

**Employment Data
Snohomish County**

	<u>Annual Averages</u>					
	<u>2015⁽¹⁾</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Civilian Labor Force	404,890	395,320	390,210	388,250	386,390	389,300
Employed	390,280	374,990	367,430	358,940	350,280	348,260
Unemployed	14,310	20,330	22,780	29,310	36,110	41,050
County Unemployment Rate	3.6%	5.1%	5.8%	7.5%	9.3%	10.5%

⁽¹⁾ Preliminary, average through April 2015.

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

**Nonagricultural Wage and Salary Employment⁽¹⁾
Snohomish County**

NAICS Industry Title	Annual Averages				
	2015 ⁽²⁾	2014	2013	2012	2011
<i>Goods Producing</i>					
Construction, Mining and Logging	18,100	17,300	16,100	15,500	15,000
Manufacturing	62,400	63,000	64,400	64,000	58,300
Total ⁽³⁾	80,500	80,300	80,500	79,500	73,300
<i>Service Providing</i>					
Trade, Transportation and Utilities	45,500	45,600	44,300	43,800	42,600
Information	5,600	5,700	5,700	5,900	5,700
Financial Activities	12,600	12,700	12,500	11,200	11,400
Professional and Business Services	24,100	23,600	23,100	23,100	21,400
Education and Health Services	34,100	33,000	32,000	31,900	31,600
Leisure and Hospitality	24,700	24,200	23,300	23,200	22,400
Other Services	10,200	10,000	9,900	10,100	9,800
Government	39,400	38,200	37,500	37,200	37,300
Total ⁽³⁾	196,200	193,100	188,400	186,400	182,100
Total Nonfarm ⁽³⁾	276,700	273,500	269,000	265,800	255,400

⁽¹⁾ Not seasonally adjusted

⁽²⁾ Preliminary, average through April 2015.

⁽³⁾ Totals may not add due to rounding.

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

LIMITATIONS ON REMEDIES; BANKRUPTCY

Limitations on Remedies

Any remedies available to the owners of the 2015 Bonds upon the occurrence of an event of default under the Electric 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 Electric System Bond Resolution or to pay principal of or interest on the 2015 Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the 2015 Bonds.

In addition to the limitations on remedies contained in the Electric System Bond Resolution, the rights and obligations under the 2015 Bonds and the Electric 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 opinion to be delivered by Orrick, Herrington & Sutcliffe LLP, as Bond Counsel to the District, concurrently with the issuance of the 2015 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 2015 Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D.

Bankruptcy

A municipality such as the District must be specifically authorized under state law in order to seek relief under Chapter 9 of the U.S. Bankruptcy Code (the "Bankruptcy Code"). While an involuntary bankruptcy petition cannot be filed against the District, the District is authorized to file for bankruptcy

under certain circumstances. Should the District file for bankruptcy, there could be adverse effects on the holders of the 2015 Bonds.

To the extent that the Revenues are “special revenues” under the Bankruptcy Code, then Revenues collected after the date of the bankruptcy filing should secure the District’s obligations under the Electric System Bond Resolution and the 2015 Bonds. “Special revenues” are defined to include receipts derived from the ownership or operation of projects or systems that are primarily used to provide utility services. No assurance can be given that a court would hold that the Revenues are special revenues. If any of the Revenues are determined not to be special revenues, then any such amounts collected after the commencement of the bankruptcy case will likely not secure the District’s obligations under the Electric System Bond Resolution or the 2015 Bonds. The holders of the 2015 Bonds may not be able to assert a claim against any property of the District other than the Revenues, and if any or all of the Revenues no longer secure the Electric System Bond Resolution and 2015 Bonds, then there may be limited, if any, funds from which the holders of the 2015 Bonds are entitled to be paid.

The Bankruptcy Code provides that “special revenues” can be applied to necessary operating expenses of the project or system, before they are applied to other obligations. This rule applies regardless of the provisions of the transaction documents. It is not clear precisely which expenses would constitute necessary operating expenses and any definition in the transaction documents may not be applicable.

If the District is in bankruptcy, the parties (including the Trustee and the holders of the 2015 Bonds) may be prohibited from taking any action to collect any amount from the District or to enforce any obligation of the District, unless the permission of the bankruptcy court is obtained. These restrictions may also prevent the Trustee from making payments to the holders of the 2015 Bonds from funds in the Trustee’s possession. The rate covenant (see “SECURITY FOR THE 2015 BONDS—Rates and Charges”) may not be enforceable in bankruptcy by the holders of the 2015 Bonds.

The District is permitted to commingle the Revenues with its own funds for certain periods of time before turning over the Revenues to the Trustee. See “SECURITY FOR THE 2015 BONDS—Flow of Funds.” If the District goes into bankruptcy, the District may not be required to turn over to the Trustee any Revenues that are in its possession at the time of the bankruptcy filing and have been commingled with other moneys. If the District has possession of Revenues (whether collected before or after commencement of the bankruptcy) and if the District does not voluntarily turn over such Revenues to the Trustee, it is not entirely clear what procedures the holders of the 2015 Bonds would have to follow to attempt to obtain possession of such Revenues, how much time it would take for such procedures to be completed, or whether such procedures would ultimately be successful.

The District may be able to borrow additional money that is secured by a lien on any of its property (including the Revenues), which lien could have priority over the lien of the Electric System Bond Resolution, or to cause some of the Revenues to be released to it, free and clear of lien of the Electric System Bond Resolution, in each case as long as the bankruptcy court determines that the rights of the Trustee and the holders of the 2015 Bonds will be adequately protected.

If the District is in bankruptcy it may be able, without the consent and over the objection of the holders of the 2015 Bonds, to alter the priority, interest rate, principal amount, payment terms, collateral, maturity dates, payment sources, covenants (including tax-related covenants), and other terms or provisions of the Electric System Bond Resolution and the 2015 Bonds, as long as the bankruptcy court determines that the alterations are fair and equitable.

There may be delays in payments on the 2015 Bonds while the court considers any of these issues. There may be other possible effects of a bankruptcy of the District that could result in delays or reductions in payments on the 2015 Bonds, or result in losses to the holders of the 2015 Bonds. Regardless of any

specific adverse determinations in a District bankruptcy proceeding, the fact of a District bankruptcy proceeding could have an adverse effect on the liquidity and value of the 2015 Bonds.

The District may invest the Revenues in the State of Washington Local Government Investment Pool. Should those investments suffer any losses, the District may have insufficient funds to make payments on the 2015 Bonds.

INITIATIVE AND REFERENDUM

Under the State Constitution, the voters of Washington State have the ability to initiate legislation and approve or reject certain pending legislation through the powers of initiative and referendum, respectively. The initiative power in Washington State 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 2015 Bonds

There is no litigation now pending or threatened restraining or enjoining the issuance and delivery of the 2015 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 2015 Bonds or affecting the validity of the 2015 Bonds.

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.

In March 2015, the District received an \$11 million claim on behalf of a child who was injured in 2012 when an abandoned utility pole fell on her. The pole was jointly owned with the predecessor to Frontier Communications. The District is evaluating this claim.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2015 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”). Bond Counsel is of the further opinion that interest on the 2015 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D hereto and will be delivered with the 2015 Bonds.

2015 Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“Premium Bonds”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2015 Bonds. The District has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2015 Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2015 Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the 2015 Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel’s attention after the date of issuance of the 2015 Bonds may adversely affect the value of, or the tax status of interest on, the 2015 Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the 2015 Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of amounts treated as interest on, the 2015 Bonds may otherwise affect a Beneficial Owner’s federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner’s other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the 2015 Bonds to be subject, directly or indirectly, in whole or in part, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. For example, the Obama Administration’s budget proposals in recent years have proposed legislation that would limit the exclusion from gross income of interest on the 2015 Bonds to some extent for high-income individuals. The introduction or enactment of any such legislative proposals or clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the 2015 Bonds. Prospective purchasers of the 2015 Bonds should consult their own tax advisors regarding the potential impact of any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel is expected to express no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel’s judgment as to the proper treatment of the 2015 Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service (“IRS”) or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the District, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The District has covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the 2015 Bonds ends with the issuance of the 2015 Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the District or the Beneficial Owners regarding the tax-exempt status of the 2015 Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the District and its appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the District legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the 2015 Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the 2015 Bonds, and may cause the District or the Beneficial Owners to incur significant expense.

CONTINUING DISCLOSURE

The District will covenant for the benefit of Owners and Beneficial Owners of the 2015 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, 2015, and to provide notices of the occurrence of certain enumerated events. The Annual Report and the notices of enumerated 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 listed events is set forth in APPENDIX F – "FORM OF CONTINUING DISCLOSURE CERTIFICATE." These covenants will be made in order to assist the Underwriters for the 2015 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").

In reviewing its continuing disclosure filings in connection with the U.S. Securities and Exchange Commission's Municipalities Continuing Disclosure Cooperation Initiative, the District determined that it had not always timely filed notices of ratings changes for bond insurers or resulting from methodology recalibrations the rating agencies and that it had not timely filed a notice of defeasance with respect to the advance refunding of certain of its outstanding bonds. The District has reviewed and updated its continuing disclosure procedures to enhance compliance with its continuing disclosure obligations in the future.

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 2015 Bonds. Such ratings reflect only the views of the respective rating agency and are not a recommendation to buy, sell or hold the 2015 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 2015 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 2015 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 2015 Bonds.

UNDERWRITING

Citigroup Global Markets Inc., acting on its own behalf and as representative of Merrill Lynch, Pierce, Fenner & Smith Incorporated and Goldman, Sachs & Co. (collectively, the “Underwriters”), has agreed, subject to certain conditions, to purchase the 2015 Bonds from the District at an aggregate purchase price of \$157,555,167.26, representing the aggregate principal amount of the 2015 Bonds, plus original issue premium of \$17,122,442.60 and less Underwriters’ discount of \$487,275.34. The Underwriters’ obligations are subject to certain conditions precedent, and they will be obligated to purchase all 2015 Bonds if any such 2015 Bonds are purchased.

The Underwriters have provided the information in the following two paragraphs for inclusion in this Official Statement. The District cannot and does not make any representation as to its accuracy or completeness.

The 2015 Bonds may be offered and sold to certain dealers at prices lower than such public offering prices, and such public offering 2015 may be changed, from time to time, by the Underwriters. The Underwriters may offer and sell the 2015 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. In connection with the offering of the 2015 Bonds, the Underwriters may over-allot or effect transactions that stabilize or maintain the market price of the 2015 Bonds at levels above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

Citigroup Global Markets Inc., one of the Underwriters of the 2015 Bonds, has entered into a retail distribution agreement with each of TMC Bonds L.L.C. (“TMC”) and UBS Financial Services Inc. (“UBSFS”). Under these distribution agreements, Citigroup Global Markets Inc. may distribute municipal securities to retail investors through the financial advisor network of UBSFS and the electronic primary offering platform of TMC. As part of this arrangement, Citigroup Global Markets Inc. may compensate TMC (and TMC may compensate its electronic platform member firms) and UBSFS for their selling efforts with respect to the 2015 Bonds.

LEGALITY

The validity of the 2015 Bonds and certain other legal matters are subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the District. A complete copy of the proposed form of Bond Counsel opinion is contained in Appendix D. Bond Counsel takes no responsibility for the accuracy, completeness or fairness of this Official Statement. Orrick, Herrington & Sutcliffe LLP, as Disclosure Counsel, will provide certain legal services for the District. Certain legal matters in connection with the issuance of the 2015 Bonds will be passed upon for the District by Kristin Hall, Interim General Counsel to the District. 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, addressed solely to the Underwriters and cannot be relied upon by investors.

From time to time, Bond Counsel represents the Underwriters in matters unrelated to the sale of the 2015 Bonds.

FINANCIAL ADVISOR

Public Financial Management, Inc. has acted as financial advisor to the District in connection with the issuance of the 2015 Bonds.

MISCELLANEOUS

The execution and delivery of this Official Statement by its Assistant General Manager-Finance and Treasurer 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 2015 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

**INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS FOR THE YEARS
ENDED DECEMBER 31, 2014 AND 2013**

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Independent Auditors' Report & Financial Statement for the Years Ended December 31, 2014 and 2013



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fax 608 249 8532
bakertilly.com

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Snohomish County Public Utility District

Report on the Financial Statements

We have audited the accompanying combined financial statements of Public Utility District No. 1 of Snohomish County, Washington ("PUD"), which comprise the Combined Statements of Net Position as of December 31, 2014 and 2013, and the related Combined Statements of Revenues, Expenses and Changes in Net Position, and Combined Statements of Cash Flows for the years then ended and the related notes to the financial statements. We have also audited the accompanying individual Statements of Net Position of the Electric, Generation, and Water Systems as of December 31, 2014, and the related Statements of Revenues, Expenses, and Changes in Net Position and Cash Flows for the year then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the PUD's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the PUD's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the PUD at December 31, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended, and the individual financial positions of the Electric, Generation, and Water Systems as of December 31, 2014, and the individual changes in their financial positions and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.



To the Board of Commissioners
Snohomish County Public Utility District

Other Matters

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audit of the consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedule information as identified in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the PUD's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the PUD's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 1, 2015

Management's Discussion and Analysis (Unaudited)

The following discussion provides an overview of Public Utility District No. 1 of Snohomish County (the PUD) financial activities for the years ended December 31, 2014 and 2013. This unaudited discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

FINANCIAL HIGHLIGHTS

OPERATING RESULTS

Snohomish County PUD continued to exhibit growth in its customer base and retail power sales revenue during 2014. The average number of Electric System customers increased 1.4% from 327,871 in 2013 to 332,516 in 2014, following a 1.0% increase in 2013. Retail power sales revenue to residential, commercial, industrial and street lighting customers increased from \$538 million in 2013 to \$545 million in 2014, following a \$17 million increase in 2013. Higher power sales revenue reflected a full year of a 2.3% general rate increase in April 2013 and a 2.7% rate increase in October 2013 to match an increase in power resource and transmission costs from the Bonneville Power Administration (BPA). Retail MWh sales declined slightly from 6,544,708 MWh in 2013 to 6,486,109 MWh in 2014, after a 9,124 MWh increase in 2013. The lower consumption in 2014 primarily resulted from an extraordinarily warm year leading to a declined heating load.

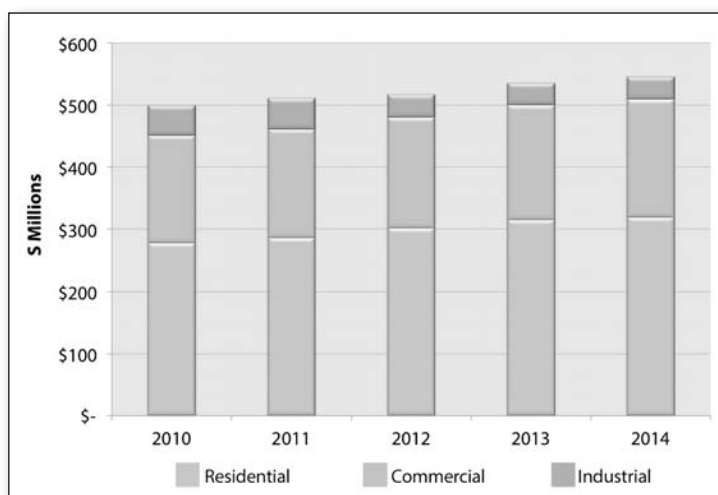


Figure 1: Retail Energy Sales

Overall, combined operating revenue increased \$20 million; from \$625 million in 2013 to \$645 million in 2014, following a \$21 million increase in 2013. Combined operating expenditures were \$585 million in 2014, a \$31 million increase over 2013, following a \$14 million increase in 2013. The largest of the operating expenditures, combined purchased power costs were \$283 million in 2014, \$12 million higher than 2013. The increase in the power costs was the result of a higher volume of purchases from the wholesale power market. In addition, a number of factors led to a \$14 million increase in combined operations costs from \$166 million in 2013 to \$180 million in 2014, including higher transmission and ancillary costs and costs related to the PUD's effort to implement a new enterprise resource planning system in 2015.

ELECTRIC SYSTEM RATE CHANGES

During the first quarter of 2013, the PUD Board of Commissioners approved a 2.3% general electric rate increase, effective April 1, 2013. Financial impacts that led to the decision to raise electric rates included increased transmission and ancillary costs, on-going financial commitments to local agencies related to the Jackson Hydroelectric Project license, increased funding for renewable resources and conservation programs, a net revenue loss from the closure of the PUD's largest customer in 2012, lower investment returns due to the depressed interest rates, and the impact of inflation on material costs.

In August 2013, BPA announced wholesale power and transmission rate increases effective October 2013. According to BPA, the rate increases were necessary to rehabilitate aging northwest hydroelectric systems currently beyond their planned design life, provide for additional fish and wildlife mitigation costs, as well as to fund increased maintenance and labor costs for an aging transmission system as a result of evolving reliability and security standards. As a result of the increased cost of power and transmission purchases from BPA, the PUD's Board of Commissioners increased retail power rates 2.7% to match the higher costs effective October 1, 2013.

BONNEVILLE POWER ADMINISTRATION (BPA) POWER SUPPLY AGREEMENT

BPA markets wholesale electricity generated from the federally owned hydroelectric projects in the Columbia River basin and one non-federal nuclear power plant and provides approximately 85% of the long-term energy resources used by the PUD to serve its customers. The PUD purchases power from the agency under a 17-year power supply agreement that began in 2011. Power purchases from BPA were \$213 and \$210 million in 2014 and 2013, respectively.

BPA passes its costs of power, transmission, and ancillary services to customers through its wholesale rates. These wholesale rates are reviewed biannually and adjusted on October 1 of each year. Subject to approval by the Board of Commissioners, the PUD adjusts retail electric rates to reflect BPA rate adjustments.

WIND ENERGY AGREEMENTS

Approximately 6% of the energy the PUD sells to its customers is supplied by three wind projects in Washington and Oregon, enough to provide energy for about 45,000 homes. The three projects are the White Creek Wind Project in Roosevelt, Washington, the Wheat Field Wind Project in Gilliam County, Oregon, and the Hay Canyon Wind Project in Sherman County, Oregon.

The cost of power from wind projects, included as purchased power expenses, was \$38 and \$37 million in 2014 and 2013, respectively.

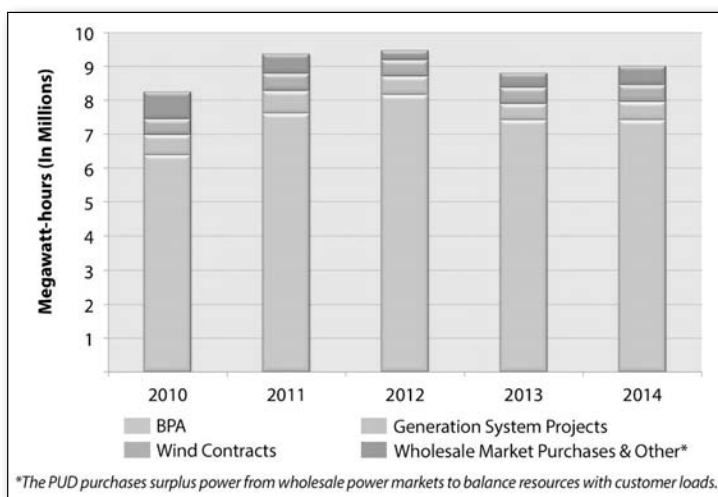


Figure 2: Power Purchases

CONSTRUCTION FOR CONTINUED GROWTH

The PUD has increased capital programs over the past three years to maintain, expand and enhance its electric distribution system. Electric System capital expenditures were \$110 million in 2014 and \$94 million in 2013. The number of electric connections and customers continues to grow in the PUD's service area, and while power consumption has exhibited a slight decrease since 2008 as a result of the impacts of an economic recession, the loss of a major customer, and the effects of the PUD's energy-efficiency programs. The need for electric distribution infrastructure and facilities to serve customers

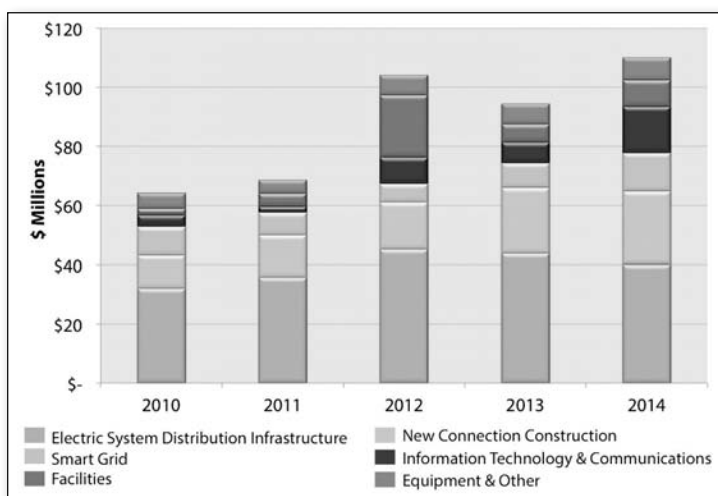


Figure 3: Capital Expenditures

and assure reliability is expected to expand over the next 10 years. Accordingly, the PUD made several investments in 2013 and 2014 in an effort to plan for future growth.

Key projects in 2014 and 2013 included expansion of the Beverly Park Switching Station to add transmission capacity, design and construction of Fitzgerald and York substations to serve growth in the Canyon Park and Mill Creek areas, a new transmission line southwest of Granite Falls, upgrades to SnoKing-Halls Lake transmission lines, the replacement of Mill Creek underground cable, upgrades to transmission circuits near Clearview, and new distribution ties between substations in Arlington and Lake Stevens. In addition, the PUD replaced transformers, circuit breakers and other equipment at numerous substations in Everett, Lake Stevens, Bothell and other communities.

The PUD continued its ongoing replacement of aging poles; approximately 700 were replaced in 2014, and 1,300 in 2013. In addition, about 60 miles of underground distribution cable were replaced in both 2014, and 2013. The PUD also worked with the Washington State Department of Transportation, Snohomish County and local municipalities to relocate lines and other facilities in Edmonds, Everett, Marysville, Mill Creek, Stanwood and other areas to accommodate road projects and other construction.

Finally, an ongoing multi-year effort is underway to automate additional substations as part of a comprehensive grid modernization plan, which will allow the PUD to better manage outages and improve efficiency. In 2014, the PUD automated nine additional substations.

REGIONAL OFFICE PLAN

Many of the Electric System's five regional offices, which support local line crews, engineering and customer service, are housed in buildings that are 40- to 50-years-old and require off-site storage for poles, transformers and other construction materials and equipment. The PUD Board of Commissioners approved a plan to replace these regional offices over the next ten years, and the utility has purchased sites for four regional office replacements.

In 2014, the PUD began engineering, demolition, grading and construction of a new South County regional office in the south Snohomish County city of Lynnwood. The new office will consolidate two sites – the current South County administrative regional office in Edmonds and the nearby Halls Lake operations facility. The new facility will house office staff and line crews as well as warehouse facilities and an expanded pole yard when completed. The PUD spent \$12 million on the project in 2014, and construction is expected to be complete in the third quarter of 2015.

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 cash reserves to fund investments in the electric distribution system infrastructure.

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 \$485 million as of December 31, 2014, compared to \$521 million in 2013.

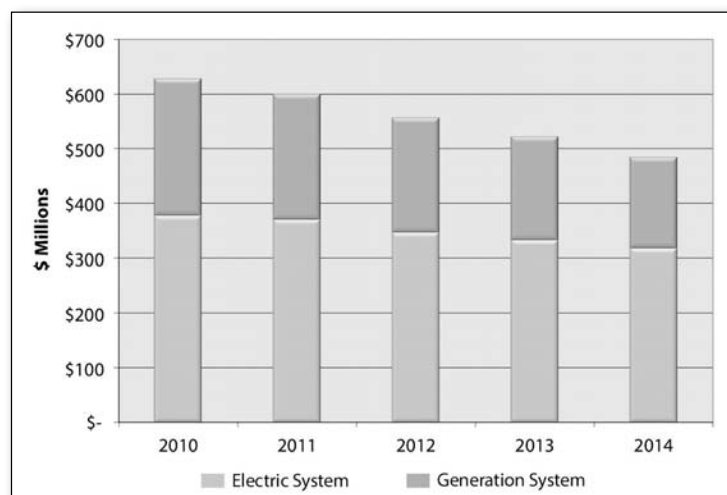


Figure 4: Long-Term Debt

ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM PROJECT

During 2014, the PUD began an extensive system project to replace its ERP, or business management software including the systems that manage materials and contract procurement, work order and asset management, financial management and reporting, and human resource management. As part of the project, project members are working with system implementation specialists to review current business processes and modify them to adopt industry best practices and optimize the system's capabilities.

The multi-year project involves numerous employees from around the PUD and is expected to have several implementation dates for various modules. The PUD has already implemented some of the human resources management and customer relations and billing capabilities, and it has also upgraded its payroll and claims management systems. In 2014, operations expense includes \$10 million related to this project.

ENERGY-EFFICIENCY PROGRAMS

The PUD and its customers continue to demonstrate their commitment to energy-efficiency through their active participation in numerous energy-efficiency programs. These programs include residential customer incentives for installation of weatherization measures, lighting modifications, purchases of energy-efficient washing machines, heat pump programs, and solar power systems, as well as commercial incentives for new construction projects that incorporate energy-efficiency measures and rebates for retrofit projects that include installation of energy efficient lighting, HVAC equipment or equipment control devices. Some of these energy-efficiency programs are funded through an agreement with BPA.

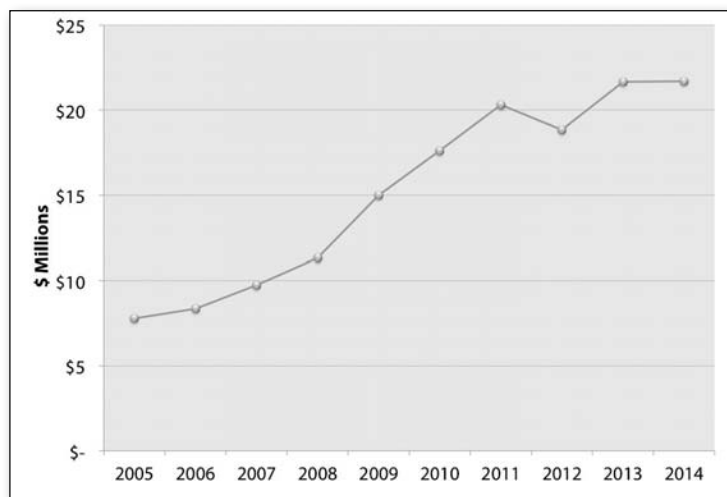


Figure 5: Energy-Efficiency Program Expenditures

Operations expenses in both 2014 and 2013 include approximately \$22 million related to energy-efficiency measures. In 2014, the PUD recorded \$9 million of energy-efficiency reimbursements from BPA as compared to \$7 million in 2013.

LED STREET LIGHT PROGRAM

In 2013 the PUD launched a systematic five-year conversion of the street-light fixtures it owns and maintains to energy-efficient Light-Emitting Diode (LED) lights. New LED lights, which will be installed as part of regular maintenance, will save energy and reduce costs. They replace high-pressure sodium (HPS) lights and provide better lighting, last two to three times longer and use one-third as much energy. As part of its regular maintenance cycle, the utility plans to change nearly 36,000 fixtures over approximately five years. To date, the PUD has replaced over 11,000 HPS fixtures. In 2014 and 2013, the PUD spent approximately \$4 and \$3 million, respectively, on this program.

ENERGY STORAGE PROJECT

The PUD and its business partners are building three energy storage systems based on a standard, non-proprietary and scalable approach to energy storage. The PUD's Modular Energy Storage Architecture (MESA) program, which forges partnerships with major U.S. and international business partners, will include two large scale multiple lithium ion batteries and an advanced vanadium flow battery. Energy storage is a critical element needed to manage renewable energy growth since wind and solar power generation is irregular, and not always available during peak energy demand hours.

In 2014, components of the first system to be energized, including a 40-foot structure resembling a shipping container that houses an array of batteries, were delivered and installed at the Hardeson Substation in southwest Everett. Also in 2014, the State of Washington announced that Snohomish County PUD will receive \$7.3 million in matching funds from the Washington Clean Energy Fund in support of its energy storage project. The PUD recorded \$3.2 million of costs related to the energy storage project in 2014, and \$0.9 million of grant funding.

TIDAL PROJECT TERMINATION

The PUD announced the termination of its tidal energy research pilot project in Admiralty Inlet, west of Whidbey Island in 2014. The PUD and its funding partners worked for eight years at federal, state and local levels to obtain permits and licenses in order to determine the requirements and associated costs of the project. The project was intended to further the knowledge base regarding tidal energy.

The requirements and projected costs of this temporary pilot project became more onerous than anticipated. The estimated costs of the materials needed to build the project increased significantly, and various entities mandated an increasing amount of studies and monitoring requirements beyond installation of the tidal turbines. Funding for the project has come from several sources including federal grants, in-kind contributions and the sale of excess renewable energy credits from the PUD's wind-power projects. In 2014, the PUD recorded a \$6.9 million charge in other income and expense related to the project termination.

WATER SYSTEM OPERATING RESULTS

Retail sales for the Water System declined from \$10.7 million in 2013 to \$10.2 million for the year ended December 31, 2014 following a \$0.8 million increase in 2013. The decrease in 2014 was a result of the transfer of 2,095 customers to the city of Marysville on December 31, 2013, as part of a one-time annexation settlement agreement. The 2013 increase was the result of both a higher level of water consumption and the impact of a rate change.

Operating expenses increased from \$8.9 million in 2012 to \$9.8 million in 2013, and decreased to \$9.5 million in 2014. This increase in 2013 was the result of higher expenditures for maintenance of meters and water mains. The decrease in 2014 reflects lower expenditures resulting from the transfer of customers and lower wholesale water purchases due to increased production from the PUD's Lake Stevens water treatment facility.

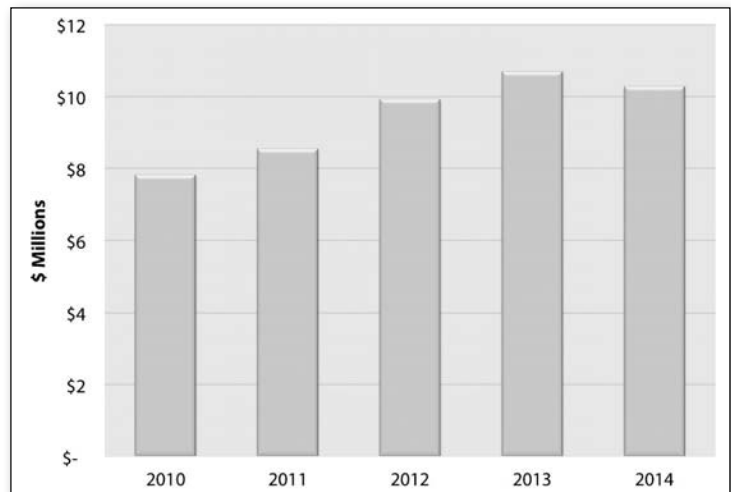


Figure 6: Retail Water Sales

CITY OF MARYSVILLE ANNEXATION SETTLEMENT AGREEMENT

In 2003, the PUD entered into a Settlement Agreement with the City of Marysville (the City) which provided, among other things, that when the City annexed several identified overlap areas of service, the PUD would transfer its Water System facilities and those customers in the overlap areas to the City in return for a negotiated settlement payment. The City annexed the overlap areas, and the PUD transferred \$5.8 million of fully depreciated assets, as well as 2,095 customers, and received the payment of \$4.6 million from the City on December 31, 2013.

Since there was no remaining book value for the assets transferred to the City, the resulting \$4.6 million gain is being recognized over five years beginning in 2013. The Water System financial statements reflect \$0.9 million in other income in 2013 and 2014, and the unrecognized gain is treated as deferred inflows as a result of this transaction.

In 2014, the city of Marysville transferred assets to the PUD related to the Settlement Agreement that it was obligated to build and transfer. The cost to construct the assets was \$0.8 million, and the Water System recorded them as a capital contribution.

WATER SYSTEM RATE CHANGE

In December 2012, the Board of Commissioners approved revisions to the Water System's service rate schedule including annual rate increases beginning January 2013 through 2016. Several factors led to the rate increase schedule, including higher wholesale water purchase prices, rising material and construction costs, and the need for funding capital infrastructure improvements to address growth in the Water System service area. For 2013 and 2014, retail water rates increased 4.3% per year.

DUBUQUE-CASCADE ACRES INTERTIE PROJECT

In 2014, the PUD's Water System completed a project to install approximately 13,100 linear feet of 12-inch ductile iron pipe to connect two areas of the Water System and provide more hydraulic benefit. The project also included installation of new fire hydrants, approximately 40 new water services and replacement of 35 existing services. The final construction cost was \$3.1 million, and funding of \$2.5 million was provided by a low-interest loan from the Public Works Board Drinking Water State Revolving Fund (DWSRF) program. The 22-year loan carries an interest rate of 1.0%.

OVERVIEW OF THE FINANCIAL STATEMENTS

BASIC FINANCIAL STATEMENTS

The Combined Statements of Net Position present the PUD's net position as the difference between assets and deferred outflows of resources, and liabilities and deferred inflows of resources. The Combined Statements of Net Position provide information about the nature and amount of investments in resources (assets), the consumption of net assets in one period that are applicable to future periods (deferred outflows of resources), the obligations to creditors (liabilities), and the acquisition of net assets that are applicable to future periods (deferred inflows of resources).

The Combined Statements of Revenues, Expenses, and Changes in Net Position report the revenues and expenses during the periods indicated and identify operating activity separately from non-operating activity.

The Combined Statements of Cash Flows provide information about the PUD's cash flows from operating activities, capital and related financing activities, investing activities, and noncapital financing activities, and presents a reconciliation of net operating income to net cash provided by operating 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)

	December 31,		
	2014	2013	2012
Current Assets and Special Funds	\$ 689	\$ 727	\$ 734
Net Utility Plant	1,269	1,208	1,157
Other Assets	34	37	40
<i>Total Assets</i>	<u>1,992</u>	<u>1,972</u>	<u>1,931</u>
Deferred Outflows of Resources	29	34	39
Current Liabilities	142	135	130
Long-Term Debt	504	545	586
Other Liabilities	53	53	48
<i>Total Liabilities</i>	<u>699</u>	<u>733</u>	<u>746</u>
Deferred Inflows of Resources	28	35	37
Net Investment in Capital Assets	755	658	581
Restricted	272	279	289
Unrestricted	267	301	299
Total Net Position	<u>\$ 1,294</u>	<u>\$ 1,238</u>	<u>\$ 1,169</u>
Operating Revenues	\$ 645	\$ 625	\$ 604
Operating Expenses	585	554	540
<i>Net Operating Income</i>	<u>60</u>	<u>71</u>	<u>64</u>
Interest Charges	(27)	(29)	(32)
Other Income and Expense	1	9	18
<i>Net Income before Capital Contributions</i>	<u>34</u>	<u>51</u>	<u>50</u>
Capital Contributions	22	18	14
<i>Net Income</i>	<u>56</u>	<u>69</u>	<u>64</u>
Net Position - beginning of year	1,238	1,169	1,105
Net Position - end of year	<u>\$ 1,294</u>	<u>\$ 1,238</u>	<u>\$ 1,169</u>

ASSETS

Current assets and special funds declined \$38 million in 2014 reflecting the use of cash to fund a portion of the PUD's capital expenditures. Current assets and special funds declined \$7 million in 2013 as compared to the prior year primarily due to the utilization of the proceeds from the Electric System Series 2010A and 2010B bonds to fund eligible capital expenditures.

The PUD had \$1,269, \$1,208, and \$1,157 million invested in a broad range of net utility capital assets as of December 31, 2014, 2013, and 2012, respectively. Utility capital assets include three hydroelectric power generation plants, electric transmission and distribution lines and substations, water transmission and distribution pipes, storage and pump station facilities, buildings and equipment. Utility plant additions were \$118 million in 2014 and \$103 million in 2013, 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 \$21 million and \$20 million in routine plant asset retirements in 2014 and 2013, respectively. Accumulated depreciation increased \$36 million and \$32 million related to routine plant asset activity in 2014 and 2013, respectively.

Other assets decreased \$3 million in 2014, reflecting the collection of some long-term receivables, including residential conservation loans. Other assets decreased \$3 million in 2013 primarily due to the receipt of funds from FEMA to reimburse the PUD for damage to electric distribution facilities caused by a severe winter storm in January 2012.

DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows of resources decreased \$5 million in 2014 and 2013 from prior years as the PUD amortized the book loss on the defeasance of debt.

LIABILITIES

Current liabilities increased \$7 million in 2014 reflecting the accrual of progress payments on a software system implementation. Current liabilities increased \$5 million in 2013 as a result of increased power purchases from the wholesale power market near the end of the year.

Long-term debt decreased \$41 million in 2014 and 2013 as a result of scheduled principal repayments on outstanding bonds and the refunding of Series 2004 Electric System bonds in 2012.

Other liabilities remained unchanged in 2014 as compared to 2013. Other liabilities increased \$5 million in 2013 as the PUD recorded a liability for retiree benefits.

DEFERRED INFLOWS OF RESOURCES

Deferred inflows of resources decreased \$7 million in 2014 and \$2 million in 2013 as the result of the amortization of the settlement on the early termination of a power resource as well as a decrease of the future obligations related to the Jackson project license.

NET POSITION

Net investment in capital assets increased \$97 million in 2014 and \$77 million in 2013 reflecting the growth in net utility plant. Capital expenditures are generally funded through rate-based revenues, contributions from customers and developers for requested facilities, and debt proceeds. The PUD added 4,760 and 3,774 Electric System customer connections in 2014 and 2013, respectively. The Water System added 227 customer connections in 2014. The Water System added 408 customer connections in 2013 without consideration of the transfer of 2,095 customers to the City of Marysville in December 2013.

Restricted net position represents resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements, and resources restricted by Board resolution. Restricted assets decreased \$7 million in 2014 and \$10 million in 2013 due to the use of a portion of a settlement designed to fund the impact of the early termination of a power resource. Unrestricted net position is available to finance day-to-day operations without constraints established by debt covenants or other legal requirements. In 2014, unrestricted net position decreased \$34 million due to lower cash reserves. The unrestricted net position remained relatively unchanged in 2013.

OPERATING REVENUES

Operating revenues increased \$20 million in 2014 as compared to 2013. Retail sales increased \$6 million as a result of a general and a power contract pass-through rate increase in 2013. Wholesale sales increased \$10 million. The PUD sells surplus power into the wholesale power markets to balance resources with customer loads. Other operating revenue increased \$4 million related to higher revenue from sales of transmission capacity and BPA energy conservation program reimbursements. Operating revenues increased \$21 million in 2013 as compared to 2012 as a result of slightly higher customer consumption of power, an Electric System 2.3% general rate increase effective April 1, 2013, and a 2.7% rate increase to pass-through a wholesale power cost increase from BPA effective October 1, 2013.

OPERATING EXPENSES

Operating expenses increased \$31 million in 2014 as a result of higher volume of power purchases from the wholesale power market and increased operations expenses due to higher transmission and ancillary costs and costs related to the PUD's effort to implement a new enterprise resource planning system. Operating expenses increased \$14 million in 2013 as a result of greater wholesale power purchases, higher transmission and ancillary costs, increased conservation program expenditures, and the recording of some post-retirement benefit costs.

OTHER INCOME AND EXPENSE

An \$8 million decrease in other income and expense in 2014 is primarily due to the terminated tidal power project. A \$9 million reduction in other income and expense in 2013 was the result of a lower level of grant reimbursements.

CAPITAL CONTRIBUTIONS

Capital contributions increased \$4 million in 2014 and 2013. Capital contributions are collected from property developers when they request to connect to the PUD's electric or water distribution systems or request engineering or construction services. The capital contributions increase reflects improvement in the economy and development of the PUD's service area.

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 STATEMENTS OF NET POSITION

December 31, 2014 and 2013

(In thousands)

	2014				2013
	Electric System	Generation System	Water System	Combined	Combined
ASSETS					
Current Assets:					
Cash and temporary investments:					
Cash and cash equivalents	\$ 57,237	\$ 15,504	\$ 2,153	\$ 74,894	\$ 87,668
Temporary investments	180,105	2,500	7,996	190,601	209,275
	<u>237,342</u>	<u>18,004</u>	<u>10,149</u>	<u>265,495</u>	<u>296,943</u>
Accounts and other receivables, net	96,945	4,117	1,753	98,007	101,063
Intersystem loans receivable	17,481	972	–	–	–
Materials and supplies	18,364	–	222	18,586	19,104
Prepayments and other	1,698	3,102	35	4,835	2,272
Total Current Assets	<u>371,830</u>	<u>26,195</u>	<u>12,159</u>	<u>386,923</u>	<u>419,382</u>
 <i>Special Funds – Bond Funds and Other</i>	 <u>264,790</u>	 <u>34,080</u>	 <u>3,144</u>	 <u>302,014</u>	 <u>308,042</u>
 Utility Plant:					
Plant in service	1,466,250	263,239	138,463	1,867,952	1,800,730
Construction work in progress	102,705	3,977	1,764	108,446	78,206
Total utility plant	1,568,955	267,216	140,227	1,976,398	1,878,936
Accumulated depreciation	(557,661)	(122,065)	(27,151)	(706,877)	(671,143)
Net Utility Plant	<u>1,011,294</u>	<u>145,151</u>	<u>113,076</u>	<u>1,269,521</u>	<u>1,207,793</u>
 Other Assets:					
Conservation loans and other receivables, net	3,507	8	624	4,139	5,789
Intersystem loans and receivables	57,424	5,267	–	–	–
FERC license charges	–	18,345	–	18,345	18,917
Other assets	2,359	8,882	–	11,241	12,632
Total Other Assets	<u>63,290</u>	<u>32,502</u>	<u>624</u>	<u>33,725</u>	<u>37,338</u>
 Total Assets	<u>1,711,204</u>	<u>237,928</u>	<u>129,003</u>	<u>1,992,183</u>	<u>1,972,555</u>
 DEFERRED OUTFLOWS OF RESOURCES					
Unamortized loss on refunding debt	2,336	25,797	446	28,579	33,700
Total Deferred Outflows of Resources	<u>2,336</u>	<u>25,797</u>	<u>446</u>	<u>28,579</u>	<u>33,700</u>
 Total Assets and Deferred Outflows	<u>\$ 1,713,540</u>	<u>\$ 263,725</u>	<u>\$ 129,449</u>	<u>\$ 2,020,762</u>	<u>\$ 2,006,255</u>

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

COMBINED STATEMENTS OF NET POSITION

December 31, 2014 and 2013

(In thousands)

	2014				2013
	Electric System	Generation System	Water System	Combined	Combined
LIABILITIES					
Current Liabilities:					
Accounts payable	\$ 59,342	\$ 3,627	\$ 952	\$ 59,836	\$ 55,091
Accrued taxes	15,748	116	47	15,911	15,673
Accrued interest	1,523	1,272	106	2,178	2,579
Other accrued liabilities	20,259	2	–	20,261	18,503
Customer deposits	4,420	–	26	4,446	4,209
Current maturities of long-term debt	14,220	23,070	2,044	39,334	38,705
Intersystem loans payable	972	17,481	–	–	–
Total Current Liabilities	116,484	45,568	3,175	141,966	134,760
Long-Term Debt:					
Revenue bonds	320,877	157,754	20,989	499,620	541,662
Other notes payable	–	–	4,627	4,627	3,487
Total Long-Term Debt	320,877	157,754	25,616	504,247	545,149
Other Liabilities:					
Intersystem loans and payables	7,870	54,821	–	–	–
FERC license obligations	–	18,345	–	18,345	18,917
Other liabilities	31,205	2,222	865	34,292	34,056
Total Other Liabilities	39,075	75,388	865	52,637	52,973
Total Liabilities	476,436	278,710	29,656	698,850	732,882
DEFERRED INFLOWS OF RESOURCES					
Unearned FERC license contributions	–	8,000	–	8,000	8,500
Unearned settlement proceeds	–	13,833	–	13,833	19,647
Other deferred inflows	3,300	–	2,781	6,081	7,363
Total Deferred Inflows of Resources	3,300	21,833	2,781	27,914	35,510
NET POSITION					
Net investment in capital assets	678,533	(9,876)	85,862	754,519	657,638
Restricted:					
Reserve funds	99,956	16,355	–	116,311	124,739
Rate stabilization	115,087	–	1,500	116,587	116,781
Debt service and other	23,845	14,840	836	39,521	38,042
Unrestricted	316,383	(58,137)	8,814	267,060	300,663
Total Net Position	1,233,804	(36,818)	97,012	1,293,998	1,237,863
Total Liabilities, Deferred Inflows and Net Position	\$ 1,713,540	\$ 263,725	\$ 129,449	\$ 2,020,762	\$ 2,006,255

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

COMBINED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Years ended December 31, 2014 and 2013

(In thousands)

	2014				2013
	Electric System	Generation System	Water System	Combined	Combined
Operating Revenues:					
Retail sales	\$ 544,762	\$ –	\$ 10,180	\$ 554,942	\$ 549,269
Wholesale sales	59,257	49,119	366	59,623	49,096
Other	24,563	5,814	256	30,633	26,443
Total Operating Revenues	628,582	54,933	10,802	645,198	624,808
Operating Expenses:					
Purchased power	332,375	–	–	283,256	271,382
Purchased water	–	–	1,899	1,899	1,877
Operations	173,035	3,486	3,384	179,905	166,369
Maintenance	25,681	1,552	894	28,127	26,383
Depreciation	48,336	7,292	2,780	58,408	54,066
Taxes	33,149	116	535	33,800	33,253
Total Operating Expenses	612,576	12,446	9,492	585,395	553,330
Net Operating Income	16,006	42,487	1,310	59,803	71,478
Interest Charges:					
Interest	17,337	11,051	999	26,736	28,301
Amortization of debt related costs	(998)	3,444	(42)	2,404	2,397
Allowance for funds used during construction	(2,148)	(108)	(97)	(2,353)	(1,635)
Total Interest Charges	14,191	14,387	860	26,787	29,063
Other Income and Expense:					
Interest income	3,895	1,219	105	2,568	2,817
Other income and expense, net	(1,582)	(380)	927	(1,035)	6,075
Total Other Income and Expense	2,313	839	1,032	1,533	8,892
Net Income Before Capital Contributions	4,128	28,939	1,482	34,549	51,307
Capital Contributions	18,287	462	2,837	21,586	17,683
Net Income	22,415	29,401	4,319	56,135	68,990
Net Position, Beginning of year	1,211,389	(66,219)	92,693	1,237,863	1,168,873
Net Position, Ending of year	\$ 1,233,804	\$ (36,818)	\$ 97,012	\$ 1,293,998	\$ 1,237,863

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

COMBINED STATEMENTS OF CASH FLOWS

Years ended December 31, 2014 and 2013

(In thousands)

	2014				2013
	Electric System	Generation System	Water System	Combined	Combined
Cash Flows From Operating Activities:					
Cash received from customers	\$ 605,895	\$ 46,347	\$ 10,898	\$ 616,791	\$ 593,639
Cash payments to suppliers	(441,544)	(1,907)	(5,029)	(402,131)	(385,445)
Cash payments to employees	(79,923)	(1,793)	(2,004)	(83,720)	(81,037)
Cash payments for taxes	(32,948)	(114)	(540)	(33,602)	(32,345)
Other cash received (paid)	17,964	(669)	179	17,474	32,155
Net Cash Provided by Operating Activities	69,444	41,864	3,504	114,812	126,967
Cash Flows From Capital & Related Financing Activities:					
Capital construction, including interest paid on debt charged to capital projects	(107,012)	(2,937)	(3,550)	(113,499)	(100,993)
Proceeds from debt	-	-	1,479	1,479	1,012
Repayment of debt	(14,700)	(22,095)	(1,910)	(38,705)	(37,038)
Interest paid on debt	(15,525)	(10,898)	(886)	(24,785)	(26,809)
Capital contributions	13,974	462	733	15,169	15,423
Capital grants received	927	-	-	927	536
Intercompany loans	13,415	(13,415)	-	-	-
Net Cash (Used for) Capital & Related Financing Activities	(108,921)	(48,883)	(4,134)	(159,414)	(147,869)
Cash Flows From Investing Activities:					
Sale of special funds and investment securities	271,190	8,329	-	279,519	332,435
Purchase of special funds and investment securities	(249,324)	-	(6,063)	(255,387)	(311,965)
Interest on investment securities	6,646	1,436	104	5,662	6,408
Net Cash Provided by (Used for) Investing Activities	28,512	9,765	(5,959)	29,794	26,878
Cash Flows From Non-Capital Financing Activities:					
Non-capital grants received	2,034	-	-	2,034	3,171
Net Cash Provided by Non-Capital Financing Activities	2,034	-	-	2,034	3,171
Net Increase (Decrease) in Cash & Cash Equivalents	(8,931)	2,746	(6,589)	(12,774)	9,147
Beginning of Year	66,168	12,758	8,742	87,668	78,521
End of Year Cash & Cash Equivalents	\$ 57,237	\$ 15,504	\$ 2,153	\$ 74,894	\$ 87,668
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:					
Net Operating Income	\$ 16,006	\$ 42,487	\$ 1,310	\$ 59,803	\$ 71,478
Adjustments to net operating income:					
Depreciation	48,336	7,292	2,780	58,408	54,066
Other cash received (paid)	(6,827)	(635)	-	(7,462)	3,571
(Increase) decrease in receivables	2,744	(2,771)	458	3,201	(3,319)
(Increase) decrease in other assets	2,549	(1,843)	(20)	686	(1,240)
Increase (decrease) in payables	5,122	3,181	(938)	4,595	3,341
Increase (decrease) in other liabilities	1,514	(5,847)	(86)	(4,419)	(930)
Total adjustments	53,438	(623)	2,194	55,009	55,489
Net Cash Provided by Operating Activities	\$ 69,444	\$ 41,864	\$ 3,504	\$ 114,812	\$ 126,967
Non-cash Investing, Capital and Related Financing Activities:					
Non-cash contributions	\$ 4,531	\$ 0	\$ 2,104	\$ 6,635	\$ 3,529
Allowance for funds used during construction	2,148	108	97	2,353	1,635
Changes in valuation of financial instruments	591	(37)	15	569	483
Amortization of debt related costs	998	(3,444)	42	(2,404)	(2,397)

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

Notes to Combined Financial Statements

December 31, 2014 and 2013

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 PUD is governed by a three-member Commission, which is elected for staggered six-year terms. The legal responsibilities and powers of the PUD, including the establishment of rates and charges for services rendered, are exercised through the Commission.

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 and two smaller hydroelectric projects. The Water System is made up of the PUD's water distribution system.

The accompanying financial statements for 2014 include the individual and combined statements of net position for the Electric System, Generation System and Water System, and the statements of revenues, expenses, and changes in net position 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.

Retail Sales

Electric and Water System customers are billed on a monthly or bimonthly cyclical basis. The accompanying financial statements include estimated unbilled revenues for energy and water delivered to customers between the last billing date and the end of the year. Unbilled energy revenue was \$48.6 million in 2014 and \$53.6 million in 2013. Unbilled water revenue was \$834,000 in 2014 and \$938,000 in 2013.

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 a separate category of non-operating revenue.

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 \$2.8 million and \$2.6 million as of December 31, 2014 and 2013, respectively.

Material and Supplies

Material and supplies are recorded at average 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, rate stabilization, qualifying capital expenditures, post-employment benefits, FERC license commitments, and other reserve requirements. It is the PUD's policy to use unrestricted funds prior to using restricted funds – except for bond proceeds used for qualifying capital expenditures and funds set aside for debt service payments.

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 77 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.

Reacquisition Costs on Bond Refundings

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.

Net Position

Net position consists of the following components:

Net investment in capital assets – 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 related costs.

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

Table 1
Utility Plant
(In thousands)

	2012		2013		2014		
	Ending Balance	Additions	Retirements & Transfers	Ending Balance	Additions	Retirements & Transfers	Ending Balance
Electric System							
Transmission	\$ 118,612	\$ 4,202	\$ (462)	\$ 122,352	\$ 3,814	\$ (448)	\$ 125,718
Distribution	986,541	57,350	(12,061)	1,031,830	59,125	(16,688)	1,074,267
General Plant & Other	240,883	13,872	(881)	253,874	14,603	(2,212)	266,265
Plant in Service ⁽¹⁾	1,346,036	75,424	(13,404)	1,408,056	77,542	(19,348)	1,466,250
Construction Work in Progress	51,517	18,826	–	70,343	32,362	–	102,705
Utility Plant	1,397,553	94,250	(13,404)	1,478,399	109,904	(19,348)	1,568,955
Less Accumulated Depreciation	(498,975)	(47,659)	16,321	(530,313)	(50,544)	23,196	(557,661)
Net Utility Plant	\$ 898,578	\$ 46,591	\$ 2,917	\$ 948,086	\$ 59,360	\$ 3,848	\$1,011,294

⁽¹⁾ Plant in service includes land and non-depreciable assets of \$102.5 million and \$102.1 million as of December 31, 2013 and 2014 respectively.

Generation System

Generation/Production	\$ 238,481	\$ 664	\$ (1,426)	\$ 237,719	\$ 2,362	\$ (1,169)	\$ 238,912
Transmission	2,848	133	(17)	2,964	–	–	2,964
Distribution	9,922	162	(11)	10,073	–	–	10,073
General Plant & Other	10,477	201	(30)	10,648	642	–	11,290
Plant in Service ⁽²⁾	261,728	1,160	(1,484)	261,404	3,004	(1,169)	263,239
Construction Work in Progress	2,010	1,967	–	3,977	–	–	3,977
Utility Plant	263,738	3,127	(1,484)	265,381	3,004	(1,169)	267,216
Less Accumulated Depreciation	(112,261)	(5,165)	1,550	(115,876)	(7,358)	1,169	(122,065)
Net Utility Plant	\$ 151,477	\$ (2,038)	\$ 66	\$ 149,505	\$ (4,354)	\$ –	\$ 145,151

⁽²⁾ Plant in service includes land and non-depreciable assets of \$12.4 million and \$12.9 million, as of December 31, 2013 and 2014 respectively.

Water System

Generation/Production	\$ 11,931	\$ –	\$ (1,264)	\$ 10,667	\$ –	\$ (616)	\$ 10,051
Transmission & Distribution	107,955	1,839	(4,019)	105,775	7,907	(58)	113,624
General Plant & Other	14,495	809	(476)	14,828	105	(145)	14,788
Plant in Service ⁽³⁾	134,381	2,648	(5,759)	131,270	8,012	(819)	138,463
Construction Work in Progress	612	3,274	–	3,886	(2,122)	–	1,764
Utility Plant	134,993	5,922	(5,759)	135,156	5,890	(819)	140,227
Less Accumulated Depreciation	(27,711)	(3,181)	5,938	(24,954)	(3,011)	814	(27,151)
Net Utility Plant	\$ 107,282	\$ 2,741	\$ 179	\$ 110,202	\$ 2,879	\$ (5)	\$ 113,076

⁽³⁾ Plant in service includes land and non-depreciable assets of \$4.7 million and \$5.2 million as of December 31, 2013 and 2014 respectively.

Unrestricted – This component consists of assets and liabilities that do not meet the definition of “net investment in capital assets” 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 \$10.4 million and \$9.9 million at December 31, 2014 and 2013, 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.

Accounting Changes and Reclassifications

Certain reclassifications have been made to the 2013 financial statements to conform to the 2014 presentation.

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 relative type of PUD’s investments at December 31, 2014 and 2013 are summarized in Table 2.

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 Washington State Local Government Investment Pool (LGIP) is an investment vehicle operated by the Washington State Treasurer, offering governmental agency investors the economies of scale available from a multi-billion-dollar pooled fund investment portfolio. As of December 31, 2014, LGIP investments include primarily U.S. Agency Securities, U.S. Treasury Securities and Repurchase Agreements. Assets held in LGIP are invested in a manner consistent with the U.S. Securities and Exchange Commission’s rule 2a-7 of the Investment Company Act of 1940.

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 LGIP, 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.

Table 2
Special Funds and Cash and Temporary Investments

	Electric System		Generation System		Water System	
	2014	2013	2014	2013	2014	2013
U.S. Treasury Notes	9%	4%	—	—	—	—
U.S. Agency Obligations						
Federal Home Loan Bank	25%	20%	7%	6%	71%	25%
Federal Farm Credit Bank	10%	18%	—	—	—	—
Federal National Mortgage Association	19%	14%	26%	24%	—	—
Federal Home Loan Mortgage Corporation	18%	27%	—	13%	—	—
Federal Agricultural Mortgage Association	2%	—	—	—	—	—
Cash and Interest-bearing Demand or Time Deposits						
US Bank	4%	4%	—	—	1%	—
Bank of America	5%	7%	29%	26%	7%	7%
Washington State Local Government Investment Pool	8%	6%	38%	31%	21%	68%

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. agency obligations 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 two years or less. Investment maturities for combined special funds and cash and temporary investments as of December 31, 2014, were as follows:

Term	Amount Invested (In thousands)	Percent of Invested Fund
Less than 30 days	\$107,285	19%
30 to 90 days	62,020	11
90 days to 1 year	95,567	17
1 year to 5 years	267,821	47
Over 5 years	3	—
Bond reserves invested to bond maturity	34,813	6
	<u>\$567,509</u>	<u>100%</u>

NOTE 3

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
Debt Service (Principal & Interest)
(In thousands)

	Electric System		Generation System		Water System	
	Principal	Interest	Principal	Interest	Principal	Interest
2015	\$ 14,220	\$ 16,336	\$ 23,070	\$ 7,946	\$ 2,044	\$ 957
2016	13,345	15,643	24,060	6,955	2,019	880
2017	15,340	14,995	25,205	5,807	2,024	816
2018	16,555	14,265	26,315	4,702	2,029	752
2019	17,285	13,493	27,605	3,408	1,979	679
2020-2024	99,810	54,503	28,935	7,716	8,610	2,318
2025-2029	54,915	33,511	2,930	2,966	5,773	1,005
2030-2034	70,700	16,656	3,510	2,072	2,388	135
2035-2039	15,730	886	4,205	1,000	—	—
2040	—	—	935	53	—	—
Total	<u>\$ 317,900</u>	<u>\$ 180,288</u>	<u>\$ 166,770</u>	<u>\$ 42,625</u>	<u>\$ 26,866</u>	<u>\$ 7,542</u>

Each system's revenues net of specified operating expenses are pledged as security for the system's revenue bonds until the bonds are defeased or repaid. Principal and interest paid for 2014 and 2013 were \$64.0 million and \$64.5 million, respectively. Total revenues available for debt service as defined for the same periods were \$143.9 million and \$151.4 million. At December 31, 2014, annual principal and interest payments are expected to require between 41% and 45% of revenues.

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, 2014 and 2013 was \$1.4 million and \$1.2 million, respectively.

Electric System

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

	December 31,	
	2014	2013
	<i>(In thousands)</i>	
Series 2012 Revenue Refunding bonds, 2.0-5.0%, due 2015-2028, earliest call 2022	\$ 55,610	\$ 55,610
Series 2011 Revenue Refunding bonds, 3.0-5.0%, due 2018-2024, earliest call 2021	35,115	38,715
Series 2010A Revenue bonds, 3.7-5.6%, due 2017-2035, currently callable	128,075	128,075
Series 2010B Revenue bonds, repaid in 2014	–	3,620
Series 2005 Revenue Refunding bonds, 5.0%, due 2015-2024, earliest call 2015	99,100	105,620
Junior Lien Revenue bonds:		
Interest Bearing bonds, repaid in 2014	–	752
Capital Appreciation bonds, repaid in 2014	–	208
Total Principal Outstanding on Long-Term Debt	\$ 317,900	\$ 332,600

Changes in the Electric System long-term debt during the years ended December 31, 2014 and 2013, follow (in thousands):

	2012	2013			2014		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	\$ 346,413	\$ –	\$ (13,813)	\$ 332,600	\$ –	\$ (14,700)	\$ 317,900
Unamortized bond premiums	20,376	–	(1,543)	18,833	–	(1,536)	17,297
Unamortized bond discounts	(110)	–	5	(105)	–	5	(100)
Total Debt	366,679	–	(15,351)	351,328	–	(16,231)	335,097
Less: Current maturities	(13,995)			(14,700)			(14,220)
Total Long-Term Debt	\$ 352,684			\$ 336,628			\$ 320,877

The PUD is required to maintain a cash reserve for certain Electric System bonds. At December 31, 2014 and 2013, the PUD maintained the reserve requirement of \$18.5 million in the Electric System.

The fair value of the Electric System's long-term debt was \$363.2 million and \$358.1 million, respectively, at December 31, 2014 and 2013. 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 PUD provided an irrevocable \$3.1 million letter of credit to Bonneville Power Administration to secure transmission projects under an agreement. The \$3.1 million letter of credit will expire on July 1, 2015. The PUD has not had any draws on this letter of credit since its inception.

Generation System

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

	December 31,	
	2014	2013
	<i>(In thousands)</i>	
Series 2010A Revenue Refunding bonds, 3.0-5.0%, due 2015-2024, earliest call 2020	\$ 152,720	\$ 174,815
Series 2010B Revenue bonds, 5.3-5.7%, due 2020-2040, currently callable	14,050	14,050
Total Principal Outstanding on Long-Term Debt	\$ 166,770	\$ 188,865

Changes in the Generation System long-term debt during the years ended December 31, 2014 and 2013, follow (in thousands):

	2012	2013			2014		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	\$ 210,035	\$ –	\$ (21,170)	\$188,865	\$ –	\$ (22,095)	\$ 166,770
Unamortized bond premiums	16,902	–	(1,419)	15,483	–	(1,418)	14,065
Unamortized bond discounts	(12)	–	1	(11)	–	–	(11)
Total Debt	226,925	–	(22,588)	204,337	–	(23,513)	180,824
Less: Current maturities	(21,170)			(22,095)			(23,070)
Total Long-Term Debt	\$ 205,755			\$ 182,242			\$ 157,754

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 PUD is required to maintain a cash reserve for certain Generation System bonds. At December 31, 2014 and 2013, the PUD maintained the reserve requirement of \$15.1 million in the Generation System.

At December 31, 2014, \$17.5 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.

The fair value of the Generation System's long-term debt was \$187.9 million and \$210.1 million, respectively, at December 31, 2014 and 2013. The fair value of the Generation System's long-term debt is estimated based on quoted market prices for the same or similar issues.

Water System

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

	December 31,	
	2014	2013
	<i>(In thousands)</i>	
Series 2011 Revenue Refunding bonds, 3.0-5.0%, due 2015-2022, earliest call 2021	\$ 7,030	\$ 8,035
Series 2009 Revenue bonds, 3.5-4.4%, due 2015-2031, earliest call 2019	11,295	11,760
Series 2006 Revenue and Refunding bonds, 4.3%, due 2015-2026, earliest call 2016	3,575	3,800
State of Washington Drinking Water Revolving Fund loans:		
equal principal payments plus 1.0% interest due annually through 2034	2,491	1,012
equal principal payments plus 1.5% interest due annually through 2029	1,239	1,322
equal principal payments plus 1.5% interest due annually through 2027	833	897
equal principal payments plus 2.5% interest due annually through 2022	383	431
Washington State Public Works Trust Fund loan, due 2015	20	40
Total Principal Outstanding on Long-Term Debt	\$ 26,866	\$ 27,297

Changes in the Water System long-term debt during the years ended December 31, 2014 and 2013, follow (in thousands):

	2012		2013		2014		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	\$ 25,435	\$ –	\$ (1,840)	\$ 23,595	\$ –	\$ (1,695)	\$ 21,900
Unamortized bond premiums	991	–	(99)	892	–	(98)	794
Unamortized bond discounts	–	–	–	–	–	–	–
Other notes payable	2,905	1,012	(215)	3,702	1,479	(215)	4,966
Total Debt	29,331	1,012	(2,154)	28,189	1,479	(2,008)	27,660
Less: Current maturities	(2,055)			(1,910)			(2,044)
Total Long-term Debt	\$ 27,276			\$ 26,279			\$ 25,616

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 PUD is required to maintain a cash reserve for certain Water System bonds. At December 31, 2014 and 2013, the PUD maintained the reserve requirement of \$1.2 million in the Water System.

The fair value of the Water System's long-term debt was \$28.6 million and \$28.7 million, respectively, at December 31, 2014 and 2013. 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 loan and the State of Washington Drinking Water Revolving Fund loans approximate fair value since such loans are exclusive and have no market.

NOTE 4

POWER PURCHASE AGREEMENTS

The PUD is a preference customer of BPA, from which it acquired approximately 82% and 84% of its energy purchases in 2014 and 2013, respectively. The PUD 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 75–85% 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 capacity 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 2014, the PUD entered into various short-term power supply transactions to meet normal load requirements. As of December 31, 2014, the PUD has committed to purchase approximately 9,600 MWh of energy in early 2015 at a cost of approximately \$0.3 million.

In 2014 and 2013, respectively, the PUD purchased 5% and 4% of its total energy kWh purchases through short-term power supply and open market purchases for a total cost of \$21.2 million and \$13.7 million.

NOTE 5

GENERATION SYSTEM PROJECTS

The Generation System consists of the PUD's Henry M. Jackson Hydroelectric Project (Jackson Project) and two smaller hydroelectric projects.

Jackson Project

The Jackson Project is a multipurpose hydroelectric project with a capacity of 111.8 megawatts. In 2014 and 2013, the Jackson Project supplied 6% and 5% of the PUD's energy needs, respectively.

The project is currently operating under a 45-year license issued by the Federal Energy Regulatory Commission (FERC). The license is scheduled to expire in 2056. The license agreement includes requirements for fish, wildlife and recreation enhancement in the Jackson Project area. The PUD has also negotiated settlement agreements with the cities of Everett and Sultan, Washington Department of Fish and Wildlife, United States Forest Service and the Tulalip Tribes that call for funding commitments over the course of the 45-year license. The Generation System recorded a liability to recognize the future commitments related to the new license, totaling \$18.3 and \$18.9 million at December 31, 2014 and 2013, respectively. Expenditures related to license commitments were \$3.3 million in 2014 and \$1.6 million in 2013.

Small Hydroelectric Projects

The Generation System currently owns two small hydroelectric projects located near Sultan, Washington, in Snohomish County: the Youngs Creek Hydroelectric Project (Youngs Creek) and the Woods Creek Hydroelectric Project (Woods Creek). Completed in 2011, Youngs Creek has a capacity of 7.5 MW, and its FERC license expires in 2042. Woods Creek was built in the 1980s and purchased by the PUD in 2008. The project has a capacity of 650 kW and has been upgraded by the PUD to meet current operating standards.

The PUD has purchased parcels of land for other potential small hydropower project sites and the Generation System has recorded \$1.1 million as plant held for future use at December 31, 2014 and 2013.

Tidal Project

The PUD terminated its tidal energy research pilot project in Admiralty Inlet, west of Whidbey Island. The PUD and its funding partners had worked for eight years at federal, state and local levels to obtain permits and licenses in order to determine the requirements and associated costs of the project. The project was intended to further the knowledge base regarding tidal energy. The estimated costs of the materials needed to build the project increased significantly, and various entities mandated an increasing amount of studies and monitoring requirements beyond installation of the tidal turbines.

The PUD has recorded a \$6.9 million charge in other income and expense related to the termination of the tidal project.

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 \$49.1 million of power in 2014 and \$52.2 million of power in 2013 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 \$0.5 million in 2014 and \$0.3 million in 2013. Amounts due the Generation System from the Electric System for routine intercompany transactions at December 31 totaled \$3.2 million in 2014 and \$0.6 million in 2013. Amounts due the Electric System from the Water System for routine intercompany transactions totaled \$0.4 million at December 31, 2014 and 2013.

The Electric and Generation Systems periodically enter into loan transactions between the systems for various purposes including to defease bonds, to fund energy generation project construction, and to fund energy generation project studies, including the purchase and development of small 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.

Electric System loans to the Generation System were \$64.2 million and \$78.5 million at December 31, 2014 and 2013, respectively. The Generation System recorded interest expense on these loans of \$2.2 million in 2014 and \$2.8 million in 2013.

A Generation System loan to the Electric System was \$6.2 million and \$7.2 million at December 31, 2014 and 2013, respectively. The Electric System recorded interest expense on this loan of \$0.4 million in 2014 and \$0.5 million in 2013.

NOTE 7

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 downloaded from the DRS website at 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, 2014, were:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer	9.21%	9.21%	9.21%
Employee	6.00%	4.92%	5%–15%

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

	PERS Plan 1	PERS Plan 2	PERS Plan 3
	<i>(In thousands)</i>		
2014	\$ 155	\$ 7,627	\$ 1,362
2013	\$ 152	\$ 6,543	\$ 1,125
2012	\$ 158	\$ 5,658	\$ 961

Post-Employment Healthcare Defined Benefit Healthcare 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 2014 and 2013, the PUD contributed \$1.5 and \$1.3 million, respectively, to the plans. Plan members receiving benefits contributed \$0.6 million in both 2014 and 2013.

The PUD's annual Post-Employment Healthcare 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. ARC amounts are calculated assuming a level percent of payroll and an open amortization period equal to the average future lifetime of the population to reflect the short duration of the liability. The following table shows the components of the PUD's annual PEHB cost for the year ended December 31, 2014, the amount actually contributed to the plan and the changes in the PUD's net PEHB obligation (in thousands):

	2014			2013
	Electric	Generation	Water	Combined
Annual required contribution (ARC)	\$ 3,986	\$ 102	\$ 86	\$ 4,094
Interest on net OPEB obligation	510	13	11	488
Adjustment to ARC	(792)	(20)	(17)	(758)
Annual OPEB costs	3,704	95	80	3,824
Contributions made	(2,481)	(20)	(157)	(5,148)
Change in net PEHB obligation	1,223	75	(77)	(1,324)
Net PEHB obligation – beginning of year	14,505	328	417	16,574
Net PEHB obligation – end of year	\$ 15,728	\$ 403	\$ 340	\$ 15,250

The PUD made contributions of \$2.0 million and \$1.5 million to the net PEHB obligation in 2014 and 2013, respectively.

As of December 31, 2014, the unfunded actuarial accrued liability (UAAL) was \$50 million, based on the entry age normal cost method. The annual payroll of active employees covered by the plan was \$99.3 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 healthcare 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. The schedule of funding progress is included in the Required Supplementary Information shown on page 50.

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 3.5%. The medical trend rate is estimated to gradually decrease from 5.8% in 2014 to 5.5% in 2021 and remain level thereafter.

Post-Employment Defined Contribution Healthcare Plan

Employees hired after July 1, 2009, are not eligible for the post-employment defined benefit healthcare plan but are instead eligible for a defined contribution health care plan. Under this plan, the PUD currently contributes \$53.86 per month into an employee's individual HRA account, also known as the Retirement Health Savings (RHS) Plan. These funds are available to the employee for qualified health care costs upon termination of employment or retirement from the PUD.

Post-Employment Defined Benefit Retiree Life Insurance Benefit

The PUD administers life insurance benefits related to a term life insurance plan terminated in 1986 for eligible retirees. The retiree life insurance benefit provisions were established by Commission resolution.

Employees who were covered by the PUD's group term life insurance prior to November 1986 may reinstate this insurance at the time of retirement subject to a \$60,000 maximum benefit. Retiree insurance premium contribution amounts are established by the Commission.

The PUD contributed \$325,000 in both 2014 and 2013 to a PUD fund used to provide for future payment of the PUD's portion of the insurance premiums and fund the costs of administering the plan.

The following table shows the components of the PUD's retiree life insurance benefit cost for the year ended December 31, 2014, the amount actually contributed to the plan and the changes in the PUD's net obligation (in thousands):

	2014			2013
	Electric	Generation	Water	Combined
Annual OPEB costs	\$ 281	\$ 7	\$ 6	\$ 8,092
Contributions made	(385)	(10)	(8)	(385)
Change in net retiree life insurance obligation	(104)	(3)	(2)	7,707
Net Retiree Life Insurance obligation – beginning of year	8,139	208	176	816
Net Retiree Life Insurance obligation – end of year	\$ 8,035	\$ 205	\$ 174	\$8,523

As of December 31, 2014, the unfunded actuarial accrued liability (UAAL) was \$8.5 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 mortality and insurance premium recoveries. Amounts determined regarding the funded status of the benefit 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. The schedule of funding progress is included in the Required Supplementary Information shown on page 50.

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. Actuarial assumptions include a rate of return on investments of 3.5%.

Deferred Compensation Plans

The PUD administers 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 administers 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 50% of the first 4% of a participant's compensation contributed as a salary deferral. The PUD made matching contributions of \$1.5 million and \$1.4 million in 2014 and 2013, respectively.

NOTE 8

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, 2014, the PUD's \$2 million self-insured retention was fully funded. Self-insurance funds of \$12.6 million as of December 31, 2014, and \$12.5 million as of December 31, 2013, are included in special funds at market value. The PUD did not utilize any of the self-insurance funds in 2014 and 2013.

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.

The PUD has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

APPENDIX B

SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION

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

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 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.

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 Bond 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 under the Electric System Bond Resolution. 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 Electric System Bond Resolution specifies how interest is calculated for Variable Interest Rate Bonds.

Once the 2005 Bonds are no longer Outstanding, the definition of “Reserve Account Requirement” will be amended to add at the end of clause (a) the phrase “and recalculated as of the date of issuance of any obligation of the District issued to refund any Bonds.”

“Resource Obligation” has the meaning set forth in the provisions of the Electric System Bond Resolution summarized in “Additional Indebtedness—Separate System Bonds; Resource Obligation.”

“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.

Once the 2005 Bonds are no longer outstanding, the definition of “Revenues” will be amended to add the following: “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 of Electric System Bonds shall constitute Electric System Revenues if designated as such by the Commission.”

“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 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 Electric System Bond Resolution in the order of priority established by the Electric System Bond Resolution; (ii) to pay all Parity Lien Obligations (as defined in the 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 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 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 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 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

The Electric System Bond Resolution provides that 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 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 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 C—"SUMMARY OF CERTAIN PROVISIONS OF THE GENERATION SYSTEM BOND RESOLUTION—Additional Indebtedness."

Separate System Bonds; Resource Obligations

The Electric System Bond Resolution provides, that upon compliance with the conditions of the Electric System Bond Resolution summarized below, the District by resolution may declare that the following constitute a "Resource Obligation" of the Electric System:

- (1) costs for the purchase of energy, capacity, capability, or reserves pursuant to a contract; or
- (2) costs for a facility or facilities for the generation of power and energy acquired or constructed by the District as a separate system of the District, which such costs shall include but are not limited to costs of operation and maintenance, renewals and replacements, additions and betterments and debt service on bonds or other evidences of indebtedness payable from the revenues of such separate system issued or incurred by the District, but shall exclude costs paid or to be paid from the proceeds of such bonds or other evidences of indebtedness.

The Electric System Bond Resolution provides that the District may declare such costs to be a Resource Obligation of the Electric System provided that the requirements summarized below have been met at the time of such declaration:

- (i) No Event of Default has occurred and is continuing.
- (ii) There shall have been filed with the Secretary of the Commission a certificate of the Professional Utility Consultant to the effect that the acquisition of the power and energy from such Resource Obligation is consistent with prudent utility practice.

(iii) There shall have been filed with the Secretary of the Commission a report of the Professional Utility Consultant to the effect that estimated annual Net Revenues for the second full Fiscal Year after the date of commercial operation of such facilities, or after the date of first delivery of energy, capacity, capability or reserves pursuant to such contract, as the case may be, shall be at least equal to 125% of maximum Annual Debt Service in any future Fiscal Year. 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.

(iv) In the event that the Resource Obligation is a contract to purchase energy, capacity, capability or reserves, there shall have been filed with the Secretary of the Commission opinions of counsel to the District and each other party to the contract, respectively, to the effect that such party has all requisite right, power and authority to execute and deliver the contract and to perform its obligations thereunder and that such contract constitutes a legally valid and binding obligation of such party thereto.

Except as permitted by the provisions of the Electric System Bond Resolution summarized under this subsection, the District is not permitted to enter into a contract or other similar arrangement with a third party for the purchase of energy, capacity, capability or reserves from a new or existing generating facility, payments under which contract or arrangement are payable as Operating Expenses of the Electric System, if: (a) such payments are pledged directly to secure the payment of bonds or other indebtedness issued or incurred to finance such facility, and (b) such payments are due regardless of whether the District takes delivery of any power or such facility or resource is producing or is capable of producing any power.

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 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 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; provided, however, that the District may, if deemed advisable by the Commission, institute or continue a self-insurance program with respect to any or all of the aforementioned risks.

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 in the Electric System Bond 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 Electric System Bond Resolution.

Protection of Security.

The Revenues and other moneys, securities and funds pledged by the Electric System Bond 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 Electric System Bond Resolution, except as otherwise expressly provided in the Electric System Bond 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 Electric System Bond Resolution are and will be valid and legally enforceable obligations of the District in accordance with their terms and the terms of the Electric System Bond 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 Electric System Bond Resolution and all the rights of the bondowners under the Electric System Bond 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 Trustee for the owners of all Bonds for the purposes set forth in the Electric System Bond Resolution. The 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 Trustee. The 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 Trustee resigns or is discharged the District shall

appoint a new 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 Trustee, which shall supersede any Trustee appointed by the District.

The Electric System Bond Resolution provides that recitals of fact contained in the Electric System Bond Resolution and in the Bonds shall be taken as the statements of the District and the Trustee assumes no responsibility for the correctness of the same and that the Trustee makes no representations as to the validity or sufficiency of the Electric System Bond Resolution or of any Bonds or in respect of the security afforded by the Electric System Bond Resolution, and the Trustee shall not incur any liability in respect thereof. The Electric System Bond Resolution provides further that the Trustee shall not be under any responsibility or duty with respect to the issuance of the Bonds for value or the application of the proceeds thereof, except to the extent that proceeds are paid to the Trustee, or the application of any moneys paid to the District, or for any losses incurred upon the sale or redemption of any securities purchased for or held in any Fund or Account under the Electric System Bond Resolution.

The Electric System Bond Resolution provides that the Trustee may exercise any powers under the Electric System Bond Resolution and perform any duties required of it through its attorneys, agents, officers or employees, and shall be entitled to advice of counsel (which may be Bond Counsel) concerning all questions under the Electric System Bond Resolution. The Electric System Bond Resolution provides further that the Trustee shall not be answerable for the exercise of any discretion or power under the Electric System Bond Resolution nor for anything whatever in connection with the trust under the Electric System Bond Resolution, except only its own willful misconduct or gross negligence, including but not be limited to failure to make a debt service payment when due if the Trustee has sufficient funds on hand with which to make such payment.

The Electric System Bond Resolution provides that the duties and obligations of the Trustee appointed by or pursuant to the provisions of the Electric System Bond Resolution prior to the occurrence of an Event of Default, and subsequent to the waiving or curing of such Event of Default, shall be determined solely by the express provisions of the Electric System Bond Resolution, and the Trustee shall not be liable except for the performance of its duties and obligations as specifically set forth in the Electric System Bond Resolution and to act in good faith in the performance thereof, and no implied duties or obligations shall be incurred by the Trustee other than those specified in the Electric System Bond Resolution, and the Trustee shall be protected and shall have no liability when acting or omitting to act in good faith upon the advice of counsel, who may be counsel to the District. The Electric System Bond Resolution provides further that in case an Event of Default has occurred which has not been waived or cured, the Trustee shall exercise such of the rights and powers vested in it by the Electric System Bond Resolution and use the same degree of care and skill in the exercise thereof as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

Subject to the provisions of the Electric System Bond Resolution, the Trustee may conclusively rely, as to the correctness of the statements, conclusions and opinions expressed therein, upon any certificate, report, opinion or other document furnished to the Trustee pursuant to any provision of the Electric System Bond Resolution. Except as otherwise expressly provided in the Electric System Bond Resolution, any request, consent, certificate, demand, notice, order, appointment or other direction made or given by the District to the Trustee are to be deemed to have been sufficiently made or given by the proper party or parties if executed on behalf of the District by an Authorized Officer.

None of the provisions contained in the Electric System Bond Resolution shall require the Trustee appointed by or pursuant to the provisions of the Electric System Bond Resolution to take any action or exercise any remedies, including but not limited to spending or risking its own funds or otherwise incurring individual financial responsibility in the performance of any of its duties or in the exercise of any of its rights or powers if in the Trustee's judgment there are reasonable grounds for believing that the prompt repayment thereof is not reasonably assured to it under the terms of the Electric System Bond Resolution.

Events of Default and Remedies

Events of Default

The following constitute "Events of Default" under the 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 Electric System Bond Resolution and such default continues for 90 days after the District receives from the Trustee or from the owners of not less than 66% in principal amount of any series of 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 Trustee

If an Event of Default is not remedied, the District, upon demand of the Trustee, shall pay to the Trustee only to the extent necessary to cure the Event of Default all funds held by the District and pledged under the Electric System Bond Resolution and Revenues upon receipt. The Trustee shall apply the funds in accordance with the Electric System Bond Resolution.

Application of Funds by Trustee

During the continuance of an Event of Default the Revenues received by the Trustee pursuant to the Payment of Funds to Trustee provisions above shall be applied by the Trustee, first, to the payment of the reasonable and proper charges, expenses and liabilities paid or incurred by the

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 Trustee.

In the event that at any time the funds held by the 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 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 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 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 Trustee or exercising any power conferred upon the Trustee.

No bondowner may institute any proceeding for the enforcement of the 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 Trustee written notice to institute such proceeding and the Trustee has refused to comply.

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 Electric System Bond Resolution (1) to add to the covenants and agreements of the District in the 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 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 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; (4) create any pledge of the Revenues 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 Electric System Bond Resolution.

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 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 C

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 and “Revenues” means Generation System Revenues.

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 C). 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 Electric System Bond Resolution. (See Appendix B—“SUMMARY OF CERTAIN PROVISIONS OF THE ELECTRIC SYSTEM BOND RESOLUTION—Certain Definitions.”)

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

“Debt Service Reserve Requirement” means, for the Bonds of all Series secured by the Reserve Account, the lesser of (i) ten percent (10%) of the principal amount of such Bonds, (ii) maximum Annual Debt Service on the Bonds in any Fiscal Year, and (iii) 125% of average Annual Debt Service on the Bonds in any Fiscal Year, in each case as determined from time to time. Any future Series of Bonds may be secured by the Reserve Account if specified in the Supplemental Resolution authorizing the issuance of such Series of Bonds. In the case of Variable Interest Rate Bonds, the interest rate thereon shall be calculated on the assumption that such Bonds will bear interest at a rate equal to a rate reported within the previous 30 days by “The Bond Buyer” as the Bond Buyer’s Municipal Bond or 40-Bond Index, or its successor index; provided that in no event shall such assumed Series of Variable Interest Rate exceed the Maximum Interest Rate for such series of Variable Interest Rate bonds. In the case of Capital Appreciation Bonds, the maximum amount of interest thereon shall be calculated to be the maximum annual accretion in value of such Capital Appreciation Bonds from the date of calculation until the final maturity thereof. In the case of Deferred Income Bonds, the maximum amount of interest thereon shall be calculated to be equal to the higher of (a) the maximum annual accretion in value of such Deferred Income Bonds from the date of calculation until the Interest Commencement Date, and (b) the maximum annual interest from the Interest Commencement Date to the final maturity thereof. In the case of a Derivative Product, the maximum amount of interest shall be calculated to include the amount of any regularly schedule District Payments adjusted by any regularly scheduled Reciprocal Payments.

“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,” 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. 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 2015 BONDS— Payment of Generation System Power Costs.”

“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 Electric System Bond Resolution. (See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE 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 Electric System Bond Resolution. (See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE 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 Electric System Bond Resolution. (See Appendix B—"SUMMARY OF CERTAIN PROVISIONS OF THE 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). 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 are to 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

The Resolution provides that 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 are to 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 are 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 are required to 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 is required to 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 is required to 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 Resolution provides that 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 is required under the Resolution to 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 is to transfer to the Term Bond Principal Account an amount equal to such installment.

The District is required to 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 are to 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 is to be paid from the Interest Account.

(3) Debt Service Reserve Account. The Resolution requires that, 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 is to 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.

The Resolution provides that 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.

The Resolution provides that 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, and that 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.

Anything in the Resolution to the contrary notwithstanding, references in this subsection to "Bonds" shall refer only to the Bonds of those Series secured by the Debt Service Reserve Account.

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 are to be withdrawn and deposited in the Revenue Fund.

Investment of Money in Funds

Money on deposit in the Construction Fund and the Revenue Fund are required to 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 are required to 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 Bond 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 Electric System Bond Resolution; Amendment Thereof

Until the obligations of the District under the 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 Electric System Bond Resolution. The District will not consent to or agree to any amendment or modification of the 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.

Trustee

U.S. Bank National Association or its successor is appointed to act as Trustee (the "Trustee") for the owners of all Bonds. 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.

The Resolution provides that the recitals of fact contained in the Resolution and in the Bonds shall be taken as the statements of the District and the Trustee does not assume any responsibility for the correctness of the same. The Resolution provides further that the Trustee does not make any representations as to the validity or sufficiency of the Resolution or of any Bonds or in respect of the security afforded by the Resolution, and the Trustee shall not incur any liability in respect thereof, and that the Trustee shall not be under any responsibility or duty with respect to the issuance of the Bonds for value or the application of the proceeds thereof, except to the extent that proceeds are paid to the Trustee, or the application of any moneys paid to the District, or for any losses incurred upon the sale or redemption of any securities purchased for or held in any Fund or Account under the Resolution.

The Resolution provides that the Trustee may exercise any powers under the Resolution and perform any duties required of it through its attorneys, agents, officers or employees, and shall be entitled to advice of counsel (which may be Bond Counsel) concerning all questions under the Resolution. The Resolution provides further that the Trustee shall not be answerable for the exercise of any discretion or power under the Resolution nor for anything whatever in connection with the trust under the Resolution, except only its own willful misconduct or negligence, which shall include but not be limited to failure to make a debt service payment when due if the Trustee has sufficient funds on hand with which to make such payment.

The Resolution provides that the duties and obligations of the Trustee appointed by or pursuant to the provisions of the Resolution prior to the occurrence of an Event of Default, and subsequent to the waiving or curing of such Event of Default, shall be determined solely by the express provisions of the Resolution, and the Trustee shall not be liable except for the performance of its duties and obligations as specifically set forth in the Resolution and to act in good faith in the performance thereof, and no implied duties or obligations shall be incurred by the Trustee other than those specified in the Resolution, and the Trustee shall be protected and shall have no liability when acting or omitting to act in good faith upon the advice of counsel, who may be counsel to the District. The Resolution provides further that in case an Event of Default has occurred which has not been waived or cured, the Trustee shall exercise such of the rights and powers vested in it by the Resolution and use the same degree of care and skill in the exercise thereof as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

The Resolution provides that none of the provisions contained in the Resolution shall require the Trustee to take any action or exercise any remedies, including but not limited to spending or risking its own funds or otherwise incurring individual financial responsibility in the performance of any of its duties or in the exercise of any of its rights or powers if in the Trustee's judgment there are reasonable grounds for believing that the prompt repayment thereof is not reasonably assured to it under the terms of the Resolution.

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 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 thereto 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.

Defeasance; Discharge of Liens and Pledges

The Resolution provides that 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.

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APPENDIX D

PROPOSED FORM OF OPINION OF BOND COUNSEL

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June __, 2015

Public Utility District No. 1 of
Snohomish County, Washington
Everett, Washington

Public Utility District No. 1 of Snohomish County, Washington
Electric System Revenue Bonds, Series 2015
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to Public Utility District No. 1 of Snohomish County, Washington (the "District") in connection with issuance of \$140,920,000 aggregate principal amount of Public Utility District No. 1 of Snohomish County, Washington Electric System Revenue Bonds, Series 2015 (the "Bonds"). The Bonds are being 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, and 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. 3602, adopted by the Commission of the District (the "Commission") on May 16, 1991 (the "Master Resolution"), as supplemented and amended, including as supplemented by Resolution No. 5720, adopted by the Commission on May 26, 2015 (the "Ninth Supplemental Resolution"). The Master Resolution as amended and supplemented, including as supplemented by the Ninth Supplemental Resolution is referred to herein as the "Resolution." The Bonds are issued for the stated purposes of (1) financing additions, betterments and improvements to and renewals, replacements and extensions of the Electric System, (2) funding a deposit to the Reserve Account with respect to the Bonds and (3) paying costs of issuing the Bonds. 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 relating to the Bonds, dated the date hereof (the "Tax Certificate"), opinions of counsel to the District and the Trustee, certificates of the District, U.S. Bank National Association, as Trustee (the "Trustee"), and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the District. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Resolution and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, receivership, 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, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, 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. Our services did not include financial or other non-legal advice. 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 (including Generation System Power Costs and Resource Obligations as set forth in the Resolution). 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 excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. Interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, 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 2015 Bonds. The 2015 Bonds will be issued as fully-registered securities 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 2015 Bond certificate will be issued for each maturity of the 2015 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.6 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the 2015 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2015 Bonds on DTC's records. The ownership interest of each actual purchaser of each 2015 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 2015 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 2015 Bonds, except in the event that use of the book-entry system for the 2015 Bonds is discontinued.

To facilitate subsequent transfers, all 2015 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the 2015 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 2015 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2015 Bonds are credited, which

may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the 2015 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the 2015 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of the 2015 Bonds may wish to ascertain that the nominee holding the 2015 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the 2015 Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the 2015 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 2015 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments on the 2015 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 Registrar, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the 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 such other nominee as may be requested by an authorized representative of DTC) are the responsibility of the District or the 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 depository with respect to the 2015 Bonds at any time by giving reasonable notice to the District or the Registrar. Under such circumstances, in the event that a successor depository is not obtained, 2015 Bond certificates are required to be printed and delivered.

The District may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, 2015 Bond certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the District believes to be reliable, but the District takes no responsibility for the accuracy thereof.

With respect to 2015 Bonds registered on the Bond Register in the name of Cede & Co., as nominee of DTC, the District and the 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 2015 Bonds with respect to (i) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any ownership interest in the 2015 Bonds; (ii) the delivery to any Participant or any other

person, other than a bondowner as shown on the Bond Register, of any notice with respect to the 2015 Bonds; (iii) the payment to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any amount with respect to principal of or interest on the 2015 Bonds; (iv) any consent given action taken by DTC as registered owner; or (v) any other matter. The District and the Registrar may treat and consider Cede & Co., in whose name each 2015 Bonds is registered on the Bond Register, as the holder and absolute owner of such 2015 Bonds for the purpose of payment of principal and interest with respect to such 2015 Bonds, for the purpose of giving notices of other matters with respect to such 2015 Bonds, for the purpose of registering transfers with respect to such 2015 Bonds, 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 2015 Bonds.

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APPENDIX F

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this “Disclosure Certificate”) is executed and delivered as of June __, 2015, by Public Utility District No. 1 of Snohomish County, Washington (the “District”) for the benefit of the Owners and Beneficial Owners of the Bonds (each as defined below), in connection with the issuance of \$140,920,000 aggregate principal amount of Electric System Revenue Bonds, Series 2015 (the “Bonds”).

WITNESSETH:

WHEREAS, pursuant to Resolution No. 3602, adopted by the Commission of the District (the “Commission”) on May 16, 1991 (the “Master Resolution”), as amended and supplemented, including as supplemented by Resolution No. 5720, adopted by the Commission on May 26, 2015 (the “Ninth 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 Certificate.

“Beneficial Owner” shall mean any person that (a) has or shares the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, or otherwise make investment decisions concerning ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

“Bond Register” shall have the meaning provided in the Resolution.

“Business Day” shall mean a day that is not a Saturday, Sunday or legal holiday on which banking institutions in the State of Washington or the State of New York are closed.

“Dissemination Agent” shall mean the District, or any successor Dissemination Agent designated in writing by the District and that has filed with the District a written acceptance of such designation.

“Listed Events” shall mean any of the events listed in Section 5(a) or Section 5(b) of this Disclosure Certificate.

“Official Statement” shall mean the Official Statement with respect to the Bonds dated June 16, 2015.

“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 Certificate. This Disclosure Certificate is being executed and delivered by the District 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, 2015, provide to the Repository an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Certificate. 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 Certificate; provided, that the audited financial statements of the District may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the District’s fiscal year changes, the District shall give notice of such change in the same manner as for a Listed Event under Section 5(g) of this Disclosure Certificate. 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 Certificate and 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 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 District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds not later than ten business days after the occurrence of the event:

- (i) Principal and interest payment delinquencies.
- (ii) Unscheduled draws on debt service reserves reflecting financial difficulties.
- (iii) Unscheduled draws on credit enhancements reflecting financial difficulties.
- (iv) Substitution of credit or liquidity providers, or their failure to perform.
- (v) Adverse tax opinions or Issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB).
- (vi) Tender offers.
- (vii) Defeasances.
- (viii) Rating changes.
- (ix) Bankruptcy, insolvency, receivership or similar event of the obligated person.

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

(b) The District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material, not later than ten business days after the occurrence of the event:

(i) Unless described in paragraph (v) of subsection (a) of this Section, other material notices or determinations by the Internal Revenue Service with respect to the tax status of the Bonds or other material events affecting the tax status of the Bonds.

(ii) Modifications to rights of holders of the Bonds.

(iii) Optional, unscheduled or contingent Bond calls.

(iv) Release, substitution, or sale of property securing repayment of the Bonds.

(v) Non-payment related defaults.

(vi) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms.

(vii) Appointment of a successor or additional Trustee or the change of name of a Trustee.

(c) The Dissemination Agent shall, promptly upon obtaining actual knowledge at the address listed in Section 12 of this Disclosure Certificate of the occurrence of any of the Listed Events, contact the District, inform the District of the event and request that the District promptly notify the Dissemination Agent in writing whether or not to report the event pursuant to subsection (g).

(d) Whenever the District obtains knowledge of the occurrence of a Listed Event described in subsection (b), whether because of a notice from the Dissemination Agent pursuant to subsection (c) or otherwise, the District shall as soon as possible determine if such event would be material under applicable federal securities laws.

(e) Whenever the District obtains knowledge of the occurrence of a Listed Event described in subsection (a), or the District determines that the occurrence of a Listed Event described in subsection (b) is 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 (g).

(f) If in response to a request under subsection (c), 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(g).

(g) 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 Listed Events described in paragraph (iii) of subsection (a) of this Section and in paragraph (vii) of subsection (a) of this Section need not be given

under this subsection 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.

(h) 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 Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the District shall give notice of such termination in the same manner as for a Listed Event under Section 5(g).

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 Certificate, 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 (if the Dissemination Agent is other than the District) may resign by providing 60 days' written notice to the District. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the District pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the District shall be the Dissemination Agent.

SECTION 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the District may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a), 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 Certificate, the District shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the District. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(g), 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 Certificate shall be deemed to prevent the District from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the District chooses to include any information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is expressly required by this Disclosure Certificate, the District shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

SECTION 10. Default. In the event of a failure of the District to comply with any provision of this Disclosure Certificate, the Dissemination Agent may (and, at the request of 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 Certificate; 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 Certificate shall not be deemed an Event of Default under the Resolution, and the sole remedy under this Disclosure Certificate in the event of any failure of the District to comply with this Disclosure Certificate shall be an action to compel performance, and no Person shall be entitled to recover monetary damages under this Disclosure Certificate.

SECTION 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent (if the Dissemination Agent is other than the District) shall have only such duties as are expressly set forth in this Disclosure Certificate, and the District agrees, to the extent permitted by law, to indemnify and save the Dissemination Agent, or the employees and agents of the Dissemination Agent, harmless against any loss, expense and liabilities which the Dissemination Agent or such employees or agents may incur arising out of or in the exercise or performance of the Dissemination Agent's powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the District under this Section 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 Certificate may be given as follows:

To the District:

Public Utility District No. 1 of Snohomish County, Washington
ATTN: Treasurer
2320 California Street
Everett, Washington 98201

To the initial Dissemination Agent:

Public Utility District No. 1 of Snohomish County, Washington
ATTN: Treasurer
2320 California Street
Everett, Washington 98201

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 Certificate 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 Certificate shall be governed by the laws of the State of Washington determined without regard to the principles of conflict of law.

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IN WITNESS WHEREOF, the District has caused this Disclosure Certificate to be executed by its proper officer thereunto duly authorized, as of the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1
OF SNOHOMISH COUNTY, WASHINGTON

By: _____
Authorized Representative

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