

**NEW ISSUE—BOOK-ENTRY ONLY**

*In the opinion of Orrick, Herrington & Sutcliffe LLP, Special Tax Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, compliance with certain covenants, interest on the Series 2001-C Bonds is excluded from gross income for federal income tax purposes under Title XIII of the Tax Reform Act of 1986, as amended (the "1986 Act"), and Section 103 of the Internal Revenue Code of 1954, as amended. In the further opinion of Special Tax Counsel, interest on the Series 2002-A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Special Tax Counsel observes that such interest is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income. Special Tax Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2002-A Bonds. See "TAX MATTERS" herein.*

**\$405,745,000**

## **Energy Northwest**

**\$248,485,000 Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A**

**\$157,260,000 Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A**

**Dated the date of delivery**

**Due: July 1, as shown on the inside cover**

The Series 2002-A Bonds are being issued for the purpose of refunding Prior Lien Bonds heretofore issued by Energy Northwest in connection with Project 1 and the Columbia Generating Station, as more fully described herein. The Series 2002-A Bonds are special revenue obligations of Energy Northwest secured and payable as provided herein on a subordinated basis to the Prior Lien Bonds. See "SECURITY FOR THE NET BILLED BONDS."

The Series 2002-A Bonds will be issued in fully registered form, registered in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 2002-A Bonds. Individual purchases will be made in book-entry form, in denominations of \$5,000 and integral multiples thereof. So long as Cede & Co. is the registered owner of the Series 2002-A Bonds and the nominee of DTC, references herein to holders or registered owners shall mean Cede & Co. and shall not mean the beneficial owners of the Series 2002-A Bonds. See "DESCRIPTION OF THE SERIES 2002-A BONDS—Book-Entry Only System; Transferability and Registration" and Appendix H hereto. Principal of the Series 2002-A Bonds is payable at the principal corporate trust office of BNY Western Trust Company, as Trustee for the Series 2002-A Bonds. Interest on the Series 2002-A Bonds is payable semiannually on January 1 and July 1 of each year, commencing July 1, 2002, by check or draft of the Trustee, as set forth herein or, under the circumstances described herein, by wire transfer to the registered owner. As long as Cede & Co. is the registered owner as nominee of DTC, payments on the Series 2002-A Bonds will be made to such registered owner and disbursement of such payments will be the responsibility of DTC and DTC participants, as described herein.

The Series 2002-A Bonds are subject to redemption prior to maturity as set forth herein.

Payments when due of the principal of and interest on the Series 2002-A Bonds specified on the inside cover will be insured by municipal bond insurance policies issued by Financial Security Assurance Inc. ("FSA") and MBIA Insurance Corporation ("MBIA"), respectively. See "SECURITY FOR THE NET BILLED BONDS—Bond Insurance."



The Series 2002-A Bonds are secured on a subordinated basis to the Prior Lien Bonds from amounts derived pursuant to Net Billing Agreements with the United States of America, Department of Energy, acting by and through the Administrator of the

## **Bonneville Power Administration**

from net billing credits and from cash payments from the Bonneville Fund, as described herein. Bonneville's obligations under the Net Billing Agreements are not general obligations of the United States of America and are not secured by the full faith and credit of the United States of America. The Series 2002-A Bonds do not constitute an obligation of the State of Washington or of any political subdivision thereof, other than Energy Northwest. Energy Northwest has no taxing power.

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**MATURITY SCHEDULE—See Inside Cover**

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The Series 2002-A Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of legality by Wilkie Farr & Gallagher, New York, New York, Bond Counsel to Energy Northwest, and to certain other conditions. Certain tax matters will be passed upon by Orrick, Herrington & Sutcliffe LLP, Special Tax Counsel. Certain legal matters will be passed upon for Energy Northwest by its General Counsel and for Bonneville by its Acting General Counsel and by its Special Counsel, Orrick, Herrington & Sutcliffe LLP, New York, New York. Certain legal matters will be passed upon for the Underwriters by O'Melveny & Myers LLP, New York, New York, Counsel to the Underwriters. It is expected that the Series 2002-A Bonds in definitive form will be available for delivery through the facilities of DTC in New York, New York, on or about February 25, 2002.

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**Salomon Smith Barney**

**Bear, Stearns & Co. Inc. Goldman, Sachs & Co. UBS PaineWebber Inc.**

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS AND PRICES**

**Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A  
\$248,485,000 Serial Bonds**

<u>Year (July 1)</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield††</u>
2013*	\$32,030,000	5.50%	4.63%
2014*	19,675,000	5.50	4.71
2014*	19,675,000	5.75	4.66
2015†	19,675,000	5.50	4.80
2015†	19,675,000	5.75	4.76
2016†	19,675,000	5.50	4.87
2016†	19,675,000	5.75	4.82
2017†	8,000,000	5.50	4.95
2017†	90,405,000	5.75	4.90

**Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A  
\$157,260,000 Serial Bonds**

<u>Year (July 1)</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield††</u>
2017†	\$12,260,000	5.50%	4.95%
2018†	40,000,000	5.20	5.18
2018†	105,000,000	5.75	4.99

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\* Insured by Financial Security Assurance Inc.

† Insured by MBIA Insurance Corporation.

†† Priced to par call on July 1, 2012.

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Sid W. Morrison  
Amy C. Solomon  
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**Administrative Staff**

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Vice President, Generation  
Vice President, Operations Support/  
Public Information Officer  
Vice President, Administration/  
Chief Financial Officer  
Vice President, Resource Development  
Vice President, General Counsel

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No dealer, broker, salesman or other person has been authorized by Energy Northwest or by the Underwriters to give any information or to make any representations, other than as contained in this Official Statement, and, if given or made, such other information or representations must not be relied upon as having been authorized by Energy Northwest or the Underwriters. 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 Series 2002-A Bonds, by any person in any jurisdiction in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

The information set forth herein has been furnished by Energy Northwest and Bonneville and includes information obtained from other sources which are believed to be reliable, the information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of Energy Northwest or Bonneville since the date hereof.

Except as specifically described herein, none of the information herein was provided by the Participants, the Pacific Northwest Electric Power and Conservation Planning Council, or the Trustee and none of such entities participated in the preparation of this Official Statement. This Official Statement has not been submitted to such entities for review, comment or approval.

Other than with respect to information concerning Financial Security Assurance Inc. (“FSA”) and MBIA Insurance Corporation (“MBIA”) contained under “SECURITY FOR THE NET BILLED BONDS — Bond Insurance”, Appendix J-1 - “FSA Specimen Municipal Bond Insurance Policy” and Appendix J-2 - “MBIA Specimen Municipal Bond Insurance Policy” herein, none of the information in this Official Statement has been supplied or verified by either FSA or MBIA and neither FSA nor MBIA makes any representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Series 2002-A Bonds; or (iii) the tax exempt status of the interest on the Series 2002-A Bonds.

This Official Statement contains statements which, to the extent they are not recitations of historical fact, constitute “forward-looking statements.” In this respect, the words “estimate,” “project,” “anticipate,” “expect,” “intend,” “believe” and similar expressions are intended to identify forward-looking statements. A number of important factors affecting Energy Northwest’s or Bonneville’s business and financial results could cause actual results to differ materially from those stated in the forward-looking statements.

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

The prospective financial information included in this offering document, including any forward-looking or prospective financial information, has been prepared by, and is the responsibility of the management of Energy Northwest and Bonneville. PricewaterhouseCoopers has neither examined nor compiled such prospective financial information and, accordingly, PricewaterhouseCoopers does not express an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers reports included in this offering document relate to the historical financial information of the Energy Northwest projects and Bonneville. They do not extend to the prospective financial information and should not be read to do so.

IN CONNECTION WITH THE OFFERING OF THE SERIES 2002-A BONDS, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF SUCH BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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# OFFICIAL STATEMENT

## ENERGY NORTHWEST

### **\$248,485,000 Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A**

### **\$157,260,000 Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A**

Energy Northwest, a municipal corporation and a joint operating agency of the State of Washington (formerly known as the Washington Public Power Supply System), proposes to issue \$248,485,000 Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A (the "Project 1 2002-A Bonds") and \$157,260,000 Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A (the "Columbia 2002-A Bonds" and, together with the Project 1 2002-A Bonds, the "Series 2002-A Bonds"). The Series 2002-A Bonds are being issued pursuant to Chapter 43.52 of the Revised Code of Washington, as amended (the "Act") and the resolutions of Energy Northwest hereinafter referred to for the purpose of refunding the Prior Lien Bonds (as hereinafter defined) heretofore issued by Energy Northwest in connection with Project 1 and the Columbia Generating Station project (hereinafter described). The Series 2002-A Bonds are secured on a subordinated basis to the Prior Lien Bonds from amounts derived pursuant to Net Billing Agreements with the United States of America, Department of Energy, acting by and through the Administrator of the Bonneville Power Administration from net billing credits and from cash payments from the Bonneville Fund, as described herein. The receipts, income and revenues derived from a Project secure only the related Series 2002-A Bonds. Accordingly, the owners of the Series 2002-A Bonds issued for a particular Project will have no claim on the receipts, income and revenues securing any other Energy Northwest Project. For further information, see "SECURITY FOR THE NET BILLED BONDS" in this Official Statement.

Energy Northwest furnishes this Official Statement, which includes the cover page and inside cover page hereof and the appendices hereto, in connection with the sale of the Series 2002-A Bonds.

### INTRODUCTION

This Introduction is not intended to provide all information material to a prospective purchaser of the Series 2002-A Bonds and is qualified in all respects by the more detailed information set forth elsewhere in this Official Statement. Unless otherwise specifically defined, certain capitalized terms used in this Introduction have the meanings given to such terms elsewhere in this Official Statement.

### ENERGY NORTHWEST

Energy Northwest was organized in 1957 as the Washington Public Power Supply System. By resolution of its Executive Board adopted on June 2, 1999, the Washington Public Power Supply System officially changed its name to Energy Northwest. It currently has 16 members, consisting of 13 public utility districts and the cities of Richland, Seattle and Tacoma, all located in the State of Washington. Energy Northwest has the authority, among other things, to acquire, construct and operate plants, works and facilities for the generation and transmission of electric power and energy and to issue bonds and other evidences of indebtedness to finance the same.

Energy Northwest owns and operates a nuclear electric generating station, the Columbia Generating Station (sometimes hereinafter referred to as "Columbia Generating Station" or "Columbia"), formerly known as Nuclear Project No. 2, with a net design electrical rating of 1,153 megawatts. Energy Northwest also owns an operating hydroelectric facility, the Packwood Lake Hydroelectric Project ("Packwood"), with a name-plate rating of 27.5 megawatts. Energy Northwest also owns and/or has financial responsibility for four other nuclear electric generating projects which have been terminated: Energy Northwest Nuclear Project No. 1 ("Project 1"), Energy Northwest Nuclear Project No. 3 ("Project 3") and Energy Northwest Nuclear Projects Nos. 4 and 5 ("Projects 4 and 5"). Energy Northwest also owns the Hanford Generating Project ("HGP"), which ceased operation in 1987, and site restoration activities coordinated with the United States Department of Energy ("DOE") are continuing. In November 2001, Energy Northwest issued approximately \$70.7 million of bonds to finance the acquisition, development and construction costs of a new project, a wind turbine farm capable of generating up to 50 megawatts of electricity (the "Nine Canyon Wind Project"). For discussions concerning the termination of Projects Nos. 1, 3, 4 and 5, see "SECURITY FOR THE NET BILLED BONDS — Project 1," "— Project 3," "— Projects 4 and 5" and "— Site Restoration of Projects 1, 3, 4 and 5" in this Official Statement. Projects 1, 3 and Columbia are collectively referred to herein as the "Net Billed Projects." Each of the foregoing projects (collectively, the "Projects" and individually, a "Project") is financed and accounted for as a separate utility system, except for Projects 4 and 5, which were financed and accounted for as a single utility system separate and apart from all other Energy Northwest Projects. All of Energy Northwest's Projects are located in the State of Washington.

The United States of America, Department of Energy, acting by and through the Administrator of the Bonneville Power Administration ("Bonneville"), has acquired the capability of Projects 1, 3 and Columbia. As more fully discussed under "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements," Bonneville pays Energy Northwest for such capability pursuant to Net Billing Agreements (as hereinafter defined), with payments being made through a combination of credits against customer bills and cash payments from the Bonneville Fund (as hereinafter defined). Bonneville's obligations to make such payments under the Net Billing Agreements continue notwithstanding suspension or termination of any of Projects 1, 3 or Columbia.

### **The Columbia Generating Station**

Columbia is an operating nuclear electric generating station located about 160 miles southeast of Seattle, Washington, near Richland, Washington on the DOE Hanford Reservation. Columbia commenced commercial operation in 1984 and has a net design

electrical rating of 1,153 megawatts. Columbia consists of a General Electric Company-designed boiling water reactor and nuclear steam supply system, a turbine-generator and the necessary transformer, switching and transmission facilities to deliver the output to the transmission facilities of the Federal System located in the vicinity of Columbia. The entire Project capability of Columbia has been acquired by Bonneville under the Columbia Net Billing Agreements. Since commencing commercial operation, Columbia has operated at a cumulative capacity factor of 65.0% and has generated 107,114,371 megawatt-hours (net of station use) of electric power through January 2002. For further information relating to Columbia, see “ENERGY NORTHWEST — The Columbia Generating Station” in this Official Statement.

Energy Northwest has obtained all permits and licenses required to operate Columbia, including a site certification agreement with the State of Washington and an operating license for Columbia issued by the United States Nuclear Regulatory Commission (the “NRC”). The operating license expires in 2023.

### **Project 1**

Project 1 is a terminated, partially constructed, nuclear electric generating project located about 160 miles southeast of Seattle, Washington, near Richland, Washington on DOE’s Hanford Reservation. In May 1994, Energy Northwest’s Board of Directors adopted a resolution terminating Project 1. For further information relating to Project 1, see “ENERGY NORTHWEST — Project 1” and “— Site Restoration of Projects 1, 3, 4 and 5” in this Official Statement. See “SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements” in this Official Statement for further discussion of the above-mentioned termination and related issues.

### **Project 3**

Project 3 is a terminated, partially constructed, nuclear electric generating project located in Grays Harbor County, Washington, about 70 miles southwest of Seattle, Washington. In May 1994, Energy Northwest’s Board of Directors adopted a resolution requesting the termination of Project 3. Project 3 was terminated in June 1994. For further information relating to Project 3, see “ENERGY NORTHWEST — Project 3” and “— Site Restoration of Projects 1, 3, 4 and 5” in this Official Statement. See “SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements” in this Official Statement for further discussion of the above-mentioned termination and related issues.

### **Projects 4 and 5**

Projects 4 and 5 were terminated in January 1982. The bonds issued by Energy Northwest in connection with Projects 4 and 5 (the “Project 4/5 Bonds”) went into default on July 22, 1983 and approximately \$2.25 billion principal amount of Project 4/5 Bonds, together with accrued interest thereon, remain unpaid except for two distributions to bondholders in 1993 and 1995. All trusts created under the resolution authorizing the Project 4/5 Bonds were terminated and Energy Northwest and the trustee under said resolution were released from all of their obligations thereunder. Bonneville is not a party to any agreements that secured payment of the costs of Projects 4 and 5.

## **THE BONNEVILLE POWER ADMINISTRATION**

The information under this heading has been derived from information provided to Energy Northwest by Bonneville. For detailed information with respect to Bonneville, see “THE BONNEVILLE POWER ADMINISTRATION” in this Official Statement.

Bonneville was created by Federal law in 1937 to market electric power from the Bonneville Dam and to construct facilities necessary to transmit such power. Today, Bonneville markets electric power from 30 federally-owned hydroelectric projects, most of which are located in the Columbia River Basin and all of which were constructed and are operated by the United States Army Corps of Engineers (the “Corps”) or the United States Bureau of Reclamation (the “Bureau”), and from several non-federally-owned projects, including the Columbia Generating Station. Bonneville sells and/or exchanges power under contracts with over 100 utilities in the Pacific Northwest and Pacific Southwest and with several industrial customers. It also owns and operates a high voltage transmission system comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest.

Bonneville’s primary customer service area is the Pacific Northwest region, an area comprised of Oregon, Washington, Idaho, western Montana and small portions of California, Nevada, Utah and Wyoming (sometimes referred to herein as the “Pacific Northwest,” the “Northwest,” the “Region,” or “Regional”). Bonneville estimates that this 300,000 square mile service area has a population of approximately ten million people. Electric power sold by Bonneville accounts for about 45% of the electric power consumed within the Region. Bonneville also exports power that is surplus to the needs of the Region to the Pacific Southwest, primarily to California.

Bonneville is one of four regional Federal power marketing agencies within the DOE. Bonneville is required by law to meet certain energy requirements in the Region and is authorized to acquire power resources, to implement conservation measures and to take other actions to enable it to carry out its purposes. Bonneville is also required by law to operate and maintain its transmission system and to provide transmission service to eligible customers and to undertake certain other programs, such as fish and wildlife protection, mitigation and enhancement.

## **SERIES 2002-A BONDS**

### **Purpose of Issuance**

The Project 1 2002-A Bonds are being issued pursuant to Resolution No. 835, adopted on November 23, 1993 (as amended and supplemented, the “Project 1 Electric Revenue Bond Resolution”), and a supplemental resolution adopted on February 15, 2002



(the “Project 1 Electric Revenue Bond Supplemental Resolution”). Energy Northwest is issuing the Project 1 2002-A Bonds for the purpose of refunding \$249,385,000 aggregate principal amount of the \$1,748,565,000 of Project 1 Prior Lien Bonds (as hereinafter defined) currently outstanding under Resolution No. 769, adopted September 18, 1975 (as amended and supplemented the “Project 1 Prior Lien Resolution”). Bonds issued pursuant to the Project 1 Prior Lien Resolution are hereinafter referred to as the “Project 1 Prior Lien Bonds.”

The Columbia 2002-A Bonds are being issued pursuant to Resolution No. 1042, adopted on October 23, 1997 (as amended and supplemented, the “Columbia Electric Revenue Bond Resolution” and, together with the Project 1 Electric Revenue Bond Resolution and Resolution No. 838, adopted on November 23, 1993 (as amended and supplemented, the “Project 3 Electric Revenue Bond Resolution”), the “Electric Revenue Bond Resolutions”) and a supplemental resolution adopted on February 15, 2002 (the “Columbia Electric Revenue Bond Supplemental Resolution” and together with the Project 1 Electric Revenue Bond Supplemental Resolution, the “Supplemental Resolutions”). Energy Northwest is issuing the Columbia 2002-A Bonds for the purpose of refunding \$152,400,000 aggregate principal amount of the \$1,754,321,101 of Columbia Prior Lien Bonds (as hereinafter defined) currently outstanding under Resolution No. 640, adopted on June 26, 1973 (as amended and supplemented the “Columbia Prior Lien Resolution”). Bonds issued pursuant to the Columbia Prior Lien Resolution are hereinafter referred to as the “Columbia Prior Lien Bonds.”

Energy Northwest currently has \$1,322,783,896 of Project 3 Prior Lien Bonds (as hereinafter defined) currently outstanding under Resolution No. 775, adopted on December 3, 1975 (as amended and supplemented, the “Project 3 Prior Lien Resolution”). Bonds issued pursuant to the Project 3 Prior Lien Resolution are hereinafter referred to as the “Project 3 Prior Lien Bonds.”

The Project 1 Prior Lien Resolution, the Columbia Prior Lien Resolution and the Project 3 Prior Lien Resolution are collectively referred to herein as the “Prior Lien Resolutions.” The Prior Lien Resolutions, the Electric Revenue Bond Resolutions and the Separate Subordinated Resolutions (as hereinafter defined) are collectively referred to herein as the “Net Billed Resolutions.” The Project 1 Prior Lien Bonds, the Columbia Prior Lien Bonds and the Project 3 Prior Lien Bonds are collectively referred to herein as the “Prior Lien Bonds.” Bonds, including the Series 2002-A Bonds, heretofore or hereafter issued pursuant to the Electric Revenue Bond Resolutions are collectively referred to herein as the “Electric Revenue Bonds.” The Prior Lien Bonds, the Electric Revenue Bonds, including the Series 2002-A Bonds, and any bonds, notes or other obligations which may be issued pursuant to the Electric Revenue Bond Resolutions or the Separate Subordinated Resolutions are collectively referred to herein as the “Net Billed Bonds.” Energy Northwest has covenanted with the owners from time to time of the Electric Revenue Bonds not to issue any more Prior Lien Bonds or any other obligations having a lien on a parity with the Prior Lien Bonds. For a discussion of additional Net Billed Bonds which may be issued by Energy Northwest for refunding and other purposes, see “SECURITY FOR THE NET BILLED BONDS — Additional Bonds” in this Official Statement.

#### **NET BILLING AGREEMENTS**

Under the Net Billing Agreements, the Participants in each Net Billed Project have contracted to purchase the capability of that Net Billed Project and have agreed to provide Energy Northwest with funds necessary to meet costs of that Net Billed Project. These costs include the amounts that Energy Northwest is obligated to pay in each contract year into the various funds provided for in the related Net Billed Resolutions for debt service and for all other purposes of the Net Billed Project. The Net Billing Agreements also effected a simultaneous assignment of the project capability from the Participants to Bonneville and created an obligation of Bonneville to pay the Participants (from net billing credits provided by Bonneville and from cash payments from the Bonneville Fund, as described herein) for their respective shares of the costs of the Net Billed Projects. Thus, Bonneville is ultimately obligated to meet such costs.

Under the Net Billing Agreements, payments to Energy Northwest are not made directly by Bonneville, but rather by the Participants. Such payments by the Participants are to be made in accordance with each Participant’s participation in the purchase of the capability of the Net Billed Project. Bonneville pays for the capability of the Net Billed Project assigned by the Participants to it by crediting (or net billing) Bonneville’s bills to Participants for power and other services purchased from Bonneville by the amount of the payment required to be made by the Participants to Energy Northwest. To the extent that the total amount of Bonneville’s bills to each Participant (and consequently the amount of such credit available) over a contract year (July 1 to June 30) is less than the payment required to be made by the Participant to Energy Northwest, Bonneville is obligated to pay the deficiency in cash to the Participant from the Bonneville Fund. In the opinion of Bonneville’s Acting General Counsel, under Federal statutes Bonneville may only make payments to the United States Treasury from net proceeds; all cash payment obligations of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses have priority over payments by Bonneville to the United States Treasury. Net proceeds are gross cash receipts remaining in the Bonneville Fund after deducting all of the costs paid by Bonneville to operate and maintain the Federal System other than those used to make payments to the United States Treasury for: (i) the repayment of the Federal investment in certain transmission facilities and the power generating facilities at federally-owned hydroelectric projects in the Pacific Northwest; (ii) debt service on bonds issued by Bonneville and sold to the United States Treasury; (iii) repayments of appropriated amounts to the Corps and the Bureau for certain costs allocated to power generation at federally-owned hydroelectric projects in the Pacific Northwest; and (iv) costs allocated to irrigation projects as are required by law to be recovered from power sales.

Cash payments and the provision of credits by Bonneville and payments by Participants under the Net Billing Agreements are required whether or not the related Net Billed Project is completed, operable or operating and notwithstanding the suspension, interruption, interference, reduction or curtailment of Net Billed Project output or termination of the related Net Billed Project and such payments or credits are not subject to any reduction, whether by offset or otherwise, and are not conditioned upon the

performance or nonperformance by Energy Northwest, Bonneville or any Participant under the Net Billing Agreements or any other agreement or instrument.

*Bonneville's obligations under the Net Billing Agreements are not general obligations of the United States of America and are not secured by the full faith and credit of the United States of America.*

For further information as to the Net Billing Agreements, see "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements" in this Official Statement.

## **DESCRIPTION OF THE SERIES 2002-A BONDS**

### **GENERAL**

The Project 1 Electric Revenue Bond Resolution authorizes the issuance of Project 1 2002-A Bonds for the purpose of refunding Project 1 Prior Lien Bonds previously issued. The Columbia Electric Revenue Bond Resolution authorizes the issuance of Columbia 2002-A Bonds for the purpose of refunding Columbia Prior Lien Bonds previously issued.

The Series 2002-A Bonds will initially be dated the date of delivery, and will mature on July 1 in the years and bear interest, payable on January 1 and July 1 of each year, commencing July 1, 2002, at the rates shown on the inside cover of this Official Statement. Interest on the Series 2002-A Bonds is payable by check or draft mailed to the registered owners thereof by BNY Western Trust Company, as Trustee for the Project 1 2002-A Bonds and Columbia 2002-A Bonds. Principal of the Series 2002-A Bonds is payable at the office of the Trustee in Seattle, Washington. Notwithstanding the foregoing, upon the written request of a registered owner of at least \$1,000,000 in aggregate principal amount of Project 1 2002-A Bonds or Columbia 2002-A Bonds outstanding delivered to the Trustee at least ten days prior to any date on which interest or both principal and interest are payable on such Bonds, the principal of and premium, if any, and interest on such Bonds will be paid by wire transfer of immediately available funds on such date to an account specified by such registered owner in its request.

### **BOOK-ENTRY ONLY SYSTEM; TRANSFERABILITY AND REGISTRATION**

The Series 2002-A Bonds will be available to the ultimate purchasers in book-entry form only, in denominations of \$5,000 and integral multiples thereof. Purchasers of the Series 2002-A Bonds will not receive certificates representing their interests in such Series 2002-A Bonds purchased, except as described in Appendix H hereto, "BOOK-ENTRY ONLY SYSTEM." The Depository Trust Company ("DTC"), New York, New York will act as securities depository ("Securities Depository") for the Series 2002-A Bonds.

As discussed in Appendix H hereto, transfers of ownership interests in the Series 2002-A Bonds will be accomplished by book entries made by DTC and, in turn, by DTC Participants acting on behalf of Beneficial Owners of the Series 2002-A Bonds. The Supplemental Resolutions provide that Energy Northwest shall not be required to issue, transfer or exchange the related Series 2002-A Bonds for a period of ten days next preceding any interest payment date therefor, to issue, transfer or exchange any Series 2002-A Bond for a period of ten days next preceding any selection of Series 2002-A Bonds to be redeemed or for a period of ten days thereafter or to transfer or exchange any such Series 2002-A Bonds which have been designated for redemption within a period of 60 days next preceding the date fixed for redemption.

Energy Northwest, the Trustee, the Paying Agent and any other person may treat the registered owner of any Series 2002-A Bond as the absolute owner of such Bond for the purpose of making payment thereof and for all other purposes and Energy Northwest, the Trustee and the Paying Agent shall not be bound by any notice or knowledge to the contrary, whether such Series 2002-A Bond shall be overdue or not. All payments of or on account of interest or principal to any registered owner of any such Series 2002-A Bond shall be valid and effectual and shall be a discharge of Energy Northwest, the Trustee and Paying Agent in respect of the liability upon such Series 2002-A Bond, to the extent of the sum or sums paid.

### **REDEMPTION**

#### **Optional Redemption**

The Series 2002-A Bonds maturing on and after July 1, 2013 will be subject to redemption prior to maturity at the option of Energy Northwest on and after July 1, 2012, in whole or in part at any time, in such order of maturity as is selected by Energy Northwest and by lot within a maturity, at a redemption price equal to 100% of the principal amount of such Series 2002-A Bonds to be redeemed, together with accrued interest to the redemption date.

#### **Notice of Redemption**

Each Supplemental Resolution requires that notice of redemption of the Series 2002-A Bonds is to be given by first-class mail or in such other manner as is required by the Supplemental Resolution not less than 30 days nor more than 60 days before the redemption date to the registered owners of the Series 2002-A Bonds which are to be redeemed. Such notice shall be deemed conclusively to be received by the registered owners of the Series 2002-A Bonds which are to be redeemed, whether or not such notice is actually received. Mailing of such notice of redemption shall not be a condition precedent to such redemption and failure to mail any such notice or any defect therein shall not affect the validity of the redemption proceedings for the Series 2002-A Bonds being redeemed. Each Supplemental Resolution further provides that, notice of redemption having been given as described above, the Series 2002-A Bonds called for redemption shall become due and payable on the redemption date specified in such notice and that interest thereon shall cease to accrue from and after the redemption date, if moneys sufficient for the redemption of the Series

2002-A Bonds to be redeemed, together with interest thereon to the redemption date, are held by the Paying Agent for such Series 2002-A Bonds on the redemption date.

## **PLAN OF REFUNDING**

### **GENERAL**

The Project 1 2002-A Bonds are being issued for the purposes of providing funds to refund \$249,385,000 aggregate principal amount of Project 1 Prior Lien Bonds (the "Project 1 Refunded Bonds") and providing for the payment of certain expenses relating to the issuance of the Project 1 2002-A Bonds. The Project 1 Refunded Bonds were issued pursuant to the Project 1 Prior Lien Resolution for the purpose of refinancing the costs of planning, construction and acquisition of Project 1. The Columbia 2002-A Bonds are being issued for the purposes of providing funds to refund \$152,400,000 aggregate principal amount of Columbia Prior Lien Bonds (the "Columbia Refunded Bonds" and, together with the Project 1 Refunded Bonds, the "Refunded Bonds") and providing for the payment of certain expenses relating to the issuance of the Columbia 2002-A Bonds. The Columbia Refunded Bonds were issued pursuant to the Columbia Prior Lien Resolution for the purpose of refinancing the costs of planning, construction and acquisition of Columbia.

A major portion of the proceeds of the Series 2002-A Bonds and other available amounts will be used to purchase investment securities permitted by the Prior Lien Resolutions (the "Investment Securities"), maturing in such amounts and at such times as shall be sufficient, together with the interest to accrue thereon, to pay the principal or redemption price, as applicable, of all of the Refunded Bonds on the dates and in the amounts set forth in the following table entitled "Refunded Bonds" and to pay interest on all Refunded Bonds to the date of their retirement. Concurrently with such purchase of Investment Securities, Energy Northwest shall deposit such Investment Securities in separate trust funds established with the Bond Fund Trustee for each of the Series of Refunded Bonds pursuant to the Supplemental Resolutions adopted by the Executive Board and escrow agreements between Energy Northwest and the Bond Fund Trustee for each of the Series of Refunded Bonds. At the time of such deposit, Energy Northwest shall direct the Bond Fund Trustee for each of the Series of Refunded Bonds to make an irrevocable provision for the giving of notice of redemption of such Refunded Bonds to be redeemed, if any.

### **REFUNDING PLAN**

In the Spring of 2000, Bonneville presented its Debt Optimization Proposal ("Bonneville Proposal") to Energy Northwest. The Bonneville Proposal involved the extension of the final maturity of outstanding Columbia Refunding Revenue Bonds from 2012 to 2018 through a series of refunding bond issues. Bonneville manages its overall debt portfolio to meet the objectives of: 1) minimizing the cost of debt to Bonneville's rate payers; 2) maximizing Bonneville's access to its lowest cost capital sources to meet future capital needs at the lowest cost to rate payers; and 3) maintaining sufficient financial flexibility to handle Bonneville's financial requirements. Implementing the Bonneville Proposal will provide Bonneville with cash flow flexibility in funding planned capital expenditures, allow Bonneville to advance the amortization of Bonneville's high interest Federal debt and reduce Bonneville's overall fixed costs.

Energy Northwest, in response to the Bonneville Proposal, developed its 2000 Refunding Plan. The 2000 Refunding Plan also reaffirmed the historical debt service savings goals for any future refinancing of Projects 1 and 3 Net Billed Bonds. The Executive Board of Energy Northwest formally adopted the 2000 Refunding Plan in October 2000.

In September 2001, Energy Northwest's Executive Board adopted an updated Refunding Plan. Such Refunding Plan included a revision which incorporated the increase in the average life of Projects 1 and 3 Net Billed Bonds as a refinancing program objective for any future refinancing of such bonds. An additional objective of the refinancing program is to advance refund outstanding, noncallable Net Billed Bonds.

Information relating to the Project 1 Prior Lien Bonds and the Columbia Prior Lien Bonds to be refunded with the proceeds of the Series 2002-A Bonds is set forth below.

### Refunded Bonds

Project	Series	Amount	Maturity (July 1)	Interest Rate	Payment Date
1	1990B	\$ 69,180,000	2009	7.25%	At Maturity*
1	1990C	24,520,000	2002	7.70	At Maturity
1	1990C	8,290,000	2003	7.75	At Maturity
1	1992A	680,000	2005	6.00	At Maturity
1	1993A	7,070,000	2002	5.30	At Maturity
1	1993A	15,535,000	2003	5.25	At Maturity
1	1993A	16,255,000	2005	5.60	At Maturity
1	1993A	17,310,000	2007	7.00	At Maturity
1	1993A	7,925,000	2008	7.00	At Maturity
1	1993A	80,000,000	2011	5.75	At Maturity*
1	1993B	2,620,000	2004	5.10	At Maturity
Columbia	1990A	33,675,000	2006	7.25	At Maturity
Columbia	1992A	14,280,000	2004	5.90	At Maturity
Columbia	1992A	10,660,000	2005	6.00	At Maturity
Columbia	1993A	12,965,000	2008	5.70	At Maturity
Columbia	1993B	6,920,000	2004	5.10	At Maturity
Columbia	1997A	7,360,000	2004	5.25	At Maturity
Columbia	1997A	11,795,000	2005	5.50	At Maturity
Columbia	1997A	12,465,000	2006	6.00	At Maturity
Columbia	1997A	13,240,000	2007	6.00	At Maturity
Columbia	1997A	14,075,000	2008	6.00	At Maturity
Columbia	1997A	14,965,000	2009	6.00	At Maturity

\* Payment date will be at maturity and at specified mandatory redemption dates.

### ESTIMATED SOURCES AND USES OF FUNDS

#### Sources of Funds

Principal of Project 1 2002-A Bonds.....	\$248,485,000.00
Principal of Columbia 2002-A Bonds .....	157,260,000.00
Original Issue Premium.....	23,941,533.35
Moneys Available under Prior Lien Bond Resolutions .....	20,554,401.67

Total Sources of Funds.....	\$450,240,935.02
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#### Uses of Funds

Project 1 2002-A Refunding Deposits.....	\$265,692,674.38
Columbia 2002-A Refunding Deposits .....	162,531,707.16
Note Repayment.....	15,795,000.00
Costs of Issuance including Underwriters' Discount.....	6,221,553.48

Total Uses of Funds.....	\$450,240,935.02
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### SECURITY FOR THE NET BILLED BONDS

#### SOURCES OF PAYMENT AND SECURITY

The Project 1 2002-A Bonds are special revenue obligations of Energy Northwest issued under and pursuant to the Project 1 Electric Revenue Bond Resolution and are secured on a subordinated basis to the Project 1 Prior Lien Bonds by a pledge of all receipts, income and revenues derived by Energy Northwest from the ownership of Project 1. Under the Project 1 Electric Revenue Bond Resolution, the Project 1 2002-A Bonds will be secured on a parity with any bonds or notes heretofore or hereafter issued by

Energy Northwest or other obligations of Energy Northwest that are secured pursuant thereto or pursuant to any Project 1 Separate Subordinated Resolution (as hereinafter defined).

The Columbia 2002-A Bonds are special revenue obligations of Energy Northwest issued under and pursuant to the Columbia Electric Revenue Bond Resolution and are secured on a subordinated basis to the Columbia Prior Lien Bonds by a pledge of all receipts, income and revenues derived by Energy Northwest from the ownership and operation of Columbia. Under the Columbia Electric Revenue Bond Resolution, the Columbia 2002-A Bonds will be secured on a parity with any bonds or notes heretofore or hereafter issued by Energy Northwest or other obligations of Energy Northwest that are secured pursuant thereto or pursuant to any Columbia Separate Subordinated Resolution (as hereinafter defined).

In March 2001, each Electric Revenue Bond Resolution was amended to add a covenant between Energy Northwest and the owners from time to time of its Electric Revenue Bonds issued thereunder, to the effect that Energy Northwest will not issue any more Prior Lien Bonds or any other bonds, warrants or other obligations which will rank on a parity with the pledge of and lien on the revenues created by the related Prior Lien Resolution.

In the Electric Revenue Bond Resolutions, Energy Northwest has reserved the right to issue from time to time, upon satisfaction of certain conditions set forth therein, additional bonds or notes or incur from time to time, upon satisfaction of certain conditions set forth therein, additional bonds or notes or incur additional obligations under each such Electric Revenue Bond Resolution and under Separate Subordinate Resolutions of the Executive Board creating a pledge of and lien on the receipts, income and revenues derived from the related Project of equal rank with the pledge and lien created by the related Electric Revenue Bond Resolution in favor of the Electric Revenue Bonds issued thereunder.

Amounts paid to Energy Northwest pursuant to the Project 1 Net Billing Agreements entered into among Energy Northwest, Bonneville and the Project 1 Participants (which amounts are ultimately derived from net billing credits provided by Bonneville and from cash payments from the Bonneville Fund) are a source of payment for the Project 1 2002-A Bonds, subject to the payments required in connection with the Project 1 Prior Lien Bonds as described in the following sentence. So long as any of the Project 1 Prior Lien Bonds remain outstanding, after making the monthly payments and deposits required by the Project 1 Prior Lien Resolution, Energy Northwest is obligated to pay to the Trustee for the Project 1 Electric Revenue Bonds into the related Debt Service Fund, out of amounts paid to Energy Northwest pursuant to the Project 1 Net Billing Agreements, amounts sufficient to pay the principal of and premium, if any, and interest on the Project 1 Electric Revenue Bonds, including the Project 1 2002-A Bonds.

Amounts paid to Energy Northwest pursuant to the Columbia Net Billing Agreements entered into among Energy Northwest, Bonneville and the Columbia Participants (which amounts are ultimately derived from net billing credits provided by Bonneville and from cash payments from the Bonneville Fund) are a source of payment for the Columbia 2002-A Bonds, subject to the payments required in connection with the Columbia Prior Lien Bonds as described in the following sentence. So long as any of the Columbia Prior Lien Bonds remain outstanding, after making the monthly payments and deposits required by the Columbia Prior Lien Resolution, Energy Northwest is obligated to pay to the Trustee for the Columbia Electric Revenue Bonds into the related Debt Service Fund, out of amounts paid to Energy Northwest pursuant to the Columbia Net Billing Agreements, amounts sufficient to pay the principal of and premium, if any, and interest on the Columbia Electric Revenue Bonds, including the Columbia 2002-A Bonds.

The Project 1 2002-A Bonds and the Columbia 2002-A Bonds are separately secured and are not general obligations of Energy Northwest. The owners of the Project 1 2002-A Bonds will have no claim on the assets, revenues or funds of any other Project of Energy Northwest, including those securing the Columbia 2002-A Bonds. The owners of the Columbia 2002-A Bonds will have no claim on the assets, revenues or funds of any other Project of Energy Northwest, including those securing the Project 1 2002-A Bonds.

*The Series 2002-A Bonds do not constitute an obligation of the State of Washington or of any political subdivision thereof, other than Energy Northwest. Energy Northwest has no taxing power.*

Bonneville may make only such expenditures from the Bonneville Fund as shall have been included in budgets submitted annually to Congress. Bonneville includes in its annual budget submittal to Congress an amount sufficient to cover its obligations under the Net Billing Agreements, including the payment of debt service on the Net Billed Bonds. Bonneville may make such expenditures without further appropriation and without fiscal year limitation, but subject to such specific directives or limitations on use of the Bonneville Fund as may be included by Congress in appropriation acts. The Bonneville Fund is a continuing appropriation available exclusively to Bonneville for the purpose of making cash payments to cover Bonneville's expenses. All receipts, collections and recoveries of Bonneville in cash from all sources are deposited in the Bonneville Fund. For a more complete discussion of the Bonneville Fund, see "BONNEVILLE FINANCIAL OPERATIONS — The Bonneville Fund" in this Official Statement.

Under each Prior Lien Resolution, the happening of one or more of the following events constitutes an Event of Default: (i) default in the performance of any obligation with respect to payments into the respective Revenue Fund; (ii) default in the payment of the principal of and premium, if any, or default for 30 days in the payment of interest on any of the respective Prior Lien Bonds or any sinking fund installment on any Project 1, Columbia or Project 3 Prior Lien Bonds; (iii) default for 90 days in the observance and performance of any other of the covenants, conditions and agreements of Energy Northwest in the respective Prior Lien Resolution; (iv) the sale or conveyance of any properties of the respective Net Billed Project except as permitted by the respective Prior Lien Resolution or the voluntary forfeiture of any license, franchise, permit or other privilege necessary or desirable in the operation of such Project; and (v) certain acts related to the insolvency or bankruptcy of Energy Northwest. Both the applicable Prior Lien Bond Fund Trustee and the holders of not less than 20% in aggregate principal amount of the respective Prior Lien Bonds then outstanding under the respective Prior Lien Resolution have the right to accelerate the maturity of such Prior Lien Bonds after an Event of Default

occurs under such Resolution. See Appendix G-2, “SUMMARY OF CERTAIN PROVISIONS OF RESOLUTIONS NOS. 769, 640 AND 775 — Events of Default; Remedies.”

Under each Prior Lien Resolution, the covenants referred to in clause (iii) of the preceding paragraph include the following, among others: (a) completing construction of the respective Net Billed Project at the earliest practicable time, operating such Project and the business in connection therewith in an efficient manner and at reasonable cost, maintaining such Project in good condition and making all necessary and proper repairs, renewals and replacements and (b) maintaining and collecting rates and charges for capability, power and energy and other services, facilities and commodities sold, furnished or supplied through such Project which will be adequate, whether or not the generation or transmission of power by such Project is suspended, interrupted or reduced for any reason whatsoever, to provide revenues sufficient, among other things, to pay the expenses of operating and maintaining such Project and the debt service on the related Prior Lien Bonds. See Appendix G-2, “SUMMARY OF CERTAIN PROVISIONS OF RESOLUTIONS NOS. 769, 640 AND 775 — Certain Covenants.”

Payments and the provision of credits by Bonneville and payments by Participants under the Net Billing Agreements relating to Project 1, the Columbia Generating Station or Project 3, respectively, that are required to be made to Energy Northwest to pay the principal of and interest on the outstanding Net Billed Bonds issued for the related Net Billed Project are required to be made notwithstanding the occurrence of an Event of Default. In the case of each Net Billed Project, if an Event of Default occurs under the related Prior Lien Resolution, whether or not such Event of Default gives rise to an acceleration of the maturity of the Prior Lien Bonds outstanding under such Resolution, Energy Northwest is required under such Resolution to pay all revenues of such Project thereafter received by it upon demand to the applicable Prior Lien Bond Fund Trustee until all such Prior Lien Bonds have been paid in full or such Event of Default has been cured, whichever occurs first. In such event, moneys intended to be applied to the payment of related Electric Revenue Bonds would be paid instead to the applicable Prior Lien Bond Fund Trustee and such Electric Revenue Bonds would not be paid until such Prior Lien Bonds have been paid in full or such Event of Default has been cured, whichever occurs first.

If the maturity of Prior Lien Bonds issued for a Net Billed Project were accelerated by the applicable Prior Lien Bond Fund Trustee or the holders of the requisite principal amount of such Prior Lien Bonds after an Event of Default under the respective Prior Lien Resolution, no assurance can be given that the principal amount of the accelerated Prior Lien Bonds would be payable currently as a cost under the terms of the Net Billing Agreements related to such Net Billed Project. See “Net Billing Agreements — Payment Procedures — Terminated Projects.”

If Bonneville and the Participants were obligated only to provide funds to meet the scheduled amounts due on the respective Prior Lien Bonds and not the amounts due upon acceleration, moneys intended to be applied to the payment of the respective Electric Revenue Bonds would be applied by the applicable Prior Lien Bond Fund Trustee to payment of such Prior Lien Bonds and the Electric Revenue Bonds would not be paid until such Prior Lien Bonds ceased to be outstanding or the Event of Default giving rise to such acceleration were cured.

See Appendix G-2 herein, “SUMMARY OF CERTAIN PROVISIONS OF RESOLUTIONS NOS. 769, 640 AND 775” for further information.

## **NET BILLING AGREEMENTS**

### **General**

Energy Northwest sold the entire capability of Project 1 to 104 publicly-owned utilities and rural electric cooperatives (the “Project 1 Participants”) under net billing agreements (as amended, the “Project 1 Net Billing Agreements”). Energy Northwest sold the entire capability of the Columbia Generating Station to 94 publicly-owned utilities and rural electric cooperatives (the “Columbia Participants”) under net billing agreements (the “Columbia Net Billing Agreements”). Energy Northwest sold the entire capability of Project 3 to 103 publicly-owned utilities and rural electric cooperatives (the “Project 3 Participants,” and collectively with the Project 1 Participants and the Columbia Participants, the “Participants”) under net billing agreements (the “Project 3 Net Billing Agreements” which, together with the Project 1 Net Billing Agreements and the Columbia Net Billing Agreements, are collectively referred to as the “Net Billing Agreements”). Each of the Participants is a customer of Bonneville. Many of the Participants are Participants in more than one Net Billed Project. See Appendix E hereto for a list of Participants and their respective shares of the Project Fiscal Year 2002 Budgets.

Each Project 1, Columbia and Project 3 Participant assigned its share of Project capability to Bonneville under a Project 1 Net Billing Agreement, Columbia Net Billing Agreement and Project 3 Net Billing Agreement, respectively.

The authority of all of the Participants to enter into the Net Billing Agreements was affirmed by the United States Court of Appeals for the Ninth Circuit in *City of Springfield v. Washington Public Power Supply System, et al.* The United States Supreme Court denied a petition for a *writ of certiorari*. For further information, see “— Assignment Agreements” in this Official Statement.

For a summary of certain provisions of the Net Billing Agreements, see Appendix F hereto, “SUMMARY OF CERTAIN PROVISIONS OF RELATED CONTRACTS.”

### **Payment Obligations**

Under the Net Billing Agreements, in payment for the share of the capability of each Net Billed Project purchased by each Participant, such Participant is obligated to pay Energy Northwest an amount equal to its share of Energy Northwest’s costs for such Net Billed Project, less amounts payable from sources other than the related Net Billing Agreements, all as shown on the

Participant's Billing Statement or accounting statement. Bonneville is obligated to pay this amount to such Participant by providing net billing credits against the amounts such Participant owes Bonneville under the Participant's power sales and other contracts with Bonneville and by making the cash payments described below (subject to the limitations described herein under "BONNEVILLE FINANCIAL OPERATIONS — The Bonneville Fund"). Each Participant is obligated to pay Energy Northwest an amount equal to the amount of such credits and cash payments as payment on account of its obligations to pay for its share of the Net Billed Project capability.

Cash payments and the provision of credits by Bonneville and payments by Participants under the Net Billing Agreements are required whether or not the related Net Billed Project is completed, operable or operating and notwithstanding the suspension, interruption, interference, reduction or curtailment of the Net Billed Project output or termination of the related Net Billed Project and such payments or credits are not subject to any reduction, whether by offset or otherwise, and are not conditioned upon the performance or nonperformance by Energy Northwest, Bonneville or any Participant under the Net Billing Agreements or any other agreement or instrument.

In 1979 and 1980, Bonneville and Energy Northwest entered into agreements with 93 of the 104 Participants (representing 75.575% of the capability of Project 1, 79.563% of the capability of Columbia and 76.499% of the capability of Project 3) relating to payments to Energy Northwest under the Net Billing Agreements, which provide that Bonneville, prior to making a reassignment of a Participant's share, may (but is not required to) pay directly to Energy Northwest, for the account of the Participant, the amount by which the Participant's obligation to Energy Northwest exceeds the billing credits allowed or estimated to be allowed to the Participant during the contract year. See "BONNEVILLE FINANCIAL OPERATIONS — Order in Which Bonneville's Costs Are Met" for more information. Because of these payments, no reassignments of Participants' shares or deficiency payments by Bonneville to Participants have been necessary. These payments have also assisted in managing the cash flow requirements of Energy Northwest.

By letter dated August 1, 1989 (the "1989 Letter Agreement"), Bonneville agreed with Energy Northwest that, in the event any Participant shall be unable for any reason, or shall fail or refuse, to pay to Energy Northwest any amount due from such Participant under its Net Billing Agreement for which a net billing credit or cash payment to such Participant has been provided by Bonneville, Bonneville will be obligated to pay the unpaid amount in cash directly to Energy Northwest, unless payment of such unpaid amount is made in a timely manner pursuant to the Net Billing Agreements. All payments required to be made under the 1989 Letter Agreement are to be made from the Bonneville Fund or other funds legally available therefor.

*Bonneville's obligations under the Net Billing Agreements are not general obligations of the United States of America and are not secured by the full faith and credit of the United States of America.*

#### **Payment Procedures — Columbia Generating Station**

The Columbia Net Billing Agreements provide for the adoption by Energy Northwest of an Annual Budget therefor, which, as amended from time to time, shall make provision for all Project costs, including but not limited to, the amounts which Energy Northwest is required to pay in each contract year (July 1 to June 30) into the various funds provided for in the Columbia Net Billed Resolutions for debt service and all other purposes. The Annual Budget also includes the source of funds proposed to be used. The Annual Budget is submitted to Bonneville and to the Participants' Review Board established under the Columbia Net Billing Agreements and becomes effective 30 days after submitted unless it is disapproved by Bonneville or unless a recommendation or modification proposed by the Participants' Review Board is not accepted by Energy Northwest. In the event of a dispute, the matter is referred to a Project Consultant as described in Appendix F hereto, "SUMMARY OF CERTAIN PROVISIONS OF RELATED CONTRACTS — The Project Agreements." Energy Northwest prepares a Billing Statement for that contract year for each Columbia Participant. The Billing Statement shows such Participant's share of the Annual Budget for Columbia less amounts payable from sources other than the Columbia Net Billing Agreements. The Annual Budget and Billing Statements may be amended during a contract year, if necessary. As described below, each Participant makes monthly payments to Energy Northwest in satisfaction of the amounts due under its Billing Statement.

In the month preceding the beginning of each contract year and in each month thereafter, Bonneville renders a bill to each Participant for power and other services under the Participant's power sales and other contracts with Bonneville. In the first month of the contract year, that bill shows an offsetting credit equal to the full amount of such bill to the extent of the Participant's share of the costs of Columbia. Within 30 days of receiving the monthly bill from Bonneville reflecting such credit, the Participant must pay Energy Northwest an amount equal to the credit for Columbia received from Bonneville. In each month thereafter during the contract year, such crediting by Bonneville and such payments to Energy Northwest by such Participant, continue until the credits received by such Participant equal the total amount shown on such Participant's Billing Statement. The effect of this payment procedure is that amounts due Bonneville from the Participants (up to the Participants' obligations to Energy Northwest as shown on their Billing Statements), are required to be paid by the Participants to Energy Northwest rather than to Bonneville.

If Bonneville determines that a Participant's payment obligations to Bonneville under its power sales and other contracts will not equal or exceed the Participant's payment obligations during a contract year under its Columbia Net Billing Agreements and, in the opinion of Bonneville and the Participant, such deficiency is expected to continue for a significant period, Bonneville is required under the Columbia Net Billing Agreements to use its best efforts to assign such Participant's share of capability in Columbia (and the associated benefits and obligations) to other Participants in Columbia or to other Bonneville customers to the extent necessary to eliminate such Participant's net billing deficiency. The Columbia capability so assigned would then be included by Bonneville under net billing arrangements with such other Participant or customer.

If Bonneville were unable to arrange for such assignments, the Participant would be required to make such assignment to other Participants pro rata. The other Participants would be obligated to accept such assignments to the extent required to eliminate such deficiency. Such mandatory assignments to any Participant may not exceed 25% of that Participant's original share of Columbia capability without the consent of that Participant. In addition, no such mandatory assignment may be made if it would cause the estimate of that Participant's obligation to Energy Northwest to exceed the estimate of the credits available to it from Bonneville, as estimated by Bonneville.

The Columbia Net Billing Agreements provide that if reassignments cannot be made in amounts sufficient to bring into balance the respective dollar obligations of Bonneville and a Participant and an accumulated balance in favor of such Participant from a previous contract year is expected by Bonneville to be carried for an additional contract year, Bonneville is obligated to pay the balance. Any subsequent monthly net balances that exceed the amount of Bonneville's bill for that month will be paid to such Participant by Bonneville as cash deficiency payments, subject to the limitations described herein under "BONNEVILLE FINANCIAL OPERATIONS — The Bonneville Fund." The Participants are obligated to pay to Energy Northwest the amounts received from Bonneville within 30 days.

#### **Payment Procedures — Terminated Projects**

Upon the termination of a Net Billed Project, the related Net Billing Agreement terminates except that those provisions are continued which provide for the billing and payment of the costs of such Net Billed Project, including all amounts which Energy Northwest is required under the related Net Billed Resolution to pay each year into the various funds for debt service and all other purposes and the crediting of the proceeds of the disposition of the assets of such terminated Net Billed Project in reduction of such costs.

In the event of a termination of the Columbia Generating Station, Energy Northwest is required under the Columbia Net Billing Agreements to provide monthly accounting statements to Bonneville and to each Columbia Participant of all costs associated with such termination. The monthly accounting statements are required to credit against such costs all amounts received by Energy Northwest from the disposition of the assets of the Columbia Generating Station. The Columbia Net Billing Agreements provide that such monthly accounting statements shall continue until all Columbia Net Billed Bonds are paid or funds are set aside for the payment or retirement thereof or the final disposition of the applicable Project, whichever is later. If the monthly accounting statements show that such costs exceed such credits, each Columbia Participant is required to pay its portion of such excess costs to Energy Northwest. The payments are required to be made at times and in amounts sufficient to discharge on a current basis such Participant's share of the amount which Energy Northwest is required to pay into the various funds provided in the Columbia Prior Lien Resolution for debt service and all other purposes.

Since Projects 1 and 3 have been terminated, Energy Northwest is required under each of the Projects 1 and 3 Net Billing Agreements to provide monthly accounting statements to Bonneville and to each Project 1 Participant or Project 3 Participant of all costs associated with such termination. The monthly accounting statements are required to credit against such costs all amounts received by Energy Northwest from the assets of Project 1 and from the disposition of Project 3 assets. The Project 1 Net Billing Agreements provide that such monthly accounting statements shall continue until all Project 1 Net Billed Bonds have been paid or funds are set aside for their payment or the final disposition of Project 1, whichever is later. The Project 3 Net Billing Agreements provide that such monthly accounting statements shall continue until all Project 3 Net Billed Bonds have been paid or funds are set aside for their payment or the final disposition of Project 3, whichever is later. If the monthly accounting statements show that such costs exceed such credits, each Project 1 Participant or Project 3 Participant, as the case may be, is required to pay its portion of such excess costs to Energy Northwest. The payments are to be made at times and in amounts sufficient to discharge on a current basis the Project 1 Participant's share or Project 3 Participant's share, as the case may be, of the amount which Energy Northwest is required to pay into the various funds provided in the related Net Billed Resolutions for debt service and all other purposes.

The costs for each Net Billed Project after termination include all of Energy Northwest's accrued costs and liabilities resulting from Energy Northwest's ownership, construction, operation (including cost of fuel) and maintenance of and renewals and replacements to the terminated Project and all other Energy Northwest costs resulting from its ownership of such Project and the salvage, discontinuance, decommissioning and disposition or sale thereof and all amounts which Energy Northwest is required under the related Net Billed Resolutions to pay in each year into the various funds for debt service and all other purposes.

Under the terms of the Net Billing Agreements, Bonneville is obligated to pay each Participant in a Net Billed Project the amounts paid by such Participant to Energy Northwest following termination of such Project, by the provision of credits and by deficiency payments to Participants made in the same manner as required prior to termination. In the case of Projects 1 and 3, net billing credits are provided and cash payments are made by Bonneville to Participants or Energy Northwest in the same manner as provided for the Columbia Generating Station. See "— Payment Procedures — the Columbia Generating Station." Payments by the Participants and Bonneville and the provision of credits by Bonneville following termination of a Net Billed Project are required notwithstanding the termination of the Project and are not subject to any reduction, whether by offset or otherwise, and are not conditioned upon the performance or nonperformance by Energy Northwest, Bonneville or any Participant under the Net Billing Agreements or any other agreement or instrument.

Bonneville and Energy Northwest have entered into Post Termination Agreements with respect to Projects 1 and 3, each dated June 14, 1994, respectively (the "Post Termination Agreements") which, among other things, facilitate the administration, budgeting and billing procedures with respect to such Projects. Nothing in the Post Termination Agreements impairs or prevents Energy Northwest from including in the monthly accounting statements with respect to each such Project all costs and obligations of Energy Northwest as discussed above.



### **Projects 1 and 3 Post Termination Agreements**

The Project Agreements and the Net Billing Agreements for Projects 1 and 3 had provided that upon termination of Projects 1 and 3, Energy Northwest should cause Projects 1 and 3 to be salvaged, discontinued, decommissioned and disposed of or sold in whole or in part to the highest bidder(s), or disposed of in such other manner as the parties may agree. The termination of Projects 1 and 3 terminated the related Project Agreements and the Net Billing Agreements, except for certain provisions of the Net Billing Agreements and except as to accrued liabilities and obligations under the Net Billing Agreements.

Pursuant to the Post Termination Agreements, Energy Northwest has prepared and submitted to Bonneville for each of Projects 1 and 3 a proposed Project Disposition Plan (the "Project Disposition Plan"). Energy Northwest has begun implementation of the Project Disposition Plans.

Under the Post Termination Agreements, Energy Northwest may sell bonds to finance such Project costs as contained in an approved Annual Budget or amended Annual Budget to the extent permitted by the Electric Revenue Bond Resolutions (as hereinafter defined) or Separate Subordinated Resolutions (as hereinafter defined).

The Post Termination Agreements terminate when all Project 1 Net Billed Bonds and Project 3 Net Billed Bonds, respectively, have been paid or funds set aside for the payment or retirement thereof in accordance with the Project 1 Net Billed Resolutions or Project 3 Net Billed Resolutions, respectively, or the final disposition of the assets of Projects 1 and 3, respectively, whichever is later.

### **Certain Participant Obligations**

The Columbia Net Billing Agreements, as well as the remaining provisions of the Net Billing Agreements for Projects 1 and 3, require each Participant to pay Energy Northwest the amount set forth in its Billing Statement or accounting statement. Each Participant is required to make payments to Energy Northwest only from revenues derived by the Participant from the ownership and operation of its electric utility properties and from payments made by Bonneville under the Net Billing Agreements. Each Participant has covenanted that it will establish, maintain and collect rates or charges for power and energy and other services furnished through its electric utility properties which shall be adequate to provide revenues sufficient to make required payments to Energy Northwest under the Net Billing Agreements and to pay all other charges and obligations payable from or constituting a charge and lien upon such revenues.

If and to the extent that a Participant is unable or fails or refuses to perform its obligations under its Columbia Net Billing Agreement and such Participant's share of Columbia capability is not voluntarily reassigned, each other Participant's share of Columbia capability is automatically increased for the remaining term of the Columbia Net Billing Agreement pro rata with that of other nondefaulting Participants. The Columbia Net Billing Agreements provide that such increase shall not, without the consent of the Participant, exceed an accumulated maximum of 25% of the Participant's original share of Columbia capability. The Columbia Net Billing Agreements also provide that such increase shall not cause the estimate of the payments to be made by each nondefaulting Participant to Energy Northwest to exceed the estimate of the credits available to it from Bonneville's billings to such Participant for power and other services. The fact that other Participants have assumed the obligation of a Participant which has failed or refused to pay any amounts due to Energy Northwest under its Columbia Net Billing Agreement would not relieve such defaulting Participant of its liability for such payments.

### **Other Net Billing Obligations**

In addition to the net billing obligations in connection with the Net Billed Projects, Bonneville has net billing obligations to certain Participants in connection with that portion of the project capability associated with the share of the Trojan Nuclear Project owned by the City of Eugene Water and Electric Board ("EWEB"). The credits and payments received by each Participant from Bonneville in each month under all of that Participant's agreements providing for net billing are required by the Net Billing Agreements to be allocated pro rata among all of the Participants' net billing obligations.

Bonneville is authorized to enter into additional contracts providing for net billing or similar credits. The Net Billing Agreements provide that Bonneville and each Participant shall not enter into any agreement providing for net billing if Bonneville estimates that, as a result of such agreement, the aggregate of its billings to such Participant will be less than 115% of Bonneville's net billing obligations to such Participant under all agreements between Bonneville and such Participant providing for net billing. Bonneville has no present plans to enter into new agreements requiring net billing with Participants.

### **THE BONNEVILLE FUND**

The Bonneville Fund is a continuing appropriation available exclusively to Bonneville for the purpose of making cash payments to cover Bonneville's expenses, including its cash payments to provide for that amount, if any, due under the Net Billing Agreements which is not paid from net billing credits. All receipts, collections and recoveries of Bonneville in cash from all sources are deposited in the Bonneville Fund. For a more complete discussion of the Bonneville Fund, see "BONNEVILLE FINANCIAL OPERATIONS — The Bonneville Fund."

Bonneville may make expenditures from the Bonneville Fund, which shall have been included in Bonneville's annual budget submitted to Congress without further appropriation and without fiscal year limitation but subject to such specific directives or limitations as may be included in appropriations acts, for any purpose necessary or appropriate to carry out the duties imposed upon Bonneville pursuant to law, including making any cash payments required under the Net Billing Agreements.

Net billing credits reduce Bonneville's cash receipts by the amount of the credits. Thus, costs of the Net Billed Projects, to the extent covered by net billing credits, can be met without regard to amounts in the Bonneville Fund.

Bonneville is required to make certain annual payments to the United States Treasury. These payments are subject to the availability of net proceeds, which are gross cash receipts remaining in the Bonneville Fund after deducting all of the costs paid by Bonneville to operate and maintain the Federal System, other than those used to make payments to the United States Treasury for: (i) the repayment of the Federal investment in certain transmission facilities and the power generating facilities at federally-owned hydroelectric projects in the Pacific Northwest; (ii) debt service on bonds issued by Bonneville and sold to the United States Treasury; (iii) repayments of appropriated amounts to the Corps and the Bureau for certain costs allocated to power generation at federally-owned hydroelectric projects in the Pacific Northwest; and (iv) costs allocated to irrigation projects as are required by law to be recovered from power sales. Bonneville met its fiscal year 2001 payment responsibility to the United States Treasury of \$729 million in full and on time.

For various reasons, Bonneville's revenues from the sale of electric power and other services may vary significantly from year to year. In order to accommodate such fluctuations in revenues and to assure that Bonneville has sufficient revenues to pay the costs necessary to maintain and operate the Federal System, all cash payment obligations of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses have priority over payments by Bonneville to the United States Treasury. In the opinion of Bonneville's Acting General Counsel, under Federal statutes, Bonneville may only make payments to the United States Treasury from net proceeds; all cash payments of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses have priority over payments by Bonneville to the United States Treasury for the costs described in (i) to (iv) in the preceding paragraph.

The requirement to pay the United States Treasury exclusively from net proceeds would result in a deferral of United States Treasury payments if net proceeds were not sufficient for Bonneville to make its payments in full to the United States Treasury. Such deferrals could occur in the event that Bonneville were to receive less revenue or if Bonneville's costs were higher than expected. Such deferred amounts, plus interest, must be paid by Bonneville in future years. Bonneville has not deferred such payments since 1983.

Because Bonneville's payments to the United States Treasury may be made only from net proceeds, payments of other Bonneville costs out of the Bonneville Fund have a priority over its payments to the United States Treasury. Thus, the order in which Bonneville's costs are met is as follows: (1) Net Billed Project costs to the extent covered by net billing credits, (2) cash payments out of the Bonneville Fund to cover all required payments incurred by Bonneville pursuant to law, including net billing cash payments, but excluding payments to the United States Treasury and (3) payments to the United States Treasury.

For further information, see "BONNEVILLE FINANCIAL OPERATIONS — Order in Which Bonneville's Costs Are Met." For a discussion of certain proposed and current direct payments by Bonneville for Federal System operations and maintenance, which payments would reduce the amount of deferrable appropriations obligations Bonneville would otherwise be responsible to repay, see "BONNEVILLE FINANCIAL OPERATIONS — Direct Funding of Corps and Bureau Federal System Operations and Maintenance Expense."

Bonneville's obligation under the Project 1 Net Billing Agreements is to pay an amount equal to the costs of Project 1 less any other funds which shall be specified in the Annual Budget as payable from sources other than the payments to be made under the Net Billing Agreements. Similar language is found in the Net Billing Agreements for Columbia and Project 3. In the opinion of Bonneville's Acting General Counsel, this provision would permit Bonneville to make payments on account of debt service on all Net Billed Bonds for a Net Billed Project directly to the applicable Bond Fund Trustee or Trustee. Such payment would be made only pursuant to an agreement with the applicable Bond Fund Trustee or Trustee requiring Bonneville to make such payment directly to the applicable Bond Fund Trustee or Trustee on or before the date such amounts would be required to be paid by Energy Northwest to the applicable Bond Fund Trustee or Trustee under the applicable Net Billed Resolution. Bonneville has no present intention of undertaking such actions. The effect of such an agreement would be to reduce the amount of costs included in the Annual Budget for the Net Billed Project to be paid under the Net Billing Agreements by the amount of the debt service payable directly by Bonneville to the applicable Bond Fund Trustee or Trustee.

For further information see "BONNEVILLE FINANCIAL OPERATIONS."

## **ASSIGNMENT AGREEMENTS**

Prior to the decision in *City of Springfield v. Washington Public Power Supply System, et al.* (holding that the Participants had authority to enter into the Net Billing Agreements), Energy Northwest and Bonneville entered into Assignment Agreements for each of Project 1, Columbia Generating Station and Project 3 (the "Assignment Agreements"). Pursuant to the Assignment Agreements, Energy Northwest assigned to Bonneville any rights to the capability of any of the Net Billed Projects that Energy Northwest may obtain as a result of a reversion of a Participant's share of such capability to Energy Northwest or otherwise. In the event that it is judicially determined that any Participant is not obligated pursuant to the Net Billing Agreements to pay for any interest in Project capability which Bonneville obtains pursuant to the Assignment Agreements, Bonneville agreed to pay directly to Energy Northwest the amounts that would have been payable by the Participant under the Net Billing Agreements for such Project capability.

## **ADDITIONAL BONDS**

### **General**

The Electric Revenue Bonds are subordinate to the Prior Lien Bonds. In each Electric Revenue Bond Resolution, Energy Northwest has reserved the right to issue from time to time, upon satisfaction of certain conditions set forth therein, additional bonds or notes under the Electric Revenue Bond Resolutions and under one or more separate resolutions (“Separate Subordinated Resolutions”) of the Executive Board creating a pledge of and lien on the receipts, income and revenues derived from the related Project of equal rank with the pledge and lien created by such Electric Revenue Bond Resolution in favor of the Electric Revenue Bonds issued thereunder. Such pledge and lien are subordinate to the pledge and lien created by the Prior Lien Resolution in favor of the Prior Lien Bonds issued thereunder.

Conditions to the issuance of additional bonds are described in Appendix G-1 hereto, “SUMMARY OF CERTAIN PROVISIONS OF ELECTRIC REVENUE BOND RESOLUTIONS AND SUPPLEMENTAL ELECTRIC REVENUE BOND RESOLUTIONS” and in Appendix G-2, “SUMMARY OF CERTAIN PROVISIONS OF PRIOR LIEN RESOLUTIONS NOS. 769, 640 AND 775 — Subsequent Series of Bonds.”

Each of the Electric Revenue Bond Resolutions permits the use of certain credit facilities of the type referred to in such Electric Revenue Bond Resolution to secure the payment of the related Electric Revenue Bonds and the incurrence by Energy Northwest of reimbursement obligations of the type referred to in such Electric Revenue Bond Resolution to reimburse the issuer of a credit facility. Each of the Electric Revenue Bond Resolutions also permits the use of interest rate exchange agreements or similar agreements. Such reimbursement obligations or obligations of Energy Northwest under such interest rate exchange agreements may be secured on a parity with the lien created by the Electric Revenue Bond Resolutions in favor of the related Electric Revenue Bonds. See Appendix G-1 hereto, “SUMMARY OF CERTAIN PROVISIONS OF ELECTRIC REVENUE BOND RESOLUTIONS AND SUPPLEMENTAL ELECTRIC REVENUE BOND RESOLUTIONS.”

For information regarding the amount of bonds and other obligations of Energy Northwest outstanding under the Electric Revenue Bond Resolutions and Separate Subordinated Resolutions, see “ENERGY NORTHWEST – Energy Northwest Indebtedness.”

### **Planned Additional Bonds**

Energy Northwest expects to issue an additional series of Electric Revenue Bonds in the second quarter of 2002, in an aggregate principal amount of approximately \$250 million pursuant to the Refunding Plan, a portion of the proceeds of which will be applied to pay the Notes discussed below. See “ENERGY NORTHWEST – Energy Northwest Indebtedness.”

Bonneville has formally requested that Energy Northwest finance all costs for the Columbia Independent Spent Fuel Storage Installation through the issuance of Electric Revenue Bonds. It is expected that such issuance, estimated to be in the range of \$40 million to \$50 million, would be sold concurrently with the refunding bonds described above and, based on the advice of Special Tax Counsel, all or a portion of such issuance may be sold on a taxable basis.

### **Certain Provisions of the Prior Lien Resolutions**

For additional information relating to the security for the Prior Lien Bonds and to the amendments to the Prior Lien Resolutions which have become effective with respect to the Project 1, Columbia and Project 3 Prior Lien Resolutions, see Appendix G-2 hereto, “SUMMARY OF CERTAIN PROVISIONS OF PRIOR LIEN RESOLUTIONS NOS. 769, 640 AND 775.”

### **Related Contracts**

Energy Northwest has executed Project Agreements with Bonneville relating to Project 1, the Columbia Generating Station and Project 3, which provide for approval of budgets, contracts and other matters pertaining to each Project. As a result of the termination of Projects 1 and 3, the Project Agreements relating to Project 1 and Project 3 have been terminated.

A summary of certain provisions of each of these contracts is set forth in Appendix F hereto, “SUMMARY OF CERTAIN PROVISIONS OF RELATED CONTRACTS.”

## **BOND INSURANCE**

### **Financial Security Assurance Municipal Bond Insurance Policy**

Concurrently with the issuance of the Series 2002-A Bonds, Financial Security Assurance (“FSA”) will issue its Municipal Bond Insurance Policy (the “FSA Policy”) for the Project 1 2002-A Bonds maturing July 1 of the years 2013 (5.50% Rate) through 2014 (5.50% Rate and 5.75% Rate), inclusive (the “FSA Insured Bonds”). The FSA Policy guarantees the scheduled payment of principal of an interest on the FSA Insured Bonds when due as set forth in the form of the FSA Policy included as Appendix J-1 to this Official Statement.

The FSA Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

### **Financial Security Assurance Inc.**

FSA is a New York domiciled insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. (“Holdings”). Holdings is an indirect subsidiary of Dexia, S.A. a publicly held Belgian corporation. Dexia, S.A.,

through its bank subsidiaries, is primarily engaged in the business of public finance in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At December 31, 2001, FSA's total policyholders' surplus and contingency reserves were approximately \$1,593,569,000 and its total unearned premium reserve was approximately \$810,898,000 in accordance with statutory accounting principles. At December 31, 2001, FSA's total shareholders' equity was approximately \$1,698,672,000 and its total net unearned premium reserve was approximately \$669,534,000 in accordance with generally accepted accounting principles.

The financial statements included as exhibits to the annual and quarterly reports filed by Holdings with the Securities and Exchange Commission are hereby incorporated herein by reference. Also incorporated herein by reference are any such financial statements so filed from the date of this Official Statement until the termination of the offering of the FSA Insured Bonds. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 350 Park Avenue, New York, New York 10022, Attention: Communications Department (telephone (212) 826-0100).

The FSA Policy does not protect investors against changes in the market value of the FSA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the FSA Insured Bonds or the advisability of investing in the FSA Insured Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided to the issuer the information presented under this caption for inclusion in the Official Statement.

### **MBIA Municipal Bond Insurance Policy**

Concurrently with the issuance of the Series 2002-A Bonds, MBIA Insurance Corporation ("MBIA") will issue its Municipal Bond Insurance Policies (the "MBIA Policies" and, together with the FSA Policies, the "Policies") for [to come]. The Series 2002-A Bonds so insured are herein referred to as the "MBIA Insured Bonds". The FSA Insured Bonds and the MBIA Insured Bonds are collectively referred to as the "Insured Bonds." The following information has been furnished by MBIA for use in this Official Statement. Reference is made to Appendix J-2 for a specimen of MBIA's Policy.

MBIA's Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of Energy Northwest to the Paying Agent or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the MBIA Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by MBIA's Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the MBIA Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

MBIA's Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any MBIA Insured Bond. MBIA's Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of MBIA Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. MBIA's Policy also does not insure against nonpayment of principal of or interest on the MBIA Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the MBIA Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of an MBIA Insured Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such MBIA Insured Bonds or presentment of such other proof of ownership of the MBIA Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the MBIA Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the MBIA Insured Bonds in any legal proceeding related to payment of insured amounts on the MBIA Insured Bonds, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners or the Paying Agent payment of the insured amounts due on such MBIA Insured Bonds, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

MBIA, formerly known as Municipal Bond Investors Assurance Corporation, is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company. MBIA Inc. is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA has one European branch in the Republic of France.

As of December 31, 1995, MBIA had admitted assets of \$3.8 billion (audited), total liabilities of \$2.5 billion (audited), and total capital and surplus of \$1.3 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of March 31, 1996, MBIA had admitted assets of \$4.0 billion (unaudited), total

liabilities of \$2.7 billion (unaudited), and total capital and surplus of \$1.3 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. All information regarding MBIA, a wholly-owned subsidiary of MBIA Inc., including the financial statements of MBIA for the year ended December 31, 1995, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of MBIA Inc. for the year ended December 31, 1995 is hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof. Any statement contained in a document incorporated by reference herein shall be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is incorporated by reference herein modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

Furthermore, copies of MBIA's year end financial statements prepared in accordance with statutory accounting practices are available from MBIA. A copy of the Annual Report on Form 10-K of MBIA Inc. is available from MBIA or the Securities and Exchange Commission. The address of MBIA is 113 King Street, Armonk, New York 10504.

Moody's Investors Service ("Moody's") rates the claims paying ability of MBIA "Aaa". Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), rates the claims paying ability of MBIA "AAA". Fitch Ratings ("Fitch"), rates the claims paying ability of MBIA "AAA".

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the MBIA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the MBIA Insured Bonds. MBIA does not guaranty the market price of the MBIA Insured Bonds nor does it guaranty that the ratings on the MBIA Insured Bonds will not be revised or withdrawn.

## ENERGY NORTHWEST

### GENERAL

Energy Northwest, a municipal corporation and a joint operating agency of the State of Washington, was organized in January 1957 pursuant to the Act. Energy Northwest was formerly known as Washington Public Power Supply System. The name was officially changed to Energy Northwest on June 2, 1999. Energy Northwest has authority, among other things, to acquire, construct and operate plants, works and facilities for the generation of and transmission of electric power and energy and to issue bonds and other evidences of indebtedness for such purposes. Energy Northwest has the power of eminent domain but is specifically precluded from the condemnation of any plants, works or facilities owned and operated by any city, public utility district or investor-owned utility. Energy Northwest has no taxing power.

Energy Northwest owns and operates Columbia and Packwood which are currently in operation, with net design electrical ratings of 1,153 megawatts and 27.5 megawatts, respectively. Energy Northwest is developing a wind turbine farm, capable of generating up to 50 megawatts of electricity. The Energy Northwest Board of Directors formally approved the project in January 2001 and the public utility purchasers have executed the Nine Canyon Wind Project power purchase agreement. In November 2001, Energy Northwest issued approximately \$70.7 million of bonds to finance the acquisition, development and construction costs of the Nine Canyon Wind Project. It is currently estimated that the Nine Canyon Wind Project will commence commercial operation in late 2002. Energy Northwest also owns and/or has financial responsibility for four nuclear electric generating projects which have been terminated: Projects 1, 3, 4 and 5. Energy Northwest also owns HGP, which ceased operation in 1987, and site restoration activities coordinated with DOE are continuing. For discussions concerning the termination of Projects 1, 3, 4 and 5, see "— Project 1," "— Project 3" and "— Projects 4 and 5."

Each of Energy Northwest's Projects is treated and accounted for by Energy Northwest as a separate utility system, with the exception of Projects 4 and 5, which comprised a single utility system. Under Washington law, a joint operating agency may create separate special funds for each of its utility systems and Energy Northwest has done so. The resolutions of Energy Northwest pursuant to which its various series of bonds are issued provide that the income, receipts and revenues of each utility system are pledged solely to the payment of obligations incurred in connection with that utility system. See Appendix B hereto for the audited financial statements of each of Energy Northwest's Projects, including the report of the independent accountants, PricewaterhouseCoopers LLP, for the fiscal year ended June 30, 2001.

## ENERGY NORTHWEST INDEBTEDNESS

The following table sets forth the principal amounts of revenue bonds and refunding revenue bonds issued by Energy Northwest and outstanding as of February 1, 2002.

### Energy Northwest Revenue Bonds Outstanding as of February 1, 2002

Bonds	Principal Amount (Dollars in Thousands)
Project 1 Prior Lien Refunding Revenue Bonds.....	\$ 1,748,565
Columbia Prior Lien Refunding Revenue Bonds .....	1,754,321 <sup>(1)</sup>
Project 3 Prior Lien Refunding Revenue Bonds.....	1,333,654 <sup>(1)</sup>
Project 1 Refunding Electric Revenue Bonds.....	252,280
Columbia Refunding Electric Revenue Bonds .....	348,365
Project 3 Refunding Electric Revenue Bonds.....	410,010
Packwood Revenue Bonds .....	4,961
Nine Canyon Wind Project Revenue Bonds.....	70,675

- (1) Includes \$69,851,101 accreted value of Compound Interest Bonds for Columbia and \$324,854,028 accreted value of Compound Interest Bonds for Project 3 as of January 1, 2002.

In September 2001, Citibank, N.A. extended a line of credit to Energy Northwest for each of the Projects pursuant to three separate credit facilities. Under the Project 1, Columbia and Project 3 credit facilities, Energy Northwest may borrow up to \$55,605,000, \$36,698,750 and \$55,225,220, respectively, from time to time during the period from September 6, 2001 to June 25, 2002. Proceeds of advances made under a line of credit may be applied to refinance a portion of the cost of the related Project by providing a portion of the funds necessary to refund principal and, in some cases, interest on certain Prior Lien Bonds maturing on July 1, 2002 issued to finance such Project. Energy Northwest's obligation to repay advances under a credit facility is evidenced by a note (the "Note") authorized to be executed and delivered by Energy Northwest pursuant to the related Separate Subordinated Resolution. As of February 1, 2002, Energy Northwest had borrowed \$30,330,000, \$20,017,500 and \$27,474,120 under the Project 1, Columbia and Project 3 credit facilities, respectively. Each Note is secured on a parity with bonds and notes issued by Energy Northwest under the related Electric Revenue Bond Resolution and with all other obligations issued pursuant to additional related Separate Subordinated Resolutions. Each Note matures on June 25, 2002. A portion of the proceeds of the additional series of Electric Revenue Bonds discussed herein under the heading "SECURITY FOR THE NET BILLED BONDS – Additional Bonds – Planned Additional Bonds" is expected to be applied to pay the Notes at or prior to maturity.

## ORGANIZATIONAL STRUCTURE

Energy Northwest currently has a membership of 16, consisting of 13 public utility districts and the cities of Richland, Seattle, and Tacoma, all located in the State of Washington. Any public utility district and any municipal entity within the State of Washington authorized to engage in the business of generating or distributing electricity may join Energy Northwest.

Energy Northwest has its principal office in Richland, Washington. The Board of Directors of Energy Northwest is comprised of 16 members, one from each of the member utilities. Pursuant to the Act, the powers and duties of the Board of Directors are limited to (i) final authority on any decision to acquire, construct, terminate or decommission any power plants, works and facilities, except that once such a final decision is made with respect to a nuclear power plant, the Executive Board has authority to make all subsequent decisions regarding such plant; (ii) the election and removal of, and establishment of salaries for, the five members of the Executive Board selected from among the members of the Board of Directors; and (iii) the selection of three of the six members of the Executive Board who are outside directors. All other powers and duties of Energy Northwest, including but not limited to the authority to sell any power plant, works and facilities are vested in the Executive Board.

The Act provides that five of the members of the Executive Board of Energy Northwest are elected by the Board of Directors from among its members and six are outside directors representative of policy makers in business, finance or science, or having expertise in the construction or management of facilities such as those owned by Energy Northwest. Three of these six outside directors are selected by the Board of Directors and three by the Governor of the State of Washington subject to confirmation by the Washington Senate.

The five members of the Executive Board who are elected from among the Board of Directors serve for four-year terms and may be removed by a majority vote of the Board of Directors. The other members of the Executive Board serve for four-year terms and may be removed by the Governor of the State of Washington for incompetence, misconduct or malfeasance in office; provided, however, the three members appointed by the Governor may be removed without cause prior to their confirmation with the consent of the Washington Senate. The Chief Executive Officer and other staff of Energy Northwest serve at the will of the Executive Board.

## EXECUTIVE BOARD

Present Executive Board members are listed below.

Name	Occupation	Term Expires
John F. Cockburn, Chairman	Retired Bank Executive	June 2004
Dan G. Gunkel, Vice Chairman	Public Utility District Commissioner	June 2002
Robert Graves, Secretary	Public Utility District Commissioner	June 2002
Vera Claussen, Assistant Secretary	Public Utility District Commissioner	June 2002
Margaret Allen	Attorney	June 2004
Darrel Bunch	Public Utility District Commissioner	June 2002
Edward E. Coates	Retired Utility Executive	June 2002
Larry Kenney	Retired Organized Labor Executive	June 2002
Sid W. Morrison	Retired Executive	June 2005
Amy C. Solomon	Management Consultant	June 2005
Roger C. Sparks	Public Utility District Commissioner	June 2002

## MANAGEMENT

The following is a list of certain key senior staff of Energy Northwest.

Name	Position	Nuclear Industry Experience
Joseph V. Parrish	Chief Executive Officer	31 years
Gregory O. Smith	Vice President, Generation	21 years
Rodney L. Webring	Vice President, Operations Support/ Public Information Officer	28 years
Gerald J. Kucera	Vice President, Administration/ Chief Financial Officer	26 years
John W. Baker	Vice President, Resource Development	31 years
Albert E. Mouncer	Vice President, General Counsel	21 years

## EMPLOYEES

Energy Northwest currently employs approximately 1,095 employees. Of these employees, 337 are members of the International Brotherhood of Electrical Workers ("IBEW"), 68 are members of the Paper, Allied Industrial, Chemical & Energy Workers ("PACE") and 6 are members of the Hanford Atomic Metal Trades Council ("HAMTC") unions. The IBEW union members comprise the Administrative, Nuclear and Plant bargaining groups, the PACE union members constitute the Security Force bargaining group and the HAMTC union members comprise part of the Standards Lab Instrument Techs. The Nuclear and Plant collective bargaining agreements expire on October 1, 2004. The Administrative collective bargaining agreement expires on October 30, 2004. The PACE collective bargaining agreement expires on November 2, 2002. The HAMTC collective bargaining agreement expires on March 31, 2002. Washington State law provides for binding interest arbitration for the Security Force collective bargaining unit. A no-strike clause is included in each of the agreements.

## INVESTMENT POLICY

Energy Northwest invests in accordance with the authority provided by the Net Billed Resolutions and its investment policy covers all funds and investment activities under the direct authority of Energy Northwest. This investment policy is approved by the Energy Northwest Executive Board.

Investment securities purchased consist generally of obligations of, or obligations the principal and interest on which is unconditionally guaranteed by, the United States of America or other investment securities permitted by the related Net Billed Resolutions. Current investment policy does not permit the purchase of leveraged or derivative-based investments.

For further information on the types of investments in which Energy Northwest is permitted to invest its funds, see Appendix G-1 hereto, "SUMMARY OF CERTAIN PROVISIONS OF ELECTRIC REVENUE BOND RESOLUTIONS AND SUPPLEMENTAL ELECTRIC REVENUE BOND RESOLUTIONS — Other Funds Established by the Prior Lien Resolutions; Flow of Revenues" and Appendix G-2, "SUMMARY OF CERTAIN PROVISIONS OF PRIOR LIEN RESOLUTIONS NOS. 769, 640 AND 775."

## THE COLUMBIA GENERATING STATION

### Description

The Columbia Generating Station ("Columbia") is an operating nuclear electric generating station located about 160 miles southeast of Seattle, Washington, near Richland, Washington on the DOE's Hanford Reservation. Its former name, Nuclear Project

No. 2, was officially changed to the Columbia Generating Station on April 27, 2000. The site has been leased from DOE for a term of 50 years commencing July 1, 1972, with options to extend the lease for two consecutive ten-year periods.

Columbia commenced commercial operation in 1984 and has a net design electrical rating of 1,153 megawatts. Columbia consists of a General Electric Company-designed boiling water reactor and nuclear steam supply system, a Westinghouse turbine-generator and the necessary transformer, switching and transmission facilities to deliver the output to the transmission facilities of the Federal System located in the vicinity of Columbia. The entire capability of Columbia has been acquired by Bonneville under the Columbia Net Billing Agreements.

Columbia consists of the following structures: the reactor building, the radioactive waste building, the turbine-generator building, the diesel generator building, the service building, six mechanical-draft evaporative cooling towers, the circulating water pumphouse and the river makeup water pumphouse. Makeup water to replace evaporative losses is obtained from the Columbia River by means of three makeup water pumps. Emergency power is supplied to Columbia by diesel generators sized to sustain all essential plant loads without the need for outside power sources.

Columbia also includes the plant engineering center and other office and support facilities located adjacent to the main plant, the plant support facility located one mile southwest of the main plant and various administrative service buildings located in Richland, Washington, approximately ten miles from the site.

Low-level radioactive waste generated at Columbia is disposed of at a commercial facility located on the Hanford Reservation.

### **Management Discussion of Operations**

All the power generated from Columbia is sold at cost to Bonneville through the Columbia Net Billing Agreements. Energy Northwest has a maintenance and operating budget for Columbia of \$196.0 million during the 2002 fiscal year.

The cost of production, using industry standard methodology (such cost calculation methodology includes capital but excludes debt service, depreciation and decommissioning costs) of Columbia electricity is projected at \$20.70 per megawatt-hour during the 2002 fiscal year, lower than the \$26.10 per megawatt-hour for the 2001 fiscal year. These costs are about average for the nuclear industry. Energy Northwest will continue to place a high priority on cost-containment.

Energy Northwest will rely heavily upon an improving capability factor to further reduce the cost of power. The capability factor is the percentage of time the plant is capable of generating electricity. The more time during which Columbia produces power in a year, the lower the cost of each megawatt-hour. A significant step in that regard, and the explanation for the higher-than-normal cost of power for the 2001 fiscal year, is a shift to a 24-month refueling cycle. The plant had been on a 12-month schedule, shutting down each spring for refueling to coincide with high water flows in hydroelectric projects. Recognizing the looming shortage of power five years ago, Energy Northwest managers began plans for a shift to a 24-month cycle. The outage completed late in fiscal year 2001 was the first to load sufficient fuel for a two-year generation campaign, hence the higher-than-normal operations and maintenance costs. However, there is no refueling outage scheduled for the next two years, which will boost the plant's capability factor. In addition, refueling outages are now scheduled to last about 30 days, in contrast to past outages that normally extended beyond 60 days. Coincidentally, this new 24-month fuel cycle will mean only two outages are scheduled during Bonneville's next five-year rate period. Under the previous cycle, with the previous method of handling outages, the plant would have been down for at least 10 months during any five-year period. For the five-year rate period beginning October 1, 2001, the plant is expected by Energy Northwest to be off-line for refueling for only two months. For fiscal year 2002, Energy Northwest currently plans for a capability factor of approximately 94%.

While Energy Northwest intends to operate Columbia a greater percentage of the time, Energy Northwest also is evaluating plans to increase the gross capacity of the plant. Engineers are in the process of finalizing a proposal that would increase the plant's name plate capacity to about 1,350 megawatts — a 12.5% increase in power. Techniques used to create this additional electrical output have been well tested in the nuclear power industry, both domestically and abroad. In essence, the change would allow the reactor to create a greater amount of thermal energy and for that thermal energy to be converted into additional electrical energy. The conversion would require a new high-pressure turbine, work on the low pressure turbines, a new generator, new transformers and other work. The current estimated cost is in the range of \$125-\$150 million, or about \$800 for installed capacity for each kilowatt of generation. Financing options for Energy Northwest and Bonneville for funding this conversion would include (1) revenues received annually under the Columbia Net Billing Agreements or (2) monies received by the issuance of additional Columbia debt. The Northwest Power Planning Council has said the cost of each installed kilowatt from a new combined-cycle, natural gas-fired combustion turbine would be about \$600. However, the additional cost of actually generating the extra power at Columbia would be slight, while the cost of operating a new combustion turbine — both fuel and labor — would be significant. Work on the power upgrade, if approved by Energy Northwest's Executive Board, would be performed during three refueling outages and completed in 2007.

To gain further use of the plant's capacity, engineers now are working on a proposal to extend Columbia's 40-year operating license by 20 years, from 2023 to 2043. The NRC has established a protocol to handle such requests, and granted several during 2000. The Executive Board will determine whether to apply for an extension.

Energy Northwest has executed the power purchase agreement for the Nine Canyon Wind Project to acquire four megawatts of the projected future output from that project for station use by Columbia. It is currently estimated that the Nine Canyon Wind Project will commence commercial operation in late 2002. Power costs for the project are expected to be in the range of 3.4



cents per kilowatt hour to 3.8 cents per kilowatt hour during the first five fiscal years of operation and would constitute an operating expense of Columbia. See “ENERGY NORTHWEST – Nine Canyon Wind Project” in this Official Statement.

Energy Northwest also has pursued several ventures beyond the operation of Columbia - all of which are designed to relieve, in part, fixed-cost pressures on Columbia. Contracts to provide engineering and testing services for other agencies have allowed Energy Northwest to better use its resources originally established for Columbia.

### Operating Performance

Columbia received a full operating license in March 1984, commenced commercial operation in December 1984 and has been in operation since that time. Since commencing commercial operation, Columbia has operated at a cumulative capacity factor of 65.0% and has generated 107,114,371 megawatt hours (net of station use) of electric power through January 2002.

Successful implementation of performance enhancement initiatives for Columbia has produced significant positive results in plant performance since 1995. Calendar year 2000 was by far the best generating calendar year for Columbia since commencing commercial operation. In fiscal year 2000, Columbia produced 8,259,566 megawatt hours of electric power while attaining a capacity factor of 79.3% and a capability factor of 87.4%. In fiscal year 2001, Columbia produced 7,995,920 megawatt hours of electric power while attaining a capacity factor of 81.8% and a capability factor of 83.2%. The reduction in produced megawatt hours of electric power and capability resulted from a forced outage in September 2000 to repair a reactor recirculation pump seal and the fact that the recent fuel outage lasted longer than planned.

On July 2, 2001, Energy Northwest completed its most recent fuel outage, which lasted 45 days. The next scheduled outage for Columbia is scheduled to start in May 2003.

During post-maintenance testing of emergency generator diesels, an emergency generator switch failed to operate which resulted in Columbia Generating Station being shut down. Energy Northwest is making the necessary repairs and inspecting similar switches. Because of the safety significance of such switch failure, the NRC has sent an inspection team to review said failure and the response and corrective action taken by Energy Northwest. Columbia Generating Station is expected to return to service within the next week. Energy Northwest believes the actions taken with respect to the switch failure were correct. However, Energy Northwest cannot predict whether the NRC will take any action with respect to the switch failure.

### Annual Costs

Annual costs for Columbia based on the audited financial statement presentation format for fiscal years ended June 30, 2000 and 2001 are shown below. The data are on a cost basis with depreciation calculated on the straight line method by major components based on expected useful life.

#### Statement of Operations<sup>(1)</sup> (Dollars in Thousands)

<u>Cost Category</u>	<u>FY 2001</u>	<u>FY 2000</u>
Operations, Maintenance and Overhead .....	\$160,450	\$ 131,613
Nuclear Fuel Burnup .....	34,204	30,744
Spent Fuel Storage Expense.....	-	23,545
Spent Fuel Disposal Fee .....	7,542	7,313
Generation Taxes .....	2,497	2,723
Decommissioning .....	16,246	14,927
Depreciation and Amortization.....	96,026	100,824
Investment Income .....	(23,643)	(14,717)
Loss/(Gain) on Bond Redemption .....	-	333
Interest Expense and Discount Amortization.....	130,161	137,215
Other Expense/(Revenue).....	(2,331)	(2,154)
<b>Total Costs .....</b>	<b>\$ 421,152</b>	<b>\$ 432,366</b>
 Net Generation (Million kWhs)	 7,995	 7,707 <sup>(2)</sup>

(1) Amounts derived from audited Energy Northwest financial statements.

(2) Excludes credit for “Economic Dispatch” of 553 million kWhs for fiscal year 2000. Total energy not generated due to reductions requested by Bonneville is referred to by Bonneville as “Economic Dispatch.”

## **Capital Improvements**

Since entering commercial operation, Energy Northwest has been making capital improvements to Columbia. In fiscal year 2001, the cash spent on capital improvements was \$15.1 million (compared to \$6.2 million in fiscal year 2000). Expenditures for capital improvements for fiscal year 2002 are planned to be approximately \$22.7 million. Of this amount, \$16.7 million is planned to be expended for the spent fuel storage project and the remainder for various plant and facilities modifications and programs. For additional information concerning spent fuel storage, see “— Nuclear Fuel” below.

## **Nuclear Regulatory Commission Actions**

The NRC is a Federal agency that regulates the design, construction, licensing and operation of nuclear power plants. Once a plant is licensed, one of the major activities of the NRC is the inspection of plant management and operation. The NRC develops policies and administers programs for inspecting licensees to ascertain whether they are complying with NRC regulations, rules, orders and license provisions. The NRC has the authority to suspend, revoke or modify the operating license of commercial nuclear plants to correct deficiencies.

Energy Northwest’s activities related to operation and support of Columbia, like those of other licensed nuclear plant operators, are periodically inspected by the NRC. In addition, the NRC maintains two on-site resident inspectors who monitor plant activities on a day-to-day basis.

In addition to the day-to-day resident inspector activities, the NRC assesses the performance of nuclear plant operators, including Columbia, by a process known as the Reactor Oversight Process (the “ROP”). The ROP is built upon a framework directly linked to the NRC’s mission to protect public health and safety. The framework includes seven cornerstones of safety. Within each cornerstone, a broad sample of information on which to assess plant operator performance in risk-significant areas is gathered. The information is collected from performance indicator data submitted by the plant operator and from NRC risk-informed baseline inspections.

The ROP calls for focusing inspections on activities where the potential risks are greater, applying greater regulatory attention to facilities with performance problems and reducing regulatory attention of facilities that perform well, using objective measurements of the performance of nuclear power plants whenever possible, giving the nuclear industry and the public timely and understandable assessments of plant performance, avoiding unnecessary regulatory burdens of nuclear facilities and responding to violations of regulations in a predictable and consistent manner that reflects the safety impact of the violations.

In addition, the NRC issues a notice of violation when appropriate. Effective March 11, 1999, the NRC revised its enforcement policy and changed its treatment of Severity Level IV violations for situations which meet specific criteria. Severity Level IV is the least severe of violations that can be issued by the NRC. The new policy allows the NRC to issue a non-cited violation rather than a Severity Level IV violation with the following exceptions: (1) the licensee fails to restore compliance within a reasonable time after the violation is identified; (2) the licensee does not place the violation into a corrective action program to address recurrence; (3) the violation is repetitive as a result of inadequate corrective action and was identified by the NRC; and (4) the violation was willful and is not subject to discretion pursuant to Section VII.B.1 of the Enforcement Policy.

On December 28, 2001, Energy Northwest received a Notice of Violation from the NRC regarding its Emergency Preparedness program. The NRC found that Energy Northwest’s Emergency Preparedness program was not sufficient to adequately assure emergency notification to certain private businesses leasing property from Energy Northwest within the exclusion area boundary of the Columbia Generating Station. The Violation did not involve the direct operation of Columbia. Energy Northwest believes that it has implemented corrective measures that have brought Columbia into compliance with NRC requirements. In addition, Energy Northwest has terminated the leases to the private businesses, the last effective July 31, 2002. While there can be no assurance, Energy Northwest expects that the NRC will find Energy Northwest’s corrective measures acceptable when reviewed by them during a planned inspection in May 2002.

## **Institute of Nuclear Power Operations**

The nuclear electric industry created the Institute of Nuclear Power Operations (“INPO”) in 1979. INPO’s mission is to promote the highest levels of safety and reliability in the operation of nuclear electric generating plants. All United States utilities that operate commercial nuclear power plants are INPO members. INPO has conducted plant evaluations of Columbia approximately every 12 to 18 months since the initial date of commercial operation.

The most recent INPO evaluation of plant performance occurred in September 2000. At the completion of the evaluation, INPO assigned Columbia a rating of “excellent.” This is based on a one-to-five rating system where “excellent” indicates the best performance and is defined by INPO as a plant whose overall performance is excellent, where industry standards of excellence are met in most areas and where no significant weaknesses are noted.

The next formal evaluation of Columbia has been scheduled for October 2002.

## **Permits and Licenses**

Energy Northwest has obtained all permits and licenses required to operate Columbia, including an NRC operating license which expires in 2023. See “— Nuclear Regulatory Commission Actions or Reports” above for a discussion of NRC activities related to Columbia.

A site certification agreement for Columbia was executed with the State of Washington in May 1972. The site certification requires Energy Northwest to, among other things, monitor the environmental effects of plant construction and plant operation, comply with standards set for the consumption and discharge of water and for discharges to the air, and develop an effective emergency plan. The state has also issued a National Pollutant Discharge Elimination System (“NPDES”) permit and the necessary Certificate of Water Right. The Certificate of Water Right expires when use ceases. The NPDES permit is effective until April 2006 and is renewable for five-year terms thereafter. The Washington State Department of Natural Resources has entered into a lease with Energy Northwest, which expires in March 2005, for that portion of the bed of the Columbia River which encompasses the plant intake and discharge facilities. Energy Northwest anticipates renewal of this lease in accordance with the right-of-renewal provisions contained therein. The Corps has issued a permit for construction and maintenance of the now completed river facilities. Energy Northwest has an interim status permit for storage of mixed radioactive and hazardous wastes. The processing of a final Resource Conservation and Recovery Act (“RCRA”) permit has been suspended by the State of Washington pending a national review of mixed waste disposal capacity. Energy Northwest continues to manage its mixed wastes in accordance with the conditions of the interim status permit.

### **Nuclear Fuel**

The supply of nuclear fuel assemblies requires four basic activities prior to insertion of the fuel assemblies into a nuclear reactor. These activities are acquisition of uranium concentrates, conversion of the uranium concentrates to uranium hexafluoride, enrichment of the uranium hexafluoride and fabrication of the enriched uranium in the form of uranium oxide pellets into finished fuel assemblies.

The initial core of fuel assemblies was fabricated by General Electric and loaded into the reactor in December 1983. A portion of the fuel was then replaced during refueling outages so that by mid-1992 all of the initial core fuel had been replaced with reload fuel assemblies.

For the period from 1986 through 1995, these reload fuel assemblies were provided under the provisions of a contract with Siemens Power Corporation. That contract provided for the supply of the uranium concentrates as well as the fuel design engineering and fabrication services. A new contract for reload fuel design and fabrication services for five firm and five optional fuel cycles was awarded to CE Nuclear Power LLC, a subsidiary of the Westinghouse Electric Company, on November 18, 1993 and executed on January 13, 1994. In February 1998, the contract was amended to accept the five optional reload fuel cycles.

Columbia has historically operated on a twelve-month fuel cycle but in 1998 a decision was made to transition to a twenty-four month fuel cycle. A twenty-four month fuel cycle eliminates refueling outages every other year and results in increased average generation. After two transition cycles totaling approximately thirty-six months in length, the first twenty-four month cycle began in 2001.

To meet the enriched uranium requirements for the reload fuel assemblies, Energy Northwest purchases uranium in various forms and holds them in inventory until needed for fuel fabrication. However, some or all of this inventory is being or might be loaned. Currently, Energy Northwest’s inventory of natural and enriched uranium hexafluoride is sufficient for plant requirements until 2005.

Energy Northwest has a contract with DOE that requires the DOE to accept title and dispose of spent nuclear fuel. For this future service, Energy Northwest pays a quarterly fee based on one mill per kilowatt-hour of net electricity generated and sold from Columbia (\$7.5 million for the twelve months ended June 30, 2001). To permanently store the spent fuel from the nation’s nuclear plants, DOE is evaluating a proposed site in Nevada for an underground geological repository. Although courts have ruled that DOE has an obligation to begin taking title to the spent fuel no later than January 31, 1998, the repository is not expected to be in operation before 2010. Once DOE begins to accept spent fuel, it will accept the oldest spent fuel first, on a national basis. Because Columbia is a relatively young plant, DOE has not planned to accept any spent fuel from Columbia during the first ten years of repository operation.

Columbia has sufficient capacity in the plant to accommodate all its spent fuel discharges through calendar year 2003. To accommodate spent fuel discharges after 2003, Energy Northwest initiated a project, the Independent Spent Fuel Storage Installation (“ISFSI”), to store spent fuel in commercially available dry storage casks on concrete pads at the plant site. Energy Northwest has a contract for a dry storage cask system, which will be available for spent fuel loading in 2002. Construction of the initial concrete pads is complete. These concrete pads will have enough capacity to handle spent fuel discharges through 2010. Completion of the lighting and security systems for the facility is expected to be complete by mid-2002. The facility will be expanded in increments as needed in the future. Initial project capital costs continue to be estimated at over \$32.7 million with costs for dry storage casks projected at approximately \$5 million every other year starting in 2004.

### **Decommissioning**

The NRC has defined decommissioning as actions taken which result in the release of the property for unrestricted use and termination of the nuclear power plant operating license. Currently, the nuclear industry recognizes three alternative methods (decontamination, safe storage and entombment) to decommission a nuclear power plant. Energy Northwest’s decommissioning plan is based on the safe storage method of decommissioning. Safe storage entails placing and maintaining the nuclear facility in a condition that allows it to be safely stored and subsequently decontaminated to levels that permit release for unrestricted use. The NRC requires that this deferred decontamination period be no longer than 60 years.

The NRC has issued rules to provide guidance to licensees of operating nuclear plants on decommissioning the plants at the end of each plant's operating life. In addition, in September 1998, the NRC approved and published its "Final Rule on Financial Assurance Requirements for Decommissioning Power Reactors." As provided in this rule, each power reactor licensee is required to report to the NRC the status of its decommissioning funding for each reactor it owns. This reporting requirement began on March 31, 1999 and reports are required every two years thereafter. Energy Northwest submitted its most recent report to the NRC on March 23, 2001.

In addition, the State of Washington has adopted regulations which require Energy Northwest to submit a plan which provides for site restoration after the plant's operating life. Energy Northwest has provided, as required, an initial plan for site restoration for Columbia. Such plan has been approved by the State of Washington. Energy Northwest is required to review this site restoration plan in light of relevant new conditions, technologies and knowledge and report to the State of Washington the results of its review at least every five years or upon any change in project status. Energy Northwest submitted an update of its Columbia site restoration plan to the State of Washington in August 1998, which represented its second five-year review.

Energy Northwest has selected the external sinking fund method to provide the NRC the required financial assurance for funding Columbia decommissioning costs. Energy Northwest established a decommissioning fund for Columbia and funds are being deposited each year in accordance with an established funding plan. This funding plan was developed jointly by Energy Northwest and Bonneville. The plan continues to be based on the safe storage method of decommissioning. The NRC requires nuclear power reactor operators to adjust annually the estimated decommissioning costs of their nuclear facilities in order to ensure adequate funds are available for payment of decommissioning costs.

Energy Northwest's current estimate of Columbia decommissioning costs is approximately \$345 million (in 1999 dollars). This estimate is based on the NRC minimum amount required to demonstrate reasonable financial assurance for a boiling water reactor with the power level of Columbia. Additionally, site restoration requirements for Columbia are governed by the site certification agreements between Energy Northwest and the State of Washington and regulations adopted by the Washington Energy Facility Site Evaluation Council ("EFSEC"). Energy Northwest submitted a site restoration plan for Columbia that was approved by EFSEC on June 12, 1995. Energy Northwest's current estimate of Columbia's site restoration costs is approximately \$54 million (in 1999 dollars).

The current funding plan requires annual deposits through fiscal year 2024, the estimated end of commercial operation of Columbia. Approximately \$4.3 million was deposited during the fiscal year ended June 30, 2001. The plan for subsequent annual deposits calls for incremental increases of 4% per year. The plan assumes that such deposits will grow at a 2% real rate of return and that Columbia will be placed in an approximately 60-year safe storage until 2085, at which time decontamination and dismantlement will be completed. Over the life of the fund, deposits and the earnings related to the reinvestment thereof are expected to provide sufficient funds to cover the cash flow requirements to decommission Columbia. This plan will be re-examined every year and modified, if necessary, to assure that the projected fund balance complies with the then current estimates and NRC requirements. Payments to the decommissioning trust fund have been made since 1985 and the balance of cash and investment securities in the fund as of December 31, 2001 totaled approximately \$68.2 million. Since July 1990, these amounts have been held in an external decommissioning trust fund in accordance with NRC requirements.

On September 30, 1996, all the cash and investment securities held in the external decommissioning trust fund were transferred into a new external decommissioning trust fund to be administered by Bonneville. This transfer, approved by the Energy Northwest Executive Board and Bonneville, was accomplished to broaden the investment authority for the fund to include purchase of equity investments in addition to previously authorized fixed income investments.

### **Insurance**

Energy Northwest maintains a risk management and insurance program which incorporates a combination of self-insurance, commercial insurance and nuclear property and liability insurance. Energy Northwest's basic risk management philosophy is to pay normal and expected losses from revenues and to purchase insurance to cover catastrophic losses. Energy Northwest, as a licensee of the NRC, is subject to retrospective premiums for nuclear liability and property insurance. Claims relating to Columbia or Project 1 that are not covered by insurance are paid from revenues under the related Project Net Billing Agreements.

Commercial liability insurance is purchased to cover all Energy Northwest premises and operations. This insurance provides coverage for injury or damage arising from non-nuclear accidents or occurrences. Energy Northwest maintains nuclear insurance in accordance with regulatory and Energy Northwest risk management policies.

Nuclear liability insurance covers third party injury or damage arising out of a nuclear incident and is required under the Price Anderson Act, enacted in 1957 as an amendment to the Atomic Energy Act (as amended, "Price Anderson"). Price Anderson provides financial protection for the public in the event of bodily injury or property damage caused by a commercial nuclear incident. The law has been extended three times and is subject to renewal in August 2002.

In accordance with Price Anderson, the nuclear liability exposures of Columbia are covered through the purchase of commercial nuclear liability insurance. This policy carries a limit of \$200 million with no deductible and forms the primary layer of protection. The excess layer of protection above this amount is provided through a mandatory industry self-insurance program featuring an assessment provision to all licensed nuclear power reactors. This excess layer amount is just over \$9.33 billion, based on 106 licensed reactors, multiplied by a current maximum retrospective assessment of \$88.095 million per reactor, per any one nuclear incident. Therefore, the total public liability coverage available per incident is approximately \$9.54 billion. It is important to note

that in the event there is an incident triggering an assessment, the maximum annual deferred premium assessment would be \$10 million per incident. This assessment is payable under the Columbia Net Billing Agreements.

Bonneville purchases nuclear property insurance for Columbia with limits of \$500 million and a deductible of \$5 million. Bonneville also purchases excess insurance of \$2.25 billion, giving Energy Northwest and Bonneville total nuclear property limits of \$2.75 billion. Additionally, Bonneville purchases business interruption coverage which pays \$3.5 million per week, following a 12 week deductible period for the first year and then for the next 110 weeks, pays 80% of this amount for a maximum indemnification of \$490 million. The limits of liability and policy coverage for Columbia meet all legal requirements for a nuclear power production facility and are consistent with that purchased by other nuclear utilities relative to similar circumstances and exposures.

#### **PACKWOOD LAKE HYDROELECTRIC PROJECT**

Energy Northwest owns and operates Packwood, a hydroelectric generating facility with a nameplate rating of 27.5 megawatts. Packwood is located near the town of Packwood in Lewis County, Washington, approximately 75 miles south-southeast of Seattle, Washington. Packwood commenced operation in June 1964 and has generated an average of 92 million net kilowatt-hours annually since that time. The electric power produced by Packwood is sold to 12 utilities, which pay the costs of Packwood, including debt service on the Packwood Lake Hydroelectric Project Revenue Bonds (the "Packwood Bonds"). The power produced by Packwood is delivered to Bonneville in exchange for electric power, transmission and other services made available to the utilities. Packwood's Federal Energy Regulatory Commission ("FERC") operating license expires on February 28, 2010 and Energy Northwest expects to initiate the relicensing process in the year 2005. An agreement for the sale of Packwood's electrical generation to Bonneville through fiscal year 2001 was executed in April 1997. On July 1, 2001, this agreement was amended and its term was extended to October 1, 2002.

In 1998, Packwood became one of three regional generating projects chosen by Bonneville for the Environmental Foundation, made up of the Renewable Northwest Project, the Northwest Energy Coalition and the National Resource Defense Council. The environmental groups have teamed with Bonneville to market "green power" from Packwood and the other two projects. The power sales agreement with Bonneville for Packwood generation was amended in September 1998 to acknowledge Packwood as a "green power project" and reflect the premium Bonneville will pay for energy delivered and sold by Bonneville as a "green," renewable resource.

#### **NINE CANYON WIND PROJECT**

Energy Northwest is developing a wind turbine farm, capable of generating up to 50 megawatts of electricity. The wind turbine farm will be located on leased land, near Kennewick, Washington, and may include up to 39 wind turbines. The Energy Northwest Board of Directors formally approved the project in January 2001 and the public utility purchasers have executed the Nine Canyon Wind Project power purchase agreement. Each turbine will have a power generating capacity of 1,300 kilowatts. An engineer-procure-construct contract has been executed with Renewable Energy Systems (USA) Inc., a Delaware corporation. The turbines will be manufactured by BONUS Energy A/S, a Denmark corporation. In early November 2001, Energy Northwest issued approximately \$70.7 million of bonds to finance the acquisition, development and construction costs of the project. The project is a separate system of Energy Northwest and the bonds are secured by, and payable solely from, the revenues derived by Energy Northwest under the power purchase agreement. Under the power purchase agreement, the purchasers (which also include Columbia) will not be obligated to make any payments until and unless the project commences commercial operation. On and after the date of commercial operation for the term of the power purchase agreement, the purchasers will be required to pay their share of the annual budget of the project, which includes debt service on the related bonds, whether or not the project is operating or capable of operating. Energy Northwest has executed the Nine Canyon Wind Project power purchase agreement to acquire a portion of Nine Canyon Wind Project output for station use by Columbia. Construction of the project has begun and is currently estimated that the project will commence commercial operation in late 2002. Power costs for the project are expected to be in the range of 3.4 cents per kilowatt hour to 3.8 cents per kilowatt hour during the first five fiscal years of operation and would constitute an operating expense of Columbia. See "ENERGY NORTHWEST — Columbia Generating Station — Management Discussion of Operations" in this Official Statement.

#### **PROJECT 1**

Project 1 is a terminated, partially completed nuclear electric generating project located about 160 miles southeast of Seattle, Washington, on DOE's Hanford Reservation, approximately one and one-half miles east of Columbia. In May 1994, Energy Northwest's Board of Directors adopted a resolution terminating Project 1. The Project 1 Project Agreement and the Project 1 Net Billing Agreements ended upon termination of Project 1, except for certain provisions relating to billing and payment processes. See "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements — Payment Procedures — Terminated Projects" in this Official Statement. The Project 1 Post Termination Agreement also facilitates the administration, budgeting and payment processes post termination.

After termination, Energy Northwest proceeded to offer for sale assets in the form of uninstalled operating equipment and construction materials in light of the fact that there was no market for the sale of Project 1 in its entirety. Certain of these assets have been sold. Energy Northwest has reduced the assets to their estimated net realizable value and has accrued for the estimated cost of removal and site restoration. Energy Northwest has been planning for the demolition of Project 1 and restoration of the site. In addition to funding for the payment of debt service on Project 1 Net Billed Bonds, funding has continued for administrative efforts associated with asset sales and planning for the demolition and site restoration activities for Project 1. Sources of funding are derived through the Project 1 Net Billing Agreements and monies held in the Project 1 Construction Fund.

In April 2001, as a result of the significant energy shortages and price increases in the western region's power market, Energy Northwest was asked to study the viability of completing Project 1. The Washington PUD Association unanimously supported the funding of such a study in a letter to Bonneville and Energy Northwest. Energy Northwest and Bonneville believe that, in the context of the tight northwest energy supply, prudent utility practice calls for consideration of all possible sources of new generation that could help meet the region's demand for electricity. Energy Northwest and Bonneville agreed to fund this study.

With agreement by Bonneville, Energy Northwest initiated the study in April 2001. The study scope consists of three phases:

- Phase 1 – A cost-to-complete estimate and schedule by Bechtel Corporation (“Bechtel”) and Framatone ANP plus operation and maintenance cost estimates and various analyses by Energy Northwest.
- Phase 2 – Review of the phase 1 results plus a market forecast and assessment, a comparison of alternatives and sensitivity analyses by R.W. Beck.
- Phase 3 – A region-wide independent review of the results of phases 1 and 2 and an assessment of the highest and best use of Project 1 to the Pacific Northwest as a whole.

Bechtel completed its work in late July 2001. R.W. Beck's report was provided in October 2001. The preliminary results indicate:

- The material condition of Project 1 is excellent and there are no known technical reasons that would prevent completion.
- Cost to complete, excluding interest during construction, is estimated at \$2.9 billion with completion in about six years. These estimates are considered very conservative.
- First year production costs would be over 51 mills per kilowatt-hour. This cost is higher than combined cycle combustion turbine costs under estimated gas price scenarios.
- The base [“public finance”] case demonstrates a positive net present value over the life of the plant of \$1.8 billion with an investment payback by year 23.

In October 2001, the Executive Board of Energy Northwest decided that completion of Project 1 construction, if any, would be carried out by Energy Northwest with a partner or by some other entity.

With that in mind, Energy Northwest signed a contract with the firm of Goldschmidt Imeson to perform the following work:

- Review the Bechtel and RW Beck portions of the study and discuss the technical, economic, and political conclusions with the Executive Board.
- Based on that review and discussion with the Executive Board, engage in a series of discussions and interviews with energy companies, federal and state governmental officials, and the regional Congressional delegation to determine the best use of Project 1, with careful consideration for the region's needs.
- After completing the foregoing, develop an outline of options for the future of Project 1, including identification of potential partnerships for those options, and present the information to the Executive Board.

Work by Goldschmidt Imeson began December 15, 2001 and is expected to be completed by April 15, 2002.

### **PROJECT 3**

Project 3 is a terminated, partially complete nuclear electric generating project located in southeastern Grays Harbor County, Washington, approximately 70 miles southwest of Seattle, Washington. In May 1994, Energy Northwest's Board of Directors adopted a resolution requesting the termination of Project 3. Project 3 was terminated in June 1994. The Project 3 Project Agreement and the Project 3 Net Billing Agreements ended upon termination of Project 3, except for certain provisions relating to billing and payment processes. See “SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements — Payment Procedures — Terminated Projects” in this Official Statement. The Project 3 Post Termination Agreement also facilitates the administration, budgeting and payment processes post termination.

After termination, Energy Northwest proceeded to offer for sale assets in the form of uninstalled operating equipment and construction materials in light of the fact that there was no market for the sale of Project 3 in its entirety. During 1995, a group from Grays Harbor County, Washington, interested in local economic development, formed the Satsop Redevelopment Project. The Satsop Redevelopment Project is a coalition of governments established by inter-local agreement between Grays Harbor County, the Port of Grays Harbor and Public Utility District No. 1 of Grays Harbor County. Legislation introduced by the Satsop Redevelopment Project and adopted into law by the State of Washington on March 7, 1996, authorized the transfer of the site properties and facilities to the local public agencies for purposes of economic development.

Energy Northwest determined that the transfer of ownership would result in significant cost savings to Energy Northwest and Bonneville. The degree of Energy Northwest site restoration responsibilities would also be significantly reduced with the transfer of regulatory authority to another entity. On October 22, 1998, Energy Northwest's Board of Directors authorized the execution of the Ownership Transfer Agreement entered into among Energy Northwest and the investor-owned utility owners of Projects 3 and 5, which transferred substantially all of the assets of the Project 3 site. Consequently, Energy Northwest had full authority to transfer all of the assets of the Project 3 site.

An agreement for the transfer of the Project 3 site (other than the Satsop CT site) and infrastructure was negotiated with the Satsop Redevelopment Project and signed on February 26, 1999. This transfer agreement included payment of \$26 million by Energy Northwest to the Satsop Redevelopment Project. Energy Northwest's estimate of total costs for the transfer were significantly less than the then current estimates for site restoration of Projects 3 and 5 of \$36 million and \$14 million, respectively. Funding for Project 3 continues for payment of debt service on Project 3 Net Billed Bonds from revenues derived through the Project 3 Net Billing Agreements.

## **PROJECTS 4 AND 5**

Projects 4 and 5 were terminated in January 1982. The Project 4/5 Bonds went into default on July 22, 1983. Subsequent to extended litigation and ultimate settlement, all trusts created under the resolution authorizing the Project 4/5 Bonds were terminated and Energy Northwest and the trustee under said resolution were released from all of their obligations thereunder.

## **SITE RESTORATION OF PROJECTS 1, 3, 4 AND 5**

Site restoration requirements for Projects 1, 3, 4 and 5 are governed by site certification agreements between Energy Northwest and the State of Washington and regulations adopted by EFSEC and additionally for Projects 1 and 4, a lease agreement with DOE. Energy Northwest submitted a site restoration plan to EFSEC on March 8, 1995, which complied with EFSEC requirements to remove the assets and restore the sites by demolition, burial, entombment or other techniques such that the sites pose minimal hazard to the public. EFSEC conditionally approved the site restoration plan on June 12, 1995. Such approval recognized that there was uncertainty associated with Energy Northwest's proposed plan. Accordingly, EFSEC's approval provided for additional reviews once the details of the plan are finalized.

### **Restoration of Projects 1 and 4 Site**

In May 1998, Energy Northwest and EFSEC started focused discussion of restoration of the Projects 1 and 4 site when it became apparent that there would be a successful transfer of ownership of the Satsop Site. EFSEC proposed that Energy Northwest amend the site certification agreement for Projects 1 and 4 to update its site restoration plan that was conditionally approved by EFSEC in 1995. Energy Northwest updated and submitted a revised site restoration plan in June 1999.

In February 1999, a group from the local area expressed interest in the potential redevelopment of the Projects 1 and 4 site. An inter-local agreement between the Port of Benton, Benton County, Public Utility District No. 1 of Benton County, the City of Richland, Washington and Energy Northwest established the Benton Redevelopment Initiative ("BRI"). Legislation introduced by BRI and adopted into law by the State of Washington in March 2000 authorized the transfer of the Projects 1 and 4 site to BRI. In June 2000, the City of Richland and Energy Northwest withdrew from the Benton Redevelopment Initiative inter-local agreement; however, Energy Northwest continues to provide administrative and management support.

In late 1999, BRI sponsored a study to review the issues, critical elements requiring resolution and the marketplace for possible reuse of the Projects 1 and 4 site. Based on this review, which was completed in April 2000 and found no fatal flaws for potential reuse, BRI developed a more detailed plan and approach for determining the necessary information to proceed. This second study was completed on July 31, 2001 and determined a realistic build-out scenario, a conceptual development plan, a business plan and an assessment of the attendant risks. Among the principal conclusions of the study was the recommendation that the final "end state" condition result be established by DOE with an associated restoration plan and assignment of restoration responsibility. In January 2002, BRI notified Bonneville that it would await resolution of these issues before further considering possible redevelopment. In November, DOE formally identified a preferred restoration end state for both the Project 1 and Project 4 facilities. Energy Northwest, Bonneville, DOE and EFSEC are now working to further define common restoration requirements and responsibilities for addressing the restoration requirements and the potential transfer of the property for possible reuse.

Physical restoration activities are also currently underway. Special authorization was received from DOE and EFSEC to store the cooling tower asbestos transite material in an onsite landfill. A landfill located on the site was prepared to accept this material. This transite removal process commenced in late 2000 and was completed in the fall of 2001. At completion, approximately 28,000 cubic yards of concrete asbestos material were deposited into the landfill in four lifts. The stored material is permanently covered with approximately two feet of cover and has been marked to prevent any future disturbance.

Energy Northwest has recorded accrued liabilities of \$64 million for Project 1 site restoration based on previous estimates. Energy Northwest believes that although Project 1 has no legal obligation to fund Project 4, it is possible that claims may be asserted against Project 1 to pay the costs of site restoration of Project 4. Under terms of prior settlements among all parties with interests in Projects 1 and 4, consolidation of Projects 1 and 4 may occur should Bonneville and Energy Northwest elect to do so. Should this occur, costs for site restoration for both Projects 1 and 4 will be borne by Project 1. Energy Northwest continues to estimate that the cost of site restoration for Project 4 will be approximately \$39 million.

### **Restoration of Projects 3 and 5 Site**

For a discussion of recent events concerning the Projects 3 and 5 site see “ENERGY NORTHWEST — Project 3” and “— Possible Future Energy Northwest Projects.”

### **HANFORD GENERATING PROJECT**

Energy Northwest owns HGP, which is located on DOE’s Hanford Reservation, approximately 140 miles southeast of Seattle, Washington. HGP was an 860 megawatt plant that operated from April 1966 through January 1987 and generated 65.9 billion kilowatt-hours of electricity.

Preservation of HGP physical assets was discontinued in September 1993. In 1997, Energy Northwest attempted to meet its restoration obligation and negotiate a transfer of the HGP facilities to DOE. These negotiations were unsuccessful and Energy Northwest initiated activities to remove and dispose of the facilities and equipment. Energy Northwest and DOE have reached agreement in principle concerning DOE’s liability for radioactive contamination and its related impacts on the HGP site restoration and the payment of costs for such restoration. DOE is continuing to reimburse Energy Northwest for all cost impacts related to the radioactive contamination of the piping and equipment until the formal agreement is completed.

Completed activities include the removal and disposal of all exterior asbestos, the removal and disposal of all uncontaminated asbestos insulation from interior piping and equipment, the removal and disposal of transformers and transmission towers, and the removal and disposal of all external piping and equipment. In 2001 environmental cleanup activities were initiated to prepare for final site demolition and restoration. Completed activities include outboard drain pond radioactive soil cleanup, underground fuel oil storage tank cleanup, cleanup of soil contamination areas in the storage yard, and PCB soil contaminated cleanup in the transformer yard.

Activities are currently underway to remove the river intake pumphouse and outfall structures and begin the final demolition and restoration phase in 2002.

All basic administrative costs incurred from September 1993 through June 1999 were paid from monies held in the HGP Revenue Fund and all such costs subsequently incurred and to be incurred in the future have been and will be paid from monies held in the Project 1 Revenue Fund.

### **OTHER ACTIVITIES**

#### **Satsop CT**

In 1990, the Board of Directors of Energy Northwest voted to study the siting of a combustion turbine power plant at the Projects 3 and 5 site. Beginning in 1992, Energy Northwest submitted a series of proposals to Bonneville in response to Bonneville’s solicitations for new generating resources. In June 1993, Bonneville notified Energy Northwest that Energy Northwest’s combustion turbine, known as the Satsop CT, was selected as one of three combustion turbine power plants to be designed and permitted and held as an “option” under Bonneville’s Resource Contingency Program. All required environmental studies and permit applications for two combustion turbine power plant units and all state and federal permits and environmental impact statements had been approved or obtained.

During 2000, because of a shortage of power on the West Coast, several energy companies approached Energy Northwest about purchasing the Satsop CT site. In response to Energy Northwest’s solicitation of proposals, Duke Energy Grays Harbor LLC (“Duke Grays Harbor”), an unregulated subsidiary of Duke Energy, submitted a proposal that was approved by Energy Northwest’s Executive Board on January 3, 2001. The purchase agreement with Duke Grays Harbor, signed on January 11, 2001, provides for Energy Northwest to receive \$10 million in payment for the site or, in the alternative, \$5 million if it successfully negotiates a contract with Duke Grays Harbor to operate the first 500 megawatt natural gas-fired power plant to be completed on the site. The agreement also provides Energy Northwest with various other options, including an option to purchase up to 50 megawatts of electricity generated from the plant for five years at the cost of production and an option to participate in a second combustion turbine power plant that Duke Grays Harbor may construct at the site. Energy Northwest has been retained to operate the first power plant on the site for an initial period of five years and has received the \$5 million payment. At the option of Duke Grays Harbor, this initial period may be extended for two additional five-year periods. Under the contract, the maximum liability of Energy Northwest is limited to the net income received from Duke Grays Harbor for the preceding 12-month period, with an aggregate liability of up to \$1 million for the term of the contract.

### **THE BONNEVILLE POWER ADMINISTRATION**

The information in this section has been furnished to Energy Northwest by Bonneville for use in this Official Statement. Such information is not to be construed as a representation by or on behalf of Energy Northwest or the Underwriters. While Energy Northwest believes that the information in this section is reliable, Energy Northwest has not independently verified such information and does not guarantee the accuracy or completeness of such information. Energy Northwest, however, has no reason to believe that such information is not accurate or complete. At or prior to the time of delivery of the Series 2002-A Bonds, Bonneville will certify to Energy Northwest that the information in this section, as well as information pertaining to Bonneville contained elsewhere in this Official Statement, is true and correct and does not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements in this section and elsewhere in this Official Statement pertaining to Bonneville, in light of the circumstances under which they were made, not misleading.



## GENERAL

Bonneville was created by an act of Congress in 1937 to market electric power from the Bonneville Dam located on the Columbia River and to construct facilities necessary to transmit such power. Congress has since designated Bonneville to be the marketing agent for power from all of the federally-owned hydroelectric projects in the Pacific Northwest. Bonneville, whose headquarters are located in Portland, Oregon, is one of four regional federal power marketing agencies within the DOE. Many of Bonneville's statutory authorities are vested in the Secretary of Energy, who appoints, and acts by and through, the Bonneville Power Administrator. Some other authorities are vested directly in the Bonneville Power Administrator.

Bonneville's primary enabling legislation includes the following federal statutes: the Bonneville Project Act of 1937 (the "Project Act"); the Flood Control Act of 1944 (the "Flood Control Act"); Public Law 88-552 (the "Regional Preference Act"); the Federal Columbia River Transmission System Act of 1974 (the "Transmission System Act"); and the Northwest Electric Power Planning and Conservation Act of 1980 (the "Northwest Power Act"). Bonneville now markets electric power from 30 federally-owned hydroelectric projects, most of which are located in the Columbia River Basin, and from several non-federally owned and operated projects including the Columbia Generating Station. Bonneville sells, purchases and exchanges firm power, non-firm energy, peaking capacity and related power services. Bonneville also constructed and operates and maintains a high voltage transmission system comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest. Bonneville uses this transmission capacity to deliver power to its customers and makes transmission capacity available to other utilities and power marketers.

Bonneville's primary customer service area is the Pacific Northwest. Bonneville estimates that the population of the 300,000 square-mile service area is approximately ten million people. Electric power sold by Bonneville accounts for about 45% of the electric power consumed within the Region. Bonneville markets the majority of this power to over 100 publicly-owned and cooperatively-owned utilities ("Preference Customers") for resale to consumers in the Region. Bonneville also has contracts to sell significant amounts of power for direct consumption to about eight companies to serve 14 separate industrial facilities ("Direct Service Industries" or "DSIs") located in the Region.

The Transmission System Act placed Bonneville on a self-financing basis, meaning that Bonneville pays its costs from revenues it receives from the sale of power and the provision of transmission and other services, which Bonneville provides at rates that seek to produce revenues that recover Bonneville's costs, including certain payments to the United States Treasury. Bonneville's rates for the foregoing services are subject to approval by the Federal Energy Regulatory Commission ("FERC") on the basis that, among other things, they recover Bonneville's costs. See "MATTERS RELATING TO THE POWER AND TRANSMISSION BUSINESS LINES — Bonneville Ratemaking and Rates." Bonneville may also issue and sell bonds to the United States Treasury and use the proceeds thereof to fund certain activities established under Federal law.

In 1996, after certain national regulatory initiatives to promote competition in wholesale power markets were announced, Bonneville separated its power marketing function from its transmission system operation and electric system reliability functions. Bonneville remains a single legal entity, but it now conducts its business as separate business lines: the "Power Business Line" and the "Transmission Business Line." See "TRANSMISSION BUSINESS LINE — Non-discriminatory Transmission Access and Separation of the Business Lines."

Bonneville's cash receipts from all sources, including from both its transmission and power-marketing business lines, must be deposited in the Bonneville Fund, which is a separate fund within the United States Treasury and which is available to pay Bonneville's costs. In accordance with the Transmission System Act, Bonneville must make expenditures from the Bonneville Fund as "shall have been included in annual budgets submitted to Congress, without further appropriation and without fiscal year limitation, but within such specific directives or limitations as may be included in appropriation acts, for any purpose necessary or appropriate to carry out the duties imposed upon [Bonneville] pursuant to law."

Bonneville is required to make certain annual payments to the United States Treasury. These payments are subject to the availability of net proceeds, which are gross cash receipts remaining in the Bonneville Fund after deducting all of the costs paid by Bonneville to operate and maintain the Federal Columbia River Power System (the "Federal System") other than those used to make payments to the United States Treasury for: (i) the repayment of the federal investment in certain transmission facilities and the power generating facilities at federally-owned hydroelectric projects in the Pacific Northwest; (ii) debt service on bonds issued by Bonneville and sold to the United States Treasury; (iii) repayments of appropriated amounts to the Corps and the Bureau for certain costs allocated to power generation at federally-owned hydroelectric projects in the Pacific Northwest; and (iv) costs allocated to irrigation projects as are required by law to be recovered from power sales. Bonneville met its fiscal year 2001 payment responsibility to the United States Treasury of \$729 million in full and on time. For more information, see "BONNEVILLE FINANCIAL OPERATIONS — Order in Which Bonneville's Costs Are Met."

For various reasons, Bonneville's revenues from the sale of electric power and other services may vary significantly from year to year. In order to accommodate such fluctuations in revenues and to assure that Bonneville has sufficient revenues to pay the costs necessary to maintain and operate the Federal System, all cash payment obligations of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses, have priority over payments by Bonneville to the United States Treasury. In the opinion of Bonneville's Acting General Counsel, under federal statutes Bonneville may make payments to the United States Treasury only from net proceeds; all cash payments of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses, have priority over payments by Bonneville to the United States Treasury for the costs described in (i) to (iv) above.

## **RECENT DEVELOPMENTS IN THE ELECTRIC UTILITY INDUSTRY AND BONNEVILLE'S COMPETITIVE POSITION**

### **Power Market Developments**

For much of its history, Bonneville had a high degree of certainty that its revenues from power and transmission services would be sufficient to recover all of its costs without concern for substantial price competition from other suppliers. In the mid-1990's, competition increased in the wholesale electricity industry. Bonneville was particularly affected because its business, both power marketing and the provision of bulk transmission, is primarily wholesale. This increase in competition was due to a number of factors, including electric power deregulation advanced under the National Energy Policy Act of 1992 ("EPA-1992").

In fiscal year 1996 the wholesale market price for electric power became equal to or slightly below Bonneville's industrial firm power rate for DSIs ("IP rate") and priority firm power rate for Preference Customers ("PF rate"). The emerging competitive wholesale electric power market and the availability of lower cost alternative supplies prompted some Bonneville customers at that time to adopt supply diversification strategies to meet greater portions of their loads from sources other than Bonneville.

Beginning in the spring of 2000 through June 2001, West Coast electric power prices in general and Pacific Southwest electric power prices in particular increased significantly over prior periods and Pacific Southwest natural gas prices increased with natural gas prices nationally. Natural gas prices can affect the market price of electric power on the West Coast because a large portion of the electric generating capacity of the area is fueled by natural gas.

In calendar year 2000, Bonneville projected that electric power market prices in fiscal years 2002-2006 would be in the low-30 mills per kilowatt hour range. However, West Coast market prices for electric power from the spring of 2000 through June 2001 reached unprecedented highs. Bonneville estimates that Pacific Northwest power market prices for energy over the twelve-month period January 1 to December 31, 2000, nearly tripled and in some instances, on-peak winter time prices were in excess of 30 times greater than Bonneville's projections of average prices in the year 2000.

During this time of unprecedented volatility in western power markets, Bonneville and its Regional customers agreed to new long-term power sales and related contracts for the period beginning October 1, 2001, under the Subscription Strategy as described herein. Among other things, the Subscription Strategy defined the Regional loads Bonneville would meet. In connection with the Subscription Contracts, Bonneville also developed proposed power rates therefor. In June 2001, Bonneville filed with FERC a final power rate proposal (the "June 2001 Final Power Rate Proposal") for the five-year period beginning October 1, 2001. Under the June 2001 Final Power Rate Proposal, Bonneville has initially increased rate levels for Regional power sales contract obligations by roughly 46% over rate levels in effect for similar service in fiscal year 2001. Bonneville determined that this increase was necessary to recover the aforementioned, unanticipated high costs of purchasing power to meet increased loads in the five years beginning October 1, 2001.

Since about July 2001, and after the entry by Bonneville and its Regional customers into the Subscription Contracts and the June 2001 Final Power Rate Proposal, the price of electricity in the West Coast power market has fallen. Bonneville believes that the main factors for this appear to have been mild weather, a slowing economy, lower gas prices and a regional price cap imposed by FERC in June 2001. In view of the foregoing developments, Bonneville now anticipates an electric power market with near-term (fiscal years 2002-03) prices in the 23.50 mills per kilowatt hour range and longer-term (fiscal years 2004-06) prices in the 27.75 mills per kilowatt hour range, in each case without transmission. In view of the falling prices in the Western energy markets, Bonneville's Subscription rates are now above both current market price levels and Bonneville's forecast of near-term price levels. Under current internal forecasts, Bonneville believes that its Subscription rates on average through fiscal year 2006 could be equal to or slightly above market prices for such period. Such belief is based on market and rate forecasts that are subject to many variables most of which are not within Bonneville's control. Bonneville cannot assure that such forecasts will be realized.

### **Subscription Strategy And Power Rates After Fiscal Year 2001**

All of Bonneville's in-Region sales contracts with Preference Customers, long-term power sales contracts with DSIs and settlements under the Residential Exchange Program, each as described herein, expired at or slightly before the end of fiscal year 2001. In December 1998, Bonneville issued a "Subscription Strategy" outlining Bonneville's approach to power marketing after fiscal year 2001. In accordance with the Subscription Strategy and after indications by Bonneville of the rates at which it expected to sell Subscription power, Bonneville entered into five- and ten-year power sales contracts that commenced as of October 1, 2001, with 135 Regional Preference Customers, eight DSI companies (for power sales to 14 separate industrial facilities) and all six of the Regional investor-owned utilities ("Regional IOUs") to whom Bonneville is required by law to provide Residential Exchange Program benefits.

The aggregate power sales commitment undertaken by Bonneville under these agreements increases from roughly 6400-6600 average megawatts at the beginning of fiscal year 2002 to roughly 8300-8600 average megawatts in fiscal years 2004 through 2006. In order to meet the load requirements under the Subscription contracts and approximately 2200 average megawatts of certain pre-existing surplus firm power sales and related obligations, about half of which expire during the 2002-2006 rate period, Bonneville will rely primarily on existing Federal System resources. However, Bonneville also expects that it may have to augment Federal System output with additional purchases of electric power from other systems or resources. Bonneville has entered into a number of such power purchase agreements but believes that it may need to make further purchases to increase the firm power capability of the Federal System by potentially up to an additional 2000 average megawatts during the later years of the five-year rate period. Bonneville believes, given current and forecasted aluminum prices and DSI rate levels, that it is increasingly unlikely that aluminum company DSIs in aggregate will require their full contracted power sales obligation after the current fiscal year, which

could thereby reduce Bonneville's need to make additional augmentation purchases of power. Nonetheless, there remains some possibility that DSIs will require the full contracted power sales obligation and Bonneville would be required to provide such power.

In 2000, Bonneville proposed initial base power rates for Subscription and certain other power sales for the five-year period beginning October 1, 2001. The base rates proposed by Bonneville are between approximately 19.3 mills per kilowatt hour and 23.0 mills per kilowatt hour (excluding transmission), depending on type of service. The base rates are at levels similar to those in effect for like service in the immediately preceding rate period.

In view of the prospect of higher costs to meet then expected Subscription loads, Bonneville subsequently proposed in its June 2001 Final Power Rate Proposal a Load-Based Cost Recovery Adjustment Clause ("LB-CRAC"), the effect of which is semi-annual adjustments to rate levels, which adjustments are tied to the cost of augmentation purchases of electric power to meet Subscription loads. Under the proposed LB-CRAC, Bonneville increased rate levels for the first six months of the rate period by 46% over both the base rates for the rate period and, coincidentally, the rates for like service in the preceding rate period. Thus, power rate levels for the initial six-month period are between roughly 28 mills per kilowatt hour and 34 mills per kilowatt hour, excluding transmission and depending on type of service. On February 14, 2002, Bonneville notified its customers that the LB-CRAC adjustment would decline for the six month period beginning April 1, 2002. The reduction in the LB-CRAC will lower overall rate levels by about 1-2 mills per kilowatt hour to between roughly 27 mills per kilowatt hour and 33 mills per kilowatt hour, excluding transmission and depending on type of service, during the six months beginning April 1, 2002. The next LB-CRAC adjustment is scheduled to be determined in August 2002.

In addition, the rate design in the June 2001 Final Power Rate Proposal allows for a Financial-Based Cost Recovery Adjustment Clause ("FB-CRAC"), which, if triggered, would result in one-year adjustments in rate levels in addition to the LB-CRAC. As proposed, the FB-CRAC would increase rate levels to obtain limited amounts of revenues in a fiscal year if Bonneville's third quarter forecast in the preceding year indicates that financial reserves (as measured by accumulated net revenues) will be below identified levels. The FB-CRAC is proposed to be available to increase revenues, if necessary, by up to \$135 million per year in fiscal year 2002, increasing annually to \$175 million in fiscal year 2006. While the June 2001 Final Power Rate Proposal includes provisions that would make the FB-CRAC potentially available in fiscal year 2002, Bonneville determined that it would have adequate accumulated net revenues at the end of fiscal year 2001 to avoid using the FB-CRAC in fiscal year 2002. As described below, the FB-CRAC may be triggered for fiscal year 2003.

FERC granted interim approval of the June 2001 Final Power Rate Proposal in an order issued on September 28, 2001. For a more detailed description of Bonneville's proposal for power rates applicable to Subscription power sales, see "POWER BUSINESS LINE — Certain Statutes and Other Matters Affecting Bonneville's Power Business Line — Power Marketing Plan for the Period After Fiscal Year 2001 — Subscription Power Rate Proposal."

#### **Bonneville's Fiscal Year 2002 Financial Condition**

Generally, a substantial portion of Bonneville's power sales revenues are derived from the sale of seasonal surplus hydroelectric energy. Bonneville's June 2001 Final Power Rate Proposal for the five years beginning October 1, 2001 is based on certain assumptions regarding expected revenues from the sale of seasonal surplus energy. In making seasonal surplus energy revenue projections to support the June 2001 Final Power Rate Proposal, Bonneville assumed average water conditions and used price forecasts finalized in May 2001, at a time when prevailing West Coast market prices for electric power were about \$200 per megawatt hour. Bonneville's rate case projections assumed that the average price it would receive in fiscal year 2002 for seasonal surplus sales would be about \$57 per megawatt hour. While early forecasts of precipitation in the Columbia River Basin are for near average water conditions in the current fiscal year, prevailing West Coast power prices are about \$20 per megawatt hour.

Although surplus energy prices are highly uncertain and volatile, Bonneville now expects that its revenues from seasonal surplus energy sales revenues for fiscal year 2002 may be about \$500 million less than forecasted in the June 2001 Final Power Rate Proposal. In addition, transmission revenues may be somewhat lower than forecasted earlier this fiscal year primarily as a result of lower than expected transmission usage.

In response, Bonneville is reducing costs and taking other actions to increase revenues in the current fiscal year. Bonneville believes that these corrective actions will assure a high probability of making its annual payments to the U.S. Treasury in full. If current conditions persist, the reduction in expected seasonal surplus energy and transmission revenues, as partially offset by cost reductions, revenue enhancements and certain financial benefits to Bonneville from being able to purchase power at lower than anticipated power prices, could result in Bonneville's (i) having negative net revenues of up to \$250 million in fiscal year 2002 and (ii) ending fiscal year 2002 with financial reserve levels of between \$150 million and \$350 million (assuming full payment to the U.S. Treasury of current scheduled obligations and certain planned early repayments and amortization of some of Bonneville's U.S. Treasury debt at the end of fiscal year 2002). By contrast, Bonneville ended fiscal year 2001 with financial reserves of about \$625 million.

Bonneville is continuing to examine the effects of continued low market prices for electricity. If they continue, there is an increasing likelihood that Bonneville will invoke the FB-CRAC beginning in fiscal year 2003. As noted above, the FB-CRAC triggers in a fiscal year when Bonneville's net revenues in the prior fiscal year are projected to be below certain thresholds. If the FB-CRAC were to trigger, Bonneville could increase power revenues by up to about \$130 million in fiscal year 2003. Bonneville will determine whether and the extent to which to increase rates under the FB-CRAC in August 2002.

While uncertainty exists, Bonneville's power purchase costs for augmenting its supply to meet contracted Subscription loads through fiscal year 2002 are declining and Bonneville expects them to continue to decline in fiscal year 2003 as well. These

augmentation costs are recovered through the LB-CRAC and, as a consequence, LB-CRAC levels fluctuate with resource augmentation costs. Bonneville currently believes that expected declines in the LB-CRAC levels through fiscal year 2003 may roughly offset rate level increases under a fully implemented FB-CRAC in fiscal year 2003.

At this time, Bonneville does not expect to utilize the Safety Net Cost Recovery Adjustment Clause (“SN-CRAC”); nonetheless, it remains available as a means for Bonneville to raise power rates if Bonneville projects that it has greater than a fifty percent likelihood that it will be unable to meet a payment responsibility to the U.S. Treasury or other party. The SN-CRAC is described more fully in “POWER BUSINESS LINE – Certain Statutes and Other Matters Affecting Bonneville’s Power Business Line – Power Marketing Plan for the Period After Fiscal Year 2001 – Subscription Power Rate Proposal.”

#### **Certain Other Developments Relating To Parties with Whom Bonneville Has Electric Power Transactions.**

Bonneville has numerous contracts in effect with electric power marketers, utilities and other entities that engage in electric power markets. Some of these entities have experienced serious financial difficulties. For a discussion of the effect on Bonneville of power market developments in California see “POWER BUSINESS LINE – Customers and Other Power Contract Parties of Bonneville’s Power Business Line – Effect On Bonneville Of Developments In California Power Markets.” For a discussion of the effect on Bonneville of the Enron bankruptcy filing see “POWER BUSINESS LINE – Customers and Other Power Contract Parties of Bonneville’s Power Business Line – Enron Bankruptcy.”

### **POWER BUSINESS LINE**

#### **Description of the Generation Resources of the Federal System**

##### *Generation*

Bonneville has statutory obligations to meet certain electric power loads placed on it by certain Regional customers. See “— Certain Statutes and Other Matters Affecting Bonneville’s Power Business Line — Bonneville’s Obligation to Meet Certain Firm Power Requirements in the Region.” To meet these loads Bonneville relies on an array of power resources and power purchases, which, together with the Bonneville-owned transmission system and certain other features, constitute the Federal System. The Federal System includes those portions of the federal investment in the Regional hydroelectric projects that have been allocated to power generation. Such projects were constructed and are operated by the Corps or the Bureau. The Federal System also includes power from non-federally-owned generating resources, including but not limited to the Columbia Generating Station and contract purchases from other power suppliers.

##### *Federal Hydro Generation*

Hydropower from federally-owned hydroelectric projects currently supplies approximately 67% of Bonneville’s firm power supply. Bonneville also acquires power from three small non-federally-owned hydroelectric projects. Bonneville’s large resource base of hydropower results in operating and planning characteristics that differ from those of major utilities that lack a substantial hydropower base. See the table entitled “Operating Federal System Projects for Operating Year 2002.”

The amount of electric power produced by a hydropower-based system such as the Federal System varies with annual precipitation and weather conditions. This variability has led Bonneville to classify power it has available into two types, firm power and seasonal surplus energy (as described below) based on certainty of occurrence.

Bonneville defines “firm power” as electric power that is (i) continuously available from the Federal System even during the most adverse water conditions, and (ii) useful for meeting Federal System firm loads. The amount of firm power that can be produced by the Federal System and marketed by Bonneville is based on “critical water” assumptions, *i.e.*, the worst low-water period on record for the Columbia River Basin. Firm power can be relied on to be available when needed. Firm power has two components: peaking capacity and firm energy. Peaking capacity refers to the generating capability to serve particular loads, at the time such power is demanded. This is distinguishable from firm energy, which refers to an amount of electric energy that is reliably generated over a period of time. Bonneville estimates that in Operating Year 2002, the Federal System, including firm energy purchases, is capable of producing about 10,000 average megawatts of firm energy.

The Federal System is primarily a hydropower system in which the peaking capacity exceeds Federal System peaking loads and power reserve requirements. Bonneville estimates that in most months its peaking capacity, for long-term planning purposes, will exceed its requirements for the next ten years. Bonneville expects this excess of peaking capacity to persist, because most of the resources added to meet firm energy needs will also contribute more peaking capacity. As a result, Bonneville’s resource planning focuses on the need to develop sufficient firm energy resources to meet firm energy loads. In contrast, most utilities with coal-, gas-, oil- and nuclear-based generating systems must focus their resource planning on having enough peaking capacity to meet peak loads.

While Bonneville markets most of its energy on a firm basis, the amount of energy that the Federal System can produce varies from period to period and depends on a number of factors, including weather conditions, streamflows, storage conditions, flood control needs, and fish and wildlife requirements.

The energy that Bonneville has to market above critical water assumptions in a specified period is referred to as seasonal surplus energy. The amount of seasonal surplus energy generated by the Federal System depends primarily on precipitation and reservoir storage levels, thermal plant performance (the Columbia Generating Station), and other factors. In an average (median) water year, the Federal System would generate seasonal surplus energy in some months of about 1,700 annual average megawatts, while in wet years the amount of such energy available may average in some months as much as 4,100 annual average megawatts. In dry years, the amount of seasonal surplus energy generated by the Federal System could be quite small.

Under the Slice of the System contracts for the ten years beginning October 1, 2002, Slice customers purchased from Bonneville, for their requirements, an aggregated 22 percent proportionate interest of the output of the Federal System. This purchase includes what would otherwise be seasonal surplus energy from the Federal System in the same proportion. See “Power Business Line—Power Marketing Plan for the Period After Fiscal Year 2001—Preference Customer Loads.”

The Corps and the Bureau operate the federally-owned hydroelectric projects in the Region to serve multiple statutory purposes. These purposes may include flood control, irrigation, navigation, recreation, municipal and industrial water supply, fish and wildlife protection and power generation. Non-power purposes have placed requirements on operation of the reservoirs and have thereby limited hydropower production. Bonneville takes into account the non-power requirements and other factors in assessing the amount of power it has available to market from these projects.

These requirements change the shape, availability and timeliness of Federal hydropower to meet load. The information in the following table reflects the biological opinions (and supplements thereto) issued with respect to the Federal System beginning in 1995, including the 2000 Biological Opinion and a biological opinion issued by FWS, both of which were issued in December 2000. As new biological opinions and similar constraints are introduced to the hydropower system, those changes will be reflected in the availability of Federal hydropower under all water conditions. See “—Certain Statutes and Other Matters Affecting Bonneville’s Power Business Line—Fish and Wildlife.”

#### *Other Generating Resources*

The balance of the Federal System includes, among other resources, nuclear power from the Columbia Generating Station. The Columbia Generating Station has the largest capacity for energy production of the non-federal resources. In addition, Bonneville has a number of power purchase contracts that are not tied to specific generating resources. The amount of power purchased under these contracts has increased substantially from prior years as Bonneville has used such contracts to obtain electric power needed to meet the increased loads taken on by Bonneville under the Subscription Strategy.

#### *Operating Federal System Projects For Operating Year 2002*

In all years, the energy generating capability of the Federal System’s hydroelectric projects depends upon the amount of water flowing through such facilities, the physical capacity of the facilities and stream flow requirements pursuant to biological opinions, and other operating limitations. Bonneville utilizes a fifty-year record of river flows based on the period from 1929-1978 for planning purposes. During this historical period, low water conditions (“Low Flows”) occurred in 1936-37, median water conditions (“Median Flows”) occurred in 1957-58 and high water conditions (“High Flows”) occurred in 1973-74. Bonneville estimates the energy generating capability of Federal System hydroelectric projects in an Operating Year (August 1 to July 30) by assuming that these historical water conditions were to occur in that Operating Year and making adjustments in the expected generating capability to reflect the current physical capacity operating limitations and current stream flow requirements. Energy generation estimates are further refined to reflect factors unique to the subject Operating Year such as initial storage reservoir conditions.

The following table shows, for Operating Year 2002, the Federal System January capacity (“Peak Megawatts” or “Peak MW”) and energy capability using Low Flows, Median Flows and High Flows. The same forecasting procedures are also used for non-federally-owned hydroelectric projects. Thermal projects, the output of which does not vary with river flow conditions, are estimated using current generating capacity and assumed plant capacity factors.

**Operating Federal System Projects For Operating Year 2002<sup>(1)</sup>**

Project	Initial Year in Service	No. of Generating Units	January Capacity (Peak MW) <sup>(2)</sup>	Maximum Energy (aMW) <sup>(3)</sup>	Median Energy (aMW) <sup>(4)</sup>	Firm Energy (aMW) <sup>(5)</sup>
<b><u>United States Bureau of Reclamation Hydro Projects</u></b>						
Grand Coulee	1941	33	5,705	3,152	2,418	1,900
Hungry Horse	1952	4	333	142	100	77
<u>Other Bureau Projects<sup>(6)</sup></u>		<u>15</u>	<u>225</u>	<u>162</u>	<u>155</u>	<u>129</u>
<b>Total Bureau of Reclamation Projects</b>		<b>52</b>	<b>6,263</b>	<b>3,456</b>	<b>2,673</b>	<b>2,106</b>
<b><u>United States Army Corps of Engineers Hydro Projects</u></b>						
Chief Joseph	1955	27	2,053	1,622	1,337	1,047
John Day	1968	16	2,211	1,561	1,147	801
The Dalles including Fishway <sup>(7)</sup>	1957	24	2,078	1,020	724	518
Bonneville including Fishway	1938	20	861	628	583	431
McNary	1953	14	992	748	696	548
Lower Granite	1975	6	811	457	327	212
Lower Monumental	1969	6	769	464	339	214
Little Goose	1970	6	771	447	324	209
Ice Harbor	1961	6	589	336	203	97
Libby	1975	5	544	280	216	161
Dworshak	1974	3	417	225	179	118
<u>Other Corps Projects<sup>(8)</sup></u>		<u>20</u>	<u>398</u>	<u>294</u>	<u>268</u>	<u>225</u>
<b>Total Corps of Engineers Projects</b>		<b><u>153</u></b>	<b><u>12,494</u></b>	<b><u>8,082</u></b>	<b><u>6,343</u></b>	<b><u>4,581</u></b>
<b>Total Bureau of Reclamation and Corps of Engineers Projects</b>		<b>205</b>	<b>18,757</b>	<b>11,538</b>	<b>9,016</b>	<b>6,687</b>
<b><u>Non-Federally-Owned Projects</u></b>						
The Columbia Generating Station	1984	1	1,162	1,000	1,000	1,000
Packwood <sup>(9)</sup>	1964	1	30	14	10	10
<u>Other Non-Fed Projects<sup>(10)</sup></u>		<u>8</u>	<u>64</u>	<u>88</u>	<u>76</u>	<u>74</u>
<b>Total Non-Federally-Owned Projects</b>		<b>10</b>	<b>1,256</b>	<b>1,102</b>	<b>1,086</b>	<b>1,084</b>
<b>Total Bonneville Contract Purchases<sup>(11)</sup></b>		<b>N/A</b>	<b><u>2,538</u></b>	<b><u>2,389</u></b>	<b><u>2,389</u></b>	<b><u>2,389</u></b>
<b>Total Federal System Resources</b>		<b><u>215</u></b>	<b><u>22,559</u></b>	<b><u>15,029</u></b>	<b><u>12,491</u></b>	<b><u>10,160</u></b>

Source: 2001 Pacific Northwest Loads and Resources Study, Bonneville, October 2001.

- (1) Operating Year 2002 is August 1, 2001 through July 31, 2002.
- (2) January capacity is the maximum generation to be produced under Low Flows in megawatts of capacity. January is a benchmark month for the system peaking capability because of the potential for high peak loads during January due to winter weather.
- (3) Maximum energy capability is the estimated amount of hydro energy to be produced using High Flows in average megawatts of energy. The hydroregulation studies for this analysis contain measures from biological opinions from and after 1995, including the 2000 Biological Opinion.
- (4) Median energy capability is the estimated amount of hydro energy to be produced using Median Flows in average megawatts of energy.
- (5) Firm energy capability is the estimated amount of hydro energy to be produced using Low Flows in average megawatts of energy.

- (6) Other Bureau Projects include: Palisades (1957), Anderson Ranch (1950), Chandler (1956), Minidoka (1909), Black Canyon (1925) and Roza (1958).
- (7) The Dalles Project is portrayed here for convenience as including the Dalles Fishway Project of 4 megawatts of peaking capacity and 3 average megawatts of energy. The Dalles Project in fact is non-Federally-owned.
- (8) Other Corps Projects include: Albeni Falls (1955), Big Cliff (1954), Cougar (1964), Detroit (1953), Dexter (1955), Foster (1968), Green Peter (1967), Green Springs (1960), Hills Creek (1962), Lookout Point (1954) and Lost Creek (1975).
- (9) Packwood is a hydro project owned by Energy Northwest.
- (10) Other Non-Federal Projects include the following hydroelectric and other projects: Mission Valley's Big Creek (1981), Lewis County PUD's Cowlitz Falls (1994), the City of Idaho Falls' Idaho Falls Project (1982) and the Western Generation Agency's Wauna Cogeneration Project (1996).
- (11) Bonneville Contract Purchases include: Pacific Northwest purchase contracts by Bonneville, non-federal Canadian Entitlement transfers to Bonneville, imports to Bonneville from outside the Pacific Northwest, intra-Regional transfers to Bonneville from within the Pacific Northwest, and a small amount of non-utility generation purchased by Bonneville.

#### **Customers and Other Power Contract Parties of Bonneville's Power Business Line**

Bonneville has power sales and related contracts with four main classes of customers: Preference Customers, DSIs, Regional IOUs and extra-Regional customers. Bonneville also sells relatively small amounts of power to several federal agencies within the Region. The revenues derived from these customers provide Bonneville with a large portion of the funds needed to pay its costs. For information regarding the relative amounts of customer revenue and other information, see the table entitled "Federal System Statement of Revenues and Expenses" under "BONNEVILLE FINANCIAL OPERATIONS — Historical Federal System Financial Data." Bonneville also earns revenues from the provision of transmission service to the foregoing and other customers. See "TRANSMISSION BUSINESS LINE — Bonneville's Transmission System."

Credit risk may be concentrated to the extent that one or more groups of counterparties in power transactions with Bonneville have similar economic, industry or other characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in market or other conditions. In addition, credit risk includes not only the risk that a counterparty may default due to circumstances relating directly to it, but also the risk that a counterparty may default due to the circumstances which relate to other market participants which have a direct or indirect relationship with such counterparty. Bonneville seeks to mitigate credit risk (and concentrations thereof) by applying specific eligibility criteria to prospective counterparties. However, despite mitigation efforts, defaults by counterparties occur from time to time. To date, no such default has had a material adverse effect on Bonneville. Bonneville continues to actively monitor the creditworthiness of counterparties with whom it executes wholesale energy transactions and uses a variety of risk mitigation techniques to limit its exposure where it believes appropriate.

#### *Preference Customers*

Preference Customers, which consist of qualifying publicly-owned utilities and consumer-owned electric cooperatives within the Region, are entitled to a statutory preference and priority (the "Public Preference") in the purchase of available Federal System power. These customers are eligible to purchase power at Bonneville's PF rate for most of their loads, and as a class are Bonneville's principal customer base. The Public Preference requires that Bonneville meet a Preference Customer's request for available Federal System power in preference to a competing request from a non-preference entity for the same power. In the opinion of Bonneville's Acting General Counsel, the Public Preference does not compel Bonneville to lower the offered price of uncommitted surplus Bonneville power to Preference Customers before meeting a competing request at a higher price for such uncommitted power from a non-preference entity.

Some Regional public bodies served by Regional IOUs are now seeking to form public body utilities to qualify as Preference Customers and obtain priority access to electric power from Bonneville. These public bodies include municipalities and port districts. Under the Subscription process Bonneville received conforming requests from and signed contingent contracts with, four such entities that are in the process of organizing as new public body utilities. Under Subscription, about 75 average megawatts of firm power at the priority firm rates were reserved for such new entities.

#### *Direct Service Industrial Customers*

Bonneville contracts with DSIs within the Region for the purchase of power for their direct consumption. Bonneville currently has contracts to sell firm power to eleven separate aluminum smelting and rolling facilities that are individually owned by five companies. These aluminum DSIs typically consume over 95% of the power Bonneville sells to DSIs. Bonneville also has contracts to sell power to three other DSIs that produce paper or chemicals.

As directed in the Northwest Power Act, Bonneville signed power sales contracts with a number of DSIs in 1981 effective through fiscal year 2001 (the "1981 Contracts"). In 1995, several DSIs elected to curtail all or substantially all of their purchases from Bonneville (about 800 average megawatts), as permitted under their 1981 Contracts. These DSIs turned to suppliers other than Bonneville to meet their power requirements. The remaining DSIs, however, elected in 1996 to enter into new contracts ("DSI Block Sales Contracts") that committed the participating DSIs to purchase fixed amounts of power from Bonneville until September 30, 2001.

For several years prior to 1995, Bonneville's annual DSI firm loads averaged approximately 2,800 average megawatts. Through the implementation of the Subscription Strategy, Bonneville has signed DSI contracts with eight companies to serve about

1500 average megawatts of DSI loads effective for the five years beginning October 1, 2001. See “Certain Statutes and Other Matters Affecting Bonneville’s Power Business Line — Power Marketing Plan for the Period After Fiscal Year 2001.”

#### *Regional Investor-Owned Utilities*

Bonneville provides firm power to six Regional IOUs under contracts other than long-term firm requirements power sales contracts. Bonneville also sells substantial amounts of peaking capacity to Regional IOUs.

As part of Bonneville’s Subscription Strategy, in October 2000, Bonneville entered into certain agreements with the Regional IOUs in settlement of Bonneville’s statutory obligation to provide benefits under the Residential Exchange Program for specified periods beginning October 1, 2001. See “— Certain Statutes and Other Matters Affecting Bonneville’s Power Business Line — Residential Exchange Program,” “— Power Marketing Plan for the Period After Fiscal Year 2001” and “BONNEVILLE FINANCIAL OPERATIONS — Historical Federal System Financial Data.”

#### *Exports of Surplus Power to the Pacific Southwest*

Bonneville sells and exchanges power via the Pacific Northwest-Pacific Southwest Intertie (the “Southern Intertie”) transmission lines to Pacific Southwest utilities, power marketers and other entities, which use most of such power to serve California loads. These sales and exchanges are composed of firm power and non-firm energy surplus to Bonneville’s Regional requirements. Exports of Bonneville power for use outside the Pacific Northwest are subject to a statutory requirement that Bonneville offer such power for sale to Regional utilities to meet Regional loads before offering such power to a customer outside the Region. However, in the opinion of Bonneville’s Acting General Counsel, Bonneville is not required to reduce the rate of proposed export sales to meet a Northwest customer’s request if the proposed export sale is at a higher FERC-approved rate than the Northwest customer is willing to pay. See “BONNEVILLE LITIGATION —Kaiser Aluminum & Chemical Corp. v. Bonneville Power Administration.”

In addition, Bonneville’s contracts for firm energy and peaking capacity sales outside the Region include, as required by the Regional Preference Act, recall provisions that enable Bonneville to terminate such sales, upon advance notice, if needed to meet Bonneville customers’ power requirements in the Region. With certain limited exceptions, Bonneville’s sales of Federal System power out of the Region are subject to termination on 60 days’ notice in the case of energy and on 60 months’ notice in the case of peaking capacity. These rights help Bonneville assure that the power needs of its Regional customers are met. Power exchange contracts are not required to contain the Regional recall provisions.

In 1995, in view of the Regional load diversification away from Bonneville that was then occurring, Congress enacted a law that authorized Bonneville to sell for export out of the Region a limited amount of power free to a degree from the Regional Preference recall rights. Bonneville entered into a number of such excess federal power contracts that have remaining terms requiring Bonneville to export power after October 1, 2001. Bonneville does not expect to have substantial new amounts of such excess federal power to sell during the five-year rate period beginning October 1, 2001. See “BONNEVILLE LITIGATION — M-S-R Public Power Agency, *et al.*, v. Bonneville Power Administration.”

Pacific Southwest utilities typically account for the greatest share of purchases of seasonal surplus energy from Bonneville and these sales account for the greatest share of revenues from Bonneville’s exports. The amount of seasonal surplus energy that Bonneville has available to export depends on precipitation and other power supply factors in the Northwest, the available transmission capacity of the Southern Intertie, the attributes of restructured power markets in the Pacific Southwest and other factors that may constrain exports notwithstanding the availability of power.

While Bonneville designs its power rates, including its rates for out-of-Region power sales, to recover its costs, it does so with flexible price levels that enable Bonneville to make additional sales in a competitive marketplace. Revenues that Bonneville obtains from exporting power out of the Region depend on market conditions and the resulting prices. These revenues are affected by the weather and other factors that affect demand in the Pacific Southwest and the cost and availability of alternatives to Bonneville’s power. The cost of alternative power is frequently dependent on other electric energy suppliers’ resource costs such as the cost of hydro, coal, oil and natural gas-fired generation. Bonneville believes that if its power sales in the Region were to decline, any resulting surpluses of power could be sold to the Pacific Southwest. Such sales may be limited, however, by Southern Intertie capacity and other factors.

#### *Effect On Bonneville Of Developments In California Power Markets*

California power markets have been in turmoil since about 1999, having experienced historically high power prices and volatility. For much of that period, the California investor-owned utilities (the “Cal-IOUs”), were faced with having a cap on the rates that they could charge their customers while being required to purchase virtually all of their power requirements at prices that are multiples of the rates they could charge.

The weakened financial positions of the Cal-IOUs, particularly Pacific Gas & Electric (PG&E), which filed for protection under federal bankruptcy laws in April 2001, and Southern California Edison (SCE), also affected the financial condition of two entities with central roles in the restructuring of California’s electric power industry. One such entity is the California Independent System Operator (“Cal-ISO”), a nonprofit entity that operates, but does not own, most transmission in the state and is responsible for assuring reliable transmission to the Cal-IOUs and others. By far the largest users of the Cal-ISO’s services and hence the largest revenue sources for the Cal-ISO were the Cal-IOUs. Defaults by PG&E and SCE in payments for energy and transmission have resulted in concerns by energy suppliers that the Cal-ISO may not be a creditworthy supplier, and led to the intervention by the State of California as purchaser of electric power to supply consumers served by the Cal-IOUs.



The second such entity is the nonprofit California Power Exchange (“Cal-PX”), which suspended operations on January 31, 2001 but was theretofore responsible for operating a day-ahead power exchange through which the Cal-IOWs were obligated to purchase virtually all of their power requirements. As a consequence of the continued operation of the exchange during periods of unprecedented high market prices when the Cal-IOWs’ retail rates could not recover the market prices for power, the Cal-PX has substantial outstanding payment obligations due from the Cal-IOWs. The Cal-PX filed for bankruptcy protection in March 2001.

Bonneville entered into certain power sales through the Cal-PX for which Bonneville is due payment but has not yet been paid. Bonneville ceased selling into the Cal-PX in December 2000. In addition, through January 10, 2001, Bonneville sold power and related service to the Cal-ISO to help it maintain transmission reliability in California. The Cal-ISO has outstanding payment obligations to Bonneville for such purchases. Bonneville also has a long-term seasonal power exchange agreement with SCE. Bonneville estimates that its total exposure for sales and exchanges with the foregoing California parties arising since October 1, 2000, is about \$88 million. Based on its current evaluation, Bonneville recorded provisions for uncollectible amounts, which in management’s best estimate are sufficient to cover any potential exposure. Nonetheless, Bonneville is continuing to pursue collection of all amounts due in bankruptcy and other proceedings.

In connection with the historically high power prices and volatility in West Coast power markets, FERC has initiated two separate proceedings to address, under the Federal Power Act, whether certain power sellers charged unjust and unreasonable prices and therefore should refund to power purchasers any amounts overcharged. Bonneville is participating in both proceedings.

In the first proceeding, FERC is reviewing the extent to which the prices of power sales through the Cal-PX and to the Cal-ISO were “unjust and unreasonable” in the period October 2, 2000 to June 19, 2001. In this proceeding, FERC has concluded that unjust and unreasonable pricing in fact occurred. FERC has bifurcated the proceeding and scheduled a hearing in March 2002 to determine a pricing structure that approximates a competitive market. FERC has scheduled a second hearing for May 2002 to determine the amount of refund liability of various power sellers that participated in such sales. Bonneville was a net seller through the Cal-PX and to the Cal-ISO during this period. Nonetheless, Bonneville cannot predict with any accuracy the amount of refund liability that FERC will attempt to assess against Bonneville. Bonneville believes that the amount of any refunds determined by FERC against Bonneville would be substantially less than the unpaid amounts owed to Bonneville by the Cal-PX and the Cal-ISO.

In the second proceeding, FERC is reviewing the extent to which the pricing of power sales in the bilateral “spot market” in the Pacific Northwest was “unjust and unreasonable” in the period December 25, 2000 through June 19, 2001. FERC has indicated that if it were to find that power sellers exacted unjust and unreasonable prices during this period, FERC would undertake a subsequent proceeding to determine refund liability.

FERC held a hearing in early September 2001 in this proceeding. On September 24, 2001, the presiding judge made recommendations to FERC concluding, among other things, that the prices charged in the bilateral “spot market” in the Pacific Northwest during the relevant period were not unjust and unreasonable, that refunds should not be ordered, and that FERC should conduct no further hearings and should terminate the proceeding. In addition, the presiding judge found that the reasoning that underlies the assertion of FERC’s refund authority over power sales from Bonneville and other non-jurisdictional utilities to the Cal-ISO and through the Cal-PX markets in the first proceeding does not apply to bilateral power sales of such utilities in the Pacific Northwest. FERC has not yet ruled on the presiding judge’s recommendations.

While Bonneville is a participant in the foregoing refund proceedings, Bonneville is taking the position before FERC in certain petitions for rehearing that FERC has no jurisdiction over Bonneville under the just and reasonable and refund provisions of the Federal Power Act, and therefore that FERC may not assess refund liability against Bonneville. Several other non-jurisdictional utilities have also filed petitions for rehearing challenging FERC’s assertion of jurisdiction over them in this matter. On December 19, 2001, FERC rejected Bonneville’s and the other nonjurisdictional utilities’ petitions. Several nonjurisdictional utilities have filed for appeal in Federal appellate court. Bonneville expects to file an appeal on February 19, 2002.

In a related matter, on February 13, 2002, FERC announced that it is initiating an investigation by FERC staff into whether any entity, including Enron Corp., manipulated short-term electric power and natural gas prices in the West or otherwise exercised undue influence over wholesale prices in the West, from the period January 1, 2000 forward. The order directing the investigation does not specify the remedial actions that FERC may implement or attempt to implement in the event it were to conclude that price manipulation or undue influence over prices in fact occurred. See “POWER BUSINESS LINE—Customers and other Power Contract Parties of Bonneville’s Power Business Line — Effect on Bonneville of the Enron Bankruptcy” immediately below.

#### *Effect on Bonneville of the Enron Bankruptcy*

On December 2, 2001, Enron Corp. and a number of its subsidiaries, including Enron Power Marketing Incorporated (“EPMI”), filed for bankruptcy protection under federal bankruptcy laws. At the time, EPMI was Bonneville’s second largest electric power trading counterparty and Bonneville and EPMI had between them about one hundred separate transactions for forward sales and purchases of electric power. The parent, Enron Corp., guaranteed performance of all of the contracts Bonneville has with EPMI.

At the time of the bankruptcy filing, the aggregate amount of forward power transactions between Bonneville and EPMI exceeded 400 megawatts annually on average over the five years ending September 30, 2006. Under certain of the transactions, Bonneville agreed to sell power to EPMI and under other transactions, Bonneville agreed to purchase power from EPMI. Bonneville estimates that the average net obligation of such transactions was that EPMI was obligated to provide an average of about 60 megawatts of power per year to Bonneville over such five year period. Bonneville has no contracts with EPMI beyond September 30, 2006.

Subsequent to the bankruptcy filing, Bonneville terminated two of the longer term contracts for the sale of power to EPMI. Following the termination of these two contracts, EPMI's net delivery obligation to Bonneville under the remaining power contracts is about 150-200 megawatts on average through September 2006. Bonneville has not terminated any other transactions with EPMI. In addition, Bonneville estimated that with respect to the remaining contracts it would have a net payment obligation to EPMI in virtually all months through September 30, 2006.

While EPMI was unable to meet some off peak delivery obligations to Bonneville in December, it has since met its power receipt and delivery obligations to Bonneville. Bonneville currently has no accounts receivable due from EPMI.

In view of the pricing of the remaining portfolio of power transactions, Bonneville believes, absent substantial changes in market prices for power, that EPMI has an economic incentive to continue to perform all of its obligations to Bonneville. Nonetheless, Bonneville cannot assure that such market conditions will continue or that EPMI will not seek to and succeed in rejecting some transactions with Bonneville. In such circumstances, Bonneville may have to purchase power at higher prices, or sell power at lower prices, than provided in the rejected transactions.

Bonneville continues to monitor the Enron bankruptcy, and, as a part of the U.S. Government and through the U.S. Department of Justice, has filed a notice of appearance in the bankruptcy proceeding.

Portland General Electric Company ("Portland General"), which is a Regional IOU as described herein and a contract party with Bonneville in several transactions, is a wholly owned subsidiary of Enron Corp. Portland General has not filed for bankruptcy protection. Bonneville continues to monitor Portland General's creditworthiness.

#### **Effect on Bonneville of the Kaiser Aluminum Bankruptcy**

Kaiser Aluminum and Chemical, Incorporated ("Kaiser"), a subsidiary of Kaiser Aluminum Corporation, is an aluminum company DSI customer of Bonneville. On February 12, 2002, both Kaiser and its parent corporation Kaiser Aluminum Corporation filed for bankruptcy protection. Bonneville has a contract (the "Kaiser Contract") to sell Kaiser about 291 megawatts of electric power during the five-year period beginning October 1, 2001. Under an arrangement with Bonneville entered into after Kaiser and Bonneville executed the Kaiser Contract, Kaiser agreed to forgo most of such purchases, and Bonneville agreed to waive the obligation of Kaiser to make most of such purchases, through October 2003. Consequently, since October 1, 2001, Kaiser has been purchasing only about 30 megawatts of power under the Kaiser Contract. Bonneville estimates that it has sold Kaiser between about \$1 million and \$2 million of power and related services for which Bonneville has not yet been paid. Such accounts receivable could be treated as unsecured, pre-petition debts of Kaiser in the bankruptcy proceeding and therefore Bonneville is uncertain whether such debts will be paid. Bonneville is evaluating whether to reserve against such amounts as uncollectible debts.

In addition, Kaiser's purchase obligation under the Kaiser Contract is a "take-or-pay" obligation meaning Kaiser must pay for the power if tendered by Bonneville. The rate under which Kaiser is obligated to make such purchases is the Bonneville's Industrial Firm Power (or "IP") Rate, which is currently about \$34 per megawatt, subject to the various cost recovery rate adjustments described herein. The current IP Rate is above the current West Coast market prices for electric power. Under these circumstances it is possible that Kaiser may seek to reject the Kaiser Contract in the bankruptcy proceeding. Bonneville estimates, on a preliminary basis, that it has about a \$60 million mark-to-market exposure if Kaiser were to avoid its purchase obligations under the Kaiser Contract. The mark-to-market exposure is subject to change with market prices for power.

Given the relatively low current world price levels for aluminum, and the comparatively high rates aluminum company DSIs are obligated to pay for electric power from Bonneville, it is possible that other aluminum company DSIs may seek bankruptcy protection or otherwise attempt to avoid their power purchase obligations with Bonneville. Apart from Kaiser, Bonneville has about 1100 megawatts of power sales to aluminum company DSIs under contract terms similar to those in the Kaiser Contract.

The United States Department of Justice is expected to file a notice of appearance in this proceeding on behalf of all Federal interests, including Bonneville.

#### **Certain Statutes and Other Matters Affecting Bonneville's Power Business Line**

##### *Bonneville's Obligation to Meet Certain Firm Power Requirements in the Region*

The Northwest Power Act requires Bonneville to meet certain firm loads in the Region placed on Bonneville by contract by various Preference Customers and Regional IOUs. Bonneville does not have a statutory obligation to meet all firm loads within the Region or to enter into contracts to sell any power directly to a DSI after fiscal year 2001.

Under the Northwest Power Act, when requested, Bonneville must offer to sell to each eligible utility, which includes Preference Customers and Regional IOUs, sufficient power to meet that portion of the utility's Regional firm power loads that it requests Bonneville to meet. The extent of Bonneville's obligation to meet the firm loads of a requesting utility is determined by the amount by which the utility's firm power loads exceed (1) the capability of the utility's firm peaking capacity and energy resources used in operating year 1979 to serve its own loads; and (2) such other resources as the utility determines, pursuant to its power sales contract with Bonneville, will be used to serve the utility's firm loads in the Region. If Bonneville has or expects to have inadequate power to meet all of its contractual obligations to its customers, certain statutory and contractual provisions allow for the allocation of available power.

As required by law, Bonneville's power sales contracts with Regional utilities contain provisions that require prior notice by the utility before it may use, or discontinue using, a generating resource to serve such utility's own firm loads in the Region. The amount of notice required depends on whether Bonneville has a firm power surplus and whether the Regional utility's generating

resource is being added to serve or withdrawn from serving the utility's own firm load. These provisions are designed to give Bonneville advance notice of the need to obtain additional resources or take other steps to meet such load.

Some of Bonneville's Preference Customers and all of its Regional IOU customers have generating resources, which they may use to meet their firm loads in the Region. Under requirements power sales contracts that expired in fiscal year 2001, each of these customers had to identify annually the amount of its loads it would meet with its own resources, thereby providing Bonneville with advance notice of the need to add resources or take other steps to meet these loads. These provisions are also included in all Subscription Agreements under which Bonneville has a load following obligation. In connection with its Subscription Strategy, Bonneville tendered proposed requirements power sales contracts to each of the Regional IOUs for specified periods following the expiration of the IOUs' requirements contracts at the end of fiscal year 2001. All of the Regional IOUs elected not to execute such agreements.

As required by law, Bonneville's power sales contracts with Regional utilities also include provisions that enable Bonneville, after giving notice, to allocate Federal System power, in accordance with statutory provisions, among its customers if Bonneville determines that it will have insufficient power, on a planning basis, to meet its firm load obligation. Bonneville does not anticipate experiencing a shortage of firm power that would require an allocation pursuant to these provisions. Bonneville's Subscription Strategy defines Bonneville's power-marketing program for the next five to ten years and seeks to extend the benefits of low-cost Federal System power widely throughout the Region. Among other things, the Subscription Strategy is intended to assure that Bonneville meets its statutory load obligations in the Region and avoids a resource planning insufficiency that would lead Bonneville to propose an allocation of Federal System power among its Regional customers. See "— Power Marketing Plan for the Period After Fiscal Year 2001."

Although Bonneville has contracts to sell firm power to extra-Regional customers, Bonneville is not required by law to offer contracts to meet these customers' firm loads. Similarly, Bonneville provides firm power to certain federal agencies within the Region; however, Bonneville is not required by law to offer to meet these agencies' firm loads.

Federal System Load/Resource Balance. In order to determine whether Bonneville will have to obtain additional electric power resources on a planning basis, and to determine the amount of firm power that Bonneville may have to market apart from committed loads, Bonneville periodically estimates the amount of load that it will be required to meet under its contracts.

Bonneville's loads and resources are subject to a number of uncertainties over the coming years. Among these uncertainties are: (i) the level of loads and types of loads placed on Bonneville in the Subscription contract and power rate development process; (ii) the amount of augmentation purchases that Bonneville will have to make to meet the ultimate Subscription loads; (iii) future non-power operating requirements from future biological opinions or amendments to biological opinions; (iv) the availability of new generation resources or contract purchases available in the Pacific Northwest to meet future Regional loads; (v) changes in the regulation of power markets at the wholesale and retail level; and (vi) the overall load growth from population changes and economic activity within the Region.

Bonneville had estimated that its loads for the five years beginning October 1, 2001 (pre-existing obligations during such period plus anticipated Subscription loads) could exceed Federal System generation resources. Bonneville made power purchases in the market to address a portion of this potential shortfall, however, prices soared in the highly volatile deregulated wholesale power market. At the higher prices, Bonneville could not meet all obligations and maintain the initial base rate levels proposed in the Subscription process. To address the volatility of the wholesale power market, Bonneville negotiated amendments to the Subscription contracts and proposed related rates, which incorporate: 1) cost recovery measures tied to the wholesale market price for power purchased by Bonneville to meet Subscription loads; and 2) reductions in Bonneville's power sales obligations through a combination of contracted load reductions and energy conservation measures. There are a number of variables that will affect the exact amount of load Bonneville will be required to serve during the five years beginning October 1, 2001. Customers have limited "off-ramps" built into the Subscription contracts. See "— Power Marketing Plan for the Period After Fiscal Year 2001." In addition, the contracted load reductions have various terms, but in no case do they extend past the end of fiscal year 2003. Thereafter, it is uncertain how much of that load will revert back to Bonneville. Among other things, the price of alternative power, load growth, and aluminum prices could affect Bonneville's power sales obligations, particularly in the later portion of the five-year rate period.

Bonneville's Authority to Add Resources. In order to meet the foregoing power sales obligations, Bonneville may have to obtain electric power from sources other than the Federal System hydroelectric projects, existing contract purchases and projects, such as the Columbia Generating Station, the capability of which Bonneville has previously acquired. By law, Bonneville may not own or construct generating facilities. However, the Northwest Power Act authorizes Bonneville to acquire resources to serve firm loads pursuant to certain procedures and standards set forth in the Northwest Power Act. "Resources" are defined in the Northwest Power Act to mean: (1) electric power, including the actual or planned electric power capability of generating facilities; or (2) the actual or planned load reduction resulting from direct application of a renewable resource by a consumer, or from conservation measures. "Conservation" is defined in the Northwest Power Act to mean measures to reduce electric power consumption as a result of increased efficiency of energy use, production or distribution.

Bonneville's statutory responsibility to meet its firm power contractual obligations may lead Bonneville to acquire additional power and conservation resources. The extent to which Bonneville does so will depend on the effects of the competitive wholesale electric power market, load growth and other factors.

The acquisition of resources under the standards and procedures of the Northwest Power Act, however, is not the sole method by which Bonneville may meet its power requirements. Other methods are available. These include, but are not limited to: (1) exchange of surplus Bonneville peaking capacity for firm energy; (2) receipt of additional power from improvements at federally and non-federally owned generating facilities; and (3) purchase of power under the Transmission System Act for periods of less than five years.

Bonneville's resource acquisitions under the Northwest Power Act are guided by a Regional conservation and electric power plan (the "Power Plan") prepared by the Pacific Northwest Electric Power and Conservation Planning Council (the "Council"). The governors of the states of Washington, Oregon, Montana and Idaho each appoint two members to the Council. The Power Plan sets forth guidance for Bonneville regarding implementing conservation measures and developing generating resources to meet Bonneville's Regional load obligations.

Bonneville's Resource Strategies. Increased competition, deregulation in the electric power market and loss of hydropower flexibility due to ESA constraints have major implications for Bonneville's resource acquisition strategy. Given long-term load placement uncertainty, any resource investment that involves irrevocable, high fixed costs over a period longer than Bonneville's contracted load obligation is much riskier than it would have been in the past. Bonneville believes that in general new resources should have fixed costs that can be recovered over a shorter period, should provide power in the times of the year when power is required, should be capable of being displaced when hydroelectric power is available and should have costs that can be offset when hydroelectric power is available. Therefore, Bonneville's current resource strategy in general is to acquire resources that can accommodate yearly fluctuations in Bonneville loads and that add flexibility to the system.

Short-term (less than five year) purchases are the only type of resource that meets this resource acquisition strategy. Short-term purchases almost always will fit these conditions better than other resources, including long-term combustion turbine resources, because purchases generally do not involve incurring high, long-term fixed costs.

One risk associated with a short-term purchase strategy is the potential for high spot market prices. In general, spot market prices are high when energy demand is strong and coal and natural gas prices are high, although such prices can also rise in dry years when there is comparatively little hydroelectric power available. Since Bonneville's resources are predominantly hydro-based while most other West Coast producers are natural gas-based, Bonneville in general is at a competitive advantage when coal and gas prices are high.

A short-term purchase strategy can lead to fluctuating revenue requirements. In dry years, Bonneville's revenue requirement would increase as it would be forced to spend a significant amount of money for short-term purchases to meet loads. In wet years, purchase requirements can be significantly reduced as Bonneville will meet more of its load with non-firm hydroelectric power. Dependence on short-term purchases also may make access to transmission a more important issue than reliability of generation.

Bonneville's short-term purchase resource strategy is complemented by two other opportunities. First, Bonneville is adding environmentally preferred, so-called "green power" resources. The bulk of these additional purchases is likely to be from wind projects because of their relatively low cost and the expectation that the new wind projects can become operational within 24-30 months of a decision to proceed. While it is possible that Bonneville could acquire up to about 1000 megawatts of wind resources, the amount of wind energy resources that Bonneville ultimately purchases is uncertain and will depend on the outcome of studies in progress that will assess, among other things, the impact of such an intermittent resource on power system operations. If there is a significant adverse impact, then wind purchases may be limited to a far lesser amount. With regard to green power resources, Bonneville has agreed to acquire a total of approximately 14.5 average megawatts from three wind energy projects in Wyoming, 12 average megawatts from a wind energy project in central Oregon, and 31 average megawatts from a wind energy project on the eastern portion of the border between Oregon and Washington, and 15 kilowatts from a solar photovoltaic project in southern Oregon. These facilities are in operation. Bonneville has contracted to purchase 49.9 megawatts from a geothermal project under construction in northern California and is considering additional purchases from renewable energy resources. Second, Bonneville will encourage electric power conservation measures by providing a .5 mills per kilowatt hour rate discount to its Customers that implement conservation measures and/or renewable resource projects. The discounts should result in about \$40 million per year (during the 2002-2006 rate period) being spent on conservation and renewable resource initiatives by Customers. In addition, Bonneville will purchase at least 100 average megawatts of conservation savings as part of its augmentation strategy. Any such resource development should lessen Bonneville's reliance on spot market power purchases.

Bonneville believes that this resource strategy over the long-term is stable and is the most cost-effective strategy today given resource lead times, product demand uncertainty, and hydro system variability. In addition, the duration of Bonneville's recently executed Subscription power sales agreements, which have terms of five and ten years, means that Bonneville is not necessarily assured that it will have long-term committed loads to support higher incremental cost, long-term capital investments in resources having expected useful lives of 15 to 20 years or more. Relying on short-term purchases for the time being does not necessarily preclude other resource acquisitions, if needed, sometime in the future.

Under the Subscription Strategy, Bonneville expects to bear a substantial load obligation that will require Bonneville to augment the Federal System with additional power purchases. Consistent with the foregoing resource strategy, Bonneville expects to rely primarily on short-term (five years or less) purchase agreements to meld with firm power and nonfirm energy from the Federal System to meet these additional firm loads. See "— Power Marketing Plan for the Period After Fiscal Year 2001." In executing its resource augmentation strategy to meet Subscription loads, Bonneville has entered into short-term system power purchases, and is negotiating a number of additional short-term purchases and reductions of certain power sale obligations.

### *Residential Exchange Program*

The Northwest Power Act created the Residential Exchange Program to extend the benefits of low-cost federal power to all residential and small farm power users in the Region. In effect, the program has resulted in cash payments by Bonneville to exchanging utilities, who are required to pass the benefit of the cash payments through in their entirety to eligible residential and small farm customers.

Under the Residential Exchange Program, Bonneville “purchases power” offered by an exchanging utility at its “average system cost,” which is determined by Bonneville through the application of a methodology limiting the costs that may be included in an exchanging utility’s average system cost to the production and transmission costs that an exchanging utility incurs for power. Bonneville then offers an identical amount of power for “sale” to the utility for the purpose of resale to the exchanging utility’s residential users. In reality, no power changes hands — Bonneville makes cash payments to the exchanging utility in an amount determined by multiplying the exchanging utility’s eligible residential load times the difference between the exchanging utility’s average system cost and Bonneville’s applicable PF rate, if such PF rate is lower. See “MATTERS RELATING TO THE POWER AND TRANSMISSION BUSINESS LINES — Bonneville Ratemaking and Rates.” The net costs of the Residential Exchange Program are shown in the Federal System Statement of Revenues and Expenses set forth under “BONNEVILLE FINANCIAL OPERATIONS — Historical Federal System Financial Data.”

In the late 1990s, Bonneville and the five Regional IOUs then receiving Residential Exchange Program benefits entered into Residential Exchange Program contract termination agreements, under which net Residential Exchange Program expenses to Bonneville declined to \$64 million in both fiscal years 1999 and 2000 and \$68 million in fiscal year 2001. In October 2000, the Regional IOUs signed agreements with Bonneville to settle for the period July 1, 2001 through September 30, 2011. These agreements provide for both sales of power and cash payments to the Regional IOUs. See “— Power Marketing Plan For The Period After Fiscal Year 2001.”

### *Fish and Wildlife*

The Northwest Power Act directs Bonneville to protect, mitigate and enhance fish and wildlife resources to the extent they are affected by federal hydroelectric projects on the Columbia River and its tributaries. Bonneville makes expenditures and incurs other costs for fish and wildlife consistent with the Northwest Power Act and the Council’s Columbia River Basin Fish and Wildlife Program (the “Council Program”). In addition, in the wake of certain listings of fish species under the ESA as threatened or endangered, Bonneville is financially responsible for expenditures and other costs arising from conformance with the ESA and certain biological opinions prepared by the NMFS and the United States Fish and Wildlife Service (“FWS”) in furtherance of the ESA.

Bonneville typically funds fish and wildlife mitigation through several mechanisms. Since the creation of the Federal System, Bonneville has repaid the United States Treasury the share of the costs of mitigation by the Corps and the Bureau that is allocated by law or pursuant to policies promulgated by FERC’s predecessor to the projects’ power purpose (as opposed to other project purposes such as irrigation, navigation and flood control). These measures mitigate for the impact of construction and operation of hydroelectric dams of the Federal System.

Bonneville also implements and funds measures proposed in the Council Program, which the Council periodically amends. The Council Program calls for a variety of mitigation measures from habitat protection to mainstem Columbia River and Snake River flow targets. When such measures affect the operation of the Federal System and force Bonneville to purchase power to fulfill contractual demands or to spill water and thereby forgo generation of electricity, for instance, those financial losses are counted as measures funded by Bonneville. While many of the measures in the Council’s Program overlap or otherwise relate to measures undertaken in connection with the ESA, the Council’s Program measures, especially those designed to benefit species not listed under the ESA, are in addition to ESA-directed measures.

As noted above, Bonneville, the Corps and the Bureau are also subject to the ESA. To a great extent, compliance with the ESA determines how the Federal System is operated for fish and dominates most fish and wildlife planning and activities. Bonneville has taken steps to ensure that its implementation of “offsite” actions (those not occurring directly at the hydroelectric projects) under the relevant Biological Opinions are integrated with its implementation of the Council’s Program. The listings have resulted in major changes in the operation of the Federal System hydroelectric projects and a substantial loss of flexibility to operate the Federal System for power generation. Apart from changes in Federal System operations that adversely affect power generation, compliance with ESA has also resulted in additional Federal System costs in the form of non-operational measures funded from Bonneville revenues.

The Endangered Species Act. Among other things, the ESA requires that federal agencies such as Bonneville, the Corps and the Bureau, take no action that would jeopardize the continued existence of listed species or result in the destruction or adverse modification of their critical habitat. Since 1991, NMFS has listed as threatened or endangered under the ESA 12 species of anadromous fish (salmon and steelhead) that are affected by operation of the Federal System. It is possible that other species may be listed or proposed for listing in the future. In general, the effect of the listing of the fish species under the ESA, and certain other operating requirements resulting from Bonneville’s fish and wildlife obligations under the Northwest Power Act, is that, except in emergencies, the Federal System is now operated for power production after meeting needs for flood control and the protection of ESA-listed fish.

In connection with the listing of these species, NMFS has prepared certain biological opinions addressing the listed species. The biological opinions provide information that Bonneville, the Corps and the Bureau can use to ensure that their actions with

respect to the operation of the Federal System satisfy the ESA. By acting consistently with the biological opinions, Bonneville, the Corps and the Bureau generally demonstrate that jeopardy to listed species is being avoided. Specifically, Bonneville, the Corps and the Bureau have chosen to implement certain specified measures recommended in the biological opinions as being necessary to avoid jeopardy. The adequacy of the biological opinions and their implementation are subject to, and have been subjected to, judicial review.

1995 Biological Opinion. In 1995, NMFS issued the 1995 Biological Opinion with respect to several listed species of salmon, as supplemented in 1998 and early 2000 to address later-listed species of salmon and steelhead. Operation of the Federal System consistent with the 1995 Biological Opinion and its supplements resulted in two principal changes in power generation. First, depending on water conditions, water that would otherwise be run through turbines to generate electricity may be spilled to aid in downstream fish migration without producing electric energy. Second, less water may be stored in the upstream reservoirs for fall and winter electric generation because more water is committed to use in the spring and summer to increase flows to aid downstream fish migration.

Consequently, there is relatively less water available for hydroelectric generation in the fall and winter and more water available in the spring and summer. Because of these changes, under certain water conditions, Bonneville has had to, and may have to, purchase additional energy for the fall and winter to meet load commitments than would otherwise have been met with the hydroelectric system. In addition, the flow changes have meant that Bonneville has had comparatively more surplus energy to market in the spring and summer. Bonneville estimates that the impact of operating the Federal System in conformance with the biological opinions and the Council Program, as in effect as of the beginning of fiscal year 2000, decreased Federal System generation capability by about 700 average megawatts, assuming average water conditions, from levels immediately preceding the issuance of the first biological opinion in 1995.

While in calendar years 1999-2001 the seasonal variance in market prices of electric power has become substantially less pronounced, historically, power prices in the Northwest have been much higher in the winter because of higher regional heating requirements and lower in the spring and summer as those requirements abated. Thus, flows in aid of fish have resulted in a reduction in the amount of power generally, and reduced the amount of power in high winter load portions of the year when power has typically had greater economic value.

2000 Biological Opinion. On December 21, 2000, NMFS promulgated a new biological opinion ("2000 Biological Opinion") that supersedes all previous opinions including the 1995 Biological Opinion and its 1998 and 2000 supplements, issued by NMFS concerning the Federal System hydroelectric dams. The 2000 Biological Opinion has been coordinated with a FWS December 20, 2000 biological opinion relating to certain other species and they are intended to be mutually consistent. The 2000 Biological Opinion includes a number of measures that will affect Federal System operations and dam configurations in order to improve anadromous fish passage survival through the hydro system. In addition, the 2000 Biological Opinion calls for other measures from increased spill and additional flow requirements to extensive Columbia River Basin-wide habitat protections and enhancement efforts and fish hatchery reforms.

The costs of complying with the 2000 Biological Opinion come in two forms; direct fish and wildlife expenses, and increased power purchase costs and lost power sales as a result of foregone power generation (revenue impacts). Bonneville's preliminary estimate of complying with the 2000 Biological Opinion is that it will increase Bonneville's total direct fish and wildlife costs to about \$352 million per year on average during fiscal years 2002-2006, exclusive of the impacts of lost power revenues and increased power purchases. Bonneville estimates that the 2000 Biological Opinion will also further decrease the generation capability of the Federal System by about 60 average megawatts (assuming average water conditions), in addition to prior reductions from previous biological opinions.

In developing the June 2001 Final Power Rate Proposal, Bonneville assumed that the cost of implementing the 2000 Biological Opinion will fall between \$428 million and \$780 million per year by fiscal year 2006, inclusive of both direct and indirect costs. The actual cost to Bonneville could be substantially higher.

Included among the 13 biological opinion scenarios around which Bonneville developed its June 2001 Final Power Rate Proposal were several that would have called for breaching four Federal System Snake River dams. The direct cost of breaching the dams would be very high. In addition, the loss of the generation from the dams would substantially affect the power generation capability of the Federal System, reducing current expected output by approximately 1200 average megawatts under average water assumptions. The 2000 Biological Opinion does not recommend implementation of dam breaching. However, NMFS indicates that if measurable improvements in survival of listed fish are not seen, it may reinitiate formal consultations under the ESA with Bonneville, the Corps and the Bureau and require that they pursue authority to breach the four dams. In the opinion of the Acting General Counsel to Bonneville, Congress would be required to enact legislation authorizing breaching of the dams.

The 2000 Biological Opinion sets forth a series of checkpoints to test the efficacy of programs identified therein to aid listed fish species. The 2000 Biological Opinion anticipates full implementation by 2010. In calendar years 2003, 2005 and 2008, NMFS will issue reports documenting whether the reasonable and prudent alternative measures identified in or to be developed under the 2000 Biological Opinion are on track or meet expectations. The report in 2003 will evaluate overall implementation of the reasonable and prudent alternative measures. The reports in year 2005 and year 2008 will evaluate whether the measures are (a) failing, (b) acceptable, or (c) between failing and acceptable, with respect to (i) whether rolling one- and five-year plans for program implementation are on track, (ii) whether hydro performance (measures to improve fish passage past dams) and offsite mitigation (improvement of hatcheries, habitat and fish harvest) measures are on track, and (iii) whether the population status of listed species is

on track. Under the 2000 Biological Opinion, NMFS indicates that the 2008 checkpoint in particular will focus on performance more than under the earlier checkpoints.

The 2000 Biological Opinion provides that if NMFS concludes that there is a failure in these respects it will recommend whether to continue with the reasonable and prudent alternatives described in the 2000 Biological Opinion, revise them and/or recommend that the dam operators seek new legal authority from Congress. The new authority to be sought could include authority to breach dams, among other authorities. If such authority were not forthcoming, NMFS indicates that it would then seek to reinstate consultation pursuant to the ESA with the Corps and the Bureau and Bonneville over their hydroelectric project operations and recommend new reasonable and prudent alternative measures. Under consultation pursuant to the ESA, NMFS would make specific individual determinations whether significant actions or proposed actions relating to operation of the Federal System hydroprojects result in jeopardy to listed species.

The 2000 Biological Opinion and the 2000 FWS biological opinion supersede prior biological opinions. Litigation with respect to the prior biological opinions has ended. A number of interests have filed litigation in connection with the 2000 FWS biological opinion. See “BONNEVILLE LITIGATION—ESA Litigation--National Wildlife Federation v. National Marine Fisheries Service.”

Interagency Memorandum of Agreement Regarding Fish Costs. Prior to the ESA listings, Bonneville’s annual fish and wildlife total expenditures grew from \$20 million in 1981 to \$150 million in 1991. After the issuance of the first of the biological opinions affecting Federal System operations, Bonneville’s fish and wildlife costs and revenue impacts rose to \$399 million in 1995. In late fiscal year 1995, compliance with the then newly issued 1995 Biological Opinion and other biological opinions then in effect was estimated to increase Bonneville’s total fish and wildlife costs and revenue impacts to between \$605 million and \$640 million annually through 2006. In October 1995, the Clinton Administration and members of the Northwest Congressional delegation agreed upon the basic framework for fiscal years 1996-2001 to provide adequate funds to implement the biological opinions, to meet Bonneville’s other fish and wildlife obligations, to provide a stable budget for Bonneville to implement its fish and wildlife obligations and to provide rate certainty to Bonneville ratepayers.

In September 1996, several federal agencies executed an Interagency Memorandum of Agreement (“Interagency MOA”) to implement the general agreement among the Northwest Congressional delegation and the Clinton Administration. The Interagency MOA was effective through the end of fiscal year 2001. It included a six-year funding plan for Bonneville, which anticipated that Bonneville would make funds available for anticipated costs of implementing the biological opinions and other fish and wildlife obligations. The amount that Bonneville was to make available was an average of \$252 million annually for fish and wildlife measures, plus a range of financial impact (\$90 million to \$280 million annually, with an expected average of \$180 million annually) for lost revenues and increased power purchases to Bonneville resulting from operations of the Federal System for fish. The fish and wildlife funding obligation encompassed virtually all of Bonneville’s anticipated fish and wildlife costs during the term of the Interagency MOA.

Additional Agreements in Connection with the Interagency MOA. Additional agreements reached in October 1995 among the U.S. Treasury, the Office of Management and Budget, DOE and others provide for certain credits that will offset Bonneville’s fish and wildlife cost referred to in the preceding paragraph. Under these documents, the Clinton Administration agreed that Bonneville would implement a previously unused provision of the Northwest Power Act, section 4(h)(10)(C). This provision allows Bonneville to exercise its Northwest Power Act authorities to implement fish and wildlife mitigation on behalf of all of a project’s Congressionally authorized purposes, such as irrigation, navigation, power and flood control, then recoup (*i.e.*, take a credit for) the portion in excess of that allocated to power purposes. The agreement directs Bonneville to recoup these expenses by reducing its cash transfers to the United States Treasury in an amount equal to the non-power share of the mitigation. The agreement also directs Bonneville to recoup replacement power costs and direct program costs (Bonneville fish and wildlife expenditures). The amount of such recoupments in fiscal year 2001 was about \$354 million, including about \$12 million in upward adjustments to past years’ recoupments based on the application of the recoupment formula to actual data. These credits are treated as revenues in Bonneville’s ratemaking process, and such recoupments are taken against Bonneville’s lowest priority financial obligation, its payments to the U.S. Treasury.

The Clinton Administration also agreed to establish a “Contingency Fund” to offset extraordinary revenue impacts from operations were there to occur certain adverse court rulings relating to biological opinions, specified poor water conditions and costs resulting from natural disasters or fishery emergencies. The source of the Contingency Fund is amounts Bonneville had theretofore expended for the non-power portion of fish and wildlife costs but had not recouped under section 4(h)(10)(C) against its payments to the U.S. Treasury. In 1997, Bonneville certified that there were approximately \$325 million in costs for past mitigation that had not been recouped against its payments to the U.S. Treasury. Bonneville obtained access to the Contingency Fund for the first time at the end of fiscal year 2001 in view of the poor water conditions that year, and applied about \$247 million from the Contingency Fund to reduce its cash payments to the U.S. Treasury.

Bonneville received both 4(h)(10)(C) and Contingency Fund credits against its fiscal year 2001 payments to the U.S. Treasury based on the best estimates at the time. Bonneville will “true-up” the amounts of both credits based on subsequent determinations of actual costs and actual water conditions, which will likely result in small additional adjustments in Bonneville’s payment obligations to the U.S. Treasury.

1998 Guidance Regarding Fish Costs. In September 1998, the Clinton Administration announced Fish and Wildlife Funding Principles (“1998 Guidance”) that would continue through fiscal year 2006 certain features of the Interagency MOA. First, the 1998 Guidance permits Bonneville to continue to receive recoupments against its U.S. Treasury repayment obligations in the

amount of certain fish and wildlife costs it incurred. Second, the 1998 Guidance provides that Bonneville will set rates for the five-year rate period beginning fiscal year 2002 to achieve no lower than an 80% probability of meeting its federal repayment responsibilities in full over such period. This goal is similar to the repayment probability guidance in the Interagency MOA. See “— Power Marketing Plan for the Period After Fiscal Year 2001.” As noted above, Bonneville received \$354 million in 4(h)(10)(C) credits and \$247 million in Contingency Fund credits in fiscal year 2001.

Council’s Fish and Wildlife Program. In November 2000, the Council adopted an amendment to its 1995 Fish and Wildlife Program (Amended Program). One of the Council’s stated goals in 1995 was to increase total adult salmon and steelhead runs above Bonneville Dam by 2025 to an average of five million annually. This goal is intended to support harvest by Indian tribes who have treaty fishing rights in the Columbia River basin, and non-tribal harvest. The Amended Program focuses on an ecosystem approach to rebuilding fish and wildlife populations in the Columbia River Basin, consistent with the 2000 Biological Opinion. The estimated costs to Bonneville of the Council’s Amended Program integrated with the off site mitigation requirements of the 2000 Biological Opinion were included in Bonneville’s power rate case assumptions for the period fiscal years 2002-2006. This amounts to an “integrated program” budget to Bonneville for both the Council Fish and Wildlife Program and the off-site mitigation program under the 2000 Biological Opinion in the amount of about \$186 million annually on average over the five-year period beginning October 1, 2001.

Bonneville can provide no assurance as to the scope or cost of future measures to protect fish and wildlife affected by the Federal System, including measures resulting from current and future listings under the ESA, current and future biological opinions or amendments thereto, future Council Fish and Wildlife Programs or amendments thereto, or litigation relating to the foregoing.

#### *Power Marketing Plan for the Period After Fiscal Year 2001*

##### General.

Under a power marketing approach (the “Subscription Strategy”) begun in 1997, Bonneville proposed to subscribe access to Federal System electric power under long-term contracts to its Regional customers to take effect on October 1, 2001, which is the date after which virtually all of Bonneville’s prior Regional power sales contracts and all of Bonneville’s Residential Exchange Program Contracts expired. Under the Subscription Strategy, Bonneville entered into long-term Subscription contracts through which it has contracted to sell all of its available firm power to Regional customers for various terms.

##### Preference Customer Loads.

Under the Subscription Strategy, Bonneville entered into long-term power sales contracts directly or indirectly to provide power to meet loads of about 135 Preference Customers. With the exception of eight contracts, which have terms of five years, such agreements have terms of ten years.

Under the Subscription Strategy, Bonneville agreed to sell Preference Customers three basic power products, which are not exclusive of each other: (i) Block Sales under which Bonneville provides fixed blocks of power at agreed times on a take or pay basis, (ii) Slice of the System, a form of requirements service in which Bonneville sells a proportion of Federal System output in return for a promise of the customer to pay a correlative proportion of the costs of the Federal System, and (iii) Partial and Full Requirements Product under which Bonneville provides partial or full requirements service for all or a portion of a customer’s loads. Full requirements customers accept constraints on their ability to shape their purchases from Bonneville for any reason other than following variations in consumer load. Partial requirements service is made available to Preference Customers who request firm power load requirements service but who also want some flexibility to shape their purchases from Bonneville to optimize their own resource operations.

Bonneville expects that under the foregoing agreements it will provide roughly 6300-6400 average megawatts of power to meet Preference Customer loads, on average, over the five year rate period beginning October 1, 2001, although Bonneville expects that its obligations will increase annually from fiscal year 2002 through fiscal year 2006. Bonneville will sell about 1600 average megawatts as Slice of the System and about 1900 average megawatts as Block Sales, in each case on average over the five years beginning October 1, 2001.

The remainder of Bonneville’s load obligations to Preference Customers is expected to be met in the form of Partial and Full Requirements Products. The exact amount of Bonneville’s obligation to Preference Customers is somewhat uncertain and depends on conservation activities, actual demand (which can fluctuate with weather and Regional economic activity), load reduction arrangements and other factors.

##### Residential Exchange Program Obligations.

As part of the Subscription Strategy, Bonneville and the six Regional IOUs participating in the Residential Exchange Program entered into six separate ten-year contracts that settle Bonneville’s statutory Residential Exchange Program obligations during such periods. For the five years beginning October 1, 2001, Bonneville contracted to satisfy this obligation through direct sales of 1000 average megawatts of firm power to the IOUs for five years, and cash payments for 900 average megawatts for the benefit of their residential and small farm loads in the Region.

Bonneville subsequently negotiated cash payments with five of the IOUs in lieu of firm power sales for varying quantities of power and varying terms over the first five years of the agreements. In addition, two of the six Regional IOUs exercised their right to terminate their firm power sales contracts and will take the monetary benefits described below. For the firm power sale obligation,



the contracts now provide that Bonneville will provide the Regional IOUs with about 300 average megawatts of actual power sales in fiscal years 2002 through 2006.

The rate for the power sales that remain in the 2002-2006 period is the Residential Load rate (RL), which is similar to Bonneville's lowest available requirements service rate, the PF Rate. All of Bonneville's power provided in settlement of the Residential Exchange Program will be "flat," meaning without shaping for seasonal or daily peak requirements.

Bonneville will also provide cash payments to the Regional IOUs for the benefit of about 900 average megawatts of their residential and small farm load in the Region, based on the difference between a forecast of the market price of power set in Bonneville's rate case and Bonneville's RL rate. Bonneville expects that these payments will amount to about \$148 million per year on average over the five years beginning October 1, 2001. See "— Certain Statutes and Other Matters Affecting Bonneville's Power Business Line — Residential Exchange Program."

For the five-year period after fiscal year 2006, Bonneville expects to meet its Residential Exchange settlement obligations in full through actual provision of about 2200 average megawatts of electric power. Bonneville believes it will have additional power available to meet this increased obligation from the expiration of other power sales obligations. Nonetheless, Bonneville negotiated default provisions for the payment of monetary benefits in lieu of power to the extent that Bonneville becomes unable to provide the full 2200 average megawatts of power in such period.

#### DSI Loads.

Under the Subscription Strategy, Bonneville contracted with eight DSI companies to sell on a take-or-pay basis an aggregate amount of approximately 1500 average megawatts to serve 14 separate industrial facilities through the five years beginning October 1, 2001. Over 95% of these sales will be to aluminum smelting or rolling facilities. This obligation will be "flat," meaning without shaping for seasonal or daily peak requirements. Subsequent to the entry into the foregoing DSI contracts, Bonneville entered into contract amendments reducing the amount of electric power Bonneville is obligated to sell to the DSIs to about 300 average megawatts starting in fiscal year 2002, and increasing back up to 1500 average megawatts in fiscal year 2003.

The new DSI power sales contracts, as amended, have terms that limit the participating DSIs' ability to curtail purchases and require that the DSIs pay for the power if Bonneville tenders it. Under these new agreements, if a DSI were unable or unwilling to take such power to operate its facilities, Bonneville will re-market the power and apply the proceeds to offset the related DSI's payment obligation to Bonneville. In the event that re-marketing proceeds are less than the amounts owing Bonneville under the DSI contract, the DSI will remain obligated to pay Bonneville the differential. In the event that re-marketing proceeds exceed the amounts due to Bonneville by the DSI, Bonneville would retain the excess proceeds as well.

#### Subscription Strategy Contracts Opt-Out Provisions.

While Bonneville and its customers have entered into the foregoing Subscription contracts, the ultimate amount of electric power load Bonneville is and will become obligated to meet under such contracts during the next five to ten years remains somewhat uncertain because the Subscription contracts have provisions allowing customers to terminate such contracts if FERC or the United States Court of Appeals for the Ninth Circuit, which reviews FERC actions on Bonneville's rates, subsequently remands Bonneville's proposed power rates because they under-recover Bonneville's costs and Bonneville publishes a record of decision that adopts higher rates for such period. The customers who do not opt out after review of the final rate proposals would be committed to purchase as provided in their Subscription contracts.

#### Risk Management.

Bonneville believes that its ability to recover power costs is and will be a function of several key risks: (i) the level and volatility of market prices for electric power in western North America, which define the cost of power Bonneville purchases to meet commitments that exceed Federal System resources; (ii) the level of Bonneville's load serving obligation after voluntary load reductions and negotiated power buy-backs; (iii) water conditions in the Columbia River drainage, which determine the amount of power Bonneville has to sell and its economic value and the amount of power it has to purchase in order to meet its commitments; (iv) changes in fish protection requirements, which could be the source of substantial additional expense to Bonneville and could further affect the amount and value of hydroelectric energy produced by the Federal System; and (v) operating costs, generally.

The ability to manage risk is measured by the U.S. Treasury payment probability. Statutes defining priority of payments dictate that Bonneville's Treasury payments be made after other payment obligations are satisfied. Therefore, the probability that Bonneville can pay the U.S. Treasury is a key indicator of Bonneville's overall cost recovery potential. Under repayment probability criteria from the Clinton Administration, beginning fiscal year 2002, Bonneville has proposed rates to obtain no less than an 80% probability of full and timely U.S. Treasury repayments over the five-year rate period. Bonneville believes that by using a combination of the following tools, among other things, its June 2001 Final Power Rate Proposal would meet an 82% to 88% probability of full and timely U.S. Treasury payments over the five-year rate period. See "—Certain Statutes and Other Matters Affecting Bonneville's Power Business Line — Fish and Wildlife."

To meet its risk targets, Bonneville will employ several tools. It will continue to implement cost reductions and manage its costs. It will continue to employ certain fish and wildlife credits allowed by the Northwest Power Act against Bonneville's U.S. Treasury payments and rely on the availability of the Contingency Fund (originally \$325 million, with an expected remaining available balance at the beginning of fiscal year 2002 of \$78 million). See "—Certain Statutes and Other Matters Affecting Bonneville's Power Business Line—Fish and Wildlife." Bonneville's June 2001 Final Power Rate Proposal includes an array of intra-rate period cost recovery adjustments that would permit Bonneville to increase rate levels within the rate period. Bonneville

believes that these adjustments will be adequate to maintain the desired U.S. Treasury payment probability and meet the identified range of purchase power cost, fish costs and other exposures.

#### Subscription Power Rate Proposal.

On June 29, 2001, Bonneville filed its June 2001 Final Power Rate Proposal with FERC, proposing power rates for the five years beginning October 1, 2001. On September 28, 2001 FERC granted interim approval of such rates pending final review.

The rate proposal includes proposed base rates applicable to the varying types of Subscription agreements and certain intra-rate period adjustments that will increase or decrease power rate levels depending on certain conditions. The base rate levels proposed by Bonneville are between approximately 19.3 mills per kilowatt hour and 23.0 mills per kilowatt hour, excluding transmission and depending on type of service. The base rates are at levels similar to those in effect for like service in the immediately preceding rate period. The rate proposal also includes three intra-rate period adjustment mechanisms under which Bonneville can increase, and in some instances decrease, power rate levels: a Load-Based Cost Recovery Adjustment Clause (LB-CRAC), a Financial-Based Cost Recovery Adjustment Clause (FB-CRAC) and a Safety-Net Cost Recovery Adjustment Clause (SN-CRAC).

The proposed LB-CRAC is designed to recover the net cost of system augmentation power purchases that is over and above the cost of such purchases that Bonneville forecasted in a rate filing prepared in July 2000. The expectation of increased system augmentation costs is based on: 1) the Bonneville's expectation that it will serve up to about 1500 average megawatts more load than was forecasted in the July 2000 rate filing, and 2) Bonneville's expectation that market prices for system augmentation purchases will be greater than the \$28.1 per megawatt-hour price forecasted in the July 2000 rate filing. The LB-CRAC is not designed to recover the cost of replacing reductions in the firm power generating capability included in the baseline estimate of Federal System firm power if any such reductions occur.

The LB-CRAC is based on periodic forecasts of Bonneville's Subscription resource augmentation costs for consecutive six-month periods during the five year rate period. Thus the LB-CRAC will be revised each six-month period during the rate period to reflect updated forecasts of Subscription Augmentation costs in the next six months. Another adjustment to the amounts recovered under LB-CRAC will reflect actual costs of Subscription Augmentation in the prior six-month period to the extent that the forecast for such augmentation costs were to differ from actual costs in such period. The LB-CRAC is proposed to be based on the cost of Subscription Augmentation only and would not be subject to any other provision limiting the amount of revenues to be derived by Bonneville thereunder.

In an effort to reduce the amount of Subscription loads and thus the amount of augmentation power purchases Bonneville would have to make, Bonneville entered into a number of load reduction agreements for the first two years of the rate period when anticipated prices for augmentation power are expected to be highest. As a consequence, Bonneville will increase rate levels under the LB-CRAC to a lesser extent than was originally expected. For the first six months of the rate period the LB-CRAC adjustment increased rate levels by 46% over the base rates for the rate period and, coincidentally, the rates for like service in the preceding rate period. Thus, power rate levels for the initial six month period will be between roughly 28 mills per kilowatt hour and 34 mills per kilowatt hour, excluding transmission and depending on type of service. On February 14, 2002, Bonneville notified its customers that the LB-CRAC for the six months beginning April 1, 2002, will be about 41% of base rates, meaning that overall rate levels will decline about 1-2 mills from rate levels in the prior six months.

The proposed FB-CRAC is designed to restore, on a forecasted basis, Bonneville's financial reserves to fiscal year-end reserve levels ("Reserve Targets") of \$300 million in fiscal years 2002 and 2003 and \$500 million in each of fiscal years 2004-2006. A rate level increase under the FB-CRAC would be implemented for an entire fiscal year and would occur during a subject fiscal year only if Bonneville's financial forecast made in the third quarter of the prior fiscal year were to indicate that the accumulated net revenues for the beginning of the subject fiscal year would be below the accumulated net revenue equivalent of the applicable Reserve Target. A rate increase under the FB-CRAC would continue through the end of the applicable fiscal year.

In fiscal years 2003-2006, the revenues to be derived under an FB-CRAC increase would be capped at a maximum of between \$135 million and \$175 million per fiscal year, depending on the year. Bonneville's third quarter fiscal year 2001 forecast concluded that Bonneville's accumulated net revenues at the end of fiscal year 2001 would be above the FB-CRAC threshold. Therefore, the FB-CRAC was not implemented for fiscal year 2002 rates. In view of power market and other developments, Bonneville believes that it is increasingly likely that Bonneville will use the FB-CRAC in fiscal year 2003. Bonneville currently believes that expected declines in the LB-CRAC levels through fiscal year 2003 may roughly offset rate level increases under a fully implemented FB-CRAC in fiscal year 2003.

The proposed SN-CRAC would be implemented to recover costs on a temporary basis if, at any time during the rate period, Bonneville were to (i) forecast a 50% probability or greater of missing a payment to the U.S. Treasury or other creditor or (ii) miss a payment to the U.S. Treasury or other creditor. A rate level increase under the SN-CRAC would occur independently of any LB-CRAC or FB-CRAC increase then in effect. The SN-CRAC could alter certain parameters of a future FB-CRAC, including the amount of revenue that can be collected, the duration of rate level adjustments, and the timing of collection of revenues, in each case under the FB-CRAC. Under the June 2001 Final Power Rate Proposal, Bonneville would determine the level of the SN-CRAC in a record of decision after a short formal rate-setting process.

The loads to be served under Slice of the System contracts (about 1600 average megawatts) will not be subject to the SN-CRAC or the FB-CRAC but will be subject to the LB-CRAC. These customers agreed to pay for a fixed portion of Federal System costs under their contracts and their rates are subject to annual adjustment to recover those costs. About 800 average megawatts of

loads of certain small Preference Customers under requirements contracts would not be subject to the LB-CRAC, or any other rate level adjustment mechanism. These Preference Customers entered into Subscription-related power sales contracts early and received certain contractual rate protections from Bonneville for making early commitments.

The June 2001 Final Power Rate Proposal also includes a provision in which Bonneville would rebate funds to Subscription customers in certain circumstances to the extent that Bonneville has financial reserves above certain fiscal year-end threshold amounts. Those amounts range between approximately \$1.7 billion at the end of fiscal year 2002, to \$1.2 billion at the end of fiscal year 2005.

With expected load growth and the expiration of certain load reduction agreements under which Bonneville agreed to pay parties to reduce their purchases of power from Bonneville, Bonneville's contracted Subscription loads could increase from about 6600 average megawatts in the aggregate in fiscal year 2002 to 8400 average megawatts in fiscal year 2003 (as about 1200 average megawatts of DSI load reduction agreements expire), thereafter gradually increasing to about 8600 average megawatts in the aggregate in fiscal year 2006. If such loads in fact are realized, the amount of resource augmentation purchases that Bonneville may be required to make could increase, and, depending on power prices and other factors, could increase power rate levels under the LB-CRAC provisions of the June 2001 Final Power Rate Proposal. Bonneville believes, however, that the prospect of substantial power rate level increases could affect the amount of Subscription loads that Bonneville will serve during the rate period. Higher rate levels could lead some customers to reduce their purchase commitments under the relevant provisions in their Subscription contracts or to negotiate load reduction agreements, as was the case in fiscal year 2001.

In particular, DSI loads as a class may decrease below Bonneville's current Subscription sales commitment of about 1500 average megawatts for fiscal years 2003 through 2006. Bonneville estimates that current aluminum prices are not sufficiently high to induce the aluminum DSI's with whom Bonneville has entered into Subscription contracts to use all of such power if Bonneville's rate levels currently in effect (on an interim basis pending final FERC review) were to continue. In addition, under certain conditions, certain Regional IOUs may also choose to exercise contract options that allow them to convert their aggregate 300 average megawatts of power purchases under their Residential Exchange Settlement contracts to cash payments in lieu of actual power deliveries. See "POWER BUSINESS LINE — Customers and Other Power Contract Parties of Bonneville's Power Business Line — Effect on Bonneville of the Kaiser Aluminum Bankruptcy."

Rate Proposal for Surplus Power. With regard to rates for surplus firm power, Bonneville continues to employ flexible rates that recover Bonneville's cost of providing such power, but at rates that enable Bonneville to participate in power markets. Bonneville does not expect to have substantial firm power to market during the next five years because of Subscription sales. The amount of surplus power that Bonneville will market at such rates will depend on generation and load conditions that vary with weather, streamflows, market conditions and numerous other factors.

#### *Recovery of Stranded Power Function Costs*

As a consequence of regulatory and economic changes in electric power markets, many utilities see potential for certain of their costs, in particular power system costs, to become unrecoverable, *i.e.*, "stranded." Stranded costs may arise where power customers are able, pursuant to new open transmission access rules, to reach new sources of supply, leaving behind unamortized power system costs incurred on their behalf. Bonneville could also face this concern. While Bonneville has separate statutory authority requiring it to assure that its revenues are sufficient to recover all of its costs, additional authority may be required to assure that Bonneville's payments to the United States Treasury are made on time and in full. Depending on the exact nature of wholesale and retail transmission access, it is possible that Bonneville's power function may not be able to recover all of its costs in the event that Bonneville's cost of power exceeds market prices. See "— Power Marketing Plan for the Period After Fiscal Year 2001." Nonetheless, Bonneville cannot predict with certainty its cost of power or market prices.

FERC's 1996 order, "Order 888," to promote competition in wholesale power markets established standards that a public utility under the Federal Power Act must satisfy to recover stranded wholesale power costs. The standards contain limitations and restrictions, which, if applied to Bonneville, could affect Bonneville's ability to recover stranded costs in certain circumstances. However, Bonneville's Acting General Counsel interprets FERC Order 888 as not addressing stranded cost recovery by Bonneville under either the Northwest Power Act or section 211/212 of the Federal Power Act. For a discussion of Order 888 and sections 211/212 of the Federal Power Act, as amended by EPA-1992, see "TRANSMISSION BUSINESS LINE — Nondiscriminatory Transmission Access and Separation of Business Lines."

Bonneville's rates for any FERC-ordered transmission service pursuant to section 211/212 of the Federal Power Act are governed only by Bonneville's applicable law, except that no such rate shall be unjust, unreasonable or unduly discriminatory or preferential, as determined by FERC. In the opinion of Bonneville's Acting General Counsel, provisions of the Northwest Power Act directing Bonneville to recover its total cost would be applicable to any stranded cost to be recovered by Bonneville were Bonneville ordered by FERC to provide transmission under section 211/212.

Shortly after the issuance of Order 888, Bonneville requested clarification of the application of FERC's stranded cost rule to Bonneville in the context of a section 211/212 order for transmission service. In FERC Order 888-A, modifying original FERC Order 888, FERC addressed Bonneville's request by stating: "We clarify that our review of stranded cost recovery by [Bonneville] would take into account the statutory requirements of the Northwest Power Act and the other authorities under which we regulate [Bonneville] . . . and/or section 212(i), as appropriate." Therefore, it remains unclear how FERC would balance Bonneville's Northwest Power Act cost recovery standards with the stranded cost rule as enunciated in FERC Order 888 in the context of FERC-ordered transmission service pursuant to section 211/212. Several of Bonneville's transmission customers, however, have taken the

position that transmission rates may not be set to recover stranded power costs as Bonneville envisions under the Northwest Power Act.

### *Changes in the Regulation of Regional Retail Power Markets*

Since the 1990's, many states and the Federal government have examined possible regulatory changes in retail electric power markets. In general, these proposals would allow end-use electricity consumers to choose their energy suppliers and to purchase power at market prices. This approach contrasts with the formerly predominant regulatory approach, where electric utilities have legal or de facto exclusive retail service territories. In general, the utilities are under an obligation to provide service to consumers located in the utilities' respective service areas. The utilities receive regulated rates of return in the case of profit-making utilities, or are required to sell their power at rates that are cost-based in the case of public agency or cooperatively owned utilities. As under wholesale competitive power markets, the core issue in establishing retail choice is assuring that facilities for transmitting electric power, at the distribution level, be available to all market participants in a manner that does not discriminate in favor of power sales by the owner of such facilities.

Bonneville is limited in its legal authority to sell power directly to end-use consumers, other than to state and Federal agencies and specified DSIs. Accordingly, Bonneville expects to continue to sell the majority of its electric power on a wholesale basis to electric utilities who resell to retail loads. The advent of competition in retail power markets could affect the manner in which Bonneville markets power and the ability of its wholesale customers, in particular its Preference Customers, to maintain the electric power loads they now rely on Bonneville to meet. In such a scenario, Bonneville may be forced to market more of its power to non-utility marketers or load aggregators for resale to end-users. Depending on the terms of any retail access legislation, the reliability of revenues Preference Customers now have from electric power consumers could be diminished. Under some retail access approaches, utilities would have a reduced ability to recover power costs in reliance on their exclusive ownership of distribution facilities for retail service to their end users.

It is possible that state law proposals for competitive retail markets may include features that would affect the ability of utilities to perform contractual commitments, such as the Net Billing Agreements, that were entered into prior to the effective date of the legislation. Under the Net Billing Agreements, the Participants have an unconditional obligation to pay amounts to Energy Northwest for which they obtain net billing credits and cash from Bonneville in amounts equal to the Participants' respective payments to Energy Northwest. Any legislation that precludes Participants from continuing to satisfy their Net Billing Agreement payment obligations could cause a disruption in the cash flow to Energy Northwest in the unlikely situation where both (i) the Participants make insufficient purchases from Bonneville to offset in total their Net Billed Project costs and (ii) the Bonneville Fund is restricted or cash in the Bonneville Fund is unavailable to meet Bonneville's payment obligation to the Participants.

In 1997, the State of Montana, in which a small number of cooperatively owned Net Billing Participants conduct business, enacted legislation providing for competitive retail markets. The legislation enables such cooperatives voluntarily to permit retail choice in their service territories. Under the legislation, if a Montana Net Billing Participant were to provide access over its distribution facilities to competitors, it would nonetheless be entitled to collect "transition costs" on a non-avoidable basis, subject to the obligation to mitigate transition costs. Transition costs are defined to include "existing commitments or obligations incurred before [the effective date of the legislation] . . . ." Under the Montana legislation, the ability of a Participant to collect transition charges is not limited in duration. Also, the Montana Net Billing Participants retain discretion to determine the extent and nature of their transition costs. To date, only one Montana electric power cooperative has chosen to permit full retail choice for all customers in its service territory. This cooperative has not experienced load loss, apparently due to the favorable rates it is able to offer its customers.

In 1999, the State of Oregon enacted a retail competition law. The Oregon law specifically preserves the ability of Net Billing Participants located in Oregon to charge rates for use of distribution facilities to recover their obligations under their Net Billing Agreements. The implementation provisions of open access contained in this law were delayed with the passage of a subsequent law in 2001.

Most of the Net Billing Participants serve retail loads in Washington. In 1997, the state legislature considered but did not enact proposals to implement competitive retail power markets. No similar bills have since been introduced in the legislature and Bonneville believes it is very unlikely that a restructuring bill will be introduced in the near future. While Bonneville believes that retail competition legislation in Washington, if enacted, would preserve the Participants' obligations under the Net Billing Agreements, Bonneville cannot predict whether the state will enact retail competition or the terms thereof should such legislation be enacted.

Several Participants serve loads in Idaho. The Idaho State legislature has not introduced legislation that would provide retail competition.

## **TRANSMISSION BUSINESS LINE**

### **Bonneville's Transmission System**

The Federal System includes the transmission system that is owned, operated and maintained by Bonneville as well as the Federal hydroelectric projects and certain non-federal power resources. The Federal transmission system is composed of approximately 15,000 circuit miles of high voltage transmission lines, and over 300 substations and other related facilities that are located in Washington, Oregon, Idaho, and portions of Montana, Wyoming and northern California. The Federal transmission system includes an integrated network for service within the Pacific Northwest ("Network"), and approximately 80% of the northern

portion (north of California and Nevada) of the combined Southern Intertie. The Southern Intertie consists of three high voltage Alternating Current (AC) transmission lines and one Direct Current (DC) transmission line and associated facilities that interconnect the electric systems of the Pacific Northwest and Pacific Southwest and provide the primary bulk transmission link between the two regions. The rated transfer capability of the Southern Intertie AC in the north to south direction is 4800 megawatts of capacity ("MW"), and in the south to north direction is 3675 MW. The rated transfer capability of the DC line in both directions is 3100 MW. The operating transfer capability (or reliability transfer capability) of these facilities varies by generation patterns, weather conditions, load conditions and system outages.

The Federal System transmission facilities are used to deliver power between resources and loads within the Pacific Northwest, and to transmit power between and among the Region, western Canada and the Pacific Southwest. Bonneville's Transmission Business Line provides transmission services and transmission reliability (ancillary) services to many customers. These customers include the Bonneville Power Business Line for its out-of-Region sales; entities that buy and sell non-Federal power in the Region, such as Regional IOUs, Preference Customers, extra-Regional IOUs, independent power producers, aggregators and marketers; in-Region purchasers of Federal System power such as Preference Customers and DSIs; and generators, power marketers and utilities that seek to transmit power into, out of, or through the Region.

Bonneville constructed the Federal transmission system and is responsible for its operation and maintenance, and makes investments necessary to maintain the electrical stability and reliability of the system. As a matter of policy, Bonneville's transmission planning and operation decisions are guided by regional reliability practices. From time to time, Bonneville undertakes investments or reinforcements to or changes in the planning and operation of its transmission facilities to comply with the transmission system reliability criteria.

Bonneville continually monitors its transmission system and evaluates cost-effective responses needed for system stability and reliability on a long-term planning basis. A number of conditions, actions, and events could affect the electric transfer capability of Bonneville's transmission system and diminish the capacity of the system to a level that could require remedial measures. For example, operating conditions such as weather, system outages and changes in generation and load patterns, may reduce the reliability transfer capability of the transmission system in some locations and limit the capacity of the system to meet the needs of users of the transmission system, including Bonneville's Power Business Line.

While Bonneville's current transmission system investment plan calls for Bonneville to make investments of about \$208 million a year over the five fiscal years commencing October 1, 2001, Bonneville is currently studying additional possible transmission investments. Bonneville has not added significant capacity to its transmission system since 1987. The transmission system is operated at or near capacity and congestion is developing in some areas of the system. Load growth on the system has been about 1.8% a year and transmission use has grown about 2% a year. In addition, Bonneville expects to interconnect between 4,000 and 8,000 megawatts of proposed and new generation to the transmission system over the next four years. To ease congestion, integrate new generation and provide a reliability margin on the transmission system, Bonneville is exploring its ability to approximately double its currently planned-for transmission investment levels over the five year period. A number of issues will have to be resolved prior to Bonneville increasing its transmission investment levels, including identifying sources of funding and determining which investments should be made by Bonneville.

#### **Non-discriminatory Transmission Access and Separation of the Business Lines**

In general, the thrust of regulatory changes in the 1990s, both by Congress and FERC, has been to encourage transmission owners to provide open transmission access to their transmission systems on terms that do not discriminate in favor of the transmission owner's own power-marketing functions. EPA-1992 amended section 211/212 of the Federal Power Act to authorize FERC to order a "transmitting utility" to provide access to its transmission system at rates, and upon terms and conditions, that are just and reasonable, and not unduly discriminatory with respect to the transmitting utility's own use of its transmission system.

While Bonneville is not generally subject to the Federal Power Act, Bonneville is a "transmitting utility" under the EPA-1992 amendments to sections 211/212 of the Federal Power Act. Therefore FERC may order Bonneville to provide others with transmission access over the Federal System transmission facilities. FERC's authority also includes the ability to set the terms and conditions for such FERC-ordered transmission service. However, the transmission rates for FERC-ordered transmission under EPA-1992 are governed only by Bonneville's other applicable laws, except that no such rate shall be unjust, unreasonable or unduly discriminatory or preferential, as determined by FERC. Based on the legislative history relating to the provisions of EPA-1992 applicable to Bonneville, Bonneville's Acting General Counsel is of the opinion that Bonneville's rates for FERC-ordered transmission services under sections 211/212 are to be established by Bonneville, rather than by FERC, and reviewed by FERC through the same process and using the same statutory requirements of the Northwest Power Act as are otherwise applicable to Bonneville's transmission rates.

In April 1996, FERC issued an order, "Order 888," to promote competition in wholesale power markets. Among other things, Order 888 established a *pro forma* tariff providing the terms and conditions for non-discriminatory open access transmission service, and required all jurisdictional utilities to adopt the tariff. Order 888 also included a "reciprocity" provision that allows non-jurisdictional utilities to obtain non-discriminatory open access from transmitting utilities if the non-jurisdictional utility submits to FERC for its approval (i) an open access transmission tariff that substantially conforms to the *pro forma* tariff and (ii) transmission rates that are comparable to the rates the non-jurisdictional utility applies to itself.

Bonneville is a non-jurisdictional utility. Notwithstanding the limited applicability of FERC Order 888 to Bonneville, however, in 1996, Bonneville voluntarily adopted terms and conditions for a non-discriminatory open access transmission tariff and filed such tariff with FERC seeking a reciprocity order. Bonneville's tariff offers transmission service to Bonneville's Power

Business Line and other transmission users at the same tariff terms and conditions, and at the same rates. In March 1999, FERC found the tariff to be an acceptable reciprocity tariff. Bonneville has since revised and filed with FERC a new, open access tariff that conforms more closely to FERC's current *pro forma* open access tariff. In March 2001, FERC found Bonneville's new tariff to be an acceptable reciprocity tariff. The revised open access transmission tariff became effective beginning October 1, 2001.

In April 1996, FERC also issued an order ("Order 889") that sets forth "standards of conduct" for jurisdictional utilities that are transmission providers and have a power-marketing affiliate or function. In general, these standards of conduct are intended to assure that wholesale power marketers that are affiliated with a transmission owner do not obtain unfair market advantage by having preferential access to information regarding the transmission owner's transmission operations. While not subject to Order 889, Bonneville nonetheless separated its transmission and power functions into separate business lines in compliance with that order and has developed and submitted standards of conduct for FERC's review. FERC found Bonneville's standards of conduct to be acceptable in February 1999.

#### **Bonneville's Transmission and Ancillary Services Rates**

Under the Northwest Power Act, Bonneville sets transmission rates, in accordance with sound business principles, that recover the cost associated with the transmission of electric power over the Federal System transmission facilities, including amortization of the federal investment in the Federal transmission system over a reasonable number of years, and other costs and expenses during the rate period. FERC confirms Bonneville's transmission rates after a finding that such rates recover Bonneville's costs and expenses during the rate period, and are sufficient to make full and timely payments to the U.S. Treasury.

Bonneville's transmission rates must also equitably allocate the cost of the Federal transmission system between Federal System power and non-federal power using the transmission system. Since 1996, the Power Business Line and customers transmitting Federal System power are charged the same transmission rates as are charged customers transmitting non-federal power. In compliance with the statutory requirements for its rates, Bonneville separately accounts for transmission and power revenues and costs. Since 1996, it also sets separate transmission and power rates to recover their respective costs.

Bonneville's 2002 transmission and ancillary services rates were approved by FERC under the standards of the Northwest Power Act and under the reciprocity standards of Order 888. Such rates are effective through September 30, 2003. In spring 2002, Bonneville will begin early stages of developing proposed transmission rates for the period beginning October 1, 2003. Bonneville expects to release its initial transmission rate proposal sometime around December 2002.

#### **Bonneville's Participation in a Regional Transmission Organization**

Following the issuance in May 1999 of a notice of proposed rulemaking on regional transmission organizations ("RTOs"), in January 2000 FERC issued a final rule on RTOs that establishes minimum characteristics and functions for an RTO and requires that each jurisdictional utility make certain filings regarding the formation of and participation in an RTO. The order, "Order 2000," encouraged each jurisdictional utility (Bonneville is not a jurisdictional utility) to file a proposal for an RTO that would be operational by December 15, 2001.

In March 2000, Bonneville, six Pacific Northwest IOUs and two Nevada utilities (collectively, the "Filing Utilities") agreed to a set of RTO Principles and a general description of an RTO Form and Structure, and proposed to work to submit an RTO proposal to FERC. The RTO Principles provide, among other things, that "[w]ith respect to the Bonneville Power Administration, the RTO shall be designed so as (a) not to increase the risk to the United States Treasury or to third party bondholders and (b) to avoid financial restructuring of low-cost Bonneville debt."

In April 2000, the Filing Utilities began work to form an RTO that would operate their transmission assets in a geographical area that encompasses, with some exceptions, all of Bonneville's service territory, Utah, Nevada, eastern Montana and western Wyoming. In October 2000, the Filing Utilities filed with FERC a response to Order 2000 proposing the formation of a nonprofit RTO (to be named RTO West) for the foregoing region. The Phase 1 application, as revised in December 2000, included several draft documents, including draft Bylaws, a draft Agreement Limiting Liability, and a draft Transmission Operating Agreement (the "TOA") under which each Filing Utility would transfer the operation of certain transmission assets to RTO West. The Filing Utilities are preparing a Phase 2 application.

Under the evolving RTO West proposal, Bonneville would retain ownership of all of the Federal System transmission assets, but would transfer operational control over most of such facilities to RTO West. The draft TOA also provides that Bonneville would retain the responsibility for maintaining the Federal System transmission assets, including making necessary investments therein. Third parties could be allowed to participate in system expansions or upgrades. Until December 2011, costs for the use of Bonneville's transmission facilities would be recovered through Bonneville's company rates and other charges as applied under the proposed RTO West Tariff, through transfer payments, which are payments derived from existing contractual arrangements with customers electing to take RTO West Tariff service, and through rates applied to existing contracts for transmission customers who do not elect to take RTO West Tariff service. The draft TOA also provides that Bonneville will continue to set its costs and billing determinants which will be applied by RTO West to derive company rates to recover Bonneville's costs from its company loads. In the opinion of the Acting General Counsel to Bonneville, assuming the entry by Bonneville into the draft TOA, the draft TOA would be consistent with Bonneville's obligation to recover its costs. Under the draft TOA, no directive of RTO West may require Bonneville to violate its obligations under applicable statutes or regulations. Moreover, RTO West would have no authority to require Bonneville to expend federal funds.

In April 2001, FERC issued an order providing preliminary guidance on the RTO West proposal. FERC concluded, among other things, that RTO West should serve as an anchor for the ultimate formation of a larger “west-wide” RTO that would also include California, Nevada, Arizona, New Mexico and portions of other western states, and directed the Filing Utilities to file a status report no later than December 1, 2001 to address: 1) the resolution of interregional coordination issues, 2) plans for participation in RTO West by Canadian entities, 3) a framework for formation of a west-wide RTO, and 4) a timetable for achieving a west-wide RTO end state. FERC agreed with the provisions providing assurances and protections to Bonneville with respect to its ability to continue to meet its statutory, treaty, contractual and other responsibilities. FERC clarified that its jurisdiction over Bonneville is limited with regard to RTO formation, and that Bonneville’s authority to participate in RTO West is not subject to review by FERC. Further, FERC explained that any approval of RTO West does not grant Bonneville or any other participant an exemption from obtaining necessary approvals from other bodies, regulatory or otherwise, to join RTO West. The General Counsel to DOE issued an opinion in May 1999, that Bonneville’s participation in or affiliation with a regional transmission entity would not require federal legislation, provided the terms of such participation do not interfere with Bonneville’s ability to perform its statutory duties.

FERC found that RTO West will have the exclusive authority to make filings under section 205 of the Federal Power Act (applicable to jurisdictional utilities) that apply to rates, terms and conditions of transmission service, but acknowledged that Bonneville is not a Federal Power Act jurisdictional utility and clarified that Bonneville’s rates are established by the Administrator, and approved or disapproved by FERC. FERC acknowledged, however, that it does not have the power to modify Bonneville’s rates under the current statutes applicable to Bonneville.

FERC also rejected the RTO West proposal limiting the liability of the RTO West participants through a “no fault” liability structure for electric system property damage, liability limitations for tariff service interruptions, and indemnity provisions for bodily injury claims. In rejecting the proposed Liability Agreement, FERC relied on the Order 888 decision that FERC’s pro forma tariff was never intended to address liability issues, to explain that the Filing Utilities are not precluded from relying on the protection of state laws, when and where applicable, protecting utilities or others from claims founded in ordinary negligence or intentional wrongdoing. In a July 2001 order on rehearing, FERC reversed itself in part and agreed to accept the Filing Utilities original proposals to allocate risk among the transmission owners and the RTO, but did not change its decision on limits on liability to transmission customers for interruptions to tariff service and bodily injury claims. In the opinion of the Acting General Counsel to Bonneville, assuming the entry by Bonneville into the TOA, the Federal Torts Claims Act, which limits the grounds and manner in which the United States may be sued for actions sounding in tort, would continue to apply to actions taken by Bonneville in connection with RTO West. However, liability for actions taken by RTO West under the TOA and the RTO West Tariff could subject RTO West to liability.

In September 2001, one of Bonneville’s Preference Customers filed a petition to review the FERC orders in the U.S. Court of Appeals for the District of Columbia Circuit. The action was later dismissed.

The Filing Utilities continue to work on the remaining complex issues that must be resolved prior to initiation of operations by RTO West. A compliance filing reporting on interregional issues, participation of Canadian Entities and the plans for a west-wide RTO was filed with FERC in December 1, 2001. The Filing Utilities plan to make a more comprehensive Phase 2 filing in spring 2002. The filing is expected to include an updated draft TOA, among other documents. Bonneville’s current expectations are that RTO West will begin operating transmission assets in calendar year 2004 or 2005.

## **MATTERS RELATING TO THE POWER AND TRANSMISSION BUSINESS LINES**

### **Bonneville Ratemaking and Rates**

#### *Bonneville Ratemaking Standards*

Bonneville is required to periodically review and, as needed, to revise rates for power sold and transmission services provided in order to produce revenues that recover Bonneville’s costs, including its payments to the United States Treasury. The Northwest Power Act incorporates the provisions of other Bonneville organic statutes, including the Transmission System Act and the Flood Control Act. The Transmission System Act requires, among other things, that Bonneville establish its rates “with a view to encouraging the widest possible diversified use of electric power at the lowest possible rates to consumers consistent with sound business principles,” while having regard to recovery of costs and repayment to the United States Treasury. Substantially the same requirements are set forth in the Flood Control Act.

#### *Bonneville Ratemaking Procedures*

The Northwest Power Act contains specific ratemaking procedures used to develop a full and complete record supporting a proposal for revised rates. The procedures include publication of the proposed rate(s), together with a statement of justification and reasons in support of such rate(s), in the Federal Register and a hearing before a hearing officer. The hearing provides an opportunity to refute or rebut material submitted by Bonneville or other parties and also provides a reasonable opportunity for cross-examination, as permitted by the hearing officer. Upon the conclusion of the hearing, the hearing officer certifies a formal hearing record (including hearing transcripts, exhibits and such other materials and information as have been submitted during the hearing) to the Bonneville Administrator. This record provides the basis for the Administrator’s final decision, which must include a full and complete reasoning in support of the proposed rate(s).

### *Federal Energy Regulatory Commission Review of Rates Established by Bonneville*

Rates established by Bonneville under the Northwest Power Act may become effective only upon confirmation and approval by FERC, although FERC may grant interim approval of Bonneville's proposed rates pending FERC's final confirmation and approval.

FERC's review of Bonneville's firm power rates, Regional non-firm energy rates and transmission rates involves three standards set out in the Northwest Power Act. These standards require FERC to confirm and approve these Bonneville rates based on findings that such rates: (1) are sufficient to assure repayment of the federal investment in the Federal System over a reasonable number of years after first meeting Bonneville's other costs; (2) are based on Bonneville's total system costs; and (3) insofar as transmission rates are concerned, equitably allocate the costs of the federal transmission system between federal and non-federal power utilizing such system. FERC does not, however, review Bonneville's rate design or the cost allocation for rates for firm power and Regional non-firm energy. For a discussion of FERC regulations related to transmission access and rates, see "TRANSMISSION BUSINESS LINE — Non-discriminatory Transmission Access and Separation of the Business Lines."

In confirming and approving Bonneville's rates for non-firm energy sold for use outside the Region, FERC reviews whether such rates were designed: (1) having regard to the recovery of cost of generation and transmission of such electric energy; (2) so as to encourage the most widespread use of Bonneville power; (3) to provide the lowest possible rates to consumers consistent with sound business principles; and (4) in a manner which protects the interests of the United States in amortizing its investments in the Federal System within a reasonable period. The Northwest Power Act provides for the possibility of an additional rate hearing before FERC on non-regional non-firm energy rates, based on the record developed at Bonneville.

Upon reviewing Bonneville's rates, FERC may either confirm or reject a rate proposed by Bonneville. FERC lacks the authority to establish a rate in lieu of a proposed rate that FERC finds does not meet the applicable standards. In the opinion of Bonneville's Acting General Counsel, if FERC were to reject a proposed Bonneville rate, FERC would be limited to remanding the proposed rate to Bonneville for further proceedings as Bonneville deems appropriate. On remand, Bonneville would have to reformulate the proposed rate to comply with the statutory ratemaking standards. If FERC were to have given Bonneville interim approval, Bonneville may be required to refund the difference between the interim rate charged and any such final, FERC-approved rate. However, Bonneville is required by law to set rates to meet all its costs; thus, it is the opinion of Bonneville's Acting General Counsel that Bonneville may be required to increase its rates to seek to recover the amount of any such refunds, if needed.

### *Judicial Review of Federal Energy Regulatory Commission Final Decision*

FERC's final approval of a proposed Bonneville rate is a final action subject to direct, exclusive review by the United States Court of Appeals for the Ninth Circuit. Suits challenging final actions must be filed within 90 days of the time such action is deemed final. The record upon review by the court is limited to the administrative record compiled in accordance with the Northwest Power Act.

Unlike FERC, the court reviews all of Bonneville's ratemaking for conformance with all Northwest Power Act standards, including those ratemaking standards incorporated by reference in the Northwest Power Act. In the opinion of Bonneville's Acting General Counsel, the court lacks the authority to establish a Bonneville rate. Upon review, the court may either affirm or remand a rate to FERC or Bonneville, as appropriate. On remand, Bonneville would have to reformulate the remanded rate. Bonneville's flexibility in establishing rates could be restricted by the rejection of a Bonneville rate, depending on the grounds for the rejection. Bonneville may be subject to refund obligations if the reformulated rate were lower than the remanded rate. However, Bonneville is required by law to set rates to meet all its costs; thus, it is the opinion of Bonneville's Acting General Counsel that Bonneville may be required to increase its rates to seek to recover the amount of any such refunds, if needed.

### *Power Customer Classes*

The Northwest Power Act, as well as other Bonneville organic statutes, provides for the sale of power: (1) to public and certain federal agency customers; (2) to direct service industrial customers; and (3) for those portions of their load which qualify as "residential," to investor-owned and public utilities participating in the Residential Exchange Program. See "POWER BUSINESS LINE — Certain Statutes and Other Matters Affecting Bonneville's Power Business Line and — Residential Exchange Program." The rates for power sold to these respective customers classes are based on allocation of the costs of the various resources available to Bonneville, consistent with the various statutory directives contained in Bonneville's organic statutes.

### *Other Firm Power Rates*

Bonneville's rates for other firm power sales within the Region are based on the cost of such resources as Bonneville may decide are applicable to such sales. Bonneville also sells similarly priced surplus firm power outside the Northwest, primarily to California, under short-term power sales that allow for flexible prices, or under long-term contract rates.

### *Non-firm Energy*

Non-firm energy is priced in accordance with the statutory standards (contained in the Northwest Power Act) applicable to such sales, as discussed above. Non-firm energy is available within and without the Pacific Northwest, with most sales being made to California utilities that use non-firm energy to displace the operation of more expensive thermal resources.



### **Limitations on Suits Against Bonneville**

Suits challenging Bonneville's actions or inaction may only be brought pursuant to certain federal statutes that waive sovereign immunity. These statutes limit the types of actions, remedies available, procedures to be followed and the proper forum. In the opinion of Bonneville's Acting General Counsel, the exclusive remedy available for a breach of contract by Bonneville is a judgment for money damages. See "Bonneville Litigation" for information regarding pending litigation seeking to compel or restrain action by Bonneville.

### **Laws Relating to Environmental Protection**

Bonneville must comply with the National Environmental Policy Act ("NEPA"), which requires that federal agencies conduct an environmental review of a proposed federal action and prepare an environmental impact statement if the action proposed may significantly affect the quality of the human environment. NEPA may require that Bonneville follow statutory procedures prior to deciding whether to implement an action. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), the Resource Conservation and Recovery Act ("RCRA"), the Toxic Substance Control Act ("TSCA") and applicable state statutes and regulations, as well as amendments thereto, may result in Bonneville incurring unplanned costs to investigate and clean up sites where hazardous substances have been released or disposed of. There are currently three such sites. One of these sites is a Bonneville-operated facility awaiting determination by the EPA, but two are non-Bonneville sites wherein Bonneville has been identified as potentially a responsible party. Normally environmental protection costs are budgeted and do not exceed \$150,000 per site. While Bonneville anticipates that additional potential costs will be between \$1 million and \$2 million total over several years, Bonneville cannot assure the ultimate level of costs that may be incurred under these statutes.

### **Other Applicable Laws**

Many statutes, regulations and policies are or may become applicable to Bonneville, several of which could affect Bonneville's operations and finances. Bonneville cannot predict with certainty the ultimate effect such statutes, regulations or policies could have on its finances.

### **Columbia River Treaty**

Bonneville and the Corps have been designated by executive order to act as the "United States Entity" which, in conjunction with the "Canadian Entity," formulates and carries out operating arrangements necessary to implement the 1964 Columbia River Treaty (the "Treaty"). The United States and Canada entered into the Treaty to increase reservoir capacity in the Canadian reaches of the Columbia River Basin for the purposes of power generation and flood control.

Regulation of stream flows by the Canadian reservoirs enables six federal and five non-federal dams downstream in the United States to generate more usable, firm electric power. This increase in firm power is referred to as the "downstream power benefits." The Treaty specifies that the downstream power benefits be shared equally between the two countries. Canada's portion of the downstream power benefits is known as the "Canadian Entitlement."

The Treaty specifies that the Canadian Entitlement be delivered to Canada at a point on the border near Oliver, British Columbia, unless the United States Entity and the Canadian Entity agree to other arrangements. The United States Entity and Canadian Entity signed the "Columbia River Treaty Entity Agreement on Aspects of the Delivery of the Canadian Entitlement for April 1, 1998, through September 15, 2024" (the "Entity Agreement") on November 20, 1996, which was subsequently revised on March 29, 1999. As a result, the United States Entity does not have to build the proposed transmission line to a point near Oliver, British Columbia, in order to return the Canadian Entitlement.

The United States Entity and Canadian Entities have consulted on terms for possible disposal of portions of the Canadian Entitlement in the United States. Direct disposal of the Canadian Entitlement in the United States was authorized by the executive branches of the United States and Canadian governments through an exchange of diplomatic notes, which occurred on March 29, 1999. The United States Entity's obligation to return the Canadian Entitlement to the border under the Entity Agreement is not dependent upon the authority to directly dispose of the Canadian Entitlement in the United States.

### **Proposals For Federal Legislation And Administrative Action Relating To Bonneville**

Congress from time to time considers legislative changes that could affect electric power markets generally and Bonneville specifically. For example, several bills have proposed, among other things, granting buyers and sellers of power access to Bonneville's transmission under regulation comparable to regulation applicable to privately-owned transmission. Under this type of regulation, in general, a transmission owner may not use its transmission system to recover costs of its power function. This type of regulation would be at odds with Bonneville's Acting General Counsel's legal opinion of its current transmission rate authority under which Bonneville, would, if necessary, be required to use transmission rates to recover its power function costs. Other proposals advanced in Congress have included privatizing the federal power marketing agencies, including Bonneville, privatizing new and replacement capital facilities at federal hydroelectric projects, and requiring that Bonneville sell its power at auctioned market prices rather than under cost-based rates. None of these bills or proposals were enacted into law.

Bonneville cannot predict whether these or any other proposals relating to it will be enacted. Nor can Bonneville predict the terms any such future proposals or laws may include. It is possible that such proposals, if enacted, could affect Bonneville's obligation with respect to the Net Billed Bonds. However, Bonneville believes that any major electric industry restructuring affecting its obligations with respect to the Net Billed Bonds would require federal legislation. It is also possible that parties may propose

terms that could, if implemented, have an adverse impact on the tax-exempt status of the Net Billed Bonds. Bonneville would oppose any proposal that would have an adverse impact on the tax-exempt status or the credit structure of the Net Billed Bonds.

Bonneville is a federal agency. It is subject to direction or guidance in a number of respects from the U.S. Office of Management and Budget, DOE, FERC, the U.S. Treasury and other federal agencies. Bonneville is frequently the subject of, or would be otherwise affected by, various executive and administrative proposals. Bonneville is unable to predict the content of future proposals; however, it is possible that such proposals could materially affect Bonneville's operations and financial condition.

## **BONNEVILLE FINANCIAL OPERATIONS**

### **The Bonneville Fund**

Prior to 1974, Congress annually appropriated funds for the payment of Bonneville's obligations, including working capital expenditures. Under the Transmission System Act, Congress created the Bonneville Fund, a continuing appropriation available to meet all of Bonneville's cash obligations.

All receipts, collections and recoveries of Bonneville in cash from all sources are now deposited in the Bonneville Fund. These include revenues from the sale of power and other services, trust funds, proceeds from the sale of bonds by Bonneville to the United States Treasury (see "Bonneville Borrowing Authority"), any appropriations by Congress for the Bonneville Fund and any other Bonneville cash receipts.

Bonneville is authorized to make expenditures from the Bonneville Fund without further appropriation and without fiscal year limitation if such expenditures have been included in Bonneville's annual budget to Congress. However, Bonneville's expenditures from the Bonneville Fund are subject to such directives or limitations as may be included in an appropriations act. Bonneville's annual budgets are reviewed and may be changed by the DOE and subsequently by the federal Office of Management and Budget. The Office of Management and Budget, after providing opportunity for Bonneville to respond to proposed changes, includes Bonneville's budget in the President's budget submitted to Congress.

The existence of the Bonneville Fund also enables Bonneville to enter into contractual obligations requiring cash payments that exceed, at the time the obligation is created, the sum of the amount of cash in the Bonneville Fund and available borrowing authority. Pursuant to the Project Act, Bonneville has broad authority to enter into contracts and make expenditures to accomplish its objectives.

No prior budget submittal, appropriation, or any prior Congressional action is required to create such obligations except in certain specified instances. These include construction of transmission facilities outside the Northwest, construction of major transmission facilities within the Northwest, construction of certain fish and wildlife facilities, condemnation of operating transmission facilities and acquisition of a major resource that is not consistent with the Power Plan.

### **The Federal System Investment**

The total cost of the multipurpose Corps and Bureau projects is allocated among the purposes served by the projects, which may include flood control, navigation, irrigation, municipal and industrial water supply, recreation, the protection, mitigation and enhancement of fish and wildlife, and the generation of power. The costs allocated to power generation from the Corps and Bureau projects as well as the cost of the transmission system prior to 1974 have been funded through appropriations. The capital costs of the transmission system since 1974, in addition to certain capital conservation and fish and wildlife costs since 1980, have been funded through the use of Bonneville's borrowing authority.

Bonneville is required by statute to establish rates that are sufficient to repay the federal investment in the power facilities of the Federal System within a reasonable period of years. The statutes, however, are not specific with regard to directives for the repayment of the Federal System investment, including what constitutes a reasonable period of years. Consequently, the details of the repayment policy have been established through administrative interpretation of the basic statutory requirements. The current administrative interpretation is embodied in the United States Secretary of Energy's directive RA 6120.2. The directive provides that Bonneville must establish rates that are sufficient to repay the federal investments within the average expected service life of the facility or 50 years, whichever is less. Bonneville develops a repayment schedule both to comply with investment due dates and to minimize costs over the repayment period. Costs are minimized in accordance with the United States Secretary of Energy's directive RA 6120.2 by repaying the highest interest-bearing investments first, to the extent possible. This method of determining the repayment schedule would result in some investments being repaid before their due dates, while assuring that all investments will be repaid by their due dates. As of September 30, 2001, Bonneville had repaid \$4.3 billion of principal of the Federal System investment and has \$4.7 billion principal amount outstanding.

### **Bonneville Borrowing Authority**

Bonneville is authorized to have outstanding up to \$3.75 billion principal amount of bonds that it may issue to the United States Treasury. Of this amount, \$2.69 billion of bonds were outstanding as of September 30, 2001. Under current law, none of this borrowing authority may be used to acquire electric power from a generating facility having a planned capability of more than 50 average megawatts.

The interest on Bonneville's outstanding bonds is set at rates comparable to rates on debt issued by other comparable federal government institutions at the time of issuance. As of September 30, 2001, the interest rates on the outstanding bonds ranged from 4.75% to 8.65% with a weighted average interest rate of approximately 6.49%. The original terms of the outstanding bonds vary from 3 to 40 years. The term of the bonds is limited by the average expected service life of the associated investment: 45 years

for transmission facilities and Corps and Bureau capital investments, 20 years for conservation investments and 15 years for fish and wildlife projects. All bonds with original maturities greater than 15 years may be called early, except for three bonds totaling \$258.8 million.

#### **Order in Which Bonneville's Costs Are Met**

Bonneville's operating revenues include net billing credits provided by Bonneville, under the Net Billing Agreements, to the Participants in return for payments by such customers to Energy Northwest to meet certain costs of the Columbia Generating Station, Project 1 and Project 3, and to the City of Eugene, Oregon, Water and Electric Board ("EWEB") to meet certain costs of the Trojan Nuclear Project, a terminated nuclear project owned in part by EWEB. Net billing credits reduce Bonneville's cash receipts by the amount of the credits. Thus, costs of the Trojan Nuclear Project, Project 1, the Columbia Generating Station and Project 3, to the extent covered by net billing credits, are paid without regard to amounts in the Bonneville Fund. These credits reduce the amount of revenues Bonneville has available to pay other obligations, including obligations due and provided by Bonneville under the Net Billing Agreements.

Bonneville is required to make certain annual payments to the United States Treasury. These payments are subject to the availability of net proceeds, which are gross cash receipts remaining in the Bonneville Fund after deducting all of the costs paid by Bonneville to operate and maintain the Federal System other than those used to make payments to the United States Treasury for: (i) the repayment of the federal investment in certain transmission facilities and the power generating facilities at federally-owned hydroelectric projects in the Pacific Northwest; (ii) debt service on bonds issued by Bonneville and sold to the United States Treasury; (iii) repayment of appropriated amounts to the Corps and the Bureau for costs that are allocated to power generation at federally-owned hydroelectric projects in the Pacific Northwest; and (iv) costs allocated to irrigation projects as are required by law to be recovered from power sales. Bonneville met its fiscal year 2001 payment responsibility to the United States Treasury of \$729 million in full and on time.

For various reasons, Bonneville's revenues from the sale of electric power and other services may vary significantly from year to year. In order to accommodate such fluctuations in revenues and to assure that Bonneville has sufficient revenues to pay the costs necessary to maintain and operate the Federal System, all cash payment obligations of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses, have priority over payments by Bonneville to the United States Treasury. In the opinion of Bonneville's Acting General Counsel, under Federal statutes, Bonneville may make payments to the United States Treasury only from net proceeds; all cash payments of Bonneville, including cash deficiency payments relating to Net Billed Bonds and other operating and maintenance expenses have priority over payments by Bonneville to the United States Treasury for the costs described in items (i) to (iv) in the preceding paragraph.

Bonneville is authorized to enter into new agreements to provide for additional net billing of its customers' bills. Nevertheless, because Bonneville is now able to enter into contractual obligations requiring cash payments that exceed, at the time the obligation is created, the sum of the amount in the Bonneville Fund and available borrowing authority, the primary reason for using net billing no longer exists. Bonneville has no present plans to enter into new agreements requiring net billing to fund resource acquisitions or other capital program investments.

The requirement to pay the United States Treasury exclusively from net proceeds would result in a deferral of payments to the United States Treasury in the event that net proceeds were not sufficient for Bonneville to make its annual payment in full to the United States Treasury. This could occur if Bonneville were to receive substantially less revenue or incur substantially greater costs than expected.

Under the repayment methodology as specified in the United States Secretary of Energy's directive RA 6120.2, amortization of the Federal System investment is paid after all other cash obligations have been met. If, in any year, Bonneville has insufficient cash to make a scheduled amortization payment, Bonneville must reschedule amortization payments not made in that year over the remaining repayment period. If a cash under-recovery were larger than the amount of planned amortization payments, Bonneville would first reschedule planned amortization payments and then defer current interest payments to the United States Treasury. When Bonneville defers an interest payment, the deferred amount is assigned a market interest rate determined by the Secretary of the United States Treasury and must be repaid before Bonneville can make any other repayment of principal to the United States Treasury. See the table under the heading "Statement of Non-Federal Project Debt Service Coverage and United States Treasury Payments" for historical United States Treasury payments.

#### **Direct Funding of Federal System Operations and Maintenance Expense**

In 1992, Congress enacted legislation authorizing but not requiring the Corps to enter into direct funding agreements with Bonneville for operations and maintenance activities for the benefit of the Federal System. Under direct funding, periodically during the course of each fiscal year, Bonneville would pay amounts directly to the Corps or Bureau for operations and maintenance of their respective Federal System hydroelectric facilities as the Corps or the Bureau and Bonneville may agree.

In November 1996, Bonneville and the Bureau agreed to a five-year direct funding agreement, beginning in fiscal year 1998, for roughly \$40 million in annual operations and maintenance expense at the Bureau's Federal System facilities. In December 1997, Bonneville and the Corps entered into a ten-year agreement for direct funding that is expected to result in roughly \$100 million per year in direct payments by Bonneville, beginning in fiscal year 1999. In September 2000, Bonneville and the FWS entered into a one-year agreement for direct funding of power related operations and maintenance costs of the Lower Snake River Compensation Plan Program ("Snake River Plan"), a fish and wildlife program funded in part by Bonneville. In January 2001, Bonneville and the FWS entered into a five-year agreement for direct funding of power related operations and maintenance costs of the Snake River

Plan. Bonneville's expenses for direct funding in fiscal year 2001 were \$55 million for the Bureau, \$117 million for the Corps, and \$13 million for the FWS.

Direct funding differs from historical practice under which (i) the Corps and Bureau obtained specific appropriations from Congress for Federal System operations and maintenance, with relatively little influence from Bonneville as to the nature or amount of any such expense and (ii) Bonneville repaid the appropriations, with interest, at the end of the fiscal year for which the appropriations were made, which repayments were otherwise subject to deferral if Bonneville had inadequate amounts in the Bonneville Fund. Under Bonneville's statutory priority of payments, Bonneville's repayments of amounts appropriated to the Corps and Bureau for Federal System operations and maintenance expense are made annually after the payment of Bonneville's non-federal payment obligations in the related fiscal year. As with Bonneville's other repayments to the Treasury, repayments of appropriated operations and maintenance expense would be subject to deferral if Bonneville were to have insufficient amounts in the Bonneville Fund to meet its non-federal payments.

Bonneville believes that, in contrast to historical practice, the direct payment approach increases Bonneville's influence on the Corps' and Bureau's Federal System operations and maintenance activities, expenses and budgets because, in general, Bonneville's approval becomes necessary for the Corps and Bureau to assure funding. Under the direct funding agreements, direct payments from Bonneville for operations and maintenance are subject to the prior application of amounts in the Bonneville Fund to the payment of Bonneville's non-federal obligations, including Bonneville's payments, if any, with respect to the Net Billed Projects. Notwithstanding the foregoing, as a practical matter, since direct payments would be made by cash disbursement from the Bonneville Fund during the course of the year rather than as a repayment of a loan at the end of the year, it is possible that direct payments could be made to the exclusion of non-federal payments that would otherwise have been paid under historical practice. A result of any direct payment obligation by Bonneville is that there would be a reduction in the amount of Federal System operations and maintenance appropriations that Bonneville would otherwise have to repay, thereby reducing the amount of Bonneville's repayments to the United States Treasury that would otherwise be subject to deferral. Nonetheless, during the proposed ten-year term of the direct payment agreement with the Corps, Bonneville expects to have roughly \$500 to \$800 million in scheduled annual payments to the United States Treasury, exclusive of the Corps' and Bureau's operation and maintenance expenses.

#### **Bureau's Reallocation of Costs of Grand Coulee Dam**

The costs of the Federally-owned hydroelectric dams of the Federal System are allocated among the various authorized purposes that the respective dams serve. In general, Bonneville is obligated to set rates to repay those portions of the costs of a Federally-owned dam that are allocated to the power purpose. In May 2000, the Bureau, in consultation with Bonneville and other Federal agencies, published a "Cost Reallocation Report" that became effective fiscal year 2001. The reallocation set forth in the report increased the proportion of joint costs of Grand Coulee Dam allocated to the power purpose (and hence to Bonneville). The reallocation increased the power purpose responsibility with respect to joint costs at the dam from about 40 percent to about 80 percent and decreased the allocation to the reclamation (irrigation) purpose ratably. Bonneville expects that its responsibility with respect to Grand Coulee Dam will increase from \$80 million per year to \$90 million per year on average over the next five years. These costs will be reflected primarily in increased interest and operations and maintenance expense borne by Bonneville.

#### **Hedging and Derivative Instrument Activities and Policies**

Bonneville's competitive success depends on its ability to manage business and financial risks associated with its commercial operations in a changing competitive environment. Effective management of electricity, aluminum and natural gas price risk can assist in efforts to manage Bonneville's revenues and expenses.

Bonneville is increasingly affected by price risk associated with commodities and streamflow uncertainty that in turn affect the predictability and stability of its revenues. These commodities include electricity, aluminum and natural gas. Bonneville desires to manage price and revenue risks resulting from electricity and natural gas volatility, hydro supply uncertainty and aluminum commodity price risk assumed by Bonneville in DSI power sales contracts.

Bonneville is concerned that its decisions to manage and economically hedge various revenue and price risks be conducted in an intelligent, business-like manner. To this end, Bonneville adopted its Hedging Policy to describe the guidelines, controls and management structure when there is a decision to hedge price and revenue risk in financial instruments. Bonneville's Hedging Policy allows the use of financial instruments such as commodity futures, options and swaps used to hedge price and revenue risk associated with electricity sales and purchases and to hedge risks associated with new product development. Bonneville uses financial instruments in the form of Over-the-Counter electricity swap agreements and options and Exchange traded futures contracts to hedge anticipated production and marketing of hydroelectric energy. The Policy does not authorize the use of financial instruments for non-hedging purposes, unless such use is expressly authorized under Section 6(d) of the Policy. The Policy does not apply to physical (power) transactions.

#### **Historical Federal System Financial Data**

Federal System historical financial data for fiscal years 1999 through 2001 are hereinafter set forth in the Federal System Statement of Revenues and Expenses. This information was extracted from audited financial statements or accounting records supporting the audited financial statements. Federal System financial statements are prepared in conformity with generally accepted accounting principles. The audited Financial Statements of the Federal System (which include accounts of Bonneville as well as those of the generating facilities of the Corps and the Bureau, for which Bonneville is the power marketing agency) for the fiscal year ended September 30, 2001 are included as Appendix A-1 hereto and Bonneville's unaudited quarterly report for the three months ended December 31, 2001 is included as Appendix A-2 hereto.

**Federal System Statement of Revenues and Expenses**  
**(Actual Dollars in Thousands)**

Fiscal year ending September 30,	1999	2000	2001
Operating Revenues:			
Sales of electric power —			
Sales within the Northwest Region —			
Publicly-owned utilities <sup>(1)</sup>	\$ 898,744	934,270	\$ 939,362
Aluminum industry	322,517	363,454	420,694
Investor-owned utilities	407,317	649,449	700,836
Other power sales	48,871	38,578	972
Sales outside the Northwest Region <sup>(2)</sup>	<u>586,139</u>	<u>652,221</u>	<u>1,084,077</u>
Total Sales of Electric Power	2,263,588	2,637,972	3,145,940
Transmission and other revenues <sup>(3)</sup>	<u>355,291</u>	<u>402,197</u>	<u>1,132,729</u>
Total Operating Revenues	2,618,879	3,040,169	4,278,669
Operating Expenses:			
Bonneville O&M <sup>(4)</sup>	463,688	506,878	530,618
Purchased Power <sup>(5)</sup>	265,304	624,882	2,291,961
Corps, Bureau and Fish & Wildlife O&M <sup>(6)</sup>	160,037	162,621	184,922
Non-Federal entities O&M — net billed <sup>(7)</sup>	185,353	193,085	208,839
Non-Federal entities O&M — non-net billed <sup>(8)</sup>	<u>41,663</u>	<u>32,942</u>	<u>30,719</u>
Total Operation and Maintenance	1,116,045	1,520,408	3,247,059
Net billed debt service	625,404	535,460	455,397
Non-net billed debt service	<u>25,689</u>	<u>25,139</u>	<u>21,818</u>
Non-Federal Projects Debt Service <sup>(9)</sup>	651,093	560,599	477,215
Federal Projects Depreciation	309,183	319,942	323,314
Residential Exchange <sup>(10)</sup>	<u>63,619</u>	<u>63,593</u>	<u>68,082</u>
Total Operating Expenses	<u>2,139,940</u>	<u>2,464,542</u>	<u>4,115,670</u>
Net Operating Revenues	<u>478,939</u>	<u>575,627</u>	<u>162,999</u>
Interest Expense:			
Appropriated Funds	314,042	315,826	317,213
Long-term debt	130,916	115,052	129,159
Capitalization Adjustment <sup>(11)</sup>	(64,886)	(67,474)	(68,784)
Allowance for funds used during construction	<u>(24,419)</u>	<u>(28,754)</u>	<u>(45,679)</u>
Net Interest Expense	355,653	334,650	331,909
Cumulative Effect of SFAS 133 <sup>(12)</sup>	<u>          </u>	<u>          </u>	<u>(168,491)</u>
Net Revenues/(Expenses)	<u>\$ 123,286</u>	<u>\$ 240,977</u>	<u>\$ (337,401)</u>
Total Sales — average megawatts (Net of Residential Exchange Program)	11,394	11,361	10,302

- (1) This customer group includes municipalities, public utility districts and rural electric cooperatives.
- (2) In general, revenues from sales outside the Northwest are highly dependent upon stream flows in the Columbia River Basin, which affect the amount of non-firm energy available for sale, and upon the costs of generating power with alternative fuels, which affect the price Bonneville can obtain for its exported non-firm energy and surplus firm power.
- (3) Bonneville obtains revenues from the provision of transmission and other related services. Bonneville also receives certain revenues from sources apart from power sales and the provision of transmission services. The \$47 million, or 13%, increase in fiscal year 2000 was primarily due to estimated Section 4(h)(10)(C) credits under the Northwest Power Act. Such credits were \$26.3 million, \$60.0 million and \$601 million for fiscal years 1999, 2000 and 2001, respectively. See "POWER BUSINESS LINE — Certain Statutes and Other Matters Affecting Bonneville's Power Business Line — Fish and Wildlife."
- (4) Bonneville operations and maintenance expenses include the costs of Bonneville's transmission system, operation and maintenance program, energy resources, power marketing, and fish and wildlife programs.
- (5) See "RECENT DEVELOPMENTS IN THE ELECTRIC UTILITY INDUSTRY AND BONNEVILLE'S COMPETITIVE POSITION — Power Market Developments."

- (6) Corps, Bureau and Fish & Wildlife operations and maintenance expenses include the costs for the Corps and Bureau generating facilities included in the Federal System as well as expenses incurred by the U.S. Fish & Wildlife Service in connection with the Federal System.
- (7) The Non-Federal entities O&M – net billed expense includes the operation and maintenance costs for generating facilities, the generating capability or output of which Bonneville has agreed to purchase under certain capitalized contracts which are net-billed.
- (8) The Non-Federal entities O&M – non-net-billed expense includes the operation and maintenance costs for generating facilities, the generating capability or output of which Bonneville has agreed to purchase under certain capitalized contracts which are not net-billed. The \$9 million, or 21%, decrease in fiscal year 2000 is largely due to decreased purchase commitments under alternative energy programs.
- (9) These amounts include payment by Bonneville for all or a part of the generating capability of, and debt service on, four nuclear power generating projects (three of which are terminated). They are Energy Northwest's Project 1, Project 3, and the Columbia Generating Station, and the City of Eugene Water and Electric Board's 30% ownership share of the Trojan Nuclear Project. These amounts also include payment by Bonneville with respect to several small generating and conservation projects.
- (10) See "POWER BUSINESS LINE — Certain Statutes and Other Matters Affecting Bonneville's Power Business Line" and "— Residential Exchange Program."
- (11) The capitalization adjustment represents the annual recognition of the reduction in principal realized from refinancing federal appropriations under legislation enacted in 1996.
- (12) On October 1, 2000, the date of adoption by Bonneville of Financial Accounting Standards Board Statement of Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), Bonneville recorded a cumulative-effect adjustment of \$168 million loss to recognize the difference between the carrying values and fair values of derivatives not designated as hedging instruments. The adjustment consisted primarily of transactions known as bookouts that the FASB initially determined should be fair valued in net revenue (expense). While authoritative accounting guidance in this area continued to emerge during fiscal year 2001, Bonneville management elected to apply the most current guidance available related to SFAS 133, as amended.

### **Management Discussion of Operating Results**

For fiscal year 2000, Bonneville had positive net revenues of approximately \$241 million, an increase of \$118 million over fiscal year 1999. Operating revenues increased by \$421 million despite a slightly below-average water year. This was primarily due to higher market prices for discretionary power sales that were essentially double those of the previous year. Sales outside the Region increased by 11% largely because of these higher wholesale prices. Revenues from the aluminum industry DSIs increased by 13% due to increasing firm power sales under certain aluminum companies' contractual provisions. Revenues from Investor-owned utilities increased significantly, about 59%, in fiscal year 2000 due to greater short-term power sales in a market with increasingly higher prices. As in the previous year, other power sales revenues decreased in fiscal year 2000 due to terminated Federal agency contracts in California and generally lower sales volume to non-aluminum customers in the Pacific Northwest.

In fiscal year 2000, purchased power expenses increased by \$360 million due to higher market prices, contributing significantly to an increase of approximately \$325 million in total operating expenses. Net-billed debt service decreased by \$90 million due primarily to the release of excess cash from certain debt service reserve accounts. Bonneville O & M increased slightly in fiscal year 2000 due to increased power marketing expenses and conservation services.

Bonneville had negative net revenues of approximately \$337 million in fiscal year 2001, a substantial decline of approximately \$578 million from net revenues in fiscal year 2000. Total operating revenues increased over fiscal year 2000 by approximately \$1.2 billion, despite a very low water year, primarily due to a tripling in market prices for discretionary power sales from the previous year, and a ten-fold increase in fish credits under the Northwest Power Act, as described below. These extremely high market prices translated into an increase of \$432 million, or 66%, in revenues from sales outside the Region. In addition, Bonneville remarketed power returned by certain aluminum company DSIs and the remarketing of this returned power increased revenues from the aluminum company DSIs by \$57 million, or 16%, in fiscal year 2001. The higher prices for power increased sales revenues from Regional IOUs by \$51 million, or 8%. Conversely, power sales revenues from non-aluminum company DSIs declined by approximately \$38 million, or 97%, due to decreased power sales to these customers. The \$731 million, or 182%, increase over fiscal year 2000 in revenues from transmission and other related services, is due to estimated Treasury repayment credits of \$354 million under Section 4(h)(10)(C) of the Northwest Power Act and to Treasury repayment credits of \$247 million from the Contingency Fund. Section 4(h)(10)(C) of the Northwest Power Act allows Bonneville to exercise its Northwest Power Act authorities to implement fish and wildlife mitigation on behalf of all of a project's Congressionally authorized purposes, such as irrigation, navigation, power and flood control, then recoup the portion in excess of that allocated to power purposes. Bonneville recoups these expenses by reducing its payments to the United States Treasury in an amount equal to the non-power share of the mitigation. The Contingency Fund is unused 4(h)(10)(C) credits that Bonneville accrued prior to fiscal year 1996. The Contingency

Fund is available to reduce Treasury payments by means of recoupment under certain specified conditions, including low water as was experienced in fiscal year 2001.

Total Operating Expenses increased by approximately \$1.6 billion in fiscal year 2001 over fiscal year 2000. This was in large part due to extremely high market prices for power in the Western markets. Purchased power expenses increased by \$1.67 billion, or 267%, due to a 137% increase in the amount of power purchased by Bonneville in response to low water conditions as well as the aforementioned high market prices at which such purchases were made. In addition, Corps, Bureau and Fish and Wildlife operations and maintenance expenses increased by \$22 million in fiscal year 2001 due to an increased maintenance program at the Corps designed to help increase the availability of generation units. Non-Federal entities O & M – net-billed expenses increased by \$16 million due to increased operating expenses related to the Columbia Generating Station. However, net-billed debt service decreased by \$80 million, or 15%, due to refinancing and restructuring of a portion of the outstanding net-billed debt.

#### **Statement of Non-Federal Project Debt Service Coverage**

The Statement of Non-Federal Project Debt Service Coverage and United States Treasury Payments uses the Federal System Statement of Revenue and Expenses to develop a non-federal Project debt service coverage ratio (“Non-Federal Project Debt Service Coverage Ratio”) which demonstrates how many times total non-federal Project debt service is covered by net funds available for non-federal Project debt service. Net funds available for non-federal Project debt service is defined as total operating revenues less operating expenses (see footnote 7 to the Statement of Non-Federal Project Debt Service Coverage below). Net funds available for non-federal Project debt service less total non-federal Project debt service yields the amount available for payment to the United States Treasury. This Non-Federal Project Debt Service Coverage Ratio does not reflect the actual priority of payments or distinctions between cash payments and credits under Bonneville’s net billing obligations. For a discussion of certain direct payments by Bonneville for Federal System operations and maintenance, which payments reduce the amount of deferrable appropriations obligations Bonneville would otherwise be responsible to repay. See “— Direct Funding of Corps and Bureau Federal System Operations and Maintenance Expense.”

**Statement of Non-Federal Project Debt Service Coverage and United States Treasury  
Payments  
(Actual Dollars in Thousands)**

Fiscal Years ending September 30,	1999	2000	2001
Total Operating Revenues	\$2,618,879	\$3,040,169	\$4,278,669
Less: Operating Expense <sup>(1)</sup>	<u>1,019,628</u>	<u>1,421,380</u>	<u>3,130,219</u>
Net Funds Available for Non-Federal Project Debt Service	1,599,251	1,618,789	1,148,450
Less: Total Non-Federal Project Debt Service <sup>(2)</sup>	<u>651,093</u>	<u>560,599</u>	<u>477,215</u>
Revenue Available for Treasury	948,158	1,058,190	671,235
Amount Paid to Treasury:			
Corps and Bureau O&M <sup>(3)</sup>	160,037	162,621	184,922
Net Interest Expense <sup>(4)</sup>	355,653	334,650	331,909
Capitalization Adjustment <sup>(5)</sup>	64,886	67,474	68,784
Allowance for Funds Used During Construction <sup>(4) (6)</sup>	8,441	8,578	12,479
Amortization of Principal	<u>190,984</u>	<u>289,925</u>	<u>210,127</u>
Total Amount Allocated for Payment to Treasury <sup>(7)</sup>	780,001	863,248	808,221
Revenues Available for Other Purposes <sup>(8)</sup>	168,157	194,942	\$ (136,986)
Non-Federal Project Debt Service Coverage Ratio <sup>(9)</sup>	2.5	2.9	2.4
Non-Federal Project Debt Service Plus Operating Expense Coverage Ratio <sup>(10)</sup>	1.6	1.5	1.2

- (1) Operating Expenses include the following items from the Federal System Statement of Revenues and Expenses: Bonneville O & M, Purchased Power, Non-Federal entities O & M-net billed, Non-Federal entities O & M non-net-billed, and the Residential Exchange Program. Operating Expenses do not include certain payments to the Corps and Bureau. Treatment of the Corps, Bureau and Fish & Wildlife operating expense is described in “— Direct Funding of Federal System Operations and Maintenance Expense.”
- (2) Includes net billed and non-net billed debt service. Non-net billed debt service amounted to \$25.7 million, \$25.1 million and \$21.8 million for fiscal years 1999, 2000 and 2001, respectively.
- (3) Amounts shown are calculated on an accrual basis and include direct operations and maintenance payments to the Corps and Bureau for fiscal years 1999, 2000 and 2001, and to Fish & Wildlife for fiscal year 2001. See “— Direct Funding of Federal System Operations and Maintenance Expense.”
- (4) Amounts shown are calculated on an accrual basis.
- (5) The capitalization adjustment is included in net interest expense but is not part of Bonneville’s payment to the United States Treasury.
- (6) The Allowance for Funds Used During Construction that Bonneville pays to the United States Treasury is Bonneville’s portion of the interest component on the Federal investment during the construction period.
- (7) Bonneville’s payments to the United States Treasury in fiscal years 1999, 2000 and 2001 were \$627 million, \$732 million and \$729 million, respectively. In fiscal years 1999, 2000 and 2001, respectively, direct payments to the Corps and Bureau for operations and maintenance were included in the amount of (i) \$106 million, \$104 million, and \$117 million for the Corps, and (ii) \$41 million, \$46 million and \$55 million for the Bureau. In fiscal year 2001, direct payments for Fish & Wildlife were \$13 million. See “— Direct Funding of Federal System Operations and Maintenance Expense.”



- (8) Revenues Available For Other Purposes approximates the change in reserves from year to year. Reserves were \$559 million at the end of fiscal year 1998 and \$625 million at the end of fiscal year 2001.
- (9) The “Non-Federal Debt Service Coverage Ratio” is defined as follows:

$$\frac{\text{Total Operating Revenues-Operating Expense (Footnote 1)}}{\text{Non-Federal Project Debt Service}}$$

- (10) The “Non-Federal Debt Service plus Operating Expense Coverage Ratio” is defined as follows:

$$\frac{\text{Total Operating Revenues}}{\text{Operating Expense (Footnote 1) + Non-Federal Project Debt Service}}$$

**Statement of Net Billing Obligations and Expenditures <sup>(1)</sup>**  
**(Actual Dollars in Thousands)**

Fiscal years ending September 30,	1999	2000	2001
Operating Revenues from Publicly-Owned Utilities <sup>(2)</sup>	\$898,744	\$934,270	\$939,362
Net Billing Obligations:			
Net Billing Credits	\$673,053	\$642,541	675,938
Payments in Lieu of Net Billing <sup>(3)</sup>	<u>138,809</u>	<u>66,992</u>	<u>57,283</u>
Net Billing Obligations — Cash	811,862	709,533	733,221
Net Billing Expenditures:			
Net Billed Debt Service	625,404	535,460	455,397
Other Entities O&M — Net Billed	185,353	193,085	208,839
Increase/(Decrease) in Prepaid Expense	<u>1,105</u>	<u>(19,012)</u> <sup>(4)</sup>	<u>68,985</u>
Net Billing Expenditures — Accrual	<u>\$811,862</u>	<u>\$709,533</u>	<u>\$733,221</u>

- (1) Bonneville funds its obligation for net billed project costs on a cash basis and it expenses the net billed project budgets on an accrual basis. This reconciliation ties the cash net billing obligation to the accrual net billing obligation through the changes in Bonneville’s prepaid expense.
- (2) Bonneville’s actual revenues from Publicly Owned Utilities exceeded net billing obligations. Most, but not all, of Bonneville’s Publicly Owned Utilities are Participants in the Net Billed Projects.
- (3) Includes voluntary direct cash payments made to Energy Northwest by Bonneville when the Participants’ obligations to Energy Northwest exceed the allowed net billing credits. See “SECURITY FOR THE NET BILLED BONDS — Payment Procedures — The Columbia Generating Station” and “— Payment Procedures — Terminated Projects,” herein, for a discussion of voluntary cash payments Bonneville makes to Energy Northwest in lieu of reassigning net billing shares among Participants.
- (4) Excludes \$22.2 million of prepaid expenses not associated with the Net Billed Projects.

**BONNEVILLE LITIGATION**

**Puget Sound Energy Inc. v. United States**

On July 1999, Puget Sound Energy Inc., (“Puget”), a Regional IOU, filed a breach of contract claim against the United States in the U.S. Court of Federal Claims (“Claims Court”), alleging that Bonneville overcharged Puget for certain construction costs relating to a segment of the Southern Intertie referred to as the “AC Line.” Under an agreement that Bonneville and Puget entered into in 1994, Puget received transmission capacity rights in the AC Line in return for a promise to reimburse Bonneville for certain costs Bonneville incurred in constructing the project. Puget seeks \$9.4 million in damages.

Upon a motion filed by Bonneville, the Claims Court transferred the case to the U.S. Court of Appeals for the Ninth Circuit (“Ninth Circuit Court”). The Claims Court ruled that the dispute is a transmission rates matter and that exclusive jurisdiction for such

challenges is vested in the Ninth Circuit Court. In January 2001, Bonneville filed a motion with the Ninth Circuit Court to dismiss the transferred case on the grounds that the original complaint was filed after the time permitted for challenging Bonneville actions in the Ninth Circuit and is therefore time-barred. The Ninth Circuit Court deferred the motion to the panel that will hear the case on the merits. Briefing on the merits has been completed. The court will now set a date for oral argument.

#### **City of Burbank, California v. United States**

In 1998, the City of Burbank, California (“Burbank”) filed a breach of contract claim against the United States in the Claims Court. Burbank alleges that Bonneville breached a Power Sales and Exchange Agreement with Burbank by (i) converting the power delivery obligation under the agreement from a power sales mode to a power exchange mode and (ii) improperly calculating the power rate that Burbank is responsible to pay under the agreement. Burbank seeks between \$3 million and \$4 million in damages.

Without motion of any party to the litigation, in July 2000, the Claims Court dismissed Burbank’s action on the grounds that the matter is a dispute over a Bonneville rate and actions taken by Bonneville under its governing statutes and therefore exclusive jurisdiction lies with the Ninth Circuit Court. In addition, on Bonneville’s motion, the court found that Burbank failed to follow certain procedures required under the Contract Disputes Act. Burbank appealed the dismissal to the U.S. Court of Appeals for the Federal Circuit. The Court of Appeals reversed the Claims Court on the jurisdictional issue and remanded the Contract Disputes Act matter to the Claims Court.

#### **Residential Exchange Program Litigation**

In connection with Subscription, Bonneville prepared certain *pro forma* Residential Purchase and Sales Agreements (“RPSAs”) and tendered the form of such agreements to the Regional IOUs for their consideration and possible execution. The *pro forma* RPSAs proposed to define Bonneville’s statutory obligations under the Residential Exchange Program provisions of the Northwest Power Act for the ten-year period beginning October 1, 2001. See “POWER BUSINESS LINE — Certain Statutes and Other Matters Affecting Bonneville’s Power Business Line,” “— Residential Exchange Program” and “— Power Marketing Plan for the Period After Fiscal Year 2001.”

During the same time-frame, Bonneville negotiated certain agreements (the “Exchange Settlements”) with Regional IOUs to settle Bonneville’s statutory Residential Exchange Program obligation under such agreements in lieu of the RPSAs for the five- and/or ten-year period beginning October 1, 2001. In October 2000, all six Regional IOUs entered into the Exchange Settlements in lieu of the RPSAs.

A number of Bonneville’s customers and customer groups filed petitions with the Ninth Circuit Court seeking review of the RPSAs and the Exchange Settlements. A number of interventions have also been filed in the foregoing challenges. Among those participating in the litigation are a group of DSIs, all six Regional IOUs and a number of Preference Customers and Preference Customer groups.

The petitions for review do not specify the precise nature of the challenges to Bonneville’s final actions with regard to the RPSAs and the Exchange Settlements, but allege generally that the RPSAs and Exchange Settlements violate the Bonneville Project Act, the Pacific Northwest Consumer Power Preference Act, the Transmission System Act, the Northwest Power Act, NEPA, and/or the Administrative Procedure Act. Bonneville expects the likely remedies sought would be that the Exchange Settlements, and/or RPSAs, be remanded to Bonneville for redevelopment or that Regional IOUs be allowed only to participate in the Residential Exchange Program under the RPSAs.

The briefing schedules have been vacated, and the cases have been stayed.

#### **Challenge to Standards for Service**

On March 27, 2000, Montana Electricity Buying Cooperative (“MEBC”) filed a petition for review in the Ninth Circuit Court challenging Bonneville’s policy on standards for service with which an entity must comply in order to qualify as a “utility” customer. Specifically, MEBC challenged Bonneville’s standard requiring that a utility customer must own the distribution system used to serve the customer’s retail consumers. MEBC, which does not own a distribution system to serve the retail customer loads at issue in the proceeding, sought to purchase power from Bonneville for ultimate service to residential ratepayers of Montana Power Company. On July 9, 2001, the Ninth Circuit Court dismissed the petition for review on the basis that it was not timely filed. MEBC did not file an appeal of the holding, thus ending the litigation.

#### **5(b)/9(c) Policy Challenge**

In July 2000, a number of Bonneville customers filed individual petitions in the Ninth Circuit Court seeking review of Bonneville’s policy on determining customer net requirements under sections 5(b) and 9(c) of the Northwest Power Act (the “5(b)/9(c) Policy”). The court subsequently consolidated the petitions into a single proceeding. Among those challenging the policy are individual Preference Customers, two Regional IOUs and a DSI. Intervenors include another Regional IOU, two associations of Preference Customers, an association of industrial electricity customers in the Region and the State of Oregon.

The 5(b)/9(c) Policy is an important component of Bonneville’s execution and implementation of the Subscription power sales contracts. Under section 5(b) of the Northwest Power Act, Bonneville is obligated to offer a contract to each requesting Preference Customer and Regional IOU to meet its respective firm loads within the Region, net of the resources used by the utility to serve such loads. In making this determination, Bonneville has a corresponding duty to apply the provisions of section 9(c) of the Northwest Power Act and section 3(d) of the Regional Preference Act. These sections require that Bonneville reduce the amount of Federal System power Bonneville would otherwise be obligated to supply by the amount of power a requesting customer is exporting

from its own resources outside the Pacific Northwest which could have been conserved or otherwise retained by the customer for use in the Pacific Northwest.

Under the 5(b)/9(c) Policy, Bonneville defines the conditions under which a Regional customer may export power out of the Region from its own resources without decreasing the amount of requirements service it may receive from Bonneville.

This matter has been included in the mediation program for the Ninth Circuit Court, and settlement discussions are underway.

#### **M-S-R Public Power Agency, *et al.*, v. Bonneville Power Administration**

In 1999, Bonneville was sued by numerous DSIs, as well as the M-S-R Public Power Agency (“M-S-R”), a power agency established pursuant to the laws of California, in the U.S. Court of Appeals for the Ninth Circuit. The DSIs and M-S-R seek review of Bonneville’s August 30, 1999 “Excess Federal Power” determination. In that determination, Bonneville provided its customers notice of the amount of surplus power Bonneville is authorized to market as excess federal power. Excess federal power is surplus power that Bonneville may sell for up to seven years without the recall constraints that would otherwise apply by reason of the Regional Preference Act. The amount of such power varies based on periodic determinations by Bonneville under its Excess Federal Power Policy. See “POWER BUSINESS LINE — Customers of Bonneville’s Power Business Line — Exports of Surplus Power to the Pacific Southwest.” These parties are asking the court to determine whether Bonneville’s determination of the amount of excess federal power for the period August 1999 through July 2009 was in compliance with its statutory authority.

In addition, M-S-R filed a petition for review of Bonneville’s September 28, 2000 preliminary annual excess federal power determination, as well as Bonneville’s September 29, 2000 notification to M-S-R that firm power will likely not be available for sale to M-S-R for the Contract Year that begins on October 1, 2004. On December 19, 2000, Bonneville issued its final Excess Federal Power determination for the year 2000.

In the event the DSIs or M-S-R were to prevail, Bonneville believes its excess federal power determinations for the years 1999 and 2000 would likely be remanded back to Bonneville for further consideration.

#### **Kaiser Aluminum & Chemical Corp. v. Bonneville Power Administration**

Three of Bonneville’s DSI customers sued Bonneville in the Ninth Circuit Court challenging Bonneville’s decisions to offer to sell them surplus firm power under Bonneville’s “FPS-96” rate schedule, rather than under Bonneville’s lower cost “IP-96” rate schedule. These DSIs – Vinalco, Inc., Kaiser Aluminum & Chemical Corporation (“Kaiser”), and the Aluminum Company of America, Inc. (“ALCOA”) – alleged that Bonneville violated provisions of the Northwest Power Act and the Regional Preference Act. They alleged that Bonneville was impermissibly marketing surplus power outside the Pacific Northwest while refusing to sell them power in the Pacific Northwest. They further alleged Bonneville was violating Bonneville’s rate schedules. In addition, Kaiser alleged Bonneville was in breach of its power sales contract by such marketing and that Bonneville’s refusal to arbitrate this case was a further breach of its power sales contract. On August 11, 2001, the Ninth Circuit Court issued an opinion and order dismissing the challenges. Kaiser thereafter filed a petition seeking rehearing of one of the rulings in the case: that a party may not arbitrate a matter that is within the exclusive jurisdiction of the Ninth Circuit Court. The petition for rehearing was denied and the case was dismissed.

#### **Pacific Northwest Generating Cooperative v. Bonneville Power Administration**

In April, 2000, Bonneville issued a document entitled “Power Subscription Strategy — Administrator’s Supplemental Record of Decision” (“Supplemental Subscription Strategy ROD”). The Supplemental Subscription Strategy ROD was issued to address issues and developments that had occurred since Bonneville issued its original Subscription Strategy Record of Decision in December 1998. The Subscription Strategy Record of Decision, and the Supplemental Subscription Strategy ROD set the course for Bonneville to establish rates and offer power sales contracts upon expiration of previously existing contracts on September 30, 2001.

Shortly after issuance of the Supplemental Subscription Strategy ROD, Bonneville was sued in the Ninth Circuit Court by Vinalco, Inc. (a DSI), Puget Sound Energy (a Regional IOU), and the Pacific Northwest Generating Cooperative (“PNGC”) and its members. The PNGC is a consortium of generating cooperative Preference Customers in the Pacific Northwest. Petitioner Vinalco has voluntarily withdrawn from the litigation, and, in an order dated January 23, 2001, the existing briefing schedule was vacated and the PNGC and Puget cases were selected for inclusion in the Ninth Circuit Court’s mediation program. The case has been stayed.

In the event that the litigation were to proceed, it is possible that the challenged decisions would be remanded to Bonneville to redetermine the amount of power allocated to various customer classes under Subscription and the terms under which such power would be provided.

#### **National Wildlife Federation v. U.S. Army Corps of Engineers**

In a lawsuit filed in March 1999 in the United States District Court for the District of Oregon, the National Wildlife Federation (“NWF”), an advocate for environmental causes, has asked the court (1) to find that the Corps has violated state water quality standards for dissolved gas and temperature at four Federal System dams in the lower Snake River and (2) to order the Corps to present to the court a plan for meeting the standards. Plaintiffs seek a court order that would require the Corps to take immediate actions to meet state water quality standards.

Among the measures that plaintiffs assert would reduce dissolved gas are a number of capital improvements such as installation of stilling basins and dividers between spillways. Example of measures to control water temperatures include boring

additional channels in a dam so that a dam could pass water from varying depths in the dam's reservoir and draining reservoirs behind the dams so that the river, although smaller in volume, flows more quickly.

On February 16, 2001, the court issued an opinion and order granting summary judgment in favor of NWF. The court found that the Corps did not adequately address compliance with its legal obligations under the Clean Water Act in the Corps' 1998 record of decision on dam operations under biological opinions, and supplements thereto, then in effect under the ESA. For a discussion of biological opinions affecting the Federal System hydroelectric projects, see "POWER BUSINESS LINE—Certain Statutes and Other Matters Affecting Bonneville's Power Business Line — Fish and Wildlife." The court ordered the Corps to issue a new decision by the latter part of April 2001 to replace the Corps' 1998 record of decision and to address compliance with the Clean Water Act in the new decision.

In May, the Corps filed with the court a new Record of Consultation and Statement of Decision ("ROCASOD"). As expressed in the ROCASOD, the Corps agreed to consider additional measures in future years to improve water quality. In August, plaintiffs filed an amended complaint challenging the adequacy of the new ROCASOD.

On December 21, 2001, the court issued an order setting forth a briefing schedule and directing plaintiffs to file a motion for summary judgment together with initial briefing on such motion by February 15, 2002. Bonneville has not yet reviewed the briefing but the Corps has informed Bonneville that at least one such brief included a request for injunctive relief in addition to a request for remand of the amended ROCASOD to the Corps. The Corps has informed Bonneville that the request for injunctive relief, if successful, could lead to increased funding or program requirements to meet state water quality standards.

### **California Oregon Intertie (COI) Transmission Dispute**

In March 2000, the Transmission Agency of Northern California ("TANC"), a joint-powers agency of the State of California and a participant in transmission facilities in that state, filed an action against Bonneville, the Sierra Pacific Power Co. ("Sierra Pacific"), PacifiCorp, and the Portland General Electric Company in California state court. TANC challenged Bonneville's participation in the interconnection of its federal transmission facilities with facilities owned and operated by Sierra Pacific (Alturas interconnection). TANC alleged the interconnection adversely affects its rights under agreements related to the Pacific Northwest-Southwest AC Intertie (COI transmission line). The action was removed to the U.S. District Court for the Eastern District of California (District Court). TANC's claims against Bonneville include inverse condemnation, trespass, nuisance, conversion and breach of contract. TANC seeks damages in the amount of \$23 million.

In November 2000, Bonneville moved to dismiss TANC's complaint on the basis that the Ninth Circuit Court has exclusive jurisdiction over Bonneville in this matter and other grounds. The other named defendants have also moved to dismiss TANC's claims on other grounds. In February 2001, the District Court dismissed all claims against Bonneville on a determination that the court lacked jurisdiction to review the claims. The court also dismissed all claims against the other defendants. In March 2001, TANC appealed the District Court's decision to the Ninth Circuit Court and the parties await a ruling.

TANC's complaint in the foregoing litigation is similar to another matter before FERC. In 1998, Sierra Pacific sought approval from FERC for the Alturas interconnection, which FERC granted. TANC and other California public and private utilities intervened in the proceeding, asserting the interconnection adversely affected reliability of the COI transmission line. In March 2001, the Presiding Administrative Law Judge ("ALJ") issued an Initial Decision, which substantially supports Bonneville's position. The Ninth Circuit heard this case on February 11, 2002. The Initial Decision is on appeal before FERC and the parties await a decision.

### **Sierra Club v. Bonneville Power Administration; Confederated Tribes of the Umatilla Indian Reservation and the Nez Perce Tribe**

On or about November 5, 2001, the Sierra Club and other environmental organizations petitioned the Ninth Circuit Court to review Bonneville's decision document of August 2001 that sets forth certain aspects of the implementation of the 2000 Biological Opinion and compliance with other laws. See "—Power Business Line—Certain Statutes and Other Matters Affecting Bonneville's Power Business Line—Fish and Wildlife—2000 Biological Opinion." A similar petition was filed by the Confederated Tribes of the Umatilla Indian Reservation and the Nez Perce Tribe. Among other things, the challenged decision document provides guidance for operating the Federal System hydroelectric dams in a manner intended to protect listed fish species under the ESA. The decision document also provides certain exceptions to such operations in the event power generation is needed to address emergency electric system needs.

The Sierra Club alleges that Bonneville's decision document does not comply with provisions of the Northwest Power Act directing Bonneville to exercise its fish and wildlife responsibilities in a manner that provides "equitable treatment" for fish and wildlife with other purposes for which the Federal System facilities are managed and operated. Petitioners seek to vacate the decision document and remand it to Bonneville to make it comply with the Northwest Power Act and other applicable law.

### **Blachly-Lane Electric Cooperative, et al. v. Bonneville Power Administration**

A consortium of publicly-owned utilities, municipalities and cooperatives filed a petition for review in the Ninth Circuit Court on or about September 18, 2001. The petitioners allege that in a Record of Decision dated June 20, 2001, Bonneville decided to sell more power than is available from the Federal Base System resources, including sales to DSIs, resulting in a shift of an estimated \$550 million per year in power costs to Bonneville's preference customers. The petitioners allege that Bonneville's actions violated public preference provisions of the Northwest Power Act.

### **Southern California Edison v. Bonneville Power Administration**

Southern California Edison (“Southern”) filed three separate petitions for review against Bonneville in the Ninth Circuit Court. The cases all challenge actions taken by Bonneville regarding the implementation of a 1988 power sales contract between Bonneville and Southern.

In the first petition for review, Southern challenges Bonneville’s decision to convert from a sale of power to an exchange of power. On January 18, 2002, the Ninth Circuit Court determined that it lacked jurisdiction over the matter and transferred the case to the Claims Court. In the second petition for review, Southern challenges a Record of Decision issued by Bonneville in its rate adjustment proceeding. Southern alleges that the rate adjustment violates its power sales contract. Motions to dismiss or transfer this case to the Claims Court are pending before the Ninth Circuit Court. In the third petition for review, Southern challenges Bonneville’s letter to Southern terminating service under its power sales contract due to Southern’s nonperformance.

### **Kevin Bell, et al. v. Bonneville Power Administration**

Two petitions for review were filed in the Ninth Circuit Court by certain individuals challenging Bonneville’s decisions to execute certain agreements with most of Bonneville’s DSIs. These agreements are generally called load reduction or curtailment agreements. The agreements were executed during 2001 to enable Bonneville to reduce its obligations to serve power to these customers, and to buy power back from these customers at below market prices at a time when market prices for power were extremely high. A briefing schedule has been established.

### **ESA Litigation**

#### **National Wildlife Federation v. National Marine Fisheries Service**

In a lawsuit filed May 4, 2001, in the United States District Court for the District of Oregon, the National Wildlife Federation and other plaintiffs asked the court: (1) to declare that NMFS’ 2000 biological opinion and incidental take statement are arbitrary and capricious, an abuse of discretion, and otherwise not in accordance with law, and (2) to order NMFS to reinstate consultation with the action agencies responsible for operation of the Federal System hydroelectric projects--the Corps, the Bureau, and Bonneville--and to prepare a new biological opinion. Plaintiffs subsequently filed a First Amended Complaint, and the action agencies filed their answer. Several entities have moved or may move to intervene in this lawsuit. Mediation is scheduled to begin in February 2002.

#### **Alsea Valley Alliance v. Evans**

On September 10, 2001, the United States District Court for the District of Oregon issued an order finding that NMFS had exceeded its authority by listing only the wild-salmon portion of the Oregon Coast Coho salmon as endangered or threatened. The court found that because NMFS did not include the entire “distinct population segment” which also includes hatchery fish, it acted arbitrarily and capriciously. As a result, the court delisted the Oregon Coast Coho salmon as endangered or threatened. If appeals of the decision are not made, or are unsuccessful, NMFS listings of other fish populations may have to be reconsidered. In light of the District Court order, other groups may commence litigation to de-list additional species of salmon and steelhead located in the Snake and Columbia River basins. The long-term implications of this decision and its effect on Bonneville are difficult to predict. Petitioners have appealed and the Ninth Circuit Court has suspended the District Court’s order pending an appeal.

### **Rates Litigation**

Bonneville’s rates are frequently the subject of litigation. Most of the litigation involves claims that Bonneville’s rates are inconsistent with statutory directives, are not supported by substantial evidence in the record or are arbitrary and capricious. Bonneville is proposing power and transmission rates to be effective October 1, 2001. See “POWER BUSINESS LINE — Power Marketing Plan for the Period After Fiscal Year 2001,” “TRANSMISSION BUSINESS LINE — Bonneville’s Transmission and Ancillary Services Rates” and “MATTERS RELATING TO THE POWER AND TRANSMISSION BUSINESS LINES — Bonneville Ratemaking and Rates.”

It is the opinion of Bonneville’s Acting General Counsel that if any rate were to be rejected, the sole remedy accorded would be a remand to Bonneville to establish a new rate. Bonneville’s flexibility in establishing rates could be restricted by the rejection of a Bonneville rate, depending on the grounds for the rejection. Bonneville is unable to predict, however, what new rate it would establish if a rate were rejected. If Bonneville were to establish a rate that was lower than the rejected rate, a petitioner may be entitled to a refund in the amount overpaid. However, Bonneville is required by law to set rates to meet all of its costs; provided, however, that in the case of a FERC ordered transmission rate no such rate shall be unjust, unreasonable or unduly discriminatory. Thus, it is the opinion of Bonneville’s Acting General Counsel that Bonneville may be required to increase its rates to seek to recover the amount of any such refunds, if needed.

### **Miscellaneous Litigation**

From time to time, Bonneville is involved in numerous other cases and arbitration proceedings, including land, contract, employment, federal procurement and tort claims, some of which could result in money judgments or increased costs to Bonneville. The combined amount of damages claimed in these unrelated actions is not expected to exceed \$50 million.

## LEGAL MATTERS

The approving opinions of Willkie Farr & Gallagher, Bond Counsel to Energy Northwest, as to the legality of the Series 2002-A Bonds will be in substantially the forms appended hereto in Appendices C-1 and C-3. The opinion of Orrick, Herrington & Sutcliffe LLP, Special Tax Counsel, as to the exclusion of the interest on the Series 2002-A Bonds from the gross income of the owner thereof for federal income tax purposes will be in substantially the forms appended in Appendix D.

Bond Counsel and General Counsel to Energy Northwest will also render opinions with respect to the validity and enforceability of the Net Billing Agreements and the Assignment Agreements relating to Project 1 and Columbia. In rendering their opinions with respect to such Net Billing Agreements, Bond Counsel and General Counsel to Energy Northwest will assume the correctness of the opinions of counsel to each of the Participants, rendered in 1971, 1972, 1973 and 1974 as to (1) the due organization of and the due authorization of such Net Billing Agreements by such Participants, (2) the due execution and delivery by such Participants of such Net Billing Agreements and (3) the fact that such Net Billing Agreements did not violate or conflict with applicable law. As to the due authorization, execution and delivery of such Net Billing Agreements and Assignment Agreements by Bonneville and certain other matters, Bond Counsel and General Counsel to Energy Northwest will rely on the opinion of Bonneville's Acting General Counsel. Copies of the proposed forms of these opinions of Bond Counsel are appended hereto in Appendices C-2 and C-4.

See "SECURITY FOR THE PRIOR LIEN BONDS — Net Billing Agreements" and "— Assignment Agreements" for a discussion of Bonneville's agreement to pay directly to Energy Northwest certain amounts which are not paid by a Participant and for a discussion of certain of Bonneville's obligations under the Assignment Agreements.

Upon delivery of the Series 2002-A Bonds, and application of the proceeds thereof in accordance with the bond resolutions and escrow agreements, Bond Counsel will also render an opinion to the effect that all of the Refunded Bonds will no longer be deemed outstanding within the meaning of the related Prior Lien Resolution.

Certain legal matters, including the enforceability against Bonneville of the Net Billing Agreements and the Assignment Agreements relating to Project 1 and Columbia, will be passed upon for Bonneville by its Acting General Counsel and by its Special Counsel, Orrick, Herrington & Sutcliffe LLP, New York, New York.

Certain legal matters will be passed upon for the Underwriters by O'Melveny & Myers LLP, New York, New York, Counsel to the Underwriters.

## TAX EXEMPTION

In the opinion of Special Tax Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, compliance with certain covenants, interest on the Series 2002-A Bonds is excluded from gross income for federal income tax purposes under Title XIII of the Tax Reform Act of 1986, as amended (the "1986 Act"), and Section 103 of the Internal Revenue Code of 1954, as amended (the "Code"). Special Tax Counsel is of the further opinion that interest on the Series 2002-A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Special Tax Counsel observes that such interest is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income. In rendering its opinion, Special Tax Counsel has relied on the opinion of Bond Counsel as to the validity of the Series 2002-A Bonds and the due authorization and issuance of the Series 2002-A Bonds. A complete copy of the proposed form of opinion of Special Tax Counsel is set forth in Appendix D hereto.

The amount by which the respective issue prices of the Series 2002-A Bonds of each maturity is less than the amount to be paid at maturity of such Series 2002-A Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series 2002-A Bonds) constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Series 2002-A Bonds, as applicable, and is excluded from gross income for federal income tax purposes. For this purpose, the issue price of each maturity of the Series 2002-A Bonds is the first price at which a substantial amount of the Series 2002-A Bonds of such maturity is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to the Series 2002-A Bonds accrues daily over the term to maturity of such Series 2002-A Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Series 2002-A Bonds to determine taxable gain or loss upon disposition (including sale, redemption or payment on maturity) of such Series 2002-A Bonds. Beneficial Owners of the Series 2002-A Bonds should consult their own tax advisors with respect to the tax consequences of ownership of the Series 2002-A Bonds, as applicable, including the treatment of purchasers who do not purchase such Series 2002-A Bonds in the original offering to the public at the first price at which a substantial amount of such Series 2002-A Bonds of the same maturity is sold to the public.

Series 2002-A Bonds purchased, whether at original issuance or otherwise, for an amount greater 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 purchaser's basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such purchaser. 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 1986 Act 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 Series 2002-A Bonds. Energy Northwest and Bonneville have covenanted to comply with certain restrictions designed to insure that interest on the Series 2002-A Bonds will not be included in federal gross income. Failure to comply with these covenants may result in interest on the Series 2002-A Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Series 2002-A Bonds. The opinion of Special Tax Counsel assumes compliance with these covenants. Special Tax Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) after the date of issuance of the Series 2002-A Bonds may adversely affect the value of, or the tax status of interest on, the Series 2002-A Bonds. Further, no assurance can be given that pending or future legislation or amendments to the 1986 Act, if enacted into law, or any proposed legislation or amendments to the 1986 Act, will not adversely affect the value of, or the tax status of interest on, the Series 2002-A Bonds.

Certain agreements, requirements and procedures contained or referred to in the Net Billed Resolutions, as applicable, the Tax Matters Certificates to be executed by Energy Northwest and by Bonneville simultaneously with the issuance of the Series 2002-A Bonds, and other relevant documents may be changed and certain actions may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Special Tax Counsel expresses no opinion as to any Series 2002-A Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than Orrick, Herrington & Sutcliffe LLP.

Although Special Tax Counsel is of the opinion that interest on the Series 2002-A Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of interest on, the Series 2002-A Bonds may otherwise affect a Beneficial Owner's federal or state tax liability. The nature and extent of these other tax consequences will depend upon the particular tax status of the Beneficial Owner or the Beneficial Owner's other items of income or deduction. Special Tax Counsel expresses no opinion regarding any such other tax consequences.

#### **RATINGS**

Fitch, Moody's and S&P have assigned the Series 2002-A Bonds the ratings of AAA, Aaa and AAA, respectively, based upon the Policies being issued for the Series 2002-A Bonds. Ratings were applied for by Energy Northwest and certain information was supplied by Energy Northwest and Bonneville to such rating agencies to be considered in evaluating the Series 2002-A Bonds. Such ratings reflect only the respective views of such rating agencies, and an explanation of the significance of such ratings may be obtained only from the rating agency furnishing the same. There is no assurance that any or all of such ratings will be retained for any given period of time or that the same will not be revised downward or withdrawn entirely by the rating agency furnishing the same if, in its judgment, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2002-A Bonds.

#### **UNDERWRITING**

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series 2002-A Bonds from Energy Northwest at an aggregate underwriting discount from the initial public offering prices set forth on the inside cover page of this Official Statement of \$2,170,732.40 and to make a bona fide public offering of the Series 2002-A Bonds at not in excess of such public offering prices. The Underwriters' obligations are subject to certain conditions precedent contained in the bond purchase contract and they will be obligated to purchase all such Series 2002-A Bonds, if any such Series 2002-A Bonds are purchased. The Series 2002-A Bonds may be offered and sold to certain dealers, banks and others (including underwriters and other dealers depositing such Series 2002-A Bonds into investment trusts) at prices lower than such initial offering prices and such initial offering prices may be changed from time to time by the Underwriters of the Series 2002-A Bonds.

#### **CONTINUING DISCLOSURE**

Pursuant to Rule 15c2-12 under the Securities Exchange Act of 1934 ("Rule 15c2-12"), Energy Northwest and Bonneville will enter into a Continuing Disclosure Agreement, to be dated the date of delivery of the Series 2002-A Bonds, for the benefit of holders of the Series 2002-A Bonds, to provide certain financial information and operating data relating to Energy Northwest (the "Energy Northwest Annual Information"), certain financial information and operating data relating to Bonneville (the "Bonneville Annual Information" and, together with Energy Northwest Annual Information, the "Annual Information") and to provide notices of the occurrence of certain enumerated events with respect to Series 2002-A Bonds, if material. Energy Northwest Annual Information is to be provided not later than December 31 of each year, commencing December 31, 2002. The Bonneville Annual Information is to be provided not later than March 31 of each year, commencing March 31, 2003. The Annual Information will be filed with each Nationally Recognized Municipal Securities Information Repository (the "NRMSIRs") and with the State Depository for the State of Washington, if such State Depository exists (the "State Depository"). At this time, there is no State Depository. Notices of aforesaid enumerated events will be filed by Energy Northwest with the NRMSIRs or the Municipal Securities Rulemaking Board (the "MSRB") and with the State Depository. Energy Northwest and Bonneville have complied with all previous undertakings with respect to Rule 15c2-12. The nature of the information to be provided in the Annual Information and the notices of such material events is set forth in Appendix I hereto, "SUMMARY OF THE CONTINUING DISCLOSURE AGREEMENT."

#### **VERIFICATION OF MATHEMATICAL ACCURACY**

The arithmetical and mathematical accuracy of the computations showing the adequacy of the maturing principal of the Investment Securities deposited in the trust funds, as described herein under "PLAN OF REFUNDING," together with the income earned thereon, to pay when due to and including the date of maturity or redemption the principal of, premium, if any, and interest on

the Refunded Bonds will be verified by Bond Logistix LLC, a wholly-owned subsidiary of Orrick, Herrington & Sutcliffe LLP (“Bond Logistix”). Such verification of the accuracy of the arithmetical and mathematical computations shall be based upon information and assumptions supplied by Salomon Smith Barney Inc. Such verification should not be viewed as, and shall not constitute, the expression of any opinion concerning the attainability of the assumptions supplied to Bond Logistix.

#### **MISCELLANEOUS**

The references, excerpts and summaries contained herein of the Net Billed Resolutions, the Net Billing Agreements, the Columbia Project Agreement, the Assignment Agreements, the Post Termination Agreements and any other documents or agreements referred to herein do not purport to be complete statements of the provisions of such documents or agreements and reference should be made to such documents or agreements for a full and complete statement of all matters relating to the Series 2002-A Bonds, the basic agreements securing the Series 2002-A Bonds and the rights and obligations of the holders thereof. Copies of the forms of the Net Billed Resolutions, Net Billing Agreements, the Columbia Project Agreement, Assignment Agreements for the Net Billed Projects, including copies of the forms of such agreements as amended for Project 1 and copies of the Post Termination Agreements and other reports, documents, agreements and studies referred to herein and in the Appendices hereto are available upon request at the office of Energy Northwest in Richland, Washington.

The authorizations, agreements and covenants of Energy Northwest are set forth in the Net Billed Resolutions and neither this Official Statement nor any advertisement of the Series 2002-A Bonds is to be construed as a contract with the holders of the Series 2002-A Bonds. Any statements made in this Official Statement involving matters of opinion or estimates, whether or not expressly so identified, are intended merely as such and not as representations of fact.

Bonneville has furnished the information herein relating to it.



The delivery of this Official Statement has been duly authorized by Energy Northwest.

ENERGY NORTHWEST

By: /s/ Dan G. Gunkel  
Vice Chairman, Executive Board

By: /s/ Gerald J. Kucera  
Authorized Officer

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To the Administrator of the  
Bonneville Power Administration,  
United States Department of Energy

In our opinion, the accompanying balance sheets and the related statements of revenues and expenses, of cash flows and of changes in capitalization and long-term liabilities present fairly, in all material respects, the financial position of the Federal Columbia River Power System (FCRPS) at September 30, 2001 and 2000, and the results of its operations, cash flows and changes in capitalization and long-term liabilities for each of the three years in the period ended September 30, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of FCRPS' management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the FCRPS changed its method of accounting for derivative instruments as of October 1, 2000.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule of Amount and Allocation of Plant Investment as of September 30, 2001 (Schedule A) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "PriceWaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

Portland, Oregon  
January 4, 2002

# FINANCIAL STATEMENTS

## BALANCE SHEETS

Federal Columbia River Power System  
As of Sept. 30 — Thousands of dollars

### Assets

	2001	2000
<b>Utility Plant</b> (Notes 1 and 3)		
Completed plant	\$ 11,249,158	\$ 11,105,332
Accumulated depreciation	(3,817,309)	(3,583,557)
	7,431,849	7,521,775
Construction work in progress	913,670	636,000
Net utility plant	8,345,519	8,157,775
<b>Nonfederal Projects</b> (Note 4)		
Conservation	50,189	52,497
Hydro	170,730	204,625
Nuclear	2,116,473	2,231,874
Terminated hydro facilities	30,245	30,905
Terminated nuclear facilities	3,804,312	3,888,964
Total nonfederal projects	6,171,949	6,408,865
<b>Trojan Decommissioning Cost</b> (Note 6)	69,221	78,307
<b>Conservation</b> , net of accumulated amortization of \$769,221 in 2001 and \$708,666 in 2000 (Notes 1 and 2)	444,021	504,504
<b>Fish and Wildlife</b> , net of accumulated amortization of \$110,954 in 2001 and \$105,138 in 2000 (Notes 1 and 2)	146,354	145,586
<b>Current Assets</b>		
Cash	667,306	848,447
Accounts receivable	381,899	238,179
Accrued unbilled revenues	5,906	118,343
Materials and supplies, at average cost	85,222	64,292
Prepaid expenses	187,149	85,895
Total current assets	1,327,482	1,355,156
<b>Other Assets</b>	265,984	192,374
	<b>\$ 16,770,530</b>	<b>\$ 16,842,567</b>

The accompanying notes are an integral part of these statements.

**Capitalization and Liabilities**

	<b>2001</b>	<b>2000</b>
<b>Accumulated Net (Expenses) Revenues</b> (Note 1)	\$ (221,151)	\$ 132,810
<b>Federal Appropriations</b> (Note 3)	4,647,017	4,499,743
<b>Capitalization Adjustment</b> (Note 3)	2,259,756	2,328,540
<b>Long-Term Debt</b> (Note 2)	2,582,542	2,513,200
<b>Nonfederal Projects Debt</b> (Note 4)	5,954,490	6,053,027
<b>Trojan Decommissioning Reserve</b> (Note 6)	<u>57,221</u>	<u>65,707</u>
Total capitalization and long-term liabilities	<u>15,279,875</u>	<u>15,593,027</u>
<b>Commitments and Contingencies</b> (Notes 6 and 7)		
<b>Current Liabilities</b>		
Current portion of federal appropriations	23,913	66,268
Current portion of long-term debt	106,000	—
Current portion of nonfederal projects debt	217,459	355,838
Current portion of Trojan decommissioning reserve	12,000	12,600
Accounts payable and other current liabilities	<u>510,957</u>	<u>372,270</u>
Total current liabilities	<u>870,329</u>	<u>806,976</u>
<b>Deferred Credits</b> (Note 1)	<u>620,326</u>	<u>442,564</u>
	<u><b>\$ 16,770,530</b></u>	<u><b>\$ 16,842,567</b></u>

## STATEMENTS OF REVENUES AND EXPENSES

Federal Columbia River Power System  
For the years ended Sept. 30 — Thousands of dollars

	2001	2000	1999
<b>Operating Revenues</b>			
Sales	\$ 3,563,182	\$ 2,903,735	\$ 2,555,550
SFAS 133 mark-to-market	47,877	—	—
Miscellaneous Revenues	66,902	76,434	36,983
U.S. Treasury Credits for Fish	600,708	60,000	26,346
Total operating revenues	<u>4,278,669</u>	<u>3,040,169</u>	<u>2,618,879</u>
<b>Operating Expenses</b>			
Operations and maintenance	955,098	913,846	850,741
Purchased power	2,291,961	633,142	265,304
Tenaska (Note 7)	—	(26,817)	—
Nonfederal projects (Note 4)	477,215	560,836	651,093
Residential exchange (Note 5)	68,082	63,593	63,619
Federal projects depreciation	323,314	319,942	309,183
Total operating expenses	<u>4,115,670</u>	<u>2,464,542</u>	<u>2,139,940</u>
Net operating revenues	<u>162,999</u>	<u>575,627</u>	<u>478,939</u>
<b>Interest Expense</b>			
Interest on federal investment:			
Appropriated funds (Note 3)	248,429	248,352	249,156
Long-term debt (Note 2)	129,159	115,052	130,916
Allowance for funds used during construction	(45,679)	(28,754)	(24,419)
Net interest expense	<u>331,909</u>	<u>334,650</u>	<u>355,653</u>
Net (expenses) revenues before cumulative effect of SFAS 133	(168,910)	240,977	123,286
<b>Cumulative effect of SFAS 133</b>	<u>(168,491)</u>	<u>—</u>	<u>—</u>
<b>Net (Expenses) Revenues</b>	(337,401)	240,977	123,286
Accumulated net (expenses) revenues, Oct. 1	132,810	(108,167)	(231,453)
Irrigation Assistance	(16,560)	—	—
Accumulated net (expenses) revenues, Sept. 30	<u>\$ (221,151)</u>	<u>\$ 132,810</u>	<u>\$ (108,167)</u>

The accompanying notes are an integral part of these statements.

## STATEMENTS OF CHANGES IN CAPITALIZATION AND LONG-TERM LIABILITIES

Federal Columbia River Power System  
Including current portions — Thousands of dollars

	Accumulated Net Revenues	Federal Appropriations	Long-Term Debt	Nonfederal Project Debt	Other	Total
<b>Balance at Sept. 30, 1999</b>	<b>\$ (108,167)</b>	<b>\$ 4,498,483</b>	<b>\$ 2,515,200</b>	<b>\$ 6,692,041</b>	<b>\$ 2,481,601</b>	<b>\$ 16,079,158</b>
Increase (decrease) in federal appropriations:						
Construction	—	129,953	—	—	—	129,953
Repayment of federal appropriations:						
Construction	—	(62,425)	—	—	—	(62,425)
Capitalization adjustment amortization	—	—	—	—	(67,474)	(67,474)
Increase in long-term debt	—	—	294,300	—	—	294,300
Repayment of long-term debt	—	—	(227,500)	—	—	(227,500)
Refinance of long-term debt	—	—	(68,800)	—	—	(68,800)
Net increase in nonfederal projects debt	—	—	—	40,443	—	40,443
Repayment of nonfederal projects debt	—	—	—	(323,619)	—	(323,619)
Trojan decommissioning reserve	—	—	—	—	(7,280)	(7,280)
Net revenues	240,977	—	—	—	—	240,977
<b>Balance at Sept. 30, 2000</b>	<b>\$ 132,810</b>	<b>\$ 4,566,011</b>	<b>\$ 2,513,200</b>	<b>\$ 6,408,865</b>	<b>\$ 2,406,847</b>	<b>\$ 16,027,733</b>
Increase (decrease) in federal appropriations:						
Construction	—	230,388	—	—	—	230,388
Repayment of federal appropriations:						
Construction	—	(125,469)	—	—	—	(125,469)
Capitalization adjustment amortization	—	—	—	—	(68,784)	(68,784)
Irrigation Assistance	(16,560)	—	—	—	—	(16,560)
Increase in long-term debt	—	—	260,000	—	—	260,000
Repayment of long-term debt	—	—	(84,658)	—	—	(84,658)
Net decrease in nonfederal projects debt	—	—	—	(60,658)	—	(60,658)
Repayment of nonfederal projects debt	—	—	—	(176,258)	—	(176,258)
Trojan decommissioning reserve	—	—	—	—	(9,086)	(9,086)
Net expenses	(337,401)	—	—	—	—	(337,401)
<b>Balance at Sept. 30, 2001</b>	<b>\$ (221,151)</b>	<b>\$ 4,670,930</b>	<b>\$ 2,688,542</b>	<b>\$ 6,171,949</b>	<b>\$ 2,328,977</b>	<b>\$ 15,639,247</b>

The accompanying notes are an integral part of these statements.

## STATEMENTS OF CASH FLOWS

Federal Columbia River Power System  
For the years ended Sept. 30 — Thousands of dollars

	2001	2000	1999
<b>Cash from Operating Activities</b>			
Net (expenses) revenues	\$ (337,401)	\$ 240,977	\$ 123,286
Expenses (income) not requiring cash:			
Depreciation	247,247	242,673	233,279
Amortization of conservation and fish and wildlife	76,067	77,269	75,904
Amortization of nonfederal projects	176,258	323,619	145,185
Amortization of capitalization adjustment	(68,784)	(67,474)	(64,886)
AFUDC	(45,679)	(28,754)	(24,419)
(Increase) decrease in:			
Receivables and unbilled revenues	(31,283)	(155,444)	(13,367)
Materials and supplies	(20,930)	6,785	3,630
Prepaid expenses	(101,254)	(3,200)	(1,105)
Increase (decrease) in:			
Accounts payable	138,687	100,699	(43,611)
Other	114,060	8,437	(12,769)
Cash provided by operating activities	<u>146,988</u>	<u>745,587</u>	<u>421,127</u>
<b>Cash from Investment Activities</b>			
Investment in:			
Utility plant	(399,220)	(310,165)	(215,155)
Conservation	141	—	(12,484)
Fish and wildlife	(16,493)	(13,898)	(14,748)
Cash used for investment activities	<u>(415,572)</u>	<u>(324,063)</u>	<u>(242,387)</u>
<b>Cash from Borrowing and Appropriations</b>			
Increase in federal appropriations:			
Operations and maintenance	—	—	160,037
Construction	230,388	129,953	93,364
Repayment of federal appropriations:			
Operations and maintenance	—	—	(160,037)
Construction	(125,469)	(62,425)	(40,984)
Irrigation assistance	(16,560)	—	—
Increase in long-term debt	260,000	294,300	192,400
Repayment of long-term debt	(84,658)	(227,500)	(150,000)
Refinance of long-term debt	—	(68,800)	(26,200)
Payment of nonfederal debt	(176,258)	(323,619)	(145,185)
Cash used for borrowing and appropriations	<u>87,443</u>	<u>(258,091)</u>	<u>(76,605)</u>
Increase in cash	(181,141)	163,433	102,135
Beginning cash balance	848,447	685,014	582,879
Ending cash balance	<u>\$ 667,306</u>	<u>\$ 848,447</u>	<u>\$ 685,014</u>

The accompanying notes are an integral part of these statements.



## 1. Summary of General Accounting Policies

### Principles of Combination

The Federal Columbia River Power System (FCRPS) includes the accounts of the Bonneville Power Administration (BPA), which purchases, transmits and markets power, and the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers (Corps) and the Bureau of Reclamation (Reclamation) for which BPA is the power marketing agency. Each entity is separately managed and financed, but the facilities are operated as an integrated power system with the financial results combined as the FCRPS. The costs of multipurpose Corps and Reclamation projects are assigned to specific purposes through a cost allocation process. Only the portion of total project costs allocated to power is included in these statements.

FCRPS accounts are maintained in accordance with generally accepted accounting principles and the uniform system of accounts prescribed for electric utilities by the Federal Energy Regulatory Commission (FERC). FCRPS accounting policies also reflect specific legislation and executive directives issued by U.S. government departments. (BPA is a unit of the Department of Energy; Reclamation is part of the Department of the Interior; and the Corps is part of the Department of Defense.) FCRPS properties and income are tax-exempt. All material intercompany accounts and transactions have been eliminated from the combined financial statements.

### Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and

expenses during the reporting period. Actual results could differ from those estimates.

### Reclassifications

Certain reclassifications were made to the 2000 combined financial statements from amounts previously reported to conform to the presentation used in fiscal year 2001. Such reclassifications had no effect on previously reported results of operations and cash flows.

### Regulatory Authority

BPA's rates are established in accordance with several statutory directives. Rates proposed by BPA are subjected to an extensive formal review process, after which they are established by BPA and reviewed by FERC. FERC's review is limited to three standards set out in the Northwest Power Act and a standard set by the National Energy Policy Act. FERC reviews BPA's rates for all firm power, for nonfirm energy sold within the region, and for transmission service. Statutory standards include a requirement that these rates be sufficient to assure repayment of the federal investment in the FCRPS over a reasonable number of years after first meeting BPA's other costs.

After final FERC approval, BPA's rates may be reviewed by the United States Court of Appeals for the Ninth Circuit. Action seeking such review must be filed within 90 days of the final FERC decision. FERC and the court of appeals may either confirm or reject a rate proposed by BPA. It is the opinion of BPA's general counsel that, if a rate were rejected, it would be remanded to BPA for reformulation. By contract, BPA has agreed that rates for the sale of power pursuant to its present contracts may not be revised on less than nine months' notice and may not be increased more than once in a 12-month period.

### SFAS 71 Assets

As of Sept. 30 — Thousands of dollars

	2001	2000
Nonfederal projects:		
Conservation	\$ 50,189	\$ 52,497
Terminated nuclear facilities	3,804,312	3,888,964
Terminated hydro facilities	30,245	30,905
Trojan decommissioning cost	69,221	78,307
Conservation	444,021	504,504
Fish and wildlife	146,354	145,586
Additional retirement contributions	68,100	53,000
<b>Total</b>	<b>\$ 4,612,442</b>	<b>\$ 4,753,763</b>

The Federal Energy Regulatory Commission granted final approval for proposed Power and Transmission rates on April 4, 1997, for fiscal years 1997 through 2001 (75 FERC 62,010 (1997)).

BPA submitted a separate Transmission and Ancillary Services Rate Filing in 2000 for fiscal years 2002 through 2003, and a Power Rate Filing in 2001 for fiscal years 2002 through 2006. The Federal Energy Regulatory Commission granted final approval of BPA's Transmission and Ancillary Services rates on May 7, 2001, for fiscal years 2002 through 2003, 62 FERC 62,094 (2001). On June 29, 2001, the Federal Energy Regulatory Commission granted final approval for the acceleration of the Ancillary Services and Control Area Services Rate (ACS-02) for Generation Imbalance Service (GIS), 95 FERC 62,286 (2001); and on October 11, 2001 the Federal Energy Regulatory Commission granted final approval for corrections of the ACS-02 rate, 97 FERC 62,020 (2001). The Federal Energy Regulatory Commission granted interim approval for proposed Power rates on Sept. 28, 2001, for fiscal years 2002 through 2006, 96 FERC 61,360 (2001).

Because of the regulatory environment in which BPA establishes rates, certain costs may be deferred and expensed in future periods under Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation.

In order to defer incurred costs under SFAS 71, a regulated entity must have the statutory authority to establish rates that recover all costs and rates so established must be charged to and collected from customers. Due to increasing competitive pressures, BPA may be required to seek alternative solutions in the future to avoid raising rates to a level that is no longer competitive. If BPA's rates should become market-based, SFAS 71 would no longer be applicable, and any costs deferred under that standard would be expensed in the Statement of Revenues and Expenses.

The SFAS 71 assets of \$4.6 billion, shown in the table on page 33, reflect a decrease of \$141 million from the prior year. Amortization of these costs aggregating \$259 million in fiscal 2001, \$276 million in 2000 and \$242 million in fiscal 1999 is reflected in the Statements of Revenues and Expenses.

### **Revenues and Net Revenues**

Operating revenues are recorded on the basis of service rendered, which includes estimated unbilled revenues. BPA operates as two segments: The Power Business Line and the Transmission Business Line. The table in Note 8 reflects the revenues and expenses attributable to each business line. Because BPA is a U.S. government power marketing agency, net revenues over time are committed to repayment of the U.S. government investment in the FCRPS and the payment of certain irrigation costs as discussed in Note 6.

### **Utility Plant**

Utility plant is stated at original cost. Cost includes direct labor and materials; payments to contractors; indirect charges for engineering, supervision and similar overhead items; and an allowance for funds used during construction. The costs of additions, major replacements and betterments are capitalized. Repairs and minor replacements are charged to operating expense. In accordance with FERC requirements the cost of utility plant retired, together with removal costs less salvage, is charged to accumulated depreciation when it is removed from service.

### **Allowance for Funds Used During Construction**

The allowance for funds used during construction (AFUDC) constitutes interest on the funds used for utility plant under construction. AFUDC is capitalized as part of the cost of utility plant and results in a non-cash reduction of interest expense. While cash is not realized currently from this allowance, it is realized under the ratemaking process over the service life of the related property through increased revenues resulting from higher plant in-service and higher depreciation expenses. AFUDC is based on the monthly construction work in progress (CWIP) balance. A portion of CWIP as stated on the balance sheets represents study and investigation costs to which AFUDC is not attributed.

AFUDC capitalization rates are stipulated in the congressional acts authorizing construction for certain generating projects (2.5 percent to 6.6 percent in 2001, 2.5 percent to 6.7 percent in 2000 and 2.5 percent to 6.8 percent in 1999). Capitalization rates for other construction approximate the cost of borrowing from the U.S. Treasury (6.5 percent in 2001, 6.6 percent in 2000 and 6.7 percent in 1999).

### **Depreciation and Amortization**

Depreciation of original cost and estimated cost to retire utility plant is computed on the straight-line method based on estimated service lives of the various classes of property, which average 40 years for transmission plant and 75 years for generation plant. Amortization of capitalized conservation and fish and wildlife costs is computed on the straight-line method based on estimated service lives, which are 20 years for conservation and 15 years for fish and wildlife.

### **Retirement Benefits**

FCRPS employees belong to either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). FCRPS and its employees contribute to the systems. Based on the statutory contribution rates, retirement benefit expense under CSRS is equivalent to 7 percent of eligible employee compensation and under FERS is variable based upon options chosen by

the participant but does not exceed 24.2 percent of eligible employee compensation. Retirement benefits are payable by the U.S. Treasury and not by the FCRPS.

Beginning in fiscal 1998, and for the remainder of the rate period ending in 2001, FCRPS agreed to contribute additional amounts as a result of an underfunded status of the CSRS. These amounts have been calculated based on an estimate of FCRPS employees who participate in the plan as well as an estimate of FCRPS' share of the underfunded status. These contributions are projected over a period of years as shown in the table on page 29. The payments, when made, will be directly to the U.S. Treasury.

BPA paid approximately \$8.0 million, \$6.0 million and \$4.1 million to the U.S. Treasury during fiscal 2001, 2000 and 1999, respectively. These amounts were recorded as expense when paid. BPA has accrued for \$68.1 million as of Sept. 30, 2001, which represents the additional deferred contribution for fiscal 1998, 1999, 2000 and 2001. This amount has been recorded as an SFAS 71 asset on the balance sheet in anticipation of recovery of the costs through rates in the next rate period beginning Oct. 1, 2001. The related liability is included in deferred credits in the accompanying Balance Sheet. At Sept. 30, 2001, BPA has scheduled additional payments totaling \$192 million as follows:

#### **Scheduled Additional CSRS Contributions**

*Millions of dollars*

<b>Scheduled Contributions</b>	
2002	\$ 55.2
2003	35.1
2004	30.9
2005	26.5
2006	23.2
2007	21.1
<b>Total</b>	<b>\$ 192.0</b>

BPA expects to recognize these amounts as expense in the years in which they are specifically recovered through rates.

#### **Cash**

For purposes of reporting cash flows, cash includes cash in the BPA fund and unexpended appropriations of Reclamation and the Corps. Cash paid for interest was \$464 million in 2001, \$403 million in 2000 and \$421 million in 1999.

Non-cash transactions include changes in nonfederal projects and nonfederal projects' debt (other than amortization of nonfederal projects and payment of nonfederal projects' debt) of \$61 million in 2001, \$40 million in 2000 and \$112 million in 1999.

## **Concentrations of Credit Risks**

### **General Credit Risk**

Financial instruments, which potentially subject the FCRPS to concentrations of credit risk, consist of available-for-sale investments held by Energy Northwest and BPA accounts receivable and accrued unbilled revenues. Energy Northwest invests exclusively in U.S. Government securities and agencies. BPA's accounts receivable and accrued unbilled revenues are concentrated with a diverse group of customers and counterparties who have purchased capacity, energy, or other products and services. These customers are generally large and stable and do not represent a significant concentration of credit risk.

BPA mitigates credit risk by insisting that counterparties and marketers are significant industry companies that are considered financially strong. BPA performs an initial financial review of new counterparties and establishes credit limits based on the results of that review. Reviews and credit limits are updated regularly to reflect the current financial conditions of the company.

In conjunction with the financial reviews, BPA often obtains credit support in the form of parental guarantees and letters of credit to support established credit limits. BPA also utilizes netting agreements to mitigate the credit risk of financial instruments.

Bonneville has open purchase and sales contracts with a diverse group of customers including Enron Power Marketing Inc. (Enron). Enron and its parent company, Enron Corp. filed for bankruptcy protection subsequent to year end. Due to the nature of the contracts with Enron, management does not consider it necessary to record a provision for loss or for uncollectible amounts as of Sept. 30, 2001 relating to Enron transactions.

### **Credit Risk from California**

California power markets have been in turmoil for over a year, having experienced historically high power prices and volatility. Defaults by Pacific Gas & Electric (which filed for bankruptcy protection in April 2001) and Southern California Edison (which has established a creditor payment plan) in payments for energy and transmission to the California Independent System Operator ("Cal-ISO") have resulted in concerns by energy suppliers that the Cal-ISO may not be a creditworthy supplier. In addition, the California Power Exchange ("Cal-PX") has substantial outstanding payment obligations due from the California investor-owned-utilities for day-ahead power exchanges. The Cal-PX filed for bankruptcy protection in March 2001.

Bonneville entered into certain power sales through the Cal-PX for which Bonneville has not yet been paid. In addition Bonneville sold power and related services to the

Cal-ISO for which Bonneville has not yet been paid in full. Bonneville also has a long-term seasonal power exchange agreement with Southern California Edison. Based on management's current evaluation, the range of ultimate or potential losses is not determinable at this time. However, Bonneville has recorded provisions for uncollectible amounts, which in management's best estimate are sufficient to cover any potential exposure. Nonetheless, Bonneville is continuing to pursue collection of all amounts due in bankruptcy and other proceedings.

### **Deferred Credits**

Deferred credits consist of \$131.3 million paid to BPA from participants under the 3<sup>rd</sup> AC intertie capacity agreement, \$93.8 million in load diversification fees and other settlement payments for long-term agreements paid to BPA from various customers, \$68.1 million in deferred CSRS contributions of which \$31.3 million is included with accounts payable and other current liabilities, \$113.5 million in advances from customers for projects which BPA is constructing on their behalf, \$39.9 million in unearned option premium revenue, \$120.6 million current fair market value of purchased and written options and certain trading physical forward sales and purchases, \$72.9 million for Golden Northwest Aluminum (GNA) remarketing, \$10.6 million leasing fees for fiber optic cable, and \$.9 million in other miscellaneous long-term liabilities. Deferred 3<sup>rd</sup> AC intertie capacity payments are recognized as revenue over the estimated 40-year life of the related assets. Diversification fees are payments by customers to BPA in consideration for a reduction in their contractually obligated power purchases from BPA. Deferred diversification fees and other settlement payments for long-term agreements are recognized as revenue over the original contract terms (diversification fee contracts generally correspond to the rate period ended Sept. 30, 2001, while other settlement agreements extend over varying periods through 2019). Advances on projects BPA constructs for customers are either applied against expenditure during the construction of the assets if the customer retains title to the assets, or if BPA retains title, are recorded to revenue over the related useful lives of the assets. GNA remarketing is an account related to GNA's development of resources with remarketing funds. Balances from this account are to be paid to GNA at the end of fiscal 2006. Leasing fees for fiber optic cable are recognized over the lease terms extending as far as 2020. The current portion of deferred credits to be recorded as revenue in fiscal 2002 is included in accounts payable and other current liabilities in the Balance Sheet.

### **Hedging and Derivative Instrument Activities**

BPA's hedging policy (the Policy) allows the use of financial instruments such as commodity futures, options and swaps to hedge the price and revenue risk associated

with electricity sales and purchases and to hedge risks associated with new product development. The Policy does not authorize the use of financial instruments for non-hedging purposes, unless such use is expressly authorized under specific provisions included in the Policy.

BPA uses financial instruments in the form of Over-the-Counter (OTC) electricity swap agreements and options and Exchange traded futures contracts to hedge anticipated production and marketing of hydroelectric energy. Under swap agreements, BPA makes or receives payments based on the differential between a specified fixed price and an index reference price of power. Under futures contracts, BPA either sells or buys Exchange traded futures contracts to hedge anticipated future electricity sales and purchases. There were no open or outstanding OTC electricity swap agreements or Exchange traded electricity futures and options at Sept. 30, 2001.

Due to changing market conditions during fiscal year 2001, previously anticipated aluminum indexed power sales transactions did not occur. As a result, BPA closed out its aluminum risk position entered into in fiscal year 2000 involving the use of both purchased and written options for aluminum. Although the exiting of these transactions effectively ended BPA's aluminum risk and cash impact, the monthly accounting and settlement will continue through 2006. As the transactions do not qualify for hedge accounting treatment, the fair values of the purchased and written aluminum options have been recorded in the Balance Sheet at Sept. 30, 2001, and the mark-to-market gains and losses have been recorded in the Statement of Revenues and Expenses for the year then ended.

At and for the years ended Sept. 30, 2001 and 2000, both the deferred and the realized gains and losses resulting from these transactions were not material to the consolidated FCRPS financial statements.

### **Written Options**

BPA sells put and call options for the purchase and sale of electricity at certain points in the future. BPA's intention is to fulfill all call options exercised with its estimated surplus generating capability at the future dates and to take delivery of power as a result of written put options. The megawatt-hour quantities that BPA sells and the premiums that BPA collects for the sales of these options are priced on market based information and a mathematical model developed by BPA. This model makes certain assumptions based on historical and other statistical data. Actual future results could vary from estimates resulting in the requirement that BPA fulfill these sales obligations with power purchases at a cost in excess of the prices stated in the contracts. In addition, BPA may be required to buy power at strike prices above market prices as a result of its written put option obligations.

As of Sept. 30, 2001, written call options totaling 409,600 megawatt-hours were outstanding with an average strike price of \$130.25 per megawatt-hour compared to 30,000 megawatt-hours outstanding and an average strike price of \$61.67 per megawatt-hour as of Sept. 30, 2000. Written put options totaling 10,112,000 megawatt-hours were outstanding as of Sept. 30, 2001, with an average strike price of \$41.66 per megawatt-hour compared to 190,000 megawatt-hours outstanding and an average strike price of \$64.84 per megawatt-hour as of Sept. 30, 2000. These options expire at various times through Dec. 2005. BPA records written options on a mark-to-market basis and includes gains and losses in operating revenues in the Statement of Revenues and Expenses.

### **Financial Instruments**

All significant financial instruments of the FCRPS were recognized in the Balance Sheet as of Sept. 30, 2001 and 2000. The carrying value reflected in the Balance Sheet approximates fair value for the FCRPS's financial assets and current liabilities. The fair values of long-term liabilities are discussed in the respective footnotes.

### **Adoption of Statement 133**

BPA adopted SFAS 133, "Accounting for Derivative Instrument and Hedging Activities," as amended, on Oct. 1, 2000. SFAS 133 requires that every derivative instrument be recorded on the balance sheet as an asset or liability measured at its fair value and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS 133 requires that as of the date of initial adoption, the difference between the fair market value of derivative instruments recorded on the balance sheet and the previous carrying amount of those derivatives be reported in net income or other comprehensive income, as appropriate.

It is BPA's policy to document and apply as appropriate the normal purchase and normal sales exception under SFAS 133, as amended by SFAS 138 paragraph 4 (a), and Derivatives Implementation Group issue C15: "Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity." For all other non-hedging related derivative transactions BPA applies fair value accounting and records the amounts in the current period Statement of Revenues and Expenses. Bonneville may also elect to use special hedge accounting provisions allowed under SFAS 133 for transactions that meet certain documentation requirements. As of Sept. 30, 2001, BPA had no outstanding transactions accounted for under the special hedge accounting provisions.

On the date of adoption (Oct. 1, 2000), in accordance with the transition provisions of SFAS 133, BPA recorded a cumulative-effect adjustment of \$(168) million in net revenue (expense) to recognize the difference between the carrying values and fair values of derivatives not designated as hedging

instruments. The adjustment consisted mainly of transactions known as bookouts that the FASB initially determined should be fair valued in net revenue (expense). While authoritative guidance in this area continued to emerge during fiscal year 2001, BPA management elected to apply the most current guidance available.

On June 29, 2001, the FASB issued definitive guidance on Derivatives Implementation Group issue C15: "Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity." Issue C15 provides additional guidance on the classification and application of SFAS 133 relating to purchases and sales of electricity utilizing forward contracts and options including bookout transactions. This guidance became effective as of July 1, 2001. Purchases and sales of forward electricity and option contracts that require physical delivery and which are expected to be used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales" under SFAS 133. These transactions are outside of the scope of SFAS 133 and therefore are not required to be marked to fair value in the financial statements. BPA elected this treatment of bookout transactions effective as of Sept. 30, 2001.

As stated above, BPA recorded a \$168 million SFAS 133 transition adjustment loss at the beginning of fiscal year 2001. Subsequently, BPA recorded \$48 million of gains from SFAS 133 fair value application during the remainder of the fiscal year. This amount included quarterly fair value adjustments to bookout transactions and certain option and physical forward sales and purchase transactions. The net result for the year ended Sept. 30, 2001 for total SFAS 133 fair value accounting application is \$120 million loss.

### **EITF 98-10 Application**

In Nov. 1998, the Emerging Issues Task Force (EITF) of the FASB reached a consensus related to the accounting for energy trading activities. In accordance with EITF 98-10, energy trading contracts must be marked to market with the gains and losses included in earnings and separately disclosed in the financial statements. BPA adopted EITF 98-10 on Oct. 1, 1999, as required, and determined initially its operations do not meet the guidelines established for trading activities. For fiscal year 2001, BPA applied the parameters outlined in 98-10 and found that although trading activities may exist as defined under EITF 98-10, BPA already applies fair value accounting to these activities under FAS 133 application.

### **Recent Accounting Pronouncements**

In June 2001, FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS 141 and 142 are not relevant to BPA.

In June 2001, FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS 143 addresses financial

accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS 143 will be effective for BPA starting with the fiscal year ending Sept. 30, 2003.

In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived

Assets." SFAS 144 address financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 will be effective for BPA starting with the fiscal year ending Sept. 30, 2003.

It is too soon to determine the impacts of SFAS 143 and SFAS 144 on BPA's financial statements.

## 2. Long-Term Debt

To finance its capital programs, BPA is authorized by the Federal Columbia River Transmission System Act to issue to the U.S. Treasury up to \$3.75 billion of interest-bearing debt with terms and conditions comparable to debt issued by U.S. government corporations. A portion (\$1.25 billion) of the \$3.75 billion is reserved for conservation and renewable resource loans and grants. At Sept. 30, 2001, \$492.8 million of this reserved amount and \$2,195.7 million of other borrowings were outstanding. The average interest

rate of BPA's borrowings from the U.S. Treasury exceeds the rate that could be obtained currently. As a result, the fair value of the BPA long-term debt, based upon discounting future cash flows using rates offered by the U.S. Treasury as of Sept. 30, 2001, for similar maturities exceeds carrying value by approximately \$389 million, or 14 percent. BPA's policy is to refinance debt that is callable when associated benefits exceed costs. The table on page 39 reflects the terms and amounts of long-term debt.

## 3. Federal Appropriations

The BPA Appropriations Refinancing Act, 16 U.S.C. 8381, required that the outstanding balance of the FCRPS federal appropriations, which Bonneville is obligated to set rates to recover, be reset and assigned prevailing market rates of interest as of Sept. 30, 1996. The resulting principal amount of appropriations was determined to be equal to the present value of the principal and interest that would have been paid to Treasury in the absence of the Act, plus \$100 million. The \$100 million was capitalized as part of the appropriations balance and was included pro rata in the new principal of the individual appropriated repayment obligations.

The amount of appropriations refinanced was \$6.6 billion. After refinancing, the appropriations outstanding were \$4.1 billion. The difference between the appropriated debt before and after the refinancing was recorded as a capitalization adjustment. This adjustment is being amortized over the remaining period of repayment so that total FCRPS net interest expense is equal to what it would have been in the absence of the Act.

Amortization of the capitalization adjustment was \$68.8 million for fiscal 2001 and \$67.5 million for 2000, and \$64.9 million for 1999. The weighted-average interest rate was 6.9 percent in 2001, and 7.1 percent in 2000 and 1999.

Construction and replacement of Corps and Reclamation generating facilities have historically been financed through annual federal appropriations. Annual appropriations were also made for their operation and maintenance costs, although these are normally repaid by BPA to the U.S. Treasury by the end of each fiscal year. As a result of the National Energy Policy Act of 1992 BPA

has begun directly funding operation and maintenance expenses and capital efficiency and reliability improvements for Corps and Reclamation generating facilities.

Federal Generation and Transmission appropriations are repaid to the U.S. Treasury within the weighted average service lives of the associated investments (maximum 50 years) from the time each facility is placed in service.

The table below shows the term repayments on the remaining federal appropriations as of Sept. 30, 2001.

If, in any given year, revenues are not sufficient to cover all cash needs, including interest, any deficiency becomes an unpaid annual expense. Interest is accrued on the unpaid annual expense until paid. This interest must be paid from subsequent years' revenues before any repayment of federal appropriations can be made.

### Federal Appropriations

*Thousands of dollars*

Term repayments (a)	
2002	\$ 23,913
2003	46,687
2004	73,484
2005	110,989
2006	68,939
2007+	4,346,918
<b>Total</b>	<b>\$ 4,670,930</b>

(a) Includes payments on historic replacements but excludes planned future replacements and irrigation assistance.

## U.S. Treasury Bonds

Long-Term Debt (a) — Thousands of dollars

	First Call Date	Maturity Date	Interest Rate	Construction and Fish & Wildlife	Conservation	Cumulative Total
September 1989	none	2002	8.65%		\$ 66,000	\$ 66,000
September 1999	none	2002	6.20%	\$ 40,000		106,000
November 1999	none	2002	6.40%	40,000		146,000
January 1996	none	2003	5.90%	60,000		206,000
April 2000	none	2003	6.85%	40,000		246,000
July 2000	none	2003	6.95%		32,000	278,000
August 2000	none	2003	6.85%	15,300		293,300
September 1999	none	2003	6.30%	20,000		313,300
January 1997	none	2004	6.80%	30,000		343,300
May 1999	none	2004	5.95%	26,200		369,500
June 2001	none	2004	4.75%	50,000		419,500
July 2000	none	2004	7.00%	50,000		469,500
September 1999	none	2004	6.40%	20,000		489,500
January 2000	none	2005	7.15%	53,500		543,000
January 2001	none	2005	5.65%	20,000		563,000
January 2001	none	2005	5.65%	25,000		588,000
May 1997	none	2005	6.90%	80,000		668,000
September 2000	none	2005	6.70%	20,000		688,000
August 1996	none	2006	7.05%	70,000		758,000
September 2000	none	2006	6.75%	40,000		798,000
August 1997	none	2007	6.65%	111,300		909,300
February 1993	1998	2008	6.95%	17,612		926,912
April 1998	none	2008	6.00%	75,300		1,002,212
April 1998	none	2008	6.00%	25,000		1,027,212
August 1998	none	2008	5.75%	40,000		1,067,212
September 1998	none	2008	5.30%		104,300	1,171,512
May 1998	none	2009	6.00%	72,700		1,244,212
May 1998	none	2009	6.00%		37,700	1,281,912
July 1989	none	2009	8.55%		40,000	1,321,912
January 2001	none	2010	6.05%	30,000		1,351,912
January 2001	none	2010	6.05%	60,000		1,411,912
January 1996	2001	2011	6.70%		30,000	1,441,912
May 1998	none	2011	6.20%	40,000		1,481,912
June 2001	none	2011	5.95%	25,000		1,506,912
August 2001	none	2011	5.75%	50,000		1,556,912
November 1996	2001	2011	6.95%	40,000		1,596,912
January 1998	none	2013	6.10%	60,000		1,656,912
August 1993	1998	2013	6.75%		40,000	1,696,912
September 1998	none	2013	5.60%		52,800	1,749,712
January 1994	1999	2014	6.75%		50,000	1,799,712
February 1999	none	2014	5.90%	60,000		1,859,712
November 1996	2001	2016	7.20%		40,000	1,899,712
July 1995	2000	2025	7.70%	37,730		1,937,442
August 1995	2000	2025	7.70%	65,000		2,002,442
April 1998	2008	2028	6.65%	50,000		2,052,442
August 1998	none	2028	5.85%	106,500		2,158,942
August 1998	none	2028	5.85%	112,300		2,271,242
May 1998	2008	2032	6.70%	98,900		2,370,142
August 1993	1998	2033	6.95%	110,000		2,480,142
October 1993	1998	2033	6.85%	108,400		2,588,542
October 1993	1998	2033	6.85%	50,000		2,638,542
January 1994	1999	2034	7.05%	50,000		2,688,542
				<b>\$ 2,195,742</b>	<b>\$ 492,800</b>	<b>\$ 2,688,542</b>
<b>Less current portion</b>						(106,000)
						<b>\$ 2,582,542</b>

(a) The weighted average interest rate was 6.5 percent on outstanding long-term debt as of Sept. 30, 2001. All construction, conservation, fish and wildlife, and Corps/Reclamation direct funding bonds are term bonds.

(b) Corps/Reclamation direct funding.

## 4. Nonfederal Projects

BPA has acquired all or part of the generating capability of five nuclear power plants. The contracts to acquire the generating capability of the projects, referred to as "net-billing agreements," require BPA to pay all or part of the annual projects' budgets, including operating expense and debt service, including projects which are not completed and/or not operating. BPA has also acquired all of the output of the Cowlitz Falls and Wasco hydro projects. BPA has agreed to fund debt service on Eugene Water and Electric Board, Emerald, City of Tacoma and Conservation and Renewable Energy System bonds issued to finance conservation programs sponsored by BPA.

BPA recognizes expenses for these projects based upon total project cash funding requirements reflected in project budgets that are adopted by BPA and the projects' owners.

Operating expense of \$217 million in fiscal 2001, \$174 million in fiscal 2000 and \$200 million in fiscal 1999 for the projects is included in operations and maintenance in the accompanying Statements of Revenues and Expenses. Debt service for the projects of \$477 million, \$561 million and \$651 million for fiscal 2001, 2000 and 1999, respectively, is reflected as nonfederal projects expense in the accompanying Statements of Revenues and Expenses.

The recorded value of all Energy Northwest debt exceeds fair value by \$230 million or 4 percent based on discounting the future cash flows using interest rates for which similar debt could be issued at Sept. 30, 2001. All other nonfederal projects' debt approximates fair value as stated.

The following table summarizes future principal payments required for nonfederal projects as of Sept. 30, 2001.

### Nonfederal Projects

*Thousands of dollars*

Debt repayments	
2002	\$ 217,459
2003	288,646
2004	323,155
2005	278,438
2006	313,527
2007+	4,750,724
<b>Total</b>	<b>\$ 6,171,949</b>

## 5. Residential Exchange

As provided for in the Pacific Northwest Electric Power Planning and Conservation Act of 1980, Section 5(c), BPA entered into residential exchange contracts with most of its electric utility customers. These contracts result in payments to the utilities, which must be passed through to its qualified residential and irrigation loads, if a utility's average system cost exceeds BPA's priority firm power rate.

Subsequently, contract termination agreements were signed by all actively exchanging Pacific Northwest utilities

except The Montana Power Co. (which had been receiving no benefits), whereby payments were made by BPA to settle the utilities' and BPA's rights and obligations under the residential exchange program through June 30, 2001, and in some cases, through June 30, 2011. In Oct. 2000, BPA's investor owned utility (IOU) customers signed settlement agreements for settlement of the period running from July 1, 2001 through Sept. 30, 2011. These agreements provide for both sales of power and cash payments to the IOUs.

## 6. Commitments and Contingencies

### Irrigation Assistance

As directed by legislation, BPA is required to make cash distributions to the U.S. Treasury for original construction costs of certain Pacific Northwest irrigation projects that have been determined to be beyond the irrigators' ability to pay. These irrigation distributions do not specifically relate to power generation and are required to be made only if doing so does not result in an increase to power rates. Accordingly, these distributions are not considered to be regular operating costs of the power program and are treated as distributions from accumulated net revenues (expenses) when paid. BPA paid irrigation assistance payments of

\$25 million and \$17 million for 1997 and 2001 respectively. Future irrigation assistance payments ultimately could total \$733 million and are scheduled over a maximum of 66 years. The May 2000 Interim Cost Reallocation Report prepared by Reclamation resulted in approximately \$77 million of Columbia Basin Project costs being moved from irrigation to commercial power. BPA is required by Public Law 89-448 to demonstrate that reimbursable costs of the FCRPS will be returned to the U.S. Treasury from BPA net revenues within the period prescribed by law. BPA is required to make a similar demonstration for the costs of irrigation projects, which are beyond the ability of the 22 irrigation water users



to repay. These requirements are met by conducting power repayment studies including schedules of distributions at the proposed rates to demonstrate repayment of principal within the allowable repayment period.

The table below summarizes future irrigation assistance distributions as of Sept. 30, 2001.

### **Irrigation Assistance**

*Thousands of dollars*

<b>Distributions</b>		
2002	\$	—
2003		—
2004		739
2005		—
2006		—
2007+		732,493
<b>Total</b>	<b>\$</b>	<b>733,232</b>

### **Net-Billing Agreements**

BPA has agreed with Energy Northwest that, in the event any participant shall be unable for any reason, or shall refuse, to pay to Energy Northwest any amount due from such participant under its net-billing agreement for which a net-billing credit or cash payment to such participant has been provided by BPA, BPA will be obligated to pay the unpaid amount in cash directly to Energy Northwest, unless payment of such unpaid amount is made in a timely manner pursuant to the net-billing agreements.

### **Nuclear Insurance**

BPA is a member of the Nuclear Electric Insurance Limited (NEIL), a mutual insurance company established to provide insurance coverage for nuclear power plants. The types of insurance coverage purchased from NEIL by BPA include: 1) Primary Property and Decontamination Liability Insurance; 2) Decommissioning Liability and Excess Property Insurance; and 3) Business Interruption and/or Extra Expense Insurance.

Under each insurance policy BPA could be subject to an assessment in the event that a member-insured loss exceeds reinsurance and reserves held by NEIL. The maximum assessment for the Primary Property and Decontamination Insurance policy is \$8.3 million. For the Decontamination Liability, Decommissioning Liability and Excess Property Insurance policy, the maximum assessment is \$12.6 million. For the Business Interruption and/or Extra Expense Insurance policy, the maximum assessment is \$4.8 million.

As a separate requirement, BPA is liable under the Nuclear Regulatory Commission's indemnity for public liability coverage under the Price-Anderson Act. In the event of a

nuclear accident resulting in public liability losses exceeding \$200 million, BPA could be subject to a retrospective assessment of \$83.9 million limited to an annual maximum of \$10 million.

### **Decommissioning and Restoration Costs**

In 1999 Energy Northwest successfully transferred assets and site restoration liability for WNP-3 to a consortium of local governments named the Satsop Redevelopment Project. In June 1999, Energy Northwest submitted a site restoration plan to the state of Washington's Energy Facility Site Evaluation Committee (EFSEC) that complied with EFSEC's requirement to restore the WNP-1 site with minimal hazard to the public. This plan updated Energy Northwest's June 1995 plan. EFSEC's approval recognized that uncertainty still exists as to the exact details of the proposed plan; accordingly, EFSEC's conditional approval provided for additional reviews once the details of the plan are finalized. As part of submitting the restoration plan to EFSEC, Energy Northwest obtained outside estimates for site restoration of WNP-1. BPA is required to fund site restoration. The cost of site restoration for WNP-1 is estimated to be up to \$60 million. Management is studying options to lower the costs and believes that existing funds from the proceeds of previously issued bonds are adequate to cover some of the site restoration costs at WNP-1. The estimated obligation is reflected as part of the nonfederal projects debt balances for WNP-1 and WNP-3 as of Sept. 30, 2001.

Decommissioning costs for Columbia Generating Station are charged to operations over the operating life of the project. An external decommissioning sinking fund for costs is being funded monthly for Columbia Generating Station. The sinking fund is expected to provide for decommissioning at the end of the project's operating life in accordance with NRC requirements. Sinking fund requirements for Columbia Generating Station are based on a Nuclear Regulatory Commission decommissioning cost estimate and assume a 40-year operating life.

The estimated decommissioning sum of expenditures for Columbia Generating Station is \$340 million (1998 dollars). Payments to the sinking fund for the years ended Sept. 30, 2001, 2000 and 1998 were approximately \$4 million per year. The sinking fund balance at Sept. 30, 2001, is \$71 million.

In January 1993, the Portland General Electric board of directors formally notified BPA of its intent to terminate the operation of the Trojan plant. PGE's rate filing in December 1997 with the Oregon Public Utility Commission included an estimated total decommissioning liability of \$424 million (in 1997 dollars). The current remaining estimate of \$299 million is based on site-specific studies less actual

expenditures to date. As of Sept. 30, 2001, BPA's 30-percent share of this estimated remaining liability is \$69 million, which has been recorded net of the decommissioning trust fund balance of \$20 million in the accompanying Balance Sheet. The Trojan Decommissioning Plan calls for prompt decontamination with delayed demolition of non-radiological structures. Funding requirements will be greater in the early years of decommissioning and then will decrease significantly. These greater early funding requirements have altered the decommissioning trust fund contributions for 1999, 2000 and 2001. For the period 1995 through 2001, funding for the Trojan decommissioning trust fund is being applied directly to the decommissioning expenses. The decision to terminate the plant is not expected to result in the acceleration of debt-service payments. BPA will continue to recover its share of Trojan's costs through rates and decommissioning trust fund withdrawals. Decommissioning costs are included in operations and maintenance expense in the Statements of Revenues and Expenses.

### **Environmental Cleanup**

From time to time, there are sites where BPA, Corps or Reclamation have been or may be identified as a potential responsible party. Costs associated with cleanup of those sites are not expected to be material to the FCRPS financial statements.

### **Endangered Species Act**

Actions related to the Endangered Species Act are included in BPA's costs and recovered through current rates.

## **7. Litigation**

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### **Involving the Tenaska Washington Partners, II L.P.**

In fiscal 1995 the Tenaska Washington Partners, II L.P. (Tenaska) and Chase Manhattan Bank (Chase) filed suit against BPA for breach of contract and lost revenues. In June 1996, BPA and Chase reached a settlement that resulted in a payment of \$115 million by BPA to Chase. In 1997, BPA paid expenses of \$38 million, which included some of the subcontractor claims. In fiscal 1998 BPA settled with Tenaska for \$158.6 million. BPA has now settled with all litigants of the Tenaska suit and no further exposure exists. In fiscal 2000, BPA sold property acquired as a result of these

### **Retirement Benefits**

See Note 1 for discussion of additional civil service retirement system contributions scheduled for payment through 2007.

### **Purchase and Sales Commitments**

BPA has commitments under billing credit agreements and other alternative energy programs whereby BPA provides a cost supplement to entities that are involved in alternative energy generation projects. BPA's aggregate cost of these commitments has approximated \$15 million, \$17 million and \$19 million for fiscal 2001, 2000 and 1999, respectively. BPA's continued cost of these commitments is expected to approximate \$15 million per year over the next five years. These commitments expire at various periods over the next 19 years.

BPA has entered into Subscription power sales for 3,000 average megawatts more power than the federal system produces on a firm-planning basis. These contracts run for as short as three and as long as 10 years from Oct. 1, 2001. Current rates recover the additional costs of the Subscription obligations through 2006. BPA's trading floor enters into sales commitments to sell expected surplus generating capabilities at future dates and purchase commitments to purchase power at future dates when BPA forecasts a shortage of generating capability and prices are favorable. Further, BPA enters into these contracts throughout the year to maximize its revenues on estimated surplus volumes. BPA records these sales and purchases in the month the underlying power is sold or purchased.

settlements for a gain of \$26.8 million, which is included in operating income in the Statement of Revenues and Expenses.

The FCRPS is party to various legal claims, actions and complaints, certain of which involve material amounts. Although the FCRPS is unable to predict with certainty whether or not it will ultimately be successful in these legal proceedings or, if not, what the impact might be, management currently believes that disposition of these matters will not have a materially adverse effect on the FCRPS's financial position or results of operations.

## **8. Segments**

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### **Adoption of Statement 131**

Effective Oct. 1, 1998, the FCRPS adopted SFAS 131, Disclosures about Segments of an Enterprise and Related Information. SFAS 131 establishes standards for the way public business enterprises report information about operating

segments, and also requires certain disclosures about products and services, geographic areas of business and major customers. The adoption of SFAS 131 did not affect the FCRPS's financial position or results of operations, but did change business segment information previously reported.

## Operating Segments

In 1997 BPA opted to implement FERC's open-access rulemaking and standards of conduct. FERC requires that transmission activities are functionally separate from wholesale power merchant functions and that transmission is provided in a nondiscriminatory open-access manner.

The FCRPS's major operating segments are defined by the utility functions of generation and transmission. The Power Business Line represents the operations of the generation function, while the Transmission Business Line represents the operations of the transmission function. The business lines are not separate legal entities. Where applicable, "Corporate" represents items that are necessary to reconcile to the financial statements, which generally include shared activity and eliminations. Each FCRPS segment operates predominantly in one industry and geographic region: the generation and transmission of electric power in the Pacific Northwest.

The FCRPS centrally manages all interest expense activity. Since the Bonneville Power Administration has one

fund with the United States Department of Treasury, all cash and cash transactions are also centrally managed. Unaffiliated revenues below represent sales to external customers for each segment. Intersegment revenues are eliminated.

FCRPS management evaluates the performance of the business lines based on Net Operating Margin (NOM) and does not track the separate balance sheets or net revenues on a business line level. NOM represents revenues generated from operations less operating and maintenance expenses of the segment's revenue-generating assets. On a consolidated basis, this amount represents \$383 million for fiscal 2001 (\$4,279 million Operating Revenues less \$48 million SFAS 133 mark-to-market, \$601 million U.S. Treasury Credits for Fish, \$955 million Operations and Maintenance and \$2,292 million Purchased Power Expenses) as shown in the Statement of Revenues and Expenses.

## Major Customers

During fiscal 2001, 2000 and 1999, no single customer represented 10 percent or more of the FCRPS's revenues.

## SFAS 131 Segment Reporting

For the years ended Sept. 30 — Thousands of dollars

	Power	Transmission	Corporate	Total
<b>2001</b>				
Unaffiliated Revenues	\$ 3,824,658	\$ 454,011	\$ —	\$ 4,278,669
Intersegment Revenues	63,394	192,662	(256,056)	—
<b>Operating Revenues</b>	<b>\$ 3,888,052</b>	<b>\$ 646,673</b>	<b>\$ (256,056)</b>	<b>\$ 4,278,669</b>
<b>Net Operating Margin</b>	<b>\$ 180,790</b>	<b>\$ 363,822</b>	<b>\$ (161,587)</b>	<b>\$ 383,025</b>
<b>2000</b>				
Unaffiliated Revenues	\$ 2,674,556	\$ 365,613	\$ —	\$ 3,040,169
Intersegment Revenues	46,385	212,727	(259,112)	—
<b>Operating Revenues</b>	<b>\$ 2,720,941</b>	<b>\$ 578,340</b>	<b>\$ (259,112)</b>	<b>\$ 3,040,169</b>
<b>Net Operating Margin</b>	<b>\$ 1,307,980</b>	<b>\$ 308,188</b>	<b>\$ (123,224)</b>	<b>\$ 1,492,944</b>
<b>1999</b>				
Unaffiliated Revenues	\$ 2,324,041	\$ 294,838	\$ —	\$ 2,618,879
Intersegment Revenues	42,381	257,296	(299,677)	—
<b>Operating Revenues</b>	<b>\$ 2,366,422</b>	<b>\$ 552,134</b>	<b>\$ (299,677)</b>	<b>\$ 2,618,879</b>
<b>Net Operating Margin</b>	<b>\$ 1,315,425</b>	<b>\$ 320,724</b>	<b>\$ (133,315)</b>	<b>\$ 1,502,834</b>

## SCHEDULE OF AMOUNT AND ALLOCATION OF PLANT INVESTMENT

Federal Columbia River Power System  
As of Sept. 30, 2001 — Thousands of dollars

### Schedule A

	Commercial Power			Irrigation (unaudited)			
	Total Plant	Completed Plant	Construction Work in Progress	Total Commercial Power	Returnable from Commercial Power Revenues	Returnable from Other Sources	Total Irrigation
<b>Bonneville Power Administration</b>							
Transmission Facilities	\$ 5,209,110	\$ 4,907,584	\$ 301,526	\$ 5,209,110	\$ —	\$ —	\$ —
<b>Bureau of Reclamation</b>							
Boise	115,827	16,576	—	16,576	(475)	40,434	39,959
Columbia Basin	1,861,365	1,198,576	1,632	1,200,208	494,514	142,920	637,434
Green Springs	35,509	11,170	—	11,170	9,934	8,070	18,004
Hungry Horse	146,526	118,863	834	119,697	—	—	—
Minidoka-Palisades	380,494	108,940	—	108,940	145	55,313	55,458
Yakima	214,294	6,014	122	6,136	13,594	127,140	140,734
Total Bureau Projects	<b>2,754,015</b>	<b>1,460,139</b>	<b>2,588</b>	<b>1,462,727</b>	<b>517,712</b>	<b>373,877</b>	<b>891,589</b>
<b>Corps of Engineers</b>							
Albeni Falls	46,484	39,923	2,776	42,699	—	—	—
Bonneville	1,348,753	871,663	73,085	944,748	—	—	—
Chief Joseph	615,881	565,416	10,300	575,716	—	163	163
Cougar	62,506	20,311	1	20,312	—	3,288	3,288
Detroit-Big Cliff	68,337	40,794	1,438	42,232	—	5,046	5,046
Dworshak	371,783	314,687	1,215	315,902	—	—	—
Green Peter-Foster	92,508	49,551	2,838	52,389	—	6,170	6,170
Hills Creek	49,388	17,640	139	17,779	—	4,605	4,605
Ice Harbor	208,554	148,413	1,405	149,818	—	—	—
John Day	637,312	473,060	17,257	490,317	—	—	—
Libby	571,885	428,891	2,343	431,234	—	—	—
Little Goose	249,473	207,553	464	208,017	—	—	—
Lookout Point-Dexter	106,945	48,231	6,794	55,025	—	1,488	1,488
Lost Creek	149,741	26,971	10	26,981	—	2,186	2,186
Lower Granite	402,663	328,342	962	329,304	—	—	—
Lower Monumental	267,701	224,483	569	225,052	—	—	—
McNary	362,799	283,839	5,291	289,130	—	—	—
The Dalles	393,766	297,306	47,312	344,618	—	—	—
Lower Snake	258,493	255,216	739	255,955	—	—	—
Columbia River Fish Bypass	717,031	239,145	442,140	681,285	—	—	—
Total Corps Projects	<b>6,982,003</b>	<b>4,881,435</b>	<b>617,078</b>	<b>5,498,513</b>	<b>—</b>	<b>22,946</b>	<b>22,946</b>
Irrigation Assistance at 12 Projects having no power generation	201,179	—	—	—	157,144	44,035	201,179
Total Plant Investment	<b>15,146,307</b>	<b>11,249,158</b>	<b>921,192</b>	<b>12,170,350</b>	<b>674,856</b>	<b>440,858</b>	<b>1,115,714</b>
Repayment Obligation Retained by Columbia Basin Project	4,639	2,836 (a)	—	2,836	1,803	—	1,803
Investment in Teton Project (b)	79,107	—	7,269	7,269	56,573	3,681	60,254
<b>Total</b>	<b>\$ 15,230,053</b>	<b>\$ 11,251,994</b>	<b>\$ 928,461</b>	<b>\$ 12,180,455</b>	<b>\$ 733,232</b>	<b>\$ 444,539</b>	<b>\$ 1,177,771</b>

(a) Amount represents joint costs transferred to Bureau of Sports Fisheries and Wildlife. This is included in other assets in the accompanying balance sheets.

(b) The \$7,269,000 commercial power portion of the Teton project is included in other assets in the accompanying balance sheets. Teton amounts exclude interest totaling approximately \$2.2 million subsequent to June 1976, which was charged to expense.

**Non-reimbursable (unaudited)**

	Navigation	Flood Control	Fish and Wildlife	Recreation	Other	Percent Returnable from Commercial Power Revenues
<b>Bonneville Power Administration</b>						
Transmission Facilities	\$ —	\$ —	\$ —	\$ —	\$ —	100.00%
<b>Bureau of Reclamation</b>						
Boise	—	—	—	—	34,149	17.76%
Columbia Basin	—	16,943	6,073	154	553	91.05%
Green Springs	—	—	—	—	6,335	59.43%
Hungry Horse	—	26,829	—	—	—	81.69%
Minidoka-Palisades	—	64,298	2,554	10,475	122,209	29.97%
Yakima	—	1,984	49,629	240	15,571	9.21%
Total Bureau Projects	<b>—</b>	<b>110,054</b>	<b>58,256</b>	<b>10,869</b>	<b>178,817</b>	<b>73.02%</b>
<b>Corps of Engineers</b>						
Albeni Falls	176	265	—	3,344	—	91.86%
Bonneville	400,677	—	—	1,266	2,062	70.05%
Chief Joseph	—	—	4,977	6,025	29,000	93.48%
Cougar	548	38,358	—	—	—	32.50%
Detroit-Big Cliff	219	20,840	—	—	—	61.80%
Dworshak	9,618	31,467	—	14,796	—	84.97%
Green Peter-Foster	365	30,270	—	1,644	1,670	56.63%
Hills Creek	628	26,376	—	—	—	36.00%
Ice Harbor	55,406	—	—	3,330	—	71.84%
John Day	90,790	17,989	—	11,807	26,409	76.94%
Libby	—	94,973	876	14,165	30,637	75.41%
Little Goose	34,737	—	—	4,115	2,604	83.38%
Lookout Point-Dexter	744	49,097	—	591	—	51.45%
Lost Creek	—	53,020	24,506	29,418	13,630	18.02%
Lower Granite	55,571	—	—	12,946	7,842	81.78%
Lower Monumental	39,379	—	—	2,853	417	84.07%
McNary	68,818	—	—	4,851	—	79.69%
The Dalles	47,059	—	—	2,067	22	87.52%
Lower Snake	2,538	—	—	—	—	99.02%
Columbia River Fish Bypass	7,240	28,506	—	—	—	95.01%
Total Corps Projects	<b>811,513</b>	<b>391,161</b>	<b>30,359</b>	<b>113,218</b>	<b>114,293</b>	<b>78.75%</b>
Irrigation Assistance at 12 Projects having no power generation	—	—	—	—	—	78.11%
Total Plant Investment	<b>811,513</b>	<b>501,215</b>	<b>88,615</b>	<b>124,087</b>	<b>293,110</b>	<b>77.18%</b>
Repayment Obligation Retained by Columbia Basin Project	—	—	—	—	—	100.00%
Investment in Teton Project (b)	—	9,151	—	2,433	—	80.70%
Total	<b>\$ 811,513</b>	<b>\$ 510,366</b>	<b>\$ 88,615</b>	<b>\$ 126,520</b>	<b>\$ 293,110</b>	<b>77.22%</b>

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**QUARTERLY REPORT FOR THE THREE MONTHS ENDED DECEMBER 31, 2001**
**Federal Columbia River Power System**
**Comparative Balance Sheets (Unaudited)**

(Thousands of Dollars)

	December 31	
	2001	2000
<b>ASSETS</b>		
<b>UTILITY PLANT:</b>		
Completed plant	\$11,261,043	\$11,107,122
Accumulated depreciation	(3,877,591)	(3,659,731)
	7,383,452	7,447,391
Construction work in progress	966,639	670,294
Net utility plant	8,350,091	8,117,685
<b>NON-FEDERAL PROJECTS</b>	6,170,380	6,407,799
<b>TROJAN DECOMMISSIONING COST</b>	69,221	78,307
<b>CONSERVATION, net of accumulated amortization</b>	428,878	486,350
<b>FISH AND WILDLIFE, net of accumulated amortization</b>	142,451	142,671
<b>CURRENT ASSETS</b>	1,175,504	1,288,190
<b>OTHER ASSETS</b>	281,727	188,972
	<b>\$16,618,252</b>	<b>\$16,709,974</b>
<b>CAPITALIZATION AND LIABILITIES</b>		
<b>ACCUMULATED NET REVENUES (EXPENSES)</b>	(\$296,848)	(\$509,152)
<b>FEDERAL APPROPRIATIONS</b>	4,671,078	4,550,583
<b>CAPITALIZATION ADJUSTMENT</b>	2,242,917	2,311,344
<b>LONG-TERM DEBT</b>	2,542,542	2,513,200
<b>NON-FEDERAL PROJECTS DEBT</b>	5,952,601	6,052,211
<b>TROJAN DECOMMISSIONING RESERVE</b>	57,221	65,707
<b>CURRENT LIABILITIES</b>	768,281	792,763
<b>DEFERRED CREDITS</b>	680,460	933,318
	<b>\$16,618,252</b>	<b>\$16,709,974</b>

**Comparative Statements of Revenues and Expenses (Unaudited)**

(Thousands of Dollars)

	Three months ended		Twelve months ended	
	December 31		December 31	
	2001	2000	2001	2000
<b>Operating Revenues:</b>				
Revenues	\$888,685	\$765,350	\$3,686,517	\$3,118,032
SFAS 133 mark-to-market (loss) gain (1)	(48,066)	(292,720)	292,531	(292,720)
Other revenues	6,707	4,637	68,972	22,963
U.S. Treasury credits for fish	20,937	18,326	603,319	0
<b>Operating Revenues</b>	<b>868,263</b>	<b>495,593</b>	<b>4,651,339</b>	<b>2,848,275</b>
<b>Operating Expenses:</b>				
Operations and maintenance	227,987	199,889	983,196	939,140
Purchased power	426,330	433,651	2,284,640	1,018,984
Tenaska	0	0	0	(26,817)
Non-Federal projects	87,014	162,550	401,679	565,739
Residential exchange	35,330	11,821	91,591	59,596
Federal projects depreciation	80,263	79,695	323,882	323,955
<b>Operating Expenses</b>	<b>856,924</b>	<b>887,606</b>	<b>4,084,988</b>	<b>2,880,597</b>
Net operating revenues	11,339	(392,013)	566,351	(32,322)
<b>Interest Expense</b>	<b>87,037</b>	<b>81,459</b>	<b>337,487</b>	<b>329,630</b>
<b>Net Income from Continuing Operations</b>	<b>(\$75,698)</b>	<b>(\$473,472)</b>	<b>\$228,864</b>	<b>(\$361,952)</b>
<b>Cumulative Effect of SFAS 133 (2)</b>	<b>0</b>	<b>(168,491)</b>	<b>0</b>	<b>(168,490)</b>
<b>NET REVENUES (EXPENSES)</b>	<b>(\$75,698)</b>	<b>(\$641,963)</b>	<b>\$228,864</b>	<b>(\$530,442)</b>

**Derivative Instruments and Hedging Activities**

(1) The SFAS 133 mark-to-market (MTM) amount is an "accounting only" (no cash impact) adjustment representing the MTM adjustment required by SFAS 133, as amended, for identified derivative instruments.

(2) On October 1, 2000, the date of adoption by Bonneville of Financial Accounting Standards Board Statement of Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), Bonneville recorded a cumulative effect adjustment of \$168 million loss to recognize the difference between the carrying values and fair values of derivatives not designated as hedging instruments. See Note 1 to Financial Statements - "Summary of General Accounting Principles - Adoption of Statement 133" in Appendix A-1.



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**Report of Independent Accountants**

To the Executive Board of  
Energy Northwest

We have audited the accompanying balance sheet of Energy Northwest and the related individual balance sheets of Energy Northwest's internal service fund and business units as of June 30, 2001, and the related statements of operations and of cash flows for the year then ended. Energy Northwest's business units include the Columbia Generating Station, Packwood Lake Hydroelectric Project, Nuclear Project No. 1, Nuclear Project No. 3, the Business Development Fund, the CT Project Fund, the Nine Canyon Wind Project Fund, and the Temporary Diesel Generation Project. These general purpose and individual financial statements are the responsibility of Energy Northwest's management. Our responsibility is to express an opinion on these general purpose and individual financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the general purpose and related individual financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the general purpose and related individual financial statements referred to above present fairly, in all material respects, the financial position of Energy Northwest and Energy Northwest's internal service fund and business units as of June 30, 2001, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

Portland, Oregon  
September 12, 2001

# BALANCE SHEETS

As of June 30, 2001 (Dollars in Thousands)

	INTERNAL SERVICE FUND	COLUMBIA GENERATING STATION	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1*	NUCLEAR PROJECT NO.3*	BUSINESS DEVELOPMENT FUND	COMBUSTION TURBINE PROJECT	NINE CANYON WIND PROJECT	DIESEL GENERATION PROJECT	COMBINED TOTAL (MEMORANDUM ONLY)
<b>ASSETS</b>										
<b>UTILITY PLANT (NOTE B)</b>										
In service	\$ 43,348	\$ 3,418,892	\$ 12,817			\$ 425				\$ 3,475,609
Accumulated depreciation	(26,022)	(1,692,186)	(11,360)			(119)				(1,729,687)
	17,326	1,726,706	1,457			306				1,745,922
Nuclear fuel, net of accumulated amortization		102,814								102,814
Construction work in progress		17,771						\$ 508		18,279
	17,326	1,847,291	1,457			306		508		1,867,015
<b>RESTRICTED ASSETS (NOTE B)</b>										
Special funds										
Cash	13,887	11	6	\$ 9	5					13,918
Available-for-sale investments	2,454	38,753	280	65,485	16,096					123,068
Accounts and other receivables	42	93,772		8,139	26					101,979
Prepayments and other	250			1						251
Debt service funds										
Cash		4,099	3	50	34					4,186
Available-for-sale investments		143,648	748	189,359	171,547					505,302
Other receivables		1,562		710	854					3,126
	16,633	281,845	1,037	263,753	188,562					751,830
<b>LONG-TERM RECEIVABLES (NOTE B)</b>										
		5,650								5,650
<b>CURRENT ASSETS</b>										
Cash		196		29	32				4	261
Available-for-sale investments	17,615	33,487	72	15,770	9,389	30			1,682	78,045
Accounts and other receivables	2,261	4,316	237	435	346	303			22	7,139
Due from Participants		145	67							933
Due from other business units	3,388	3,899	14	12		1,546				8,859
Due from other funds		36,918	19	20,569	15,353					72,859
Materials and supplies		67,319								67,319
Prepayments and other	123	259	1	7,561		9				392
Nuclear fuel held for sale				3,365						7,561
Plant & equipment held for sale		146,539	410	47,741	25,120	1,888	1,708			3,365
	23,387	146,539	410	47,741	25,120	1,888	1,708			246,793
<b>DEFERRED CHARGES</b>										
Costs in excess of billings			2,620	1,860,973	1,614,299					3,477,892
Unamortized debt expense		14,597	3	16,297	12,405					43,302
Other deferred charges		1		1						863
		14,598	2,623	1,877,271	1,626,704					3,522,077
<b>TOTAL ASSETS</b>	\$ 57,346	\$ 2,295,923	\$ 5,527	\$ 2,188,765	\$ 1,840,513	\$ 2,194	\$ 2,569	\$ 508	\$ -	\$ 6,393,365

\* Project recorded on a liquidation basis  
See notes to financial statements

**FUND EQUITY AND LIABILITIES**

	INTERNAL SERVICE FUND	COLUMBIA GENERATING STATION	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1*	NUCLEAR PROJECT NO.3*	BUSINESS DEVELOPMENT FUND	COMBUSTION TURBINE PROJECT	NINE CANYON WIND PROJECT	DIESEL GENERATION PROJECT	COMBINED TOTAL (MEMORANDUM ONLY)
FUND EQUITY	\$ 1,218					\$ 1,911	\$ (47)		\$ (665)	\$ 2,417
BILLINGS IN EXCESS OF COSTS		\$ 41,569								41,569
LONG-TERM DEBT (NOTE E)										
Revenue bonds payable		2,087,180	\$ 5,028	\$ 2,086,585	\$ 2,033,665					6,212,458
Unamortized discount on bonds - net		(10,085)	(14)	(1,403)	(222,801)					(234,303)
Unamortized gain/(loss) on bond refundings		(49,026)	41	(53,043)	(23,245)					(125,273)
		2,028,069	5,055	2,032,139	1,787,619					5,852,882
LIABILITIES- PAYABLE FROM RESTRICTED ASSETS (NOTE B)										
Special funds										
Accounts payable and accrued expenses	15,717	94,213		77,474						187,404
Due to other business units				2,164						2,164
Due to other funds		35,022	6	16,847	12,763					64,638
Debt service funds										
Accrued interest payable		3,362	65	54,807	36,493					94,727
Due to other funds		1,896	13	3,722	2,590					8,221
	15,717	134,493	84	155,014	51,846					357,154
OTHER NONCURRENT LIABILITIES		4,652								4,652
CURRENT LIABILITIES										
Cash overdrafts	2,559									2,559
Current maturities of long-term debt		45,615	343							45,958
Accounts payable and accrued expenses	32,132	40,358	45	705	454	74	1	20		73,789
Due to Participants	4,422	1,167		846	284					2,297
Due to other business units	39,113	87,140	388	1,612	1,048	209	540	488	665	6,695
						283	541	508	665	131,298
DEFERRED CREDITS										
Advances from Members and others	1						2,095			2,096
Other deferred credits	1,298						2,095			1,297
										3,393
COMMITMENTS AND CONTINGENCIES (NOTE F)										
TOTAL LIABILITIES	56,128	2,295,923	5,527	2,188,765	1,840,513	263	2,636	508	665	6,390,948
TOTAL FUND EQUITY AND LIABILITIES	\$ 57,346	\$ 2,295,923	\$ 5,527	\$ 2,188,765	\$ 1,840,513	\$ 2,194	\$ 2,569	\$ 508	\$ -	\$ 6,393,365

\* Project recorded on a liquidation basis  
See notes to financial statements

**STATEMENTS OF OPERATIONS AND FUND EQUITY**

For the year ended June 30, 2001 (Dollars in Thousands)

	INTERNAL SERVICE FUND	COLUMBIA GENERATING STATION	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1*	NUCLEAR PROJECT NO.3†	BUSINESS EQUIPMENT FUND	COMBUSTION TURBINE PROJECT	NINE CANYON WIND PROJECT	DIESEL GENERATION PROJECT	COMBINED TOTAL (MEMORANDUM ONLY)
<b>OPERATING REVENUES</b>	\$	421,152	\$ 1,741			\$ 5,218				\$ 428,111
<b>OPERATING EXPENSES</b>										
Nuclear fuel		34,204								34,204
Fuel disposal fee		7,542								7,542
Decommissioning		16,246								16,246
Depreciation and amortization		96,026	363			210				96,999
Operations and maintenance		144,325	1,161							145,486
Administrative & general		16,125	99							16,224
Generation tax		2,497	14							2,511
New business initiatives						5,643				5,643
Total operating expenses		316,965	1,637			5,863				324,465
<b>NET OPERATING REVENUES(EXPENSES)</b>		104,187	104			(635)				103,656
<b>OTHER INCOME &amp; EXPENSE</b>										
Non-operating revenues										
Investment income	\$ 59,480			\$ 119,165	\$ 97,019		\$ 84			275,748
Gain/(loss) on current bond redemption	383	23,643	95	14,714	9,971	12	93			48,911
Interest expense and discount amortization			7	(250)	25					(218)
Plant preservation and termination costs			(206)	(126,030)	(105,536)					(361,933)
Depreciation and amortization	(1,482)			(6,708)	(1,475)		(1)			(9,183)
Revaluation of Site Restoration				(35)						(1,518)
Services to other business units	(57,111)			(856)						(856)
Other		2,331		0	(4)		(223)			(57,111)
<b>NET REVENUES(EXPENSES)</b>		1,270	0	0	0	(4)	(223)	0	(665)	1,439
Distribution & Contributions	(1,260)					(623)	(47)	0	(665)	(65)
Beginning Fund Equity	1,208	0	0	0	0	1,110	0	0	0	(150)
<b>ENDING FUND EQUITY</b>	\$ 1,218	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,911	\$ (47)	\$ 0	\$ (665)	\$ 2,417

\* Project recorded on a liquidation basis  
See notes to financial statements

**STATEMENTS OF CASH FLOWS**  
For the year ended June 30, 2001 (Dollars in Thousands)

	INTERNAL SERVICE FUND	COLUMBIA GENERATING STATION	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO. 1*	NUCLEAR PROJECT NO. 3*	BUSINESS DEVELOPMENT FUND	COMBUSTION TURBINE PROJECT	NINE CANYON WIND PROJECT	DIESEL GENERATION PROJECT	COMBINED TOTAL (MEMORANDUM ONLY)
<b>CASH FLOWS FROM OPERATING AND OTHER ACTIVITIES</b>										
Net operating revenues										\$ 103,656
Adjustments to reconcile net operating revenues to cash provided by operating activities:										
Cost incurred in excess of cash		19,782	(356)							19,426
Depreciation and amortization		128,672	359			127				129,158
Decommissioning		16,246								16,246
Other		2,183								2,183
Change in operating assets and liabilities:										
Accounts receivable		1,988	(112)			(242)				1,634
Materials and supplies		(7,070)								(7,070)
Prepaid and other assets		1,010	2			28				1,040
Due from/to other business units, funds and Participants		16,156	(271)			435				16,320
Accounts payable		9,717	(163)			301				9,855
Non-operating revenue receipts	\$ 3,268			\$ 162,365	\$ 127,974		\$ 1,570			295,177
Cash payments for preservation, termination expense				(7,371)	(5,180)					(12,551)
Cash payments for services	(2,940)									(2,940)
Cash payments for new business	(2,063)									(2,063)
Net cash provided/(used) by operating and other activities	(1,735)	292,871	(437)	154,994	122,794	14	1,570	0	0	570,071
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>										
Proceeds from bond refundings		244,124		135,275	243,608					623,007
Refunded bond escrow requirement		(192,342)		(109,684)	(215,150)					(517,176)
Payment for bond issuance and financing costs		(2,976)		(1,131)	(2,078)					(6,185)
Capital and nuclear fuel acquisitions		(33,571)								(33,571)
Interest paid on revenue bonds		(113,754)	(208)	(119,520)	(81,445)					(314,927)
Principal paid on revenue bond maturities		(171,480)	(474)	(79,264)	(78,588)					(329,806)
Net cash used by capital and related financing activities	(289,999)	(682)	(682)	(174,324)	(133,653)					(578,658)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>										
Purchases of investment securities	(186,293)	(1,207,615)	(10,826)	(790,524)	(508,213)	(1,541)	(2,693)			(2,707,705)
Sales of investment securities	186,358	1,166,211	11,781	792,423	506,018	1,511	1,042			2,665,344
Interest on investments	1,856	18,667	134	12,674	8,529	12	62			42,134
Receipts from sales of plant assets				165						165
Net cash provided/(used) by investing activities	1,921	(22,537)	1,089	14,738	6,334	(18)	(1,589)			(62)
<b>NET INCREASE(DECREASE) IN CASH</b>	186	335	(30)	(4,592)	(4,525)	(4)	(19)			(8,649)
<b>CASH AT JUNE 30, 2000</b>	11,142	3,971	39	4,680	4,596	4	23	0	0	24,455
<b>CASH AT JUNE 30, 2001 (NOTE B)</b>	\$ 11,328	\$ 4,306	\$ 9	\$ 88	\$ 71	\$ -	\$ 4	\$ -	\$ -	\$ 15,806

\* Project recorded on a liquidation basis  
See notes to financial statements

## **OUTSTANDING LONG-TERM DEBT**

*As of June 30, 2001 (Dollars in Thousands)*

SERIES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>COLUMBIA (NUCLEAR PROJECT NO. 2) REFUNDING REVENUE BONDS</b>			
1990A	7.25%	7-1-2006	\$ 35,790
1990C	7.50	7-1-2002	6,310
	(A)	7-1-2004/2005	18,054
			<u>24,364</u>
1991A	6.50-6.60	7-1-2002/2004	53,415
	(A)	7-1-2006/2007	10,267
			<u>63,682</u>
1992A	5.90-6.30	7-1-2004/2009	76,085
	6.25	7-1-2012	14,525
	6.30	7-1-2012	50,000
			<u>140,610</u>
1993A	5.25-6.00	7-1-2002/2010	94,520
	5.75	7-1-2012	10,690
			<u>105,210</u>
1993B	5.10-5.65	7-1-2004/2008	61,645
	5.55	7-1-2010	51,000
			<u>112,645</u>
1994A	4.60-6.00	7-1-2002/2011	511,870
	5.40	7-1-2012	100,200
	(A)	7-1-2009	4,776
			<u>616,846</u>
1996A	5.00-6.00	7-1-2002/2012	<u>196,995</u>
1997A	5.10-6.00	7-1-2004/2012	<u>124,255</u>
1997B	5.00-5.50	7-1-2003/2011	<u>72,270</u>
1997-2A-1,2	Variable	7-1-2001/2012	<u>120,865</u>
1998A	5.00-5.75	7-1-2002/2012	<u>224,900</u>

(A) Compound interest bonds

(B) Excludes amounts due July 1, 2001 which were paid as of June 30, 2001

(C) Includes amounts due July 1, 2001

(D) The estimated fair value shown has been reported to meet the disclosure requirements of Statement of Financial Accounting Standards (SFAS) 107 and does not purport to represent the amounts at which these obligations would be settled

(E) Auction Rate Certificates thereafter

## OUTSTANDING LONG-TERM DEBT

As of June 30, 2001 (Dollars in Thousands)

SERIES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
--------	----------------	---------------------------------	--------

COLUMBIA (NUCLEAR PROJECT NO. 2) REFUNDING REVENUE BONDS (Continued)

2001A	5.00-5.50	7-1-2013/2017	\$ 186,600
2001B	5.50	7-1-2009	48,000
	(E)	7-1-2018	48,000
<i>Compound interest bonds accretion</i>			59,763
<i>Revenue bonds payable</i>			\$ 2,132,795 (B)
<i>Estimated fair value at June 30, 2001</i>			\$ 2,228,120 (D)

PACKWOOD LAKE PROJECT REVENUE BONDS

1962	3.625%	3-1-2012	\$ 4,031
1965	3.75	3-1-2012	1,340
<i>Revenue bonds payable</i>			\$ 5,371
<i>Estimated fair value at June 30, 2001</i>			\$ 5,285 (D)

NUCLEAR PROJECT NO. 1 REFUNDING REVENUE BONDS

1989A	7.10	7-1-2001	\$ 3,705
1989B	7.15	7-1-2001	5,545
	7.125	7-1-2016	41,070
			46,615
1990A	7.40	7-1-2001	6,925
1990B	7.10	7-1-2001	7,740
	7.25	7-1-2009	72,770
			80,510
1990C	7.625-7.75	7-1-2001/2003	55,585
1991A	6.30	7-1-2001	4,745
1992A	5.60-6.10	7-1-2001/2006	3,765
	6.25	7-1-2017	63,420
			67,185

(A) Compound interest bonds

(B) Excludes amounts due July 1, 2001 which were paid as of June 30, 2001

(C) Includes amounts due July 1, 2001

(D) The estimated fair value shown has been reported to meet the disclosure requirements of Statement of Financial Accounting Standards (SFAS) 107 and does not purport to represent the amounts at which these obligations would be settled

(E) Auction Rate Certificates thereafter

## **OUTSTANDING LONG-TERM DEBT**

*As of June 30, 2001 (Dollars in Thousands)*

SERIES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 1 REFUNDING REVENUE BONDS (Continued)</b>			
1993A	5.25-7.00%	7-1-2001/2008	\$ 136,965
	5.75	7-1-2011	80,000
	5.70	7-1-2017	176,180
			<u>393,145</u>
1993B	5.00-7.00	7-1-2001/2010	60,980
	5.60	7-1-2015	94,635
			<u>155,615</u>
1993C	4.60-5.30	7-1-2001/2010	18,455
	5.40	7-1-2012	66,400
	5.375	7-1-2015	75,650
			<u>160,505</u>
1993-1A-1,2,3	Variable	7-1-2001/2017	<u>130,200</u>
1996A	5.00-6.00	7-1-2001/2012	<u>345,330</u>
1996B	5.00-6.00	7-1-2001/2005	<u>29,365</u>
1996C	5.00-6.00	7-1-2001/2015	88,180
	5.50	7-1-2017	24,860
			<u>113,040</u>
1997A	5.00-6.00	7-1-2001/2008	<u>20,575</u>
1997B	5.00-5.125	7-1-2001/2017	<u>252,200</u>
1998A	5.00-5.75	7-1-2001/2017	<u>92,970</u>
2001A	4.00-5.50	7-1-2001/2013	<u>104,770</u>
2001B	5.50	7-1-2008	23,600
	(E)	7-1-2017	23,600
			<u>23,600</u>
<i>Revenue bonds payable</i>			<u>\$ 2,086,585 (C)</u>
<i>Estimated fair value at June 30, 2001</i>			<u>\$ 2,208,216 (D)</u>

(A) Compound interest bonds

(B) Excludes amounts due July 1, 2001 which were paid as of June 30, 2001

(C) Includes amounts due July 1, 2001

(D) The estimated fair value shown has been reported to meet the disclosure requirements of Statement of Financial Accounting Standards (SFAS) 107 and does not purport to represent the amounts at which these obligations would be settled

(E) Auction Rate Certificates thereafter



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

*As of June 30, 2001 (Dollars in Thousands)*

SERIES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 3 REFUNDING REVENUE BONDS</b>			
1989A	7.10%	7-1-2001	\$ 3,595
	(A)	7-1-2003/2014	<u>18,668</u>
			<u>22,263</u>
1989B	7.15	7-1-2001	12,400
	(A)	7-1-2004/2014	70,580
	7.125	7-1-2016	<u>76,145</u>
			<u>159,125</u>
1990B	7.375	7-1-2001	7,350
	(A)	7-1-2001/2010	<u>38,685</u>
			<u>46,035</u>
1991A	6.30	7-1-2001	<u>3,990</u>
1993B	5.00-7.00	7-1-2001/2009	87,540
	5.625	7-1-2012	14,555
	5.60	7-1-2015	49,095
	5.60	7-1-2017	37,795
	5.70	7-1-2018	<u>20,605</u>
			<u>209,590</u>
1993C	4.60-7.50	7-1-2001/2010	144,265
	5.40	7-1-2012	105,000
	(A)	7-1-2013/2018	23,963
	5.375	7-1-2015	188,335
	5.50	7-1-2018	<u>20,805</u>
			<u>482,368</u>
1993-3A-3	Variable	7-1-2001/2018	<u>24,720</u>
1996A	5.00-6.00	7-1-2001/2009	<u>31,605</u>
1997A	5.00-6.00	7-1-2001/2018	<u>109,650</u>
1997B	5.00	7-1-2002	<u>4,075</u>

(A) Compound interest bonds

(B) Excludes amounts due July 1, 2001 which were paid as of June 30, 2001

(C) Includes amounts due July 1, 2001

(D) The estimated fair value shown has been reported to meet the disclosure requirements of Statement of Financial Accounting Standards (SFAS) 107 and does not purport to represent the amounts at which these obligations would be settled

(E) Auction Rate Certificates thereafter

## **OUTSTANDING LONG-TERM DEBT**

*As of June 30, 2001 (Dollars in Thousands)*

SERIES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 3 REFUNDING REVENUE BONDS (Continued)</b>			
1998A	5.00-5.125%	7-1-2001/2018	<u>\$ 148,665</u>
1998-3A	Variable	7-1-2001/2018	<u>159,500</u>
2001A	4.00-5.50	7-1-2001/2018	<u>208,755</u>
2001B	5.00	7-1-2003/2004	15,000
	5.50	7-1-2010	<u>10,675</u>
	(E)	7-1-2018	<u>25,675</u>
<i>Compound interest bonds accretion</i>			<u>397,649</u>
<i>Revenue bonds payable</i>			<u>\$ 2,033,665 (C)</u>
<i>Estimated fair value at June 30, 2001</i>			<u>\$ 1,934,034 (D)</u>

(A) Compound interest bonds

(B) Excludes amounts due July 1, 2001 which were paid as of June 30, 2001

(C) Includes amounts due July 1, 2001

(D) The estimated fair value shown has been reported to meet the disclosure requirements of Statement of Financial Accounting Standards (SFAS) 107 and does not purport to represent the amounts at which these obligations would be settled

(E) Auction Rate Certificates thereafter

## ***DEBT SERVICE REQUIREMENTS***

*As of June 30, 2001 (Dollars in Thousands)*

FISCAL YEAR	COLUMBIA GENERATING STATION			PACKWOOD LAKE PROJECT		
	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
6/30/2001						
Balance:*	\$ 7,100	\$ 3,362	\$ 10,462	\$ 172	\$ 65	\$ 237
2002	45,615	110,262	155,877	523	125	648
2003	124,165	107,620	231,785	548	171	719
2004	163,609	112,604	276,213	574	151	725
2005	124,340	116,202	240,542	598	130	728
2006	140,186	98,926	239,112	624	108	732
Balance Through						
2012					208	208
2018	1,468,017	374,874	1,842,891	2,332		2,332
Adjustment **	59,763	(59,763)	0			
	\$ 2,132,795	\$ 864,087	\$ 2,996,882	\$ 5,371	\$ 958	\$ 6,329

\* Bond Fund Account balances less accrued investment income

\*\* Adjustment for Compound Interest Bonds accretion; Compound Interest Bonds are reflected at their face amount less discount on the balance sheet

**DEBT SERVICE REQUIREMENTS (Continued)**

As of June 30, 2001 (Dollars in Thousands)

FISCAL YEAR	NUCLEAR PROJECT NO. 1			NUCLEAR PROJECT NO. 3		
	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
6/30/2001						
Balance:*	\$ 85,740	\$ 54,807	\$ 140,547	\$ 70,695	\$ 36,493	\$ 107,188
2002	79,850	113,054	192,904	78,527	81,556	160,083
2003	70,255	108,338	178,593	79,987	79,670	159,657
2004	81,610	104,462	186,072	62,906	91,427	154,333
2005	73,765	99,761	173,526	64,471	91,989	156,460
2006	91,195	95,620	186,815	65,392	90,494	155,886
Balance Through						
2017	1,604,170	601,360	2,205,530			
2018				1,214,038	761,070	1,975,108
Adjustment **				397,649	(397,649)	0
	<u>\$ 2,086,585</u>	<u>\$ 1,177,402</u>	<u>\$ 3,263,987</u>	<u>\$ 2,033,665</u>	<u>\$ 835,050</u>	<u>\$ 2,868,715</u>

\* Bond Fund Account balances less accrued investment income

\*\* Adjustment for Compound Interest Bonds accretion; Compound Interest Bonds are reflected at their face amount less discount on the balance sheet

## NOTES TO FINANCIAL STATEMENTS

### **NOTE A - GENERAL**

#### Organization

Energy Northwest, a municipal corporation and joint operating agency of the State of Washington, was organized in 1957. It is empowered to finance, acquire, construct and operate facilities for the generation and transmission of electric power. On June 30, 2001, its membership consisted of 10 public utility districts and the cities of Richland, Seattle and Tacoma. All members own and operate electric systems within the State of Washington. Energy Northwest is exempt from federal income tax. Energy Northwest has no taxing authority.

#### Energy Northwest Business Units

Energy Northwest operates Columbia Generating Station, a 1,153 MWe (Design Electric Rating, net) generating plant completed in 1984. On April 27, 2000, Energy Northwest's executive board approved a name change from Nuclear Project No. 2 to Columbia Generating Station (Columbia). Energy Northwest has obtained all permits and licenses required to operate Columbia, including a Nuclear Regulatory Commission (NRC) operating license which expires in December 2023. Energy Northwest also operates the Packwood Lake Hydroelectric Project (Packwood), a 27.5 MWe generating plant completed in 1964. Packwood operates under a fifty-year license from the Federal Energy Regulatory Commission (FERC) that expires on February 28, 2010.

Nuclear Project No. 1, a 1,250 MWe plant, was placed in extended construction delay status in 1982, when it was 65 percent complete. Nuclear Project No. 3, a 1,240 MWe plant, was placed in extended construction delay status in 1983, when it was 75 percent complete. On May 13, 1994, Energy Northwest's Board of Directors adopted resolutions terminating Nuclear Projects Nos. 1 and 3 (see Note F - Nuclear Projects Nos. 1 and 3 Termination). In fiscal year 1999, the assets and liabilities of Hanford Generating Project were consolidated into Nuclear Project No. 1. The Hanford Generating Project site is being restored and all funding requirements are net-billed obligations of Nuclear Project No. 1. Nuclear Project No. 1 is wholly-owned by Energy Northwest. Nuclear

Project No. 3 was jointly-owned, 70 percent by Energy Northwest and 30 percent by four investor-owned utilities until fiscal year 1999. In fiscal year 1999, the ownership agreements were terminated and the real and personal property interests were transferred to Energy Northwest. The financial effect of the termination of the ownership agreement was a write-off for Nuclear Project No. 3 of a \$3.7 million receivable from the former joint owners.

Each Energy Northwest business unit is financed and accounted for separate from all other current or future business units.

All electrical energy produced by Energy Northwest business units is ultimately delivered to electrical distribution facilities owned and operated by the Bonneville Power Administration (BPA) as part of the Federal Columbia River Power System. BPA in turn distributes the electricity to electric utility systems throughout the Northwest, including participants in Energy Northwest's business units, for ultimate distribution to consumers. Participants in Energy Northwest's business units consist of publicly-owned utilities and rural electric cooperatives located in the western United States who have entered into net-billing agreements with Energy Northwest and BPA for participation in one or more of Energy Northwest's business units. BPA is obligated by law to establish rates for electric power which will recover the cost of electric energy acquired from Energy Northwest and other sources as well as BPA's other costs. See Note E, Security - Nuclear Projects Nos. 1, 3 and Columbia, for discussion of BPA's obligations with respect to Nuclear Projects Nos. 1, 3 and Columbia.

Energy Northwest also manages the Business Development Fund, Nine Canyon Wind Project, Combustion Turbine (CT) Project, Temporary Diesel Generation Project, and the Internal Service Fund. The Business Development Fund was established in April 1997 to pursue and develop new energy-related business opportunities. The Nine Canyon Wind Project was established in January 2001 for the purpose of exploring and establishing a wind energy project. Finalization of the project agreements and construction of the project are expected to take place in fiscal year 2002. The CT Project was established in July 1990 to collect advances and contributions to pay the costs of investigating new generating projects, including the feasibility of a combustion turbine near Satsop, Washington. The Temporary Diesel Generation Project was established in May 2001 to provide immediate additional electrical generation using temporary diesel generators. Changing circumstances have since resulted in the stoppage of this project after initial expenditures but prior to

finalizing an order for the diesel generators. The negative equity of the Temporary Diesel Generation Project will be absorbed by the Business Development Fund in FY 2002. The Internal Service Fund (formerly General Fund) was established in May 1957. It is currently used to account for the central procurement of certain common goods and services for the business units on a cost reimbursement basis. It is also used to account for the performance fees paid by BPA to Energy Northwest for achieving performance goals related to the operation of Columbia.

## **NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### Basis of Accounting

Energy Northwest has adopted accounting policies and principles that are in accordance with accounting principles generally accepted in the United States of America. Accounts are maintained in accordance with the uniform system of accounts of the FERC. Separate funds and books of account are maintained for each business unit. Payment of obligations of one business unit with funds of another business unit is prohibited, and would constitute violation of bond resolution covenants.

Energy Northwest maintains an Internal Service Fund for centralized control and accounting of certain fixed assets such as data processing equipment, and for payment and accounting of internal services, payrolls, benefits, administrative and general expenses, and certain contracted services on a cost reimbursement basis. In addition, it is used to account for performance fees paid by BPA to Energy Northwest for achieving performance goals related to the operation of Columbia. The performance fee is a general asset of Energy Northwest not allocable to other funds. Other assets of the Internal Service Fund are owned by Energy Northwest's business units and are held in trust by the Internal Service Fund as reflected by the due to and from other business units. Depreciation relating to fixed assets is charged to the appropriate business units based upon an allocation formula. Liabilities of the Internal Service Fund represent accrued payrolls, vacation pay, employee benefits, and common accounts payable which have been charged directly or indirectly to business units and will be funded by the business units when paid. Net amounts owed to or receivable from Energy Northwest business units are recorded under Current Liabilities - Due to other business units, or current assets - Due from other business units on the Internal Service Fund balance sheet.

The Combined Total (Memorandum Only) column on the financial statements is for presentation only as each Energy Northwest business unit is financed and accounted for separate from all other current and future business units. There are no eliminations for transactions between business units in the Combined Total column.

Pursuant to Statement No. 20 of the Governmental Accounting Standards Board (GASB), "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," Energy Northwest has elected to apply all Financial Accounting Standards Board statements and interpretations, except for those that conflict with or contradict GASB pronouncements. Specifically, Statement of Governmental Accounting Standard No. 7 and No. 23 conflict with Statement of Financial Accounting Standard (SFAS) No. 125. As such, the guidance under Statement of Governmental Accounting Standard No. 7 and No. 23 is followed. Such guidance governs the accounting for bond defeasances and refundings.

The preparation of Energy Northwest financial statements in conformity with accounting principles generally accepted in the United States of America necessarily requires management to make estimates and assumptions that directly affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates. Certain incurred expenses and revenues are allocated to the business units based on specific allocation methods and management considers the allocation methods to be reasonable.

Energy Northwest's fiscal year begins on July 1<sup>st</sup> and ends on June 30<sup>th</sup>.

### Utility Plant

Utility plant is stated at original cost. Plant in service is depreciated by the straight-line method over the estimated useful lives of the various classes of plant, which range from five to 40 years.

During the normal construction phase of a project, Energy Northwest's policy is to capitalize all costs relating to the project, including interest expense (net of interest income), and related administrative and general expense.



Nuclear Projects Nos. 1 and 3 have been reduced to their estimated net realizable values due to termination. A write-down of Nuclear Projects Nos. 1 and 3 was recorded in fiscal year 1995 and is included in Cost in Excess of Billings. Nuclear Project No. 3's utility plant value consists of the land owned by the project. Interest expense, termination expenses and asset disposition costs for Nuclear Projects Nos. 1 and 3 have been charged to operations.

### Nuclear Fuel

All expenditures related to the purchase of nuclear fuel for Columbia, including interest, are capitalized and carried at cost. When the fuel is placed in the reactor, the fuel cost is amortized to operating expense on the basis of quantity of heat produced for generation of electric energy. Accumulated nuclear fuel amortization (the amortization of the cost of nuclear fuel assemblies in the reactor used in the production of energy) is \$106 million as of June 30, 2001 for Columbia.

Energy Northwest has a contract with the Department of Energy (DOE) that requires the DOE to accept title and dispose of spent nuclear fuel. Although the courts have ruled that the DOE had the obligation to accept title to spent nuclear fuel by January 31, 1998, the repository is not expected to be in operation before 2010. Columbia has capacity to store spent fuel in existing facilities until November 2004. To accommodate the spent fuel discharges after this date, Energy Northwest has initiated a project to store the spent fuel in commercially available dry storage casks on a concrete pad at the Columbia site. Effective fiscal year 2000, Energy Northwest began accruing the fuel cask obligations based on the rate of fuel consumption (\$1.4 million for fiscal year 2001). To recognize the cask costs associated with fuel consumed in FY 2000 and prior years, \$25.0 million was charged to operations in fiscal year 2000. Current period operating expense for Columbia includes a \$7.5 million charge for future spent nuclear fuel storage and disposal to be provided by the DOE in accordance with the Nuclear Waste Policy Act of 1982.

Energy Northwest has entered into an agreement to transfer enriched uranium to General Electric Company in exchange for equivalent amounts of uranium at reload enrichments in future years and usage/loan fees. Energy Northwest has transferred approximately 488,151 pounds of UF<sub>6</sub> and 263,137 SWU of Columbia uranium. The exchange agreement has been secured by an irrevocable

letter of credit issued in the amount of the replacement value of the loaned uranium product, adjusted semiannually. The cost of the loaned uranium, \$34 million, is included in the carrying amount of Columbia's nuclear fuel.

**Until June 30, 2002, Columbia has an option to purchase the remaining fuel at Nuclear Project No. 1. At June 30, 2001, the market value is \$8.3 million, including escalation.**

#### Restricted Assets

In accordance with project bond resolutions, related agreements, or state law, separate restricted funds have been established for each business unit. The assets held in these funds are restricted for specific uses including construction, debt service, capital additions, extraordinary operation and maintenance costs, termination, decommissioning and workers' compensation claims.

#### Long-Term Receivables

Long-term receivables include minimum guaranteed amounts adjusted annually pertaining to future discounts for certain goods and services to be provided to Columbia as the result of a litigation settlement and subsequent revisions.

#### Accounts and Other Receivables

The Accounts and other Receivables for the Internal Service Fund include miscellaneous receivables outstanding for other business units that have not yet been collected. The amounts due to each business unit is reflected in the due to/from other business units account.

#### Decommissioning and Site Restoration

Energy Northwest established decommissioning and site restoration funds for Columbia and monies are being deposited each year in accordance with an established funding plan.

The NRC has issued rules to provide guidance to licensees of operating nuclear plants on decommissioning the plants at the end of each plant's operating life. In September 1998, the NRC approved and published its "Final Rule on Financial Assurance Requirements for Decommissioning Power Reactors." As provided in this rule, each power reactor licensee is required to report to the NRC the status of its decommissioning funding for each reactor or share of a reactor it owns. This reporting requirement began on March 31, 1999 and reports are required every two years thereafter. Energy Northwest submitted its most recent report to the NRC on March 23, 2001.

Energy Northwest's current estimate of Columbia's decommissioning costs is approximately \$345 million (in 1999 dollars). This current estimate is based on the NRC minimum amount required to demonstrate reasonable financial assurance for a boiling water reactor with the power level of Columbia.

Site restoration requirements for Columbia are governed by the site certification agreements between Energy Northwest and the State of Washington and regulations adopted by the Washington Energy Facility Site Evaluation Council (EFSEC). Energy Northwest submitted a site restoration plan for Columbia that was approved by the EFSEC on June 12, 1995. Energy Northwest's current estimate of Columbia's site restoration costs is approximately \$54 million (in 1999 dollars).

Both decommissioning and site restoration estimates (in 1999 dollars) are used as the basis for establishing a funding plan that includes escalation and interest earnings until decommissioning activities occur. Payments to the decommissioning and site restoration funds have been made since January 1985. The fair value of cash and investment securities in the decommissioning and site restoration funds as of June 30, 2001 totaled approximately \$68.0 million and \$5.5 million, respectively. Since September 1996 these amounts have been held and managed by BPA in external trust funds in accordance with NRC requirements and site certification agreements.

Energy Northwest's accrued liability for decommissioning and site restoration for Columbia is \$93.7 million as of June 30, 2001. Per the net-billing agreements, BPA is obligated to provide for the entire cost of decommissioning and site restoration. A corresponding receivable has been established within Restricted Assets reflecting amounts owed to Columbia by BPA. The decommissioning and site restoration liability is not based on the funding plan. Annual

decommissioning and site restoration expense is accounted for on a pro-rata basis over the life of the plant and is based on the total estimated decommissioning and site restoration costs, adjusted for inflation.

### Materials and Supplies

Materials and supplies are valued at cost, using weighted-average methods.

### Financing Expense, Bond Discount, and Deferred Gain and Losses

Financing expenses and bond discounts are amortized over the terms of the respective bond issues using the bonds outstanding method.

In accordance with the Statement of Governmental Accounting Standard No. 23 effective for periods after June 15, 1994, losses on debt refundings have been deferred and amortized as a component of interest expense over the shorter of the remaining life of the old or new debt. The balance sheet includes the original deferred amount less recognized amortization expense and is included as a reduction to the new debt.

### Current Maturities of Revenue Bonds

Current maturities of revenue bonds payable from restricted assets are reflected in Long-Term Debt. Current maturities of bonds for which funds have not yet been restricted are reflected in Current Liabilities.

### Accounts Payable and Accrued Expenses

Restricted Liabilities – Internal Service Fund accounts payable and accrued expenses include \$13.9 million for unclaimed bearer bonds. Columbia includes \$93.7 million for decommissioning and site restoration. Nuclear Project No. 1 includes \$59.2 million for its own site restoration and \$13.5 million for Hanford Generating Project site restoration.

Current liabilities – Internal Service Fund accounts payable and accrued expenses include \$1.3 million for payroll and related benefits, \$13.6 million for Personal Time Bank, and \$4.5 million for outstanding warrants. Columbia includes \$4.7 million for fuel casks, \$11.9 million for a contractor’s services, \$2.2 million for arbitrage rebate (as defined by the Internal Revenue Code) and \$2.6 million for fuel sales tax. Nuclear Project No. 1 includes \$705 thousand for arbitrage rebate. Nuclear Project No. 3 includes \$275 thousand for arbitrage rebate.

### Fair Value of Financial Instruments

The fair value of financial instruments has been estimated using available market information and certain assumptions. Considerable judgment is required in interpreting market data to develop fair value estimates and such estimates are not necessarily indicative of the amounts that could be realized in a current market exchange. The following methods and assumptions were used to estimate the fair value of each of the following financial instruments.

Financial instruments for which the carrying value is considered a reasonable approximation of fair value include: cash, accounts and other receivables, accounts payable and accrued expenses, advances from Members and others, other noncurrent liabilities and due to/from Participants, funds, and other business units. The fair values of investments (see Note C) and revenue bonds payable (see Outstanding Long-Term Debt Schedule) have been estimated based on quoted market prices for such instruments or based on the fair value of financial instruments of a similar nature and degree of risk.

## Revenues

Energy Northwest accounts for revenues on an accrual basis, and recovers, through various agreements, actual cash requirements for operations and debt service for Columbia, Packwood, Nuclear Project No. 1 and Nuclear Project No. 3. For these business units, Energy Northwest recognizes revenues equal to expenses for each period. No net revenue or loss is recognized, and no equity is accumulated. The difference between cumulative billings received and cumulative expenses is recorded as either billings in excess of costs (liability) or as costs in excess of billings (asset), as appropriate. Such amounts will be settled during future operating periods.

Energy Northwest accounts for revenues and expenses on an accrual basis for the remaining business units. The difference between cumulative revenues and cumulative expenses is recognized as net revenue or losses and included in fund equity for each period.

## Deferred Revenues

Advances of \$1.2 million to the CT Project for the sale of land and licenses which is not complete, are included in the Advances from Members and others account and were not included in current year income.

## Concentration of Credit Risk

Financial instruments which potentially subject Energy Northwest to concentrations of credit risk consist of available-for-sale investments, accounts receivable, other receivables, long-term receivables and costs in excess of billings. Energy Northwest invests exclusively in U.S. Government securities and agencies. Energy Northwest's accounts receivable and costs in excess of billings are concentrated with project Participants and BPA through the net billing agreements. See Note E, Security - Nuclear Projects Nos. 1, 3 and Columbia and Security - Packwood Lake Hydroelectric Project. The long-term receivable is with a large and stable company which Energy Northwest considers to be of low credit risk. Other large receivables are secured through the use of letters of credit and other similar security mechanisms or are with large and stable companies which Energy Northwest considers to be of low credit risk. As a consequence, Energy Northwest considers the exposure of the business units to concentration of credit risk to be limited.

## Statements of Cash Flows

For purposes of the statements of cash flows, cash includes unrestricted and restricted cash balances. Short-term, highly liquid investments are not considered cash equivalents.

### **NOTE C - CASH AND INVESTMENTS**

Cash and investments for each business unit are separately maintained. Energy Northwest's deposits are insured by federal depository insurance or through the Washington Public Deposit Protection Commission. Energy Northwest resolutions and investment policies limit investment authority to obligations of the United States Treasury, Federal National Mortgage Association and Federal Home Loan Banks. All investments are held for the benefit of the individual Energy Northwest business units by safekeeping agents, custodians, or trustees.

Investments are classified as available-for-sale and are stated at fair value with unrealized gains and losses reported in investment income. Available-for-sale investments at June 30, 2001 are categorized below to give an indication of the types and amounts of investments held by each business unit at year end. (See tables below)

**AVAILABLE-FOR-SALE INVESTMENTS (Dollars in Thousands)**

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<b>Columbia</b>				
U.S. Government Securities	\$ 66,135	\$ 1,585	\$ (135)	\$ 67,585
U.S. Government Agencies	<u>147,337</u>	<u>1,075</u>	<u>(109)</u>	<u>148,303</u>
Total	<u>\$ 213,472</u>	<u>\$ 2,660</u>	<u>\$ (244)</u>	<u>\$ 215,888</u>
<b>Packwood</b>				
U.S. Government Securities	\$ 1,100	\$ 0	\$ 0	\$ 1,100
Total	<u>\$ 1,100</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,100</u>
<b>Nuclear Project No. 1</b>				
U.S. Government Securities	\$ 37,304	\$ 793	\$ 0	\$ 38,097
U.S. Government Agencies	<u>232,052</u>	<u>532</u>	<u>(67)</u>	<u>232,517</u>
Total	<u>\$ 269,356</u>	<u>\$ 1,325</u>	<u>\$ (67)</u>	<u>\$ 270,614</u>
<b>Nuclear Project No. 3</b>				
U.S. Government Securities	\$ 31,722	\$ 690	\$ 0	\$ 32,412
U.S. Government Agencies	<u>164,461</u>	<u>172</u>	<u>(13)</u>	<u>164,620</u>
Total	<u>\$ 196,183</u>	<u>\$ 862</u>	<u>\$ (13)</u>	<u>\$ 197,032</u>
<b>Business Development Fund</b>				
U.S. Government Agencies	\$ 30	\$ 0	\$ 0	\$ 30
Total	<u>\$ 30</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 30</u>
<b>CT Project</b>				
U.S. Government Agencies	\$ 1,680	\$ 2	\$ 0	\$ 1,682
Total	<u>\$ 1,680</u>	<u>\$ 2</u>	<u>\$ 0</u>	<u>\$ 1,682</u>
<b>Internal Service Fund</b>				
U.S. Government Securities	\$ 11,100	\$ 167	\$ 0	\$ 11,267
U.S. Government Agencies	<u>8,797</u>	<u>5</u>	<u>0</u>	<u>8,802</u>
Total	<u>\$ 19,897</u>	<u>\$ 172</u>	<u>\$ 0</u>	<u>\$ 20,069</u>

At June 30, 2001, the contractual maturities of available-for-sale investments are:

	<u>&lt; 1 Year</u>	<u>1-5 Years</u>	<u>5-10 Years</u>	<u>&gt; 10 Years</u>	<u>TOTAL</u>
<b>Columbia</b>					
U.S. Government Securities	\$ 17,637	\$ 24,920	\$ 25,028	\$ 0	\$ 67,585
U.S. Government Agencies	<u>103,611</u>	<u>21,678</u>	<u>13,340</u>	<u>9,674</u>	<u>148,303</u>
Total	<u>\$ 121,248</u>	<u>\$ 46,598</u>	<u>\$ 38,368</u>	<u>\$ 9,674</u>	<u>\$ 215,888</u>
<b>Packwood</b>					
U.S. Government Securities	\$ 1,100	\$ 0	\$ 0	\$ 0	\$ 1,100
Total	<u>\$ 1,100</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,100</u>
<b>Nuclear Project No. 1</b>					
U.S. Government Securities	\$ 8,951	\$ 28,432	\$ 0	\$ 714	\$ 38,097
U.S. Government Agencies	<u>205,102</u>	<u>17,934</u>	<u>9,035</u>	<u>446</u>	<u>232,517</u>
Total	<u>\$ 214,053</u>	<u>\$ 46,366</u>	<u>\$ 9,035</u>	<u>\$ 1,160</u>	<u>\$ 270,614</u>
<b>Nuclear Project No. 3</b>					
U.S. Government Securities	\$ 17,922	\$ 13,052	\$ 0	\$ 1,438	\$ 32,412
U.S. Government Agencies	<u>153,944</u>	<u>6,648</u>	<u>4,028</u>	<u>0</u>	<u>164,620</u>
Total	<u>\$ 171,866</u>	<u>\$ 19,700</u>	<u>\$ 4,028</u>	<u>\$ 1,438</u>	<u>\$ 197,032</u>
<b>Business Development Fund</b>					



	< 1 Year	1-5 Years	5-10 Years	> 10 Years	TOTAL
U.S. Government Agencies	\$ 30	\$ 0	\$ 0	\$ 0	\$ 30
Total	\$ 30	\$ 0	\$ 0	\$ 0	\$ 30
<b>CT Project</b>					
U.S. Government Agencies	\$ 1,682	\$ 0	\$ 0	\$ 0	\$ 1,682
Total	\$ 1,682	\$ 0	\$ 0	\$ 0	\$ 1,682
<b>Internal Service Fund</b>					
U.S. Government Securities	\$ 11,267	\$ 0	\$ 0	\$ 0	\$ 11,267
U.S. Government Agencies	8,802	0	0	0	8,802
Total	\$ 20,069	\$ 0	\$ 0	\$ 0	\$ 20,069

#### **NOTE D - RETIREMENT BENEFITS**

Substantially all Energy Northwest full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirements Systems, Administrative Services Division, P.O. Box 48380, Olympia, WA 98504-8380. The following disclosures are made pursuant to GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers.

#### Public Employee's Retirement System (PERS) Plans 1 and 2

##### Plan Description

PERS is a cost-sharing multiple-employer defined benefit pension plan. Membership in the plan includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges in a judicial retirement system); employees of legislative committees; college and university employees not in national higher education retirement programs; judges of district and municipal courts; non-certificated employees of school districts; and employees of local government. The PERS system includes two plans. Participants who joined the system by September 30, 1977 are Plan 1 members. Those joining thereafter are enrolled in Plan 2. Retirement benefits are financed from employee and employer contributions and investment earnings. Retirement benefits in both Plan 1 and Plan 2 are vested after completion of five years of eligible service.

Plan 1 members are eligible for retirement at any age after completing 30 years of service, or at age 60 with five years of service, or at age 55 with 25 years of service. The annual pension is two percent of the average final compensation per year of service, capped at 60 percent. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months. If qualified, after reaching age 66 a cost-of-living allowance is granted based on years of service credit and is capped at three percent annually.

Plan 2 members may retire at age 65 with five years of service, or at age 55 with 20 years of service, with an allowance of two percent per year of service of the average final compensation. Plan 2 retirements prior to 65 are actuarially reduced. There is no cap on years of service credit and a cost-of-living allowance is granted, capped at three percent annually.

#### Funding Policy

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates and Plan 2 employer and employee rates. Employee contribution rates for Plan 1 are established by statute at six percent and do not vary from year to year. The employer and employee contribution rates for Plan 2 are set by the director of the Department of Retirement Systems based on recommendations by the Office of the State Actuary to continue to fully fund the plan. All employers are required to contribute at the level established by state law. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 Revised Code of Washington.

The required contribution rates expressed as a percentage of current year covered payroll, as of June 30, 2001 were:

	PERS Plan 1	PERS Plan 2
Employer	4.44%*	4.44%*
Employee	6.00%	2.43%

\*The employer rates do not include the employer administrative expense fee currently set at 0.23%.

Both Energy Northwest and the employees made the required contributions. Energy Northwest's required contributions for the years ended June 30 were:

	PERS Plan 1	PERS Plan 2
2001	\$410,640	\$3,100,152
2000	\$415,538	\$2,929,576
1999	\$718,527	\$4,697,392

In addition to the pension benefits available through PERS, Energy Northwest offers post-employment life insurance benefits to retirees who are eligible to receive pensions under PERS Plan 1 and Plan 2. One hundred twenty-six retirees have elected to participate in this insurance. In 1994, Energy Northwest's Executive Board approved provisions which continued the life insurance benefit to retirees at 25 percent of the premium for employees who retire prior to January 1, 1995 and charged the full 100 percent premium to employees who retired after December 31, 1994. The life insurance benefit is equal to the employee's annual rate of salary at retirement for non-bargaining employees retiring prior to January 1, 1995. The cost of coverage for employees who retired after January 1, 1995 is \$2.33 per \$1,000 of coverage. Employees who retired prior to January 1, 1995 contribute \$.58 per \$1,000 of coverage while Energy Northwest pays the remainder. Premiums are paid to the insurer on a current period basis.

At the time each employee retires, Energy Northwest accrues a liability for the actuarial value of estimated future premiums, net of retiree contributions. The total liability recorded at June 30, 2001 was \$1.291 million for these benefits.

During fiscal year 2001, pension costs for Energy Northwest employees and post-employment life insurance benefit costs for retirees were calculated and allocated to each business unit based on direct labor dollars. Approximately 92 percent of all such costs were allocated to Columbia during fiscal year 2001.

#### 401(k) Deferred Compensation Plan

Energy Northwest provides a 401(k) Deferred Compensation Plan (the 401(k) Plan). The 401(k) Plan is a defined contribution plan that was established to provide a means for investing savings by employees for retirement purposes. All permanent, full time employees are eligible to enroll in the Plan. Each participant may elect to contribute up to 17.5% of pre-tax annual compensation, subject to current Internal Revenue Service limitations. Energy Northwest matches 50% of the portion of the participant's salary deferral amount, which does not exceed 3% of the participant's 401(k) eligible earnings for the 401(k) Plan year. Participants direct the investment of their contributions. Participants are immediately vested in their contributions plus actual earnings thereon. During FY 2001, Energy Northwest contributed \$1,030,512 in company matching funds.

#### **NOTE E - LONG-TERM DEBT**

Each Energy Northwest business unit is financed separately. The resolutions of Energy Northwest authorizing issuance of revenue bonds for each business unit provide that such bonds are payable from the revenues of that business unit. All bonds issued under Resolutions Nos. 769, 775 and 640 for Nuclear Projects Nos. 1, 3 and Columbia, respectively, have the same priority of payment within the business unit (the "Prior Lien Bonds"). All bonds issued under Resolution Nos. 835, 838 and 1042 for Nuclear Projects Nos. 1, 3 and Columbia, respectively, are subordinate to the Prior Lien Bonds and have the same subordinated priority of payment within the business unit (the "Electric Revenue Bonds"). In conjunction with the sale of the Series 2001-A and Series 2001-B Refunding Electric Revenue Bonds, in March and May 2001, respectively, Energy Northwest covenanted with

the owners of Electric Revenue Bonds not to issue any more Prior Lien Bonds or any other obligations having a lien on parity with the Prior Lien Bonds. The variable rate debt instruments issued for Nuclear Projects Nos. 1, 3 and Columbia are Electric Revenue Bonds.

During the year ended June 30, 2001, Energy Northwest issued, for Nuclear Projects Nos. 1, 3 and Columbia, the Series 2001-A Bonds and the Series 2001-B Bonds. The Series 2001-A Bonds, in the aggregate principal amount of \$500.1 million, are fixed rate bonds with an average coupon interest rate of 5.42%. The Series 2001-A Bonds refunded \$499.5 million of outstanding bonds having an average coupon rate of 5.70%. Remaining debt service on the refunded bonds prior to the refunding was \$162.9 million, \$354.9 million and \$255.7 million for Nuclear Projects Nos. 1, 3 and Columbia, respectively. The debt service on the 2001-A Bonds is \$156.1 million, \$345.1 million and \$330.9 million for Nuclear Projects Nos. 1, 3 and Columbia, respectively. Columbia's debt service increases because the final maturity date was extended from 2012 to 2017. Net proceeds from the Series 2001-A Bonds were deposited in a separate irrevocable trust for each Project under the control of the trustee/escrow agent bank to provide all required future debt service payments on the refunded bonds until the dates of redemption. As a result, the refunded bonds are considered to be defeased and the liability of these bonds has been removed from long-term debt.

The Series 2001-B Bonds, in the aggregate principal amount of \$97.3 million, were issued as "Auction Rate Certificates". The interest rates on the Series 2001-B Bonds ranged from 5.00% to 5.50% for the "Initial Interest Periods". The Series 2001-B Bonds refunded \$101.1 million of outstanding bonds, all of which, except for \$230,000 Nuclear Project No. 3 bonds, matured on July 1, 2001. Net proceeds from the Series 2001-B Bonds were deposited in the Principal Accounts in the Bond Funds and the Debt Service Accounts for each Project under the control of the trustee banks to provide all required remaining deposits for principal payments on the refunded bonds until the dates of redemption.

In prior fiscal years, Energy Northwest also defeased certain revenue bonds by placing the net proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the financial statements in accordance with GASB No. 7 and No. 23. Including the fiscal year 2001 defeasements, approximately \$400.9 million, \$170.8 million and \$495.1 million of

deceased bonds were not called or had not matured at June 30, 2001 for Nuclear Projects Nos. 1, 3 and Columbia, respectively.

Outstanding revenue bonds for the various business units as of June 30, 2001, and future debt service requirements for these bonds are presented at the end of the Financial section of this report.

In October 2000, Energy Northwest's Executive Board adopted the 2000 Refunding Plan. Under the 2000 Refunding Plan, Energy Northwest expects to continue its "Traditional Refinancing Program" by refinancing higher interest rate outstanding bonds, previously issued for Nuclear Projects Nos. 1, 3 and Columbia, when economically feasible. Additionally, Energy Northwest expects to continue to issue refunding bonds to extend the final maturity of Columbia debt from 2012 to 2018.

#### Subsequent Event

Energy Northwest's Executive Board, on August 23, 2001, authorized the issuance of Promissory Notes and the execution of Credit Agreements for Nuclear Projects Nos. 1, 3 and Columbia, respectively. Under the Credit Agreements, Energy Northwest may borrow, on a taxable basis, up to \$55.6 million, \$55.2 million and \$36.7 million for the purpose of providing a portion of the funds necessary to refund the principal of outstanding bonds maturing on July 1, 2002 for Nuclear Projects Nos. 1, 3 and Columbia, respectively. This transaction anticipates the sale of refunding bonds in the Spring of 2002, the net proceeds of which will pay off the Promissory Notes and all remaining deposits for principal payments on the refunded bonds until their maturity date of July 1, 2002.

#### Security - Nuclear Projects Nos. 1, 3 and Columbia

Project participants have purchased all of the capability of Nuclear Projects Nos. 1, 3 and Columbia. BPA has in turn acquired the entire capability from the participants under contracts referred to as net-billing agreements. Under the net-billing agreements for each of the business unit's, Participants are obligated to pay Energy Northwest their pro rata share of total annual costs of the respective projects, including debt service on bonds relating to each business unit, and BPA in turn is obligated to pay the Participants identical amounts by reducing amounts due to BPA by Participants under BPA power sales agreements. The net-billing agreements provide that Participants and BPA are obligated

to make such payments whether or not the projects are completed, operable or operating and notwithstanding the suspension, interruption, interference, reduction or curtailment of the projects' output.

On May 13, 1994, Energy Northwest's Board of Directors adopted resolutions terminating Nuclear Projects Nos. 1 and 3. The Nuclear Projects Nos. 1 and 3 project agreements and the net-billing agreements, except for certain sections which relate only to billing processes and accrued liabilities and obligations under the net-billing agreements, ended upon termination of the projects. Energy Northwest entered into an agreement with BPA to provide for continuation of the present budget approval, billing and payment processes. With respect to Nuclear Project No. 3, the ownership agreement among Energy Northwest, Puget Sound Power & Light Company, PacifiCorp, Portland General Electric Company and AVISTA Corporation was terminated in fiscal year 1999. The ownership of all real and personal property interests was transferred to Energy Northwest.

#### Security - Packwood Lake Hydroelectric Project

Energy Northwest and BPA signed an agreement which became effective on October 1, 1996 for the period through July 1, 2001, and states that BPA will pay Energy Northwest in exchange for the project's total output of electric capacity and energy delivered from the project. BPA will pay 17.5 mills per kWh for the first 86,750 megawatt hours delivered to the interconnections and 5 mills per kWh for any energy delivered to the interconnections in excess of 86,750 megawatt hours during the fiscal year. In addition, BPA pays to Energy Northwest its Lewis County PUD No. 1 transmission costs and Energy Northwest receives generation credit for spill requested by BPA. Packwood is now a "certified resource" in BPA's environmental foundation pool. When Packwood's generation is marketed as "green" power, a stipend of 2.5 mills per kWh will be received from BPA. The Packwood participants are obligated to pay annual costs of the project including debt service, whether or not the project is operable, until the outstanding bonds are paid or provision is made for the retirement in accordance with provisions of the bond resolution.

#### **NOTE F - COMMITMENTS AND CONTINGENCIES**

##### Nuclear Project No. 1 Termination

Since the Nuclear Project No.1 termination, Energy Northwest has been planning for the demolition of Nuclear Project No. 1 and restoration of the site, recognizing the fact that there is no market for the sale of the Project in its entirety and to date, no viable alternative use has been found. A study has been initiated on the feasibility of completing the Project. The study is expected to be completed late in the fall of 2001. Funding for the Project has continued for administrative efforts associated with termination and planning of demolition activities for the Project. Preservation activities have been continued for certain high-value assets to maximize the return on their expected resale. At this time, the eventual disposition of the Project is unknown.

### Nuclear Project No. 3 Termination

In June 1994, the Nuclear Project No. 3 Owners Committee voted unanimously to terminate the Project. In February 1999, Energy Northwest entered into a transfer agreement with the Satsop Redevelopment Project (SRP) to transfer the real and personal property at the site of Nuclear Project No. 3 and Nuclear Project No. 5. The SRP also agreed to assume regulatory responsibility for site restoration. Therefore, Energy Northwest is no longer responsible to the State of Washington and Washington EFSEC for any site restoration costs.

### Nuclear Projects Nos. 1 and 4 Site Restoration

Site restoration requirements for Nuclear Projects Nos. 1 and 4 are governed by site certification agreements between Energy Northwest and the State of Washington and regulations adopted by the Washington EFSEC, and a lease agreement with the DOE. Energy Northwest submitted a site restoration plan for Nuclear Projects Nos. 1 and 4 to EFSEC on March 8, 1995, which complied with EFSEC requirements to remove the assets and restore the sites by demolition, burial, entombment, or other techniques such that the sites pose minimal hazard to the public. EFSEC approved Energy Northwest's site restoration plan on June 12, 1995. In its approval, EFSEC recognized that there is uncertainty associated with Energy Northwest's proposed plan. Accordingly, EFSEC's conditional approval provides for additional reviews once the details of the plan are finalized.



Based on current estimates for site restoration, Energy Northwest has accrued liabilities of \$59.2 million for Nuclear Project No. 1. Funding for this liability will be provided by BPA. No source of funding has been identified for site restoration of Nuclear Project No. 4, which is located approximately one-half mile from Nuclear Project No. 1. Energy Northwest believes that although Nuclear Project No. 1 has no legal obligation to fund Nuclear Project No. 4, it is possible that claims may be asserted against Nuclear Project No. 1 to pay the costs of site restoration for Nuclear Project No. 4. Energy Northwest currently estimates that the cost of site restoration for Nuclear Project No. 4 is \$40.1 million. Nuclear Project No. 1 has not accrued any costs for Nuclear Project No. 4.

#### Business Development Fund Interest in Northwest Open Access Network

The Business Development Fund is a member of the Northwest Open Access Network (“NoaNet”). Members formed NoaNet pursuant to an Interlocal Cooperation Agreement for the development and efficient use of a communication network in conjunction with BPA for use by the Members and others.

The Business Development Fund has a 7.38% interest in NoaNet with an additional 25% step-up possible for a maximum 9.23%. In July 2001, NoaNet issued \$27 million of bonds. The members are obligated to pay the principal and interest on the bonds when due, in the event and to the extent that NoaNet’s Gross Revenue (after payment of costs of Maintenance and Operation) is insufficient for this purpose. The maximum principal share (with step-up) that the Business Development Fund could be required to pay is \$2,490,800.

#### Other Litigation and Commitments

Energy Northwest is involved in various claims, legal actions and contractual commitments and in certain claims and contracts arising in the normal course of business. Although some suits, claims and commitments are significant in amount, final disposition is not determinable. In the opinion of management, the outcome of such litigation, claims or commitments will not have a material adverse effect on the financial positions of the business units or Energy Northwest as a whole. The future annual cost of the business units, however, may either be increased or decreased as a result of the outcome of these matters.

## Nuclear Licensing and Insurance

Energy Northwest is a licensee of the Nuclear Regulatory Commission and is subject to routine licensing and user fees, to retrospective premiums for nuclear liability insurance, and to license modification, suspension, or revocation or civil penalties in the event of violations of various regulatory and license requirements.

The Price Anderson Act currently provides for nuclear liability insurance of over \$9.54 billion per incident, which is covered by a combination of commercial nuclear insurance and mandatory industry self-insurance. Energy Northwest has purchased the maximum commercial insurance available of \$200 million, which is the first layer of protection. The second layer of protection is provided through a mandatory industry self-insurance plan wherein each licensed nuclear facility required to participate in the plan (currently 106) may be assessed up to \$88.1 million per incident, subject to a maximum annual assessment of \$10 million per year.

Nuclear property damage and decontamination liability insurance requirements are met through a combination of commercial nuclear insurance policies purchased by Energy Northwest and BPA. The total amount of insurance purchased is currently \$2.75 billion. The deductible for this coverage is \$5 million per occurrence.

## NOTE G – NEW ACCOUNTING PRONOUNCEMENTS

The FASB has recently issued SFAS No. 143, Accounting for Obligations Associated with the Retirement of Long-Lived Assets, which is effective for fiscal years beginning after June 15, 2002. Energy Northwest has chosen not to adopt the Statement early. This Statement will require an entity to recognize the fair value of a liability for an asset retirement obligation (ARO), such as nuclear decommissioning and site restoration liabilities, in the period in which it is incurred, rather than using a cost-accumulation approach. An asset retirement cost will be capitalized as part of the cost of the related long-lived asset, then allocated to depreciation expense over the life of that asset. The fair value of the liability will be discounted initially, then accreted with a charge to expense based on the risk-free interest rate in effect at the time of initial recognition. Upon adoption of the Statement, an entity will use a cumulative-effect approach to recognize transition amounts for any existing ARO liabilities, asset retirement costs, and accumulated depreciation. The impact on Energy Northwest's financial statements is expected to increase Utility Plant by approximately \$325 million and Accounts Payable and accrued expenses by a like amount.

GASB No. 34, Basic Financial Statement and MD&A for State and Local Governments, as amended by GASB Nos. 37 and 38, establishes requirements for the basic financial statements and required supplementary information (RSI) for general purpose governments. Such financial statements and RSI will include 1) Management's discussion and analysis (MD&A), and 2) Basic Financial Statements. MD&A will introduce the basic financial statements and provide an analytical overview of the government's financial activities before the basic financial statements. The basic financial statements will consist of government-wide financial statements (statement of net assets and statement of activities), fund financial statements (a series of statements that focus on information about the government's major funds, including its blended component units), notes to the financial statements and RSI. Interfund activity will be reported separately in the fund financial statements and eliminated in the aggregated government-wide financial statements. This statement is effective for Energy Northwest's fiscal year beginning July 1, 2001, and Energy Northwest has elected not to adopt early.

**CURRENT DEBT RATINGS (Unaudited)**

<b>ENERGY NORTHWEST (Long-Term)</b>	<u><b>RATING</b></u>	<u><b>OUTLOOK</b></u>
Fitch	AA	Stable
Moody's Investors Service, Inc. (Moody's)	Aa1	
Standard and Poor's Rating Services (S & P)	AA-	Stable
<b>VARIABLE RATE DEBT</b>	<u><b>S &amp; P</b></u>	<u><b>MOODY'S</b></u>
Letter of Credit Banks		
Bank of America		
Long-Term	AA-	Aa1
Short-Term	A-1+	P-1
Morgan Guaranty Trust Company		
Long-Term	AA	Aa3
Short-Term	A-1+	P-1
Bond Insurance (Long-Term)		
MBIA Insurance Corporation	AAA	Aaa
Bank Credit Facility (Short-Term)		
Credit Suisse First Boston	A-1+	P-1

**Upon delivery of the Series 2002-A Bonds  
Bond Counsel proposes to render  
an opinion in substantially the following form.**

Executive Board  
Energy Northwest  
Richland, Washington 99352-0968

Ladies and Gentlemen:

We have acted as bond counsel to Energy Northwest (formerly known as the Washington Public Power Supply System), a municipal corporation of the State of Washington (the "State"), created and existing under and pursuant to Chapter 43.52 of the Revised Code of Washington, as amended (the "Act"), in connection with the issuance of its \$248,485,000 Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A (the "Series 2002-A Bonds"). The Series 2002-A Bonds are authorized to be issued pursuant to (i) the Act, (ii) Resolution No. 835 (the "Electric Bond Resolution"), adopted by the Executive Board of Energy Northwest (the "Executive Board") on November 23, 1993, and (iii) a resolution entitled "A Supplemental Resolution Providing for the Issuance of \$248,485,000 Energy Northwest Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A" (the "Supplemental Resolution") adopted by the Executive Board pursuant to the Electric Bond Resolution on February 15, 2002. The Electric Bond Resolution and the Supplemental Resolution are hereinafter, collectively, referred to as the "Electric Bond Resolutions." All capitalized terms used herein and not otherwise defined shall have the respective meanings ascribed thereto in the Electric Bond Resolutions.

The Series 2002-A Bonds are initially dated the date of delivery and will mature on July 1 in the years and in the respective principal amounts, and will bear interest at the respective rates per annum, all as set forth in the Supplemental Resolution. The Series 2002-A Bonds are subject to redemption in the manner and upon the terms and conditions set forth in the Electric Bond Resolutions, including mandatory redemption at par by application of sinking fund payments. The Series 2002-A Bonds rank junior as to security and payment to bonds issued and outstanding under the Prior Lien Resolution. The Series 2002-A Bonds rank equally as to security and payment with all other Parity Debt.

In connection with the issuance of the Series 2002-A Bonds, we have examined the following:

- (a) The Constitution and statutes of the State, including particularly the Act, and such court decisions, rulings and regulations, both State and Federal, as we have deemed relevant;
- (b) A certified copy of Energy Northwest Resolution No. 769 adopted on September 18, 1975, as amended and supplemented (the "Prior Lien Resolution");
- (c) Certified copies of the proceedings of Energy Northwest preliminary to and in connection with the issuance of the Series 2002-A Bonds, including particularly (i) the Electric Bond Resolution which authorizes, among other things, the issuance, from time to time, of Parity Debt, (ii) the Supplemental Resolution which authorizes, among other things, the issuance of the Series 2002-A Bonds and (iii) a resolution, adopted by Energy Northwest on February 15, 2002 (the "Electric Bond Sale Resolution"), authorizing, among other things, the sale of the Series 2002-A Bonds and the execution and delivery of: a Contract of Purchase, dated February 15, 2002 (the "Contract of Purchase"), by and between Energy Northwest and the underwriters named therein;
- (d) The Contract of Purchase, and such legal opinions, certificates and proofs submitted to us relative to the issuance and sale of the Series 2002-A Bonds as we deemed necessary or advisable; and
- (e) The lowest sequentially numbered and executed Series 2002-A Bond issued on the date hereof.

Based upon the foregoing, it is our opinion that:

1. Energy Northwest is a municipal corporation and joint operating agency, duly created and existing under the laws of the State, including particularly the Act, having the right and power under the Act to acquire, construct, own and operate the Project, adopt the Prior Lien Resolution, the Electric Bond Resolutions and the Electric Bond Sale Resolution,

issue the Series 2002-A Bonds and apply the proceeds of the Series 2002-A Bonds in accordance with the Supplemental Resolution.

2. The Electric Bond Resolutions and the Electric Bond Sale Resolution have been duly and lawfully adopted by Energy Northwest, are in full force and effect, are valid and binding upon Energy Northwest and are enforceable in accordance with their terms.

3. The Prior Lien Bond Resolution has been duly and lawfully adopted by Energy Northwest, is in full force and effect, is valid and binding upon Energy Northwest and is enforceable in accordance with its terms.

4. The Series 2002-A Bonds have been duly and validly authorized and issued under the Act and the Electric Bond Resolutions and constitute valid and binding special revenue obligations of Energy Northwest, enforceable in accordance with their terms and the terms of the Electric Bond Resolutions.

5. The Series 2002-A Bonds are payable solely from the revenues and other amounts pledged to such payment under the Electric Bond Resolutions. The Series 2002-A Bonds are not a debt of the State or any political subdivision thereof (other than Energy Northwest) and neither the State nor any other political subdivision of the State is liable thereon.

In rendering the foregoing opinions, we wish to advise you that the enforceability of the Electric Bond Resolutions, the Electric Bond Sale Resolution, the Prior Lien Resolution and the Series 2002-A Bonds may be limited by (i) any applicable bankruptcy, insolvency or other law or enactment now or hereinafter enacted by the State or Federal government affecting the enforcement of creditors' rights and (ii) the unavailability of equitable remedies or the application thereto of equitable principles. Further, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. We have not verified, and express no opinions as to, the accuracy of any "CUSIP" identification number which may be printed on any Series 2002-A Bond.

Very truly yours,

**Upon delivery of the Series 2002-A Bonds  
Bond Counsel proposes to render  
an opinion in substantially the following form.**

Executive Board  
Energy Northwest  
Richland, Washington 99352-0968

Ladies and Gentlemen:

We are acting as bond counsel with respect to the issuance of Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A, in the aggregate principal amount of \$248,485,000 (the "Series 2002-A Bonds"), by Energy Northwest (formerly known as the Washington Public Power Supply System), a municipal corporation and a joint operating agency organized and existing under the laws of the State of Washington (the "State"). The Series 2002-A Bonds are authorized to be issued pursuant to (i) Chapter 43.52 of the Revised Code of Washington, as amended (the "Act"), (ii) Electric Revenue Bond Resolution No. 835, entitled "A Resolution Providing For The Issuance Of Washington Public Power Supply System Project No. 1 Electric Revenue Bonds," adopted by the Executive Board of Energy Northwest (the "Executive Board") on November 23, 1993 (the "Resolution"), and (iii) Resolution No. 1222, entitled "A Supplemental Resolution Providing for the Issuance of the Energy Northwest Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A" adopted by the Executive Board on February 15, 2002 (the "Supplemental Resolution"). Capitalized terms used herein and not otherwise defined shall have the respective meanings set forth in the Resolution or the Supplemental Resolution, as applicable.

In connection with the issuance of the Series 2002-A Bonds, Energy Northwest has requested that we examine the validity of the WPPSS No. 1 Project Net Billing Agreements (the "Net Billing Agreements"), the Project No. 1 Assignment Agreement, dated as of August 24, 1984 (the "Assignment Agreement"), by and between Energy Northwest and the United States of America, Department of Energy, acting by and through the Administrator (the "Administrator") of the Bonneville Power Administration ("Bonneville"), the letter agreement, dated August 1, 1989 (the "1989 Letter Agreement"), by and between Energy Northwest and the Administrator, and the agreement dated August 11, 1989 (the "Bonneville Agreement"), between the Administrator and Energy Northwest regarding the disposition of Project 1 properties after termination.

For the purpose of rendering this opinion, we have reviewed the following:

- (a) The Constitution of the State and such statutes and regulations as we deemed relevant to this opinion, including particularly the Act;
- (b) The Constitution of the United States of America and such statutes and regulations as we deemed relevant to this opinion, including particularly the Bonneville Project Act of 1937, as amended (the "Bonneville Act"), the Flood Control Act of 1944, Public Law 88-552, as amended, the Federal Columbia River Transmission System, Act of 1974, as amended, and the Pacific Northwest Electric Power Planning and Conservation Act of 1980, as amended;
- (c) Executed or certified copies of the Resolution and the Supplemental Resolution;
- (d) Executed or certified copies of the Net Billing Agreements, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement;
- (e) The Certificate of the Chairman or Vice Chairman of the Executive Board, dated the date hereof, certifying that, except as described in the Official Statement for the Series 2002-A Bonds, dated February 15, 2002, (i) neither Energy Northwest nor, to the best of his knowledge, any other party thereto has taken any action to (1) repeal, modify or terminate the Net Billing Agreements, the Assignment Agreement, the 1989 Letter Agreement or the Bonneville Agreement, or (2) repeal any proceeding authorizing the execution and delivery of any such Agreement, and (ii) to the best of his knowledge, each such Agreement remains in full force and effect as of the date hereof;
- (f) The Certificate of the Administrator, dated the date hereof, certifying that (i) neither the Administrator nor, to the best of his knowledge, any other party thereto has taken any action to (1) repeal, modify or terminate the Net Billing Agreements, the Assignment Agreement, the 1989 Letter Agreement or the Bonneville Agreement, or (2) repeal any

proceeding authorizing the execution and delivery of any such Agreement, and (ii) to the best of his knowledge, each such Agreement remains in full force and effect as of the date hereof;

(g) Certified copies of the proceedings of Energy Northwest authorizing the execution and delivery of the Net Billing Agreements, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement and such other documents, proceedings and matters relating to the authorization, execution and delivery of such Agreements by each of the parties thereto as we deemed relevant;

(h) The respective opinions of counsel for each of the WPPSS No. 1 Project Participants (collectively, the "Local Counsel Opinions"), rendered in 1971 and 1972, to the effect that, *inter alia*, the Net Billing Agreement to which such WPPSS No. 1 Project Participant is a party was duly authorized, executed and delivered by such Participant and did not constitute a violation of or conflict with the provisions of applicable law;

(i) The opinion of Acting General Counsel to Bonneville, dated the date hereof, to the effect that, *inter alia*, (i) the office of Administrator was duly established and is validly existing under the Bonneville Act, (ii) the Administrator was duly authorized to execute and deliver the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement and (iii) each of the Net Billing Agreements, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement has been duly authorized, executed and delivered by the Administrator and did not constitute a violation of or conflict with the provisions of applicable law;

(j) The opinion of Lindsay, Hart, Neil & Weigler, special counsel to Energy Northwest, dated March 14, 1990, to the effect that the WPPSS No. 1 Project Participant identified therein is validly existing and that such Participant has duly adopted, ratified and confirmed the execution and delivery of the Net Billing Agreement to which it is a party;

(k) The decision of the United States Court of Appeals for the Ninth Circuit in *City of Springfield v. Washington Public Power Supply System, et al.*, 752 F.2d 1423 (9th Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986);

(l) A certified copy of Energy Northwest Resolution No. 769 adopted on September 18, 1975, as amended and supplemented (the "Prior Lien Resolution"); and

(m) Such other documents, agreements, proceedings, pleadings, court decisions, statutes, matters and questions of law as we deemed necessary or appropriate for the purposes hereof.

Based upon the foregoing and in reliance thereon, we are of the opinion that each of the Net Billing Agreements and the Assignment Agreement is a legal and valid obligation of each of the parties thereto, enforceable against such parties in accordance with its terms, and that the 1989 Letter Agreement and the Bonneville Agreement are legal and valid obligations of Energy Northwest, enforceable against Energy Northwest in accordance with their terms; provided, however, that the enforceability of all such Agreements may be subject to (i) the valid exercise of sovereign state police powers; (ii) the limitations on legal remedies against the United States of America under Federal law now or hereafter enacted; (iii) applicable bankruptcy, insolvency, reorganization, moratorium and other similar laws or enactments now or hereafter enacted by any state or the Federal government affecting the enforcement of creditors' rights; and (iv) the unavailability of equitable remedies or the application of general principles of equity (regardless of whether enforcement is sought in a proceeding in equity or at law).

In rendering this opinion, (a) we have assumed with your consent (1) the authenticity of all documents submitted to us as originals, the genuineness of all signatures, the legal capacity of natural persons, and the conformity to the originals of all documents submitted to us as copies; (2) the truth and accuracy of all representations set forth in the Certificates of the Chairman or Vice Chairman of the Executive Board and the Administrator referred to above in paragraphs (e) and (f); and (3) the correctness, as of its date and the date hereof, of each Local Counsel Opinion referred to above in paragraph (h) as to (A) the due incorporation and valid organization and existence as a municipality, publicly owned utility or rural electric cooperative, as applicable, of the WPPSS No. 1 Project Participant represented by such counsel, (B) the due authorization by all requisite governmental or corporate action, as the case may be, and due execution and delivery of the Net Billing Agreement to which such Participant is a party by such Participant and (C) no violation of or conflict with the provisions of applicable law; and (b) we have, with your consent, relied on (1) the opinion of Acting General Counsel to Bonneville referred to above in paragraph (i) as to the matters described therein and (2) the opinion of Lindsay, Hart, Neil & Weigler referred to above in paragraph (j) as to the matters described therein.

Very truly yours,



**Upon delivery of the Series 2002-A Bonds  
Bond Counsel proposes to render  
an opinion in substantially the following form.**

Executive Board  
Energy Northwest  
Richland, Washington 99352-0968

Ladies and Gentlemen:

We have acted as bond counsel to Energy Northwest (formerly known as the Washington Public Power Supply System), a municipal corporation of the State of Washington (the "State") created and existing under and pursuant to Chapter 43.52 of the Revised Code of Washington, as amended (the "Act"), in connection with the issuance of its \$157,260,000 Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A (the "Series 2002-A Bonds"). The Series 2002-A Bonds are authorized to be issued pursuant to (i) the Act, (ii) Resolution No. 1042, adopted by the Executive Board of Energy Northwest on October 23, 1997 (the "Electric Bond Resolution"), and (iii) a resolution entitled "A Supplemental Resolution Providing for the Issuance of \$157,260,000 Energy Northwest Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A" (the "Supplemental Resolution") adopted by Energy Northwest pursuant to the Electric Bond Resolution on February 15, 2002. The Electric Bond Resolution and the Supplemental Resolution are hereinafter collectively referred to as the "Electric Bond Resolutions." All capitalized terms used herein and not otherwise defined shall have the respective meanings ascribed thereto in the Electric Bond Resolutions.

The Series 2002-A Bonds are initially dated the date of delivery and will mature on July 1 in the years and in the respective principal amounts, and will bear interest at the respective rates per annum, all as set forth in the Supplemental Resolution. The Series 2002-A Bonds are subject to redemption in the manner and upon the terms and conditions set forth in the Electric Bond Resolutions, including mandatory redemption at par by application of sinking fund payments. The Series 2002-A Bonds rank junior as to security and payment to bonds heretofore or hereafter issued and outstanding under the Prior Lien Resolution. The Series 2002-A Bonds rank equally as to security and payment with all other Parity Debt.

In connection with the issuance of the Series 2002-A Bonds, we have examined the following:

- (a) The Constitution and statutes of the State, including particularly the Act, and such court decisions, rulings and regulations, both State and Federal, as we have deemed relevant;
- (b) A certified copy of Supply System Resolution No. 640 adopted on June 26, 1973, as amended and supplemented (the "Prior Lien Resolution");
- (c) Certified copies of the proceedings of Energy Northwest preliminary to and in connection with the issuance of the Series 2002-A Bonds, including particularly (i) the Electric Bond Resolution which authorizes, among other things, the issuance, from time to time, of Parity Debt, (ii) the Supplemental Resolution which authorizes, among other things, the issuance of the Series 2002-A Bonds and (iii) a resolution, adopted by Energy Northwest on February 15, 2002 (the "Electric Bond Sale Resolution"), authorizing, among other things, the sale of the Series 2002-A Bonds and the execution and delivery of: a Contract of Purchase, dated February 15, 2002 (the "Contract of Purchase"), by and between Energy Northwest and the underwriters named therein;
- (d) The Contract of Purchase, and such legal opinions, certificates and proofs submitted to us relative to the issuance and sale of the Series 2002-A Bonds as we deemed necessary or advisable; and
- (e) The lowest sequentially numbered and executed Series 2002-A Bond issued on the date hereof.

Based upon the foregoing, it is our opinion that:

1. Energy Northwest is a municipal corporation and joint operating agency, duly created and existing under the laws of the State, including particularly the Act, having the right and power under the Act to acquire, construct, own and operate the Project, adopt the Prior Lien Resolution, the Electric Bond Resolutions and the Electric Bond Sale Resolution,

issue the Series 2002-A Bonds and apply the proceeds of the Series 2002-A Bonds in accordance with the Supplemental Resolution.

2. The Electric Bond Resolutions and the Electric Bond Sale Resolution have been duly and lawfully adopted by Energy Northwest, are in full force and effect, are valid and binding upon Energy Northwest and are enforceable in accordance with their terms.

3. The Prior Lien Bond Resolution has been duly and lawfully adopted by Energy Northwest, is in full force and effect, is valid and binding upon Energy Northwest and is enforceable in accordance with its terms.

4. The Series 2002-A Bonds have been duly and validly authorized and issued under the Act and the Electric Bond Resolutions and constitute valid and binding special revenue obligations of Energy Northwest, enforceable in accordance with their terms and the terms of the Electric Bond Resolutions.

5. The Series 2002-A Bonds are payable solely from the revenues and other amounts pledged to such payment under the Electric Bond Resolutions. The Series 2002-A Bonds are not a debt of the State or any political subdivision thereof (other than Energy Northwest) and neither the State nor any other political subdivision of the State is liable thereon.

In rendering the foregoing opinions, we wish to advise you that the enforceability of the Electric Bond Resolutions, the Electric Bond Sale Resolution, the Prior Lien Resolution and the Series 2002-A Bonds may be limited by (i) any applicable bankruptcy, insolvency or other law or enactment now or hereinafter enacted by the State or Federal government affecting the enforcement of creditors' rights and (ii) the unavailability of equitable remedies or the application thereto of equitable principles. Further, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. We have not verified, and express no opinions as to, the accuracy of any "CUSIP" identification number which may be printed on any Series 2002-A Bond.

Very truly yours,

**Upon delivery of the Series 2002-A Bonds  
Bond Counsel proposes to render  
an opinion in substantially the following form.**

Executive Board  
Energy Northwest  
Richland, Washington 99352-0968

Ladies and Gentlemen:

We are acting as bond counsel with respect to the issuance of Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A, in the aggregate principal amount of \$157,260,000 (the "Series 2002-A Bonds") by Energy Northwest (formerly known as the Washington Public Power Supply System), a municipal corporation and a joint operating agency organized and existing under the laws of the State of Washington (the "State"). The Series 2002-A Bonds are authorized to be issued pursuant to (i) Chapter 43.52 of the Revised Code of Washington, as amended (the "Act"), (ii) Electric Revenue Bond Resolution No. 1042, entitled "A Resolution Providing For The Issuance Of Washington Public Power Supply System Project No. 2 Electric Revenue Bonds," adopted by the Executive Board of Energy Northwest (the "Executive Board") on October 23, 1997 (the "Resolution"), and (iii) Resolution No. 1223, entitled "A Supplemental Resolution Providing for the Issuance of the Energy Northwest Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A" adopted by the Executive Board on February 15, 2002 (the "Supplemental Resolution"). Capitalized terms used herein and not otherwise defined shall have the respective meanings set forth in the Resolution or the Supplemental Resolution, as applicable.

In connection with the issuance of the Series 2002-A Bonds, Energy Northwest has requested that we examine the validity of the WPPSS No. 2 Project Net Billing Agreements (the "Net Billing Agreements"), the WPPSS No. 2 Project Agreement (the "Project Agreement"), the Project No. 2 Assignment Agreement, dated as of August 24, 1984 (the "Assignment Agreement"), by and between Energy Northwest and the United States of America, Department of Energy, acting by and through the Administrator (the "Administrator") of the Bonneville Power Administration ("Bonneville"), the letter agreement, dated August 1, 1989 (the "1989 Letter Agreement"), by and between Energy Northwest and the Administrator, and the agreement dated March 1, 1990 (the "Bonneville Agreement"), between the Administrator and Energy Northwest regarding the disposition of the Columbia Generating Station properties after termination. The Columbia Generating Station was formerly known as Nuclear Project No. 2.

For the purpose of rendering this opinion, we have reviewed the following:

- (a) The Constitution of the State and such statutes and regulations as we deemed relevant to this opinion, including particularly the Act;
- (b) The Constitution of the United States of America and such statutes and regulations as we deemed relevant to this opinion, including particularly the Bonneville Project Act of 1937, as amended (the "Bonneville Act"), the Flood Control Act of 1944, Public Law 88-552, as amended, the Federal Columbia River Transmission System, Act of 1974, as amended, and the Pacific Northwest Electric Power Planning and Conservation Act of 1980, as amended;
- (c) Executed or certified copies of the Resolution and the Supplemental Resolution;
- (d) Executed or certified copies of the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement;
- (e) The Certificate of the Chairman or Vice Chairman of the Executive Board, dated the date hereof, certifying that (i) neither Energy Northwest nor, to the best of his knowledge, any other party thereto has taken any action to (1) repeal, modify or terminate the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement or the Bonneville Agreement, or (2) repeal any proceeding authorizing the execution and delivery of any such Agreement, and (ii) to the best of his knowledge, each such Agreement remains in full force and effect as of the date hereof;
- (f) The Certificate of the Administrator, dated the date hereof, certifying that (i) neither the Administrator nor, to the best of his knowledge, any other party thereto has taken any action to (1) repeal, modify or terminate the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement or the Bonneville Agreement, or (2) repeal any proceeding authorizing the execution and delivery of any such Agreement, and (ii) to the best of his knowledge, each such Agreement remains in full force and effect as of the date hereof;
- (g) Certified copies of the proceedings of Energy Northwest authorizing the execution and delivery of the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement and such other documents, proceedings and matters relating to the authorization, execution and delivery of such Agreements by each of the parties thereto as we deemed relevant;

(h) The respective opinions of counsel (collectively, the “Local Counsel Opinions”) for each WPPSS No. 2 Project Participant, (herein “Columbia Generating Station Participant”) rendered in 1971 and 1972, to the effect that, *inter alia*, the Net Billing Agreement to which such Columbia Generating Station Participant is a party was duly authorized, executed and delivered by such Participant and did not constitute a violation of or conflict with the provisions of applicable law;

(i) The opinion of Acting General Counsel to Bonneville, dated the date hereof, to the effect that, *inter alia*, (i) the office of Administrator was duly established and is validly existing under the Bonneville Act, (ii) the Administrator was duly authorized to execute and deliver the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement and (iii) each of the Net Billing Agreements, the Project Agreement, the Assignment Agreement, the 1989 Letter Agreement and the Bonneville Agreement has been duly authorized, executed and delivered by the Administrator and did not constitute a violation of or conflict with the provisions of applicable law;

(j) The opinion of Lindsay, Hart, Neil & Weigler, special counsel to Energy Northwest, dated March 14, 1990, to the effect that the Columbia Generating Station Participant identified therein is validly existing and that such Participant has duly adopted, ratified and confirmed the execution and delivery of the Net Billing Agreement to which it is a party;

(k) The decision of the United States Court of Appeals for the Ninth Circuit in *City of Springfield v. Washington Public Power Supply System, et al.*, 752 F.2d 1423 (9th Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986);

(l) A certified copy of Supply System Resolution No. 640 adopted on June 26, 1973, as amended and supplemented (the “Prior Lien Resolution”); and

(m) Such other documents, agreements, proceedings, pleadings, court decisions, statutes, matters and questions of law as we deemed necessary or appropriate for the purposes hereof.

Based upon the foregoing and in reliance thereon, we are of the opinion that each of the Net Billing Agreements, the Project Agreement and the Assignment Agreement is a legal and valid obligation of each of the parties thereto, enforceable against such parties in accordance with its terms, and that the 1989 Letter Agreement and the Bonneville Agreement are legal and valid obligations of Energy Northwest, enforceable against Energy Northwest in accordance with their terms; provided, however, that the enforceability of all such Agreements may be subject to (i) the valid exercise of sovereign state police powers; (ii) the limitations on legal remedies against the United States of America under Federal law now or hereafter enacted; (iii) applicable bankruptcy, insolvency, reorganization, moratorium and other similar laws or enactments now or hereafter enacted by any state or the Federal government affecting the enforcement of creditors’ rights; and (iv) the unavailability of equitable remedies or the application of general principles of equity (regardless of whether enforcement is sought in a proceeding in equity or at law).

In rendering this opinion, (a) we have assumed with your consent (1) the authenticity of all documents submitted to us as originals, the genuineness of all signatures, the legal capacity of natural persons, and the conformity to the originals of all documents submitted to us as copies; (2) the truth and accuracy of all representations set forth in the Certificates of the Chairman or Vice Chairman of the Executive Board and the Administrator referred to above in paragraphs (e) and (f); and (3) the correctness, as of its date and the date hereof, of each Local Counsel Opinion referred to above in paragraph (h) as to (A) the due incorporation and valid organization and existence as a municipality, publicly-owned utility or rural electric cooperative, as applicable, of the Columbia Generating Station Participant represented by such counsel, (B) the due authorization by all requisite governmental or corporate action, as the case may be, and due execution and delivery of the Net Billing Agreement to which such Participant is a party by such Participant and (C) no violation of or conflict with the provisions of applicable law; and (b) we have, with your consent, relied on (1) the opinion of Acting General Counsel to Bonneville referred to above in paragraph (i) as to the matters described therein and (2) the opinion of Lindsay, Hart, Neil & Weigler referred to above in paragraph (j) as to the matters described therein.

Very truly yours,

**Upon delivery of the Series 2002-A Bonds  
Special Tax Counsel proposes to render  
an opinion in substantially the following form.**

Energy Northwest  
P.O. Box 968  
Richland, Washington 99352

Energy Northwest  
\$248,485,000 Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A  
\$157,260,000 Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A

Ladies and Gentlemen:

We have acted as Special Tax Counsel in connection with the issuance by Energy Northwest (formerly known as the Washington Public Power Supply System), a municipal corporation and a joint operating agency of the State of Washington, of \$248,485,000 aggregate principal amount of Project No. 1 Refunding Electric Revenue Bonds, Series 2002-A (the "Project 1 2002-A Bonds") and \$157,260,000 aggregate principal amount of Columbia Generating Station Refunding Electric Revenue Bonds, Series 2002-A (the "Columbia 2002-A Bonds" and, together with the Project 1 2002-A Bonds, the "Series 2002-A Bonds"). The Project 1 2002-A Bonds are being issued pursuant to Chapter 43.52 of the Revised Code of Washington, as amended (the "Act"), and Resolution No. 835, adopted by Energy Northwest on November 23, 1993, as amended and supplemented, and a supplemental resolution adopted on February 15, 2002 (the "Project 1 Resolution"). The Columbia 2002-A Bonds are being issued pursuant to the Act and Resolution No. 1042, adopted by Energy Northwest on October 23, 1997, as amended and supplemented, and a supplemental resolution adopted on February 15, 2002 (the "Columbia Resolution" and together with the Project 1 Resolution, the "Resolutions"). The Series 2002-A Bonds are being issued for the purpose of refunding certain outstanding bonds issued by Energy Northwest.

In such connection, we have reviewed certified copies of the Resolutions; the Tax Matters Certificate executed and delivered by Energy Northwest on the date hereof and the Tax Matters Certificate executed and delivered on the date hereof by the Bonneville Power Administration (collectively, the "Tax Certificates"); the opinion of Willkie Farr & Gallagher, as Bond Counsel; certificates of Energy Northwest, the Bonneville Power Administration and others; and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

Certain agreements, requirements and procedures contained or referred to in the Resolutions, the Tax Certificates and other relevant documents may be changed and certain actions (including, without limitation, defeasance of Series 2002-A Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Series 2002-A Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based upon 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. Our engagement with respect to the Series 2002-A Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties. 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 Resolutions and the Tax Certificates, 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 Series 2002-A 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 Series 2002-A Bonds, the Resolutions and the Tax Certificates and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on

legal remedies against bodies politic and corporate of the State of Washington and against the Bonneville Power Administration. Finally, as Special Tax Counsel we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement of Energy Northwest, dated February 15, 2002, relating to the Series 2002-A Bonds or other offering material relating to the Series 2002-A Bonds and express no opinion with respect thereto.

We have relied with your consent on the opinion of Willkie Farr & Gallagher, Bond Counsel, with respect to the validity of the Series 2002-A Bonds and the due authorization and issuance of the Series 2002-A Bonds.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that interest on the Series 2002-A Bonds is excluded from gross income for federal income tax purposes under Title XIII of the Tax Reform Act of 1986, as amended, and Section 103 of the Internal Revenue Code of 1954, as amended. Interest on the Series 2002-A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that such interest is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income.

The amount by which the respective issue price of the Series 2002-A Bonds of any maturity is less than the amount to be paid at maturity of such Series 2002-A Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series 2002-A Bonds) constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Series 2002-A Bonds and is excluded from gross income for federal income tax purposes to the same extent as set forth in the preceding paragraph hereof. For this purpose, the issue price of each maturity of the Series 2002-A Bonds is the first price at which a substantial amount of the Series 2002-A Bonds of such maturity is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers).

Except as expressly stated herein, we express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2002-A Bonds.

Faithfully yours,

**ENERGY NORTHWEST  
PARTICIPANT UTILITY SHARE  
FISCAL YEAR 2002 BUDGETS**

<b>Participant Utility</b>	<b>Project 1 Share</b>	<b>Columbia Share</b>	<b>Project 3 Share</b>
City of Albion, Idaho	0.004	0.016	0.003
Alder Mutual Light Company, Washington	0.002		
City of Bandon, Oregon	0.166	0.263	0.144
* Public Utility District No. 1 of Benton County, Washington	4.965	5.350	4.295
Benton Rural Electric Association, Washington	0.308	0.666	0.645
Big Bend Electric Cooperative, Inc., Washington	0.179	1.610	0.374
Blachly-Lane County Cooperative Electric Association, Oregon	0.234	0.272	0.491
Blaine City Light, Washington	0.109	0.185	0.101
City of Bonners Ferry, Idaho, Electric Department	0.115	0.182	0.099
City of Burley, Idaho, Electric	0.179	0.694	0.155
Canby Utility Board, Oregon	0.296	0.090	0.256
City of Cascade Locks, Oregon	0.074	0.054	0.064
Central Electric Cooperative, Inc., Oregon	0.462	0.586	0.966
Central Lincoln People's Utility District, Oregon	4.169	4.017	3.607
City of Centralia, Washington, Electric Light Department	0.298	0.739	0.258
Public Utility District No. 1 of Chelan County, Washington	0.501		0.433
City of Cheney, Washington, Light Department	0.511	0.539	0.442
Public Utility District No. 1 of Clallam County, Washington	1.157	1.769	1.001
Public Utility District No. 1 of Clark County, Washington	14.285	6.151	13.633
Clatskanie People's Utility District, Oregon	0.418	1.996	0.530
Clearwater Power Company, Idaho	0.274	0.775	0.573
Columbia Basin Electric Cooperative, Inc., Oregon	0.161	0.673	0.338
Columbia Power Cooperative Association, Oregon	0.042	0.143	0.088
Columbia Rural Electric Association, Inc., Washington	0.621	0.761	1.298
Consolidated Irrigation District No. 19, Washington	0.005		0.005
Consumers Power, Inc., Oregon	1.068	0.453	2.242
Coos-Curry Electric Cooperative, Inc., Oregon	0.223	1.634	0.781
Town of Coulee Dam, Washington, Light Department	0.048	0.137	0.041
Public Utility District No. 1 of Cowlitz County, Washington	7.379	5.525	3.461
City of Declo, Idaho	0.026	0.019	0.023
Public Utility District No. 1 of Douglas County, Washington	0.044		0.049
Douglas Electric Cooperative, Inc., Oregon	0.331	0.363	0.692
City of Drain, Oregon, Light and Power	0.096	0.218	0.083
East End Mutual Electric Company, Ltd., Idaho	0.011	0.033	0.023
Town of Eatonville, Washington	0.010		
City of Ellensburg, Washington	0.780	1.028	0.675
Elmhurst Mutual Power and Light Co., Washington	0.170		
Eugene Water & Electric Board, Oregon	0.061		
Fall River Rural Electric Cooperative, Inc., Idaho	0.188	0.409	0.393
Farmers Electric Co., Idaho	0.005	0.041	0.011

<b>Participant Utility</b>	<b>Project 1 Share</b>	<b>Columbia Share</b>	<b>Project 3 Share</b>
* Public Utility District No. 1 of Ferry County, Washington	0.105	0.171	0.091
City of Fircrest, Washington	0.056		
Flathead Electric Cooperative, Inc., Montana	0.123	0.370	0.257
City of Forest Grove, Oregon, Light and Power Department	0.470	0.181	0.091
* Public Utility District No. 1 of Franklin County, Washington	1.330	2.370	1.151
Glacier Electric Cooperative, Inc., Montana	0.098		
* Public Utility District No. 2 of Grant County, Washington	0.486		0.420
* Public Utility District No. 1 of Grays Harbor County, Washington	2.769	3.075	2.386
Harney Electric Cooperative, Inc., Oregon	0.105	0.719	0.221
City of Heyburn, Idaho	0.167	0.504	0.145
Hood River Electric Cooperative, Oregon	0.224	0.502	0.469
Idaho County Light and Power Cooperative Association, Inc., Idaho	0.047	0.186	0.098
City of Idaho Falls, Idaho, Electric Division	0.908	2.376	0.787
Inland Power & Light Company, Washington	0.907	1.222	1.915
* Public Utility District No. 1 of Kittitas County, Washington	0.238	0.220	0.206
* Public Utility District No. 1 of Klickitat County, Washington	0.517	1.009	0.448
Kootenai Electric Cooperative, Inc., Idaho	0.212	0.391	0.443
Lakeview Light and Power Company, Washington	0.168		
Lane Electric Cooperative, Inc., Oregon	0.537	1.452	1.123
Public Utility District No. 1 of Lewis County, Washington	1.276	2.274	1.103
Lincoln Electric Cooperative, Inc., Montana	0.087	0.255	0.182
Lost River Electric Cooperative, Inc., Idaho	0.056	0.202	0.118
Lower Valley Power and Light, Inc., Wyoming	0.266	0.820	0.557
* Public Utility District No. 1 of Mason County, Washington	0.186	0.231	0.161
* Public Utility District No. 3 of Mason County, Washington	1.262	1.446	1.265
Town of McCleary, Washington	0.069	0.234	0.059
McMinnville Water and Light, Oregon	1.141	1.227	0.547
Midstate Electric Cooperative, Inc., Oregon	0.336	0.488	0.704
City of Milton, Washington	0.027		
Milton-Freewater Light and Power, Oregon	0.238	0.583	0.002
City of Minidoka, Idaho	0.001	0.005	0.001
Missoula Electric Cooperative, Inc., Montana	0.168	0.294	0.352
City of Monmouth, Oregon	0.679	0.236	0.588
Nespelem Valley Electric Cooperative, Inc., Washington	0.059	0.149	0.123
Northern Lights, Inc., Idaho	0.234	0.455	0.489
Northern Wasco County People's Utility District, Oregon	0.246	0.051	0.213
Ohop Mutual Light Company, Washington	0.025		
Okanogan County Electric Cooperative, Inc., Washington	0.038	0.190	0.079
* Public Utility District No. 1 of Okanogan County, Washington	0.255	1.042	0.143
Orcas Power and Light Company, Washington	0.251	0.725	0.733
Public Utility District No. 2 of Pacific County, Washington	1.006	1.503	0.870
Parkland Light and Water Company, Washington	0.096		
Public Utility District No. 1 of Pend Oreille County, Washington	0.055		0.047
Peninsula Light Company, Washington	0.261		
City of Port Angeles, Washington	0.665	2.416	0.576
Raft River Rural Electric Cooperative, Inc., Idaho	0.224	0.853	0.468
Ravalli County Electric Cooperative, Inc., Montana	0.195	0.301	0.409
* City of Richland, Washington, Energy Service Department	1.828	2.780	1.592



<b>Participant Utility</b>	<b>Project 1 Share</b>	<b>Columbia Share</b>	<b>Project 3 Share</b>
Riverside Electric Company, Idaho	0.007	0.020	0.015
City of Rupert, Idaho, Electric Department	0.123	0.348	0.106
Salem Electric, Oregon	0.662	0.453	1.385
Salmon River Electric Cooperative, Inc., Idaho	0.046	0.170	0.097
City of Seattle, Washington, City Light Department	8.605	7.193	7.206
* Public Utility District No. 1 of Skamania County, Washington	0.321	0.547	0.278
* Public Utility District No. 1 of Snohomish County, Washington	19.584	15.363	19.334
South Side Electric Lines, Inc., Idaho	0.032	0.073	0.067
City of Springfield, Oregon, Utility Board	0.228	0.363	0.238
Town of Steilacoom, Washington	0.038		
City of Sumas, Washington	0.021	0.048	0.018
Surprise Valley Electrification Corp., California	0.049	0.323	0.102
* Tacoma Power, Washington	5.971		5.803
Tanner Electric Cooperative, Washington	0.050	0.122	0.104
Tillamook People's Utility District, Oregon	0.963	1.729	0.833
Umatilla Electric Cooperative, Oregon	0.997	0.036	2.107
United Electric Cooperative, Inc., Idaho	0.320	0.466	0.670
Vera Water and Power, Washington	0.314	0.701	0.401
Vigilante Electric Cooperative, Inc., Montana	0.042	0.294	0.088
* Public Utility District No. 1 of Wahkiakum County, Washington	0.229	0.328	0.198
Wasco Electric Cooperative, Inc., Oregon	0.116	0.342	0.244
Wells Rural Electric Company, Nevada	0.102		0.214
West Oregon Electric Cooperative, Inc., Oregon	0.121	0.182	0.252
Public Utility District No. 1 of Whatcom County, Washington	0.387		0.335
<b>TOTAL PARTICIPANT UTILITIES (112)</b>	<b>100.000</b>	<b>100.000</b>	<b>100.000</b>

\* Energy Northwest members.

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## SUMMARY OF CERTAIN PROVISIONS OF RELATED CONTRACTS

The following summary of certain provisions of the Net Billing Agreements, the Project No. 2 Project Agreement (hereinafter referred to as the “Columbia Project Agreement”), and the Assignment Agreements does not purport to be complete. A copy of the foregoing agreements may be obtained from Energy Northwest.

### THE NET BILLING AGREEMENTS

On February 6, 1973, Energy Northwest, Bonneville and each Project 1 Participant entered into a Project 1 Net Billing Agreement. As originally executed, the Project 1 Net Billing Agreements contained a description of Project 1 which included the use of the generating facilities which are a part of HGP. Subsequently, on May 31, 1974, Energy Northwest, Bonneville and each Project 1 Participant entered into Amendatory Agreement No. 1 to each Project 1 Net Billing Agreement (the “Project 1 Amendatory Agreements”). Under the Project 1 Amendatory Agreements, among other things, the description of Project 1 was changed so that it no longer includes the use of HGP generating facilities. However, the provisions relating to the obligations incurred with respect to HGP after July 1, 1980 remain in effect. See “ENERGY NORTHWEST PROJECTS — Hanford Generating Project” in this Official Statement.

On January 4, 1971, Energy Northwest, Bonneville and each Columbia Participant entered into a Columbia Net Billing Agreement.

On September 25, 1973, Energy Northwest, Bonneville and each Project 3 Participant entered into a Project 3 Net Billing Agreement.

Many of the provisions of the Net Billing Agreements have been summarized under the heading “SECURITY FOR THE NET BILLED BONDS.” A summary of certain additional provisions of the Net Billing Agreements, as amended, follows. Except where the text indicates otherwise, reference to Project 1 Net Billing Agreements is to such Agreements as amended by the Project 1 Amendatory Agreements. The full text of the form of the Net Billing Agreements may be obtained from Energy Northwest. The summary describes the common features of, and highlights the differences among, the Net Billing Agreements for each of Project 1, Columbia and Project 3. Each of the Net Billing Agreements for the same Net Billed Project is identical except as to the Participants’ shares.

The capitalization of any word or words which are not conventionally capitalized indicates that such words are defined in the Net Billing Agreements. (The same practice is followed in the summaries of the Columbia Project Agreement and the Net Billed Resolutions which follow.)

### Term

Each Net Billing Agreement became effective upon its execution and delivery and will terminate as provided therein. See “Termination” below.

Although the Net Billing Agreements may be terminated prior to the maturity of the related Net Billed Bonds, the obligation of each of the Participants thereunder to pay its proportionate share of debt service on the related Net Billed Bonds shall continue until such Net Billed Bonds have been retired, and Bonneville will continue to be obligated to offset or credit these payments against payments pursuant to the Participant’s contracts with Bonneville.

Project 1 and Project 3 and the Project 1 and Project 3 Net Billing Agreements have been terminated. See “SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements — Payment Procedures — Terminated Projects” in this Official Statement.

### Ownership and Operation

Energy Northwest covenants in the Columbia Net Billing Agreement to use its best efforts to arrange for the financing, design, construction, operation and maintenance of the Columbia Generating Facility. Similar covenants of Energy Northwest under the Project 1 and Project 3 Net Billing Agreements terminated when the Board of Directors of Energy Northwest terminated Projects 1 and 3.

### Sale, Purchase and Assignment

Under the Columbia Net Billing Agreements, Energy Northwest sells, and each Participant purchases, the Participant’s share of the Columbia Generating Station capability and each Participant in turn assigns its share of such capability to Bonneville. Such shares in the Columbia Generating Station for selected years are shown in the last four columns of Exhibit A attached thereto. Similar provisions in the Project 1 and Project 3 Net Billing Agreements terminated when the Board of Directors of Energy Northwest terminated Projects 1 and 3.

The provisions of the Net Billing Agreements with respect to payments are summarized under the heading “SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements” above.

If Bonneville is unable to satisfy its obligation to a Participant by net billing, assignment or cash payment and determines that this condition will continue for a significant period, the affected Participant may direct that all or a portion of the energy associated with its share of the Columbia Generating Station capability be delivered by Energy Northwest for the Participant's account at a specified point of delivery, either for the expected period of such inability or the remainder of the term of the Columbia Net Billing Agreement, whichever is specified by the Participant when it elects to have such energy delivered to it. The amount of energy delivered will be limited to the amount of the Participant's share of the Columbia Generating Station capability for which payment by Bonneville cannot be made.

#### **Energy Northwest Costs Payable Under Net Billing Agreements**

All costs of Project 1, Columbia and Project 3 are payable under the respective Net Billing Agreements, and the Annual Budgets adopted by Energy Northwest shall make provision for all such costs, including accruals and amortizations, resulting from the ownership, operation (including cost of fuel), and maintenance of Project 1, Columbia and Project 3 and repairs, renewals, replacements, and additions to the Projects, including, but not limited to, the amounts which Energy Northwest is required under the respective Resolutions to pay into the various funds provided for in the Resolutions for debt service and all other purposes. Each Participant is required to pay the amount specified in the Annual Budget, less amounts payable from sources other than payments under the Net Billing Agreements, multiplied by such Participant's share of Project capability.

#### **Termination**

If the Columbia Generating Station is ended pursuant to Section 15 of the Columbia Project Agreement, as described below under "The Columbia Project Agreement," Energy Northwest is required to give notice of termination of the Columbia Net Billing Agreement effective upon the date of termination of such Project Agreement. Energy Northwest shall then terminate all activities relating to construction and operation of the Project and shall undertake the salvage and disposition or sale of such Project as provided in the Columbia Project Agreement.

In May 1994, the Board of Directors of Energy Northwest adopted a resolution which terminated Project 1 and a resolution requesting that the Project 3 Owners Committee declare the termination of Project 3. The Project 3 Owners Committee voted unanimously to terminate Project 3 in June 1994. In October of 1998, Energy Northwest acquired all of the remaining assets of Project 3. Since that time, Energy Northwest has sold a portion of the Project 3 site to the Satsop Redevelopment Project and the balance of the site to Duke Energy Grays Harbor LLC. See "ENERGY NORTHWEST — Project 1", "— Project 3" and "— Other Activities" and "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements — Projects 1 and 3 Post Termination Agreements."

For a description of payments required to be made following termination of the Net Billing Agreements, see "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements — Payment Procedures — Terminated Projects" in this Official Statement.

#### **Modification and Assignment of Agreement**

Each Net Billing Agreement provides that it shall not be amended, modified or otherwise changed by agreement of the parties in any manner that will impair or adversely affect the security afforded by its provisions for the payment of the principal, interest, and premium, if any, on the related Net Billed Bonds. The Net Billing Agreements further provide that, except for the reassignments of Participants' shares of Project capability provided for therein, no transfer or assignment of the Net Billing Agreements by any party thereto (except to the United States or an agency thereof) is permitted without the written consent of the other parties and that no assignment or transfer relieves the parties of any obligations thereunder.

#### **Participants' Review Board**

Each of the Net Billing Agreements provides for the establishment of a Participants' Review Board consisting of nine members who are elected by the Participants in the related Net Billed Project. Except in the event of an emergency requiring immediate action, copies of all proposed Construction and Annual Budgets and fuel management plans, including amendments thereto, and plans for refinancing a Net Billed Project are required to be submitted by Energy Northwest to the Participants' Review Board within a reasonable time prior to the time such proposed budgets and plans are adopted by Energy Northwest.

The Net Billing Agreements provide that written recommendations of the Participants' Review Board shall be forwarded to Energy Northwest within a reasonable time and that Energy Northwest will consider such recommendations, giving due regard to Prudent Utility Practice and Energy Northwest's statutory duties. If Energy Northwest modifies or rejects a written recommendation of the Participants' Review Board, the Participants' Review Board may refer the matter to the Project Consultant in the manner described in the Project Agreement for his written decision and his decision shall be binding. Pending any such decision by the Project Consultant, Energy Northwest shall proceed in accordance with the Project Agreement. See "THE PROJECT AGREEMENTS — Term" hereinafter. The Net Billing Agreements provide that the provisions described above shall not affect the procedure for the settlement of any dispute between Bonneville and Energy Northwest under the Net Billing Agreements or the Project Agreement. See "THE PROJECT AGREEMENTS — Bonneville's Approval and Project Consultant" hereinafter.

Prudent Utility Practice has the same meaning as is given in “THE PROJECT AGREEMENTS — Design Licensing and Construction of the Projects.”

The Net Billing Agreements provide that, except as specifically provided in the Project Agreement, Energy Northwest shall not proceed with any item as proposed by it and not concurred in by Bonneville without approval of the Participants’ Review Board.

### **THE PROJECT AGREEMENTS**

On February 6, 1973, Energy Northwest and Bonneville entered into an agreement (the “Project 1 Project Agreement”) which, among other things, provided standards for the design, licensing, financing, construction, fueling, operation and maintenance of Project 1, and for the making of any replacements, repairs or capital additions thereto. Subsequently on May 31, 1974, Energy Northwest and Bonneville entered into Amending Agreement No. 1 to the Project 1 Project Agreement for the purpose of changing the description of Project 1 to conform to the changes made in the Project 1 Net Billing Agreements and to revise provisions relating to HGP.

On January 4, 1971, Energy Northwest and Bonneville entered into an agreement (the “Columbia Project Agreement”) which, among other things, contains provisions with respect to the licensing, financing, construction, fueling, operation and maintenance of Columbia, and the making of any replacements, repairs or capital additions thereto, and budgeting under the Columbia Net Billing Agreements.

On September 25, 1973, Energy Northwest and Bonneville entered into an agreement (the “Project 3 Project Agreement”) and, together with the Project 1 Project Agreement and the Columbia Project Agreement, the “Project Agreements”) which, among other things, contained provisions with respect to the financing, construction, operation and maintenance of Project 3, and the making of any replacements, repairs or capital additions thereto, and budgeting under the Project 3 Net Billing Agreements.

### **Term**

The Project 1 Project Agreement terminated as provided in Section 15 of the Project 1 Project Agreement in May 1994 when the Board of Directors of Energy Northwest adopted a resolution terminating Project 1.

The Columbia Project Agreement became effective upon its execution and delivery and will terminate as provided in Section 15 of the Columbia Project Agreement.

Section 15 of the Columbia Project Agreement provides that Columbia shall terminate and Energy Northwest shall cause Columbia to be salvaged, discontinued, decommissioned and disposed of or sold, in whole or in part, to the highest bidder or bidders, or disposed of in such other manner as the parties may agree when:

- (a) Energy Northwest determines that it is unable to construct, operate, or proceed as owner of Columbia due to licensing, financing, or operating conditions or other causes which are beyond its control,
- (b) The parties determine that Columbia is not capable of producing energy consistent with Prudent Utility Practice, or, if the parties disagree, the Project Consultant so determines, or
- (c) Bonneville directs the end of Columbia pursuant to the provisions of the Columbia Project Agreement, which provides that if the estimated cost of a replacement or repair or capital addition required by a governmental agency after the date of commercial operation exceeds 20% of the then depreciated value of Columbia, Bonneville may direct that Energy Northwest end Columbia in accordance with Section 15.

In May 1994 the Board of Directors of Energy Northwest adopted a resolution requesting that the Project 3 Owners Committee declare the termination of Project 3. The Project 3 Owners Committee voted unanimously to terminate Project 3 and the Project 3 Project Agreement terminated in June 1994. In October of 1998, Energy Northwest acquired all of the remaining assets of Project 3.

### **Design, Licensing and Construction of the Projects**

In the Columbia Project Agreement, Energy Northwest agrees, among other things, (i) to perform its duties and exercise its rights under such agreement in accordance with Prudent Utility Practice; (ii) to use its best efforts to obtain all licenses, permits and other rights and regulatory approvals necessary for the ownership, construction, and operation of the related Project; (iii) to construct the related Project in accordance with Prudent Utility Practice; and (iv) to keep Bonneville informed of all significant matters with respect to planning and construction of the related Project.

“Prudent Utility Practice,” as defined in the Columbia Project Agreement, at a particular time means any of the practices, methods and acts, including those engaged in or approved by a significant portion of the electrical utility industry prior to such time, which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, would have been expected to accomplish the desired result at the lowest reasonable cost consistent with reliability, safety and

expedition. In evaluating whether any matter conforms to Prudent Utility Practice, Bonneville, Energy Northwest and any Project Consultant shall take into account the fact that Energy Northwest is a municipal corporation with statutory duties and responsibilities and the objective to integrate the entire Project capability with the generating resources of the Federal System in order to achieve optimum utilization of the resources of that System taken as a whole and to achieve efficient and economical operation of that System.

### **Financing**

With respect to Columbia, Energy Northwest agrees in the Columbia Project Agreement to use its best efforts to issue and sell Columbia Net Billed Bonds (if such Bonds may then be legally issued and sold) to finance the costs of Columbia and of any capital additions, renewals, repairs, replacements or modifications to Columbia.

The Columbia Project Agreement also provides that Energy Northwest may, after submitting its financing proposal to Bonneville, or shall, if requested by Bonneville, authorize the issuance and sale of additional Columbia Net Billed Bonds to refund outstanding Columbia Net Billed Bonds in accordance with the Columbia Net Billed Resolution. A proposal to refund outstanding Columbia Net Billed Bonds is required to be referred to the Project Consultant if, in the judgment of Bonneville or Energy Northwest, no substantial benefits will be achieved by such refunding. See “Bonneville’s Approval and Project Consultant” below.

Net Billed Resolutions and resolutions of Energy Northwest supplementing or amending the Net Billed Resolutions are subject to approval by Bonneville, and Bonneville has approved each Net Billed Resolution and each supplemental resolution.

### **Budgets**

Separate Annual Budgets for the Net Billed Projects will be prepared annually. See “SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements.” The Annual Budget and any amendment thereof are to be submitted to Bonneville for its approval. In the absence of any objection by Bonneville, the Annual Budget will become effective within 30 days after submittal, and within seven days in the case of any amendment thereof. Any item disapproved is required to be referred to the Project Consultant. See “Bonneville’s Approval and Project Consultant” below.

### **Operation and Maintenance**

Energy Northwest shall operate and maintain Columbia in accordance with Prudent Utility Practice and in accordance with the requirements of government agencies having jurisdiction.

### **Bonds for Replacements, Repairs and Capital Additions**

If in any contract year the amounts in an Annual Budget relating to renewals, repairs, replacements and betterments and for capital additions necessary to achieve design capability or required by governmental agencies (“Amounts for Extraordinary Costs”), whether or not such amounts are costs of operation or costs of construction, exceed the amount of reserves, if any, maintained for such purpose pursuant to the Columbia Net Billed Resolutions plus the proceeds of insurance, if any, available by reason of loss or damage to Columbia, by the lesser of (1) \$3,000,000 or (2) an amount by which the amount of Bonneville’s estimate of the total of the net billing credits available in such contract year to the Participants in Columbia and the amounts of such reserves and insurance proceeds, if any, exceeds the Annual Budget for such contract year exclusive of Amounts for Extraordinary Costs, Energy Northwest is required to, in good faith, use its best efforts to issue and sell Columbia Net Billed Bonds to pay such excess.

### **Bonneville’s Approval and Project Consultant**

If a proposal submitted by Energy Northwest to Bonneville under any provision of the Columbia Project Agreement is not disapproved by Bonneville within the time specified or, if no time is specified, within seven days after receipt, the proposal is deemed approved. With certain exceptions specified in the Columbia Project Agreement (including Bonneville’s right to approve a Net Billed Resolution and any supplemental resolutions), disapproval by Bonneville is required to be based solely on whether the proposal is consistent with Prudent Utility Practice.

If any proposal subject to approval by Bonneville is disapproved by Bonneville and an alternative proposal is suggested by Bonneville, Energy Northwest shall adopt such suggestion or, within seven days after receipt of such disapproval, shall appoint a Project Consultant acceptable to Bonneville to review the proposal. Proposals found by the Project Consultant to be consistent with Prudent Utility Practice shall become immediately effective. Proposals found by the Project Consultant to be inconsistent with Prudent Utility Practice shall be modified to conform to the recommendation of the Project Consultant or as the parties otherwise agree and shall become effective as and when modified. If any proposal referred to the Project Consultant has not been resolved and will affect the continuous operation of Columbia, Energy Northwest shall continue to operate Columbia and may proceed as proposed by Energy Northwest, or as proposed by Bonneville, or as modified by mutual agreement of Energy Northwest and Bonneville. If Energy Northwest proceeds with its proposal, and it is determined by the Project Consultant to be inconsistent with Prudent Utility Practice, Energy Northwest shall bear any net increase in the cost of construction or operation of Columbia resulting from such proposal without charge to Columbia to the extent such proposal is found by the Project Consultant to be inconsistent with Prudent Utility Practice.

## ASSIGNMENT AGREEMENTS

In August 1984, prior to the resolution of *City of Springfield v. Washington Public Power Energy Northwest, et al.*, Energy Northwest and Bonneville executed Assignment Agreements for each of Project 1, Columbia, and Project 3. The purpose of the Assignment Agreements is to assure that Bonneville receives the entire output of Project 1, Columbia, and Project 3, and to assure that Energy Northwest receives sufficient funds to pay all obligations incurred in connection with the Projects, including debt service.

The Assignment Agreements provide that, subject only to the Participants' rights under the Net Billing Agreements, Energy Northwest assigns to Bonneville any rights which it now has or may hereafter obtain in project capability by a reversion of any Participant's share in project capability to Energy Northwest or by any other means. Bonneville accepted this assignment, and in the event that any Participant is determined not to be obligated pursuant to the Net Billing Agreements to pay for any interest in project capability which Bonneville obtains pursuant to the Assignment Agreements, Bonneville agrees to pay directly to Energy Northwest the amounts that would have been payable under the Net Billing Agreements for such project capability.

The Assignment Agreements are designed to assure that Bonneville will obtain any interest Energy Northwest has or may hereafter obtain in project capability, subject only to the Participants' rights and obligations under the Net Billing Agreements, and that the same economic and practical consequences will result for Bonneville and Energy Northwest as if Bonneville had acquired such interest in project capability pursuant to the assignment of project capability contained in the Net Billing Agreements.

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**SUMMARY OF CERTAIN PROVISIONS  
OF ELECTRIC REVENUE BOND RESOLUTIONS  
AND SUPPLEMENTAL ELECTRIC REVENUE BOND RESOLUTIONS**

The following summary is a brief outline of certain provisions contained in the Electric Revenue Bond Resolutions, and the Supplemental Electric Revenue Bond Resolutions and is not to be considered as a full statement thereof. This summary is qualified by reference to and is subject to the Electric Revenue Bond Resolutions, copies of which may be examined at the principal offices of Energy Northwest and the Trustee. Capitalized terms not otherwise defined in this Appendix G-1 shall have the meanings ascribed to them in the Official Statement.

**Definitions**

“*Authorized Purpose*” shall mean any one or more of the purposes described in Section 201 of the Electric Revenue Bond Resolutions.

“*Bank Bond*” means any Electric Revenue Bond owned by the Related Credit Issuer or its permitted assigns in connection with the provision of moneys under the Related Credit Facility.

“*Code*” means the Internal Revenue Code of 1986, as amended and supplemented from time to time, and the applicable temporary, proposed, or final regulations promulgated by the United States Treasury Department thereunder or under the Internal Revenue Code of 1954, as amended.

“*Credit Facility*” means a letter of credit, line of credit, insurance policy, surety bond, standby bond purchase agreement or standby payment agreement or similar obligation or instrument or any combination of the foregoing issued by a bank, insurance company or similar financial institution or by the parent corporation of any of the foregoing or by the State or the Federal Government or any agency, authority, instrumentality or subdivision thereof, including, without limitation, the Administrator.

“*Debt Service Deposit Date*” shall mean any date on which a deposit is required to be made into the related Debt Service Fund by each Electric Revenue Bond Resolution or any Supplemental Electric Revenue Bond Resolution.

“*Defeasance Obligations*” shall mean (a) any of the obligations described in clause (i) of the definition of Investment Securities, (b) Refunded Municipal Obligations, and (c) with respect to any Series of Electric Revenue Bonds, such other obligations as are described in the Supplemental Electric Revenue Bond Resolutions authorizing such Series.

“*Engineer*” shall mean any nationally recognized independent engineer or engineering firm appointed by Energy Northwest, and may be the Consulting Engineer appointed pursuant to Resolution Nos. 769, 640 and 775.

“*Investment Securities*” shall mean any of the following, if and to the extent that the same are legal for the investment of funds of Energy Northwest:

- (i) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States of America;
- (ii) obligations of any agency, subdivision, department, division or instrumentality of the United States of America, including, without limitation, the Federal Home Loan Mortgage Corporation, the Federal Agricultural Mortgage Corporation, the Student Loan Marketing Association and the International Bank for Reconstruction and Development; or obligations fully guaranteed as to interest and principal by any agency, subdivision, department, division or instrumentality of the United States of America;
- (iii) direct obligations of, or obligations guaranteed as to principal and interest by, any state or direct obligations of any agency or public authority thereof, insured or uninsured, provided such obligations are rated, at the time of purchase, in one of the two highest rating categories by each rating agency then rating the Electric Revenue Bonds;
- (iv) bank time deposits evidenced by certificates of deposit and bankers’ acceptances issued by any bank or trust company (which may include the Trustee) which is a member of the Federal Deposit Insurance Corporation (or any successor thereto), provided that such time deposits and bankers’ acceptances (a) do not exceed at any one time in the aggregate five percent (5%) of the total of the capital and surplus of such bank or trust company, or (b) are secured by obligations described in items (i) or (ii) of this definition of Investment Securities, which such obligations at all times have a market value at least equal to such time deposits so secured;
- (v) repurchase agreements with (1) any bank or trust company (which may include the Trustee) which is a member of the Federal Deposit Insurance Corporation (or any successor thereto), or (2) any securities broker which is a member of the Securities Investor Protection Corporation, which such agreements are secured by securities which

are obligations described in items (i) or (ii) of this definition of Investment Securities, provided that each such repurchase agreement (a) is in commercially reasonable form and is for a commercially reasonable period, and (b) results in transfer to the Trustee or Energy Northwest of legal title to, or the grant to the Trustee or Energy Northwest of a prior perfected security interest in, identified securities referred to in items (i) or (ii) of this definition which are free and clear of any claims by third parties and are segregated in a custodial or trust account held by a third party (other than the repurchaser) as the agent solely of, or in trust solely for the benefit of, the Trustee or Energy Northwest; provided that such securities acquired pursuant to such repurchase agreements shall be valued at the lower of the then current market value of such securities or the repurchase price thereof set forth in the applicable repurchase agreement;

(vi) certificates or other obligations that evidence ownership of the right to payments of principal of or interest on obligations of the United States of America or any state of the United States of America or any political subdivision thereof or any agency or instrumentality of the United States of America or any state or political subdivision, provided that such obligations shall be held in trust by a bank or trust company or a national banking association meeting the requirements for a Trustee under the Electric Revenue Bond Resolutions, and provided further that, in the case of certificates or other obligations that evidence ownership of the right to payments of principal or interest on obligations of a state or political subdivision, the payments of all principal of and interest on such certificates or such obligations shall be fully insured or unconditionally guaranteed by, or otherwise unconditionally payable pursuant to a credit support arrangement provided by, one or more financial institutions or insurance companies or associations which shall be rated in the highest rating category by each rating agency then rating the Electric Revenue Bonds or, in the case of an insurer providing municipal bond insurance policies insuring the payment, when due, of the principal of and interest on municipal bonds, such insurance policy shall result in such municipal bonds being rated in the highest rating category by each rating agency then rating the Electric Revenue Bonds;

(vii) investment agreements rated in one of the two highest rating categories by each rating agency then rating the Electric Revenue Bonds or the long-term unsecured debt obligations of the issuer of which are rated in one of the two highest rating categories by the respective agency rating such investment agreements or investment agreements which result in transfer to the Trustee or Energy Northwest of legal title to, or the grant to the Trustee or Energy Northwest of a prior perfected security interest in, identified securities referred to in items (i) or (ii) of this definition which are free and clear of any claims by third parties and are segregated in a custodial or trust account held by a third party (other than the counterparty to the investment agreement) as the agent solely of, or in trust solely for the benefit of, the Trustee or Energy Northwest;

(viii) bankers' acceptances drawn on and accepted or guaranteed by a commercial bank rated in either of the two highest rating categories by each rating agency then rating the Electric Revenue Bonds;

(ix) commercial paper rated, at the time of purchase, in the highest rating category by each rating agency then rating the Electric Revenue Bonds;

(x) shares of any publicly offered mutual fund of the type commonly known as a "money market fund" that, at the time of investment, has at least 85% of its assets directly invested in securities of the type described in items (i), (ii) and (iii) of this definition of Investment Securities; and

(xi) such other investments with respect to any Series of Electric Revenue Bonds as shall be specified in the Supplemental Electric Revenue Bond Resolution authorizing such Series of Electric Revenue Bonds.

"*Parity Debt*" shall mean bonds, notes or other obligations issued under a resolution or resolutions authorized pursuant to the Electric Revenue Bond Resolutions, the Electric Revenue Bonds and any Parity Reimbursement Obligation.

"*Parity Reimbursement Obligation*" shall mean a reimbursement obligation the payment of which, pursuant to the provisions of a Supplemental Electric Revenue Bond Resolution, is secured as to payment by the pledge created by the Electric Revenue Bond Resolutions.

"*Payment Agreement*" shall mean a written agreement which provides for an exchange of payments based on interest rates, or for ceilings or floors on such payments, or an option on such payments, or any combination, entered into on either a current or forward basis.

"*Payment Date*" shall mean each date on which interest shall be due and payable and each date on which both interest shall be due and payable and a scheduled Principal Installment (whether by payment of principal scheduled to mature or a sinking fund installment to be paid) shall be required to be made on any of the outstanding Electric Revenue Bonds according to their respective terms.

*“Principal Installment”* shall mean, as of any date of calculation and with respect to any Series or Subseries, as the case may be, (a) the principal amount of Electric Revenue Bonds (including any amount designated in, or determined pursuant to, the applicable Supplemental Electric Revenue Bond Resolution, as the “principal amount” with respect to any bonds) of such Series or Subseries scheduled to mature on a certain future date for which no sinking fund installments have been established, or (b) the unsatisfied balance of sinking fund installments scheduled to be paid on a certain future date for Electric Revenue Bonds of such Series or Subseries, or (c) if such future dates coincide as to different Electric Revenue Bonds of such Series or Subseries, the sum of such principal amount and such unsatisfied balance scheduled to mature or to be paid on such future date; in each case in the amounts and on the dates as provided in the applicable Supplemental Electric Revenue Bond Resolution authorizing such Series or Subseries regardless of any retirement of Electric Revenue Bonds except pursuant to Section 505 of the Electric Revenue Bond Resolutions or (d) that portion of a Parity Reimbursement Obligation which corresponds to the amount of principal scheduled to mature or a sinking fund installment scheduled to be paid or that portion of a Parity Reimbursement Obligation payable on a certain future date which corresponds to the amount of principal scheduled to mature or a sinking fund installment scheduled to be paid.

*“Rating Agency”* shall mean Fitch Ratings (“Fitch”), Moody’s Investors Service, Inc. (“Moody’s”) or Standard & Poor’s Corporation (“S&P”) or, if either Fitch, Moody’s or S&P no longer furnishes ratings on a particular Series of the Electric Revenue Bonds, as the case may be, then such other nationally recognized rating agency then rating such Series of the Electric Revenue Bonds, as the case may be.

*“Reserve Account Requirement”* shall mean, with respect to a Series of Electric Revenue Bonds, the amount, if any, prescribed by the Supplemental Electric Revenue Bond Resolution authorizing such Series of Electric Revenue Bonds.

*“Reserve Guaranty”* shall mean an insurance policy or surety bond provided by an insurer whose claims-paying ability is rated in either of the two highest rating categories by at least two nationally recognized rating agencies, or a letter of credit or other similar Credit Facility the long-term unsecured debt of the issuer of which is rated in either of the two highest rating categories by at least two nationally recognized rating agencies.

*“Subordinate Lien Obligation”* shall mean any bond, note, certificate, warrant or other evidence of indebtedness of Energy Northwest.

#### **Effect of Amendments Adopted March 9, 2001 (Project 1, Columbia and Project 3)**

The Supplemental Resolutions adopted by the Executive Board of Energy Northwest on March 9, 2001 amend the Project 1, Columbia and Project 3 Electric Revenue Bond Resolutions, respectively, to add a covenant to the effect that, from and after the issuance of the Series 2001-A Bonds, Energy Northwest will not issue or authorize the issuance of Prior Lien Bonds under the related Prior Lien Resolution and shall not otherwise create any other special fund or funds for the payment of bonds, warrants or other obligations which will rank on a parity with the pledge and lien on the Revenues created by such Prior Lien Resolution.

Each Supplemental Resolution also amends the related Electric Revenue Bond Resolution to add a definition of the term “Energy Northwest” and to change the definition of the term “System,” as follows:

“Energy Northwest” shall mean the joint operating agency organized and existing under the provisions of the Act and formerly known as the Washington Public Power Supply System.

“System” shall mean Energy Northwest.

The Project 1 Supplemental Resolution further amends the Project 1 Electric Revenue Bond Resolution to provide that all bonds, notes and other obligations, including without limitation Parity Debt initially issued by Energy Northwest under the Project 1 Electric Revenue Bond Resolution, from and after the date of adoption of the Project 1 Electric Revenue Bond Supplemental Resolution, including any bonds, notes or other obligations substituted or exchanged therefor from and after the adoption of such Project 1 Electric Revenue Bond Supplemental Resolution, shall be known, as “Energy Northwest Project 1 Electric Revenue Bonds.”

The Columbia Supplemental Resolution further amends the Columbia Electric Revenue Bond Resolution to provide that all bonds, notes and other obligations, including without limitation Parity Debt initially issued by Energy Northwest under the Columbia Electric Revenue Bond Resolution, from and after the date of adoption of the Columbia Electric Revenue Bond Supplemental Resolution, including any bonds, notes or other obligations substituted or exchanged therefor from and after the adoption of such Columbia Electric Revenue Bond Supplemental Resolution, shall be known, as “Energy Northwest Columbia Generating Station Electric Revenue Bonds.”

The Project 3 Supplemental Resolution further amends the Project 3 Electric Revenue Bond Resolution to provide that all bonds, notes and other obligations, including without limitation Parity Debt initially issued by Energy Northwest under the Project 3 Electric Revenue Bond Resolution, from and after the date of adoption of the Project 3 Electric Revenue Bond Supplemental Resolution, including any bonds, notes or other obligations substituted or exchanged therefor from and after the adoption of such Project 3 Electric Revenue Bond Supplemental Resolution, shall be known, as “Energy Northwest Project 3 Electric Revenue Bonds.”

### **Electric Revenue Bond Resolutions to Constitute Contract (Section 103)**

Each Electric Revenue Bond Resolution shall constitute a contract between Energy Northwest and the owners from time to time of the Electric Revenue Bonds, and the issuer of a Credit Facility, if any, relating to such Subseries of Electric Revenue Bonds; and the pledge made in each related Electric Revenue Bond Resolution and the covenants and agreements therein set forth to be performed on behalf of Energy Northwest shall be for the equal benefit, protection and security of the owners of any and all of the Electric Revenue Bonds and the issuer of any related Credit Facility where the obligation of Energy Northwest to reimburse such issuer is a Party Reimbursement Obligation, each of which, regardless of time or times of maturity or due dates, shall be of equal rank without preference, priority or distinction of the Electric Revenue Bonds over any other thereof except as expressly provided in or permitted by the Electric Revenue Bond Resolutions.

### **Authorization of Bonds (Section 201)**

The Project 1 Electric Revenue Bond Resolution creates and establishes an issue of Electric Revenue Bonds of Energy Northwest known and designated as "Energy Northwest Project No. 1 Electric Revenue Bonds," Columbia Electric Revenue Bond Resolution creates and establishes an issue of Electric Revenue Bonds of Energy Northwest known and designated as "Energy Northwest Columbia Electric Revenue Bonds," and the Project 3 Electric Revenue Bond Resolution creates and establishes an issue of Electric Revenue Bonds of Energy Northwest known and designated as "Energy Northwest Project No. 3 Electric Revenue Bonds."

The Electric Revenue Bonds may be issued under each Electric Revenue Bond Resolution from time to time in series, which may consist of two or more Subseries, pursuant and subject to the terms, conditions and limitations of the Electric Revenue Bond Resolutions and any Supplemental Electric Revenue Bond Resolutions providing for the issuance of Electric Revenue Bonds, in such amounts as may be determined by Energy Northwest, for one or more of the following purposes: (i) refunding any outstanding Prior Lien Bond, any outstanding Electric Revenue Bond or any outstanding Subordinate Lien Obligation; (ii) the payment, or reimbursement of Energy Northwest for the payment, of the costs of the acquisition, construction or installation of additional facilities or modifications to the related Project in compliance with the order or decision of any State or Federal agency or authority having competent jurisdiction; (iii) the payment, or the reimbursement of Energy Northwest for the payment, of all or a portion of the costs of making renewals, repairs, replacements, improvements or betterments to the related Project, including costs associated with the upgrading of the output capacity of the related Project, including expenses incurred in connection with the upgrading of any operating license in connection therewith; (iv) the payment, or the reimbursement of Energy Northwest for the payment, of all or a portion of the costs of capital additions, improvements or betterments to the related Project necessary to achieve design capability; (v) the payment, or the reimbursement of Energy Northwest for the payment, of all or a portion of the costs of (1) decommissioning the related Project or (2) restoring the site of the related Project, in compliance with applicable Federal or State law or any order or decision of any State or Federal agency or authority having competent jurisdiction; (vi) payment, or the reimbursement of Energy Northwest for the payment, of all or a portion of the costs of purchasing fuel for the related Project; (vii) providing funds for deposit into the Reserve Accounts or any other reserves established by any Supplemental Electric Revenue Bond Resolution for the payment of the principal of or interest on the Series of Bonds authorized thereby and paying the costs incident to the issuance of such Series of Electric Revenue Bonds; and (viii) the payment, or the reimbursement of Energy Northwest for the payment, of the costs of any other purpose permitted by law; provided, however, that prior to the expenditure of the proceeds of any Series of Electric Revenue Bonds to pay the costs of the purposes described in items (iii) or (iv) above, Energy Northwest and the Trustee shall receive a Certificate of an Engineer stating that the making of such contemplated renewals, replacements, additions, betterments, improvements or extensions is consistent with prudent utility practice; provided, further, that any such Certificate delivered by an Engineer in connection with the expenditure of Electric Revenue Bond proceeds to pay the costs of an Authorized Purpose described in clause (iv) above shall also state the opinion of such Engineer that such Authorized Purpose is necessary or desirable to improve operating reliability, to increase output capacity or to reduce power costs.

### **Pledge Effected by the Electric Revenue Bond Resolutions (Section 202)**

Energy Northwest pledges for the payment of the principal or redemption price of, and interest on the Electric Revenue Bonds in accordance with their terms and the provisions of the Electric Revenue Bond Resolutions (i) the proceeds of the sale of the Electric Revenue Bonds pending application thereof in accordance with the provisions of the Electric Revenue Bond Resolutions or of any Supplemental Electric Revenue Bond Resolutions, (ii) subject to the provisions of each Electric Revenue Bond Resolution, all revenues and (iii) the Debt Service Fund established by each Electric Revenue Bond Resolution, including the investments, if any, therein; provided, however, that, subject to each Electric Revenue Bond Resolution, amounts on deposit to the credit of any Reserve Account in the Debt Service Funds are pledged only to the Series of Electric Revenue Bonds for which such Reserve Account was established pursuant to the Supplemental Electric Revenue Bond Resolutions authorizing such Series and may be applied only to pay the principal or redemption price, if any, of and interest on the Electric Revenue Bonds of such Series.

Except as may be otherwise provided in the Electric Revenue Bond Resolutions or in the Supplemental Electric Revenue Bond Resolutions authorizing a Series of Electric Revenue Bonds, the Electric Revenue Bonds of each such Series shall be equally and ratably payable and secured under the related Electric Revenue Bond Resolution without priority by reason of the

date of adoption of the Supplemental Electric Revenue Bond Resolutions providing for their issuance or by reason of their Series or Subseries, number or date, date of issue, execution, authentication or sale thereof, or otherwise.

The revenues and other moneys pledged and received by Energy Northwest shall immediately be subject to the lien of the pledge without any physical delivery or further act, and the lien of the pledge shall be valid and binding as against any parties having claims of any kind in tort, contract or otherwise against Energy Northwest, irrespective of whether such parties have notice thereof.

#### **Refunding Bonds (Section 204)**

All Electric Revenue Bonds issued to refund outstanding Electric Revenue Bonds shall be authenticated and delivered by the Trustee only upon receipt by it, in addition to other documents required by the Electric Revenue Bond Resolutions (and in addition to further documents required by the provisions of any Supplemental Electric Revenue Bond Resolutions) of:

(i) irrevocable instructions to the Trustee, satisfactory to it, to give due notice of redemption of all the Electric Revenue Bonds to be redeemed on a redemption date or dates specified in such instructions;

(ii) if the Electric Revenue Bonds to be refunded are not to be redeemed within the next succeeding ninety (90) days, irrevocable instructions to the Trustee, satisfactory to it, to give due notice of any refunding of such Electric Revenue Bonds on a specified date prior to their maturity, as provided in Article VI of each Electric Revenue Bond Resolution or in the Supplemental Electric Revenue Bond Resolution which authorized such Electric Revenue Bonds to be refunded, and Section 1101 of each Electric Revenue Bond Resolution;

(iii) either (A) moneys (which may include all or a portion of the proceeds of the refunding Electric Revenue Bonds to be issued) in an amount sufficient to effect payment of the principal or the redemption price of the Electric Revenue Bonds to be refunded, together with accrued interest on such Electric Revenue Bonds to the maturity or redemption date thereof, as the case may be, or (B) Defeasance Obligations in such principal amounts, of such maturities, bearing such interest and otherwise having such terms and qualifications and any moneys, as shall be necessary to comply with the provisions of Section 1101 of each Electric Revenue Bond Resolution, which Defeasance Obligations and moneys shall be held in trust and used only as provided in Section 1101 of each Electric Revenue Bond Resolution; and

(iv) such further documents and moneys as are required by the provisions of each Electric Revenue Bond Resolution or any Electric Revenue Bond Supplemental Resolutions.

In addition, all refunding Electric Revenue Bonds of a Series issued to refund outstanding Prior Lien Bonds shall be authenticated and delivered by the Trustee, upon receipt by the Trustee, in addition to other documents required by the Electric Revenue Bond Resolutions, of evidence satisfactory to it that:

(i) irrevocable instructions have been delivered to the Prior Lien Bond Fund Trustee to give due notice of payment or redemption of all the Project 1, Columbia or Project 3 Prior Lien Bonds to be redeemed prior to their respective maturity dates on the date specified in such instructions, all in accordance with either Resolution Nos. 769, 640 or 775, as the case may be; and

(ii) such further documents and moneys as are required by the provisions of the Electric Revenue Bond Resolutions or any Electric Revenue Bond Supplemental Resolutions.

#### **Subordinate Obligations (Section 205)**

Nothing contained in the Electric Revenue Bond Resolutions prohibits or prevents Energy Northwest from authorizing and issuing bonds, notes, certificates, warrants or other evidences of any indebtedness for any purpose relating to the Projects payable as to principal and interest from the revenues subject and subordinate to the deposits and credits required to be made to the funds established under the Electric Revenue Bond Resolutions or from securing such bonds, notes, certificates, warrants or other evidences of indebtedness and the payment thereof by a lien and pledge on the revenues junior and inferior to the lien and the pledge on the revenues created by either Resolution Nos. 769, 640 or 775, as the case may be, and created by the Electric Revenue Bond Resolutions.

#### **Credit Facilities (Section 208)**

Electric Revenue Bond Supplemental Resolutions providing for the issuance of a Series of Electric Revenue Bonds may provide that Energy Northwest obtain or cause to be obtained Credit Facilities providing for payment of all or a portion of the purchase price or Principal Installment or Redemption Price of, or interest due or to become due on specified Electric Revenue Bonds of such Series or any Subseries thereof, or providing for the purchase of such Electric Revenue Bonds or a portion thereof by the issuer of the Credit Facilities, or providing, in whole or in part, for the funding of the Reserve Accounts pursuant to Section 505 of each Electric Revenue Bond Resolution, provided such Credit Facilities are Reserve Guaranties. In connection therewith, Energy Northwest may enter into agreements with the issuers of the Credit Facilities to provide for the terms and conditions thereof, including the security, if any, to be provided to such issuers.

Energy Northwest may secure the Credit Facilities by agreements providing for the purchase of the Electric Revenue Bonds secured thereby with such adjustments to the rate of interest, method of determining interest, maturity, or redemption provisions as specified in the Supplemental Electric Revenue Bond Resolutions. Interest with respect to any Series of Electric Revenue Bonds so secured shall be calculated for purposes of the Reserve Account Requirement for such Series by using the actual rate of interest or, if applicable, the Certified Interest Rate on the Electric Revenue Bonds prior to adjustment under such agreement. Energy Northwest may also agree to reimburse directly the issuers of the Credit Facilities for any amounts paid thereunder together with interest thereon. Energy Northwest may provide that any such obligations to reimburse shall be Parity Reimbursement Obligations. In addition, Energy Northwest may, in connection with any such Credit Facility, agree to pay the fees and expenses of, and other amounts payable to, the issuers of such Credit Facilities, the payment of which may be secured by pledges of revenues, funds and other moneys pledged pursuant to the Electric Revenue Bond Resolutions on a parity with the pledges created by the Electric Revenue Bond Resolutions.

#### **Establishment of Funds (Section 502)**

The following special trust funds are established by each Electric Revenue Bond Resolution:

- (a) General Revenue Fund, to be held and maintained by Energy Northwest; and
- (b) Debt Service Fund, to be held and maintained by the Trustee. The Debt Service Fund shall include a separate Debt Service Account for each Series of Electric Revenue Bonds and a separate Subaccount for each Subseries of Electric Revenue Bonds issued under each Electric Revenue Bond Resolution and each such Debt Service Account and Subaccount shall be designated using the designation of the Series or Subseries, if any, to which such Debt Service Account or Subaccount relates.

The existence of such funds shall be continued for so long as any Electric Revenue Bonds remain outstanding. Energy Northwest may establish pursuant to Supplemental Electric Revenue Bond Resolutions authorizing the issuance of Electric Revenue Bonds, additional funds, accounts and Subaccounts for the purposes designated in such Supplemental Electric Revenue Bond Resolutions.

#### **Disposition of Revenues (Section 503)**

So long as the Project 1, Columbia or Project 3 Prior Lien Bonds shall remain outstanding, Energy Northwest obligates and binds itself irrevocably to pay, after first providing for all required deposits and payments under Resolution Nos. 769, 640 and 775, respectively, to each trustee or paying agent of Parity Debt (including the Trustee), and to each person entitled thereto in the event there is no trustee or paying agent for such Parity Debt, the respective stated amounts scheduled to be paid on such Parity Debt in accordance with its terms without preference or priority of any Parity Debt over any other Parity Debt, including the deposits into the Debt Service Accounts or Subaccounts, as the case may be, hereinafter specified. In the event that Energy Northwest shall have insufficient funds to make all payments required pursuant to the preceding sentence, Energy Northwest shall pay to each trustee or paying agent of Parity Debt (including the Trustee) and to each person entitled thereto, as applicable, its pro rata share of the amounts available to Energy Northwest for such payments. With respect to payments to be made to the Trustee, Energy Northwest shall set aside and pay (i) on or before the 25th day in each month immediately preceding a Payment Date to the Trustee for deposit into the Debt Service Account for each Series, or, in the event a Series consists of two or more Subseries, into each debt service Subaccount in the related Debt Service Account, from the revenues theretofore deposited in the Revenue Fund the amount, which, when added to the amount then on deposit in each respective Debt Service Account or Subaccount thereof, as appropriate, will make the amount on deposit in each such Debt Service Account, or, with respect to Subseries, each Subaccount thereof, equal to the amount of principal scheduled to mature, the amount of each scheduled sinking fund installment required to be paid and the amount of interest due and payable, or if such amount of interest is not known as of such date, the amount reasonably estimated by Energy Northwest to be necessary to pay interest, on the Electric Revenue Bonds of each Series or Subseries on the next succeeding Payment Date, (ii) as and when required, the amounts required to be deposited in the accounts and Subaccounts of the Debt Service Fund and (iii) to the extent not included in clause (i) above, to the issuer of any Credit Facility and the counterparty to any Payment Agreement, and, with respect to any Parity Reimbursement Obligation, the amounts, if any, provided to be so paid pursuant to the related Supplemental Electric Revenue Bond Resolution, in each case, in the amounts, at the times and in the manner provided therein. There shall also be deposited in the Debt Service Fund and any accounts and Subaccounts thereof, as and when received by the Trustee, all other amounts required by the Electric Revenue Bond Resolutions to be so deposited.

On and after the date on which there shall be no Prior Lien Bonds outstanding, Energy Northwest covenants and agrees that it will pay into each General Revenue Fund as promptly as practical after receipt thereof all revenues and all other amounts required by the Electric Revenue Bond Resolutions to be so deposited.

#### **Purposes of Funds (Sections 504 and 505)**

*General Revenue Fund.* The amounts on deposit in each General Revenue Fund shall be trust funds in the hands of Energy Northwest and, subject to certain provisions described herein, shall be used and applied as provided in the applicable Electric Revenue Bond Resolution solely for the purpose of paying principal and interest on Parity Debt, the cost of operating and maintaining the related Project and paying all other costs, charges and expenses in connection with the costs of making

repairs, renewals, replacements, additions, betterments and improvements to and extensions of the related Project and for purposes of paying all other charges and obligations against said revenues, income, receipts, profits and other moneys of whatever nature now or hereafter imposed thereon by law or contract, to the payment of which for such purposes said revenues and other moneys are pledged, including amounts required to be paid to the issuers of any Credit Facilities pursuant to the provisions of any related Supplemental Electric Revenue Bond Resolutions.

After the date on which there are no Prior Lien Bonds outstanding, Energy Northwest shall pay, from the moneys on deposit in each General Revenue Fund, to each trustee or paying agent of Parity Debt (including the Trustee), and to each person entitled thereto in the event there is no trustee or paying agent for such Parity Debt, the respective stated amounts scheduled to be paid on such Parity Debt in accordance with its terms without preference or priority of any Parity Debt over any other Parity Debt, including the deposits into the Debt Service Accounts or Subaccounts, as the case may be, hereinafter specified. In the event that the moneys on deposit in the General Revenue Fund shall be insufficient to make all payments required pursuant to the preceding sentence, Energy Northwest shall pay to each trustee or paying agent of Parity Debt and to each person thereof entitled thereto, as applicable, its pro rata share of the amounts on deposit in the General Revenue Fund. With respect to payments to be made to the Trustee, Energy Northwest shall set aside and pay (i) on or before the last Business Day in each month immediately preceding a Payment Date to the Trustee for deposit into the Debt Service Account for each Series, or, in the event a Series consists of two or more Subseries, into each relevant debt service Subaccount in the related Debt Service Account, the amount, which, when added to the amount, if any, then on deposit in each respective Debt Service Account or Subaccount thereof, as appropriate, will make the amount on deposit in each such Debt Service Account, or, with respect to Subseries, each Subaccount thereof, equal to the amount of principal scheduled to mature, the amount of each sinking fund installment required to be paid, and the amount of interest due and payable, or, if such amount of interest is not known as of such date, the amount reasonably estimated by Energy Northwest to be necessary to pay interest on the Electric Revenue Bonds of each Series or Subseries on the next succeeding Payment Date, (ii) as and when required, the amounts required to be deposited in the accounts and Subaccounts of the Debt Service Fund and (iii) to the extent not included in clause (i) above, to the issuer of any Credit Facility and the counterparty to any Payment Agreement, and, with respect to any Parity Reimbursement Obligation, the amounts, if any, required to be so paid pursuant to the provisions of the related Supplemental Electric Revenue Bond Resolution, in each case, in the amounts, at the times and in the manner provided therein. There shall also be deposited in the Debt Service Fund and any accounts and Subaccounts thereof, as and when received by the Trustee, all other amounts required by the applicable Electric Revenue Bond Resolution to be so deposited.

*Debt Service Fund.* The Trustee shall, for each Series or Subseries of Electric Revenue Bonds outstanding, pay from the moneys on deposit in each relevant Debt Service Account or Subaccount of each Debt Service Fund (i) the amounts required for the payment of the principal, if any, due on each Payment Date and (ii) the amount required for the payment of interest due on each Payment Date and (iii) on any redemption date the amounts required to pay the redemption price of the Electric Revenue Bonds to be redeemed on such date, unless the payment of such redemption price shall be otherwise provided, and (iv) on any redemption date or date of purchase, the amounts required for the payment of accrued interest on Electric Revenue Bonds to be redeemed or purchased on such date unless the payment of such accrued interest shall be otherwise provided and (v) at the times and in the manner provided in the related Supplemental Electric Revenue Bond Resolution and the agreements between Energy Northwest and any issuer of a Credit Facility or counterparty to any Payment Agreement, to the issuer of any Credit Facility and the counterparty to any Payment Agreement, and, with respect to any Parity Reimbursement Obligation, the amounts provided to be so paid.

Unless otherwise provided for a Series of Electric Revenue Bonds in the Supplemental Electric Revenue Bond Resolutions authorizing such Series, Energy Northwest may, prior to the forty-fifth day preceding the due date of any sinking fund installment purchase Electric Revenue Bonds of the Series or Subseries, as the case may be, and maturity for which such sinking fund installment was established, at prices (including any brokerage and other charges) not exceeding the redemption price payable for such Electric Revenue Bonds when such Electric Revenue Bonds are redeemable by application of such sinking fund installment plus unpaid interest accrued to the date of purchase, such purchases to be made by the Trustee as directed in writing by an authorized officer of Energy Northwest.

Unless otherwise provided for a Series of Electric Revenue Bonds in the Supplemental Electric Revenue Bond Resolutions authorizing such Series, upon the purchase or redemption (other than by application of sinking fund installments) of any Electric Revenue Bond, an amount equal to the principal amount of the Electric Revenue Bond so purchased or redeemed shall be credited toward the sinking fund installments thereafter to become due as directed in writing by an authorized officer of Energy Northwest.

At the option of Energy Northwest, Energy Northwest may, in lieu of depositing all or any part of the sinking fund installments into each relevant Debt Service Account or Subaccount thereof of each Debt Service Fund, furnish the Trustee with a Certificate of an authorized officer stating that Energy Northwest has purchased for cancellation term bonds of a Series or Subseries of Electric Revenue Bonds in the principal amount, and bearing the numbers, specified therein, and that said term bonds have not been previously included in any such Certificate; and thereupon the sinking fund installments with respect to the term bonds of such Series or Subseries, as the case may be, may be reduced by the principal amount of such term bonds canceled, as provided by such Certificate.

Unless otherwise provided for a Series of Electric Revenue Bonds or Subseries thereof, as the case may be, in the Supplemental Electric Revenue Bond Resolutions authorizing such Series, as soon as practicable after the forty-fifth day preceding the due date of any such sinking fund installment, the Trustee shall proceed to call for redemption, pursuant to Article IV of each Electric Revenue Bond Resolution or the applicable Supplemental Electric Revenue Bond Resolutions, as the case may be, on such due date, Electric Revenue Bonds of the Series or Subseries, as the case may be, and maturity for which such sinking fund installment was established in such amount as shall be necessary to complete the retirement of the principal amount specified for such sinking fund installment of the Electric Revenue Bonds of such Series or Subseries, as the case may be, and maturity. The Trustee shall so call such Electric Revenue Bonds for redemption whether or not it then has moneys in each Debt Service Account or Subaccount thereof of each Debt Service Fund established for such Series or Subseries, as the case may be, sufficient to pay the applicable redemption price thereof on the redemption date. The Trustee shall apply to the redemption of the Electric Revenue Bonds on each such redemption date, the amount required for the redemption of such Electric Revenue Bonds.

#### **Investment of Funds (Section 508)**

Moneys held in each Debt Service Fund shall, to the fullest extent practicable and reasonable, be invested and reinvested by the Trustee upon request of Energy Northwest (promptly confirmed in writing) solely in Investment Securities which shall mature or be subject to redemption at the option of the owner thereof on or prior to the respective dates when the moneys therein will be required for the purposes intended. However, moneys in each Reserve Account in each Debt Service Fund not required for immediate disbursement for the purpose for which said Account is created shall, to the fullest extent practicable and reasonable, be invested and reinvested by the Trustee at the direction of Energy Northwest (promptly confirmed in writing) solely in, and obligations credited to each Reserve Account shall be, Investment Securities which, unless otherwise provided in the related Supplemental Electric Revenue Bond Resolution, shall mature or be subject to redemption at the option of the owner thereof on or prior to the last maturity date of the related Series of Bonds. The Trustee shall not be liable for any depreciation in value of any such investments. For the purpose of Section 508 of the Electric Revenue Bond Resolutions, the term "Investment Securities" shall be limited to obligations described in clauses (i) and (v) of the definition of Investment Securities.

Nothing in the Electric Revenue Bond Resolutions shall prevent any Investment Securities acquired as investments of funds held thereunder from being issued or held in book-entry form.

#### **Valuation or Sale of Investments (Section 509)**

Investment Securities in any fund or account created under the provisions of each Electric Revenue Bond Resolution shall be deemed at all times to be part of such fund or account and any profit realized from the liquidation of such investment shall be credited to such fund or account and any loss resulting from liquidation of such investment shall be charged to such fund or account. So long as the Project 1, Columbia or Project 3 Prior Lien Bonds shall remain outstanding, any net profits remaining after accumulating the sum of all profits realized and losses suffered from the liquidation of such investments in any fund or account shall be retained in the related Debt Service Accounts (or Subaccounts) of each Debt Service Fund, unless otherwise provided in Supplemental Electric Revenue Bond Resolutions authorizing Series of Electric Revenue Bonds; provided, however, that if the money and value of investments in any Reserve Account in each Debt Service Fund shall exceed the applicable Reserve Account Requirement for the Series of Bonds for which such Reserve Account was established, the amount of such excess shall be transferred by the Trustee, without further authorization or direction by Energy Northwest to each Debt Service Account established for such Series, unless otherwise provided in Supplemental Electric Revenue Bond Resolutions authorizing such Series of Electric Revenue Bonds. After the date on which there shall be no Project 1, Columbia or Project 3 Prior Lien Bonds outstanding, any such net profits or excess shall be transferred by the Trustee, without further authorization or direction by Energy Northwest, or paid to, or retained in, each General Revenue Fund.

In computing the amount in any fund or account, Investment Securities therein shall be valued at cost or, if purchased at a premium or discount, at their amortized value. Any such computation shall include accrued interest on the Investment Securities paid as part of the purchase price thereof and not repaid. Such computation shall be made annually on June 30th for all funds and accounts established pursuant to the Electric Revenue Bond Resolutions and at such other times as Energy Northwest shall determine or as may be required by the Electric Revenue Bond Resolutions.

Except as otherwise provided in the Electric Revenue Bond Resolutions, the Trustee, as directed by an authorized officer of Energy Northwest (promptly confirmed in writing), shall use its best efforts to sell at the best price obtainable, or present for redemption, any Investment Securities held by the Trustee in any fund or account whenever it shall be necessary, and upon oral request (promptly confirmed in writing) from an authorized officer of Energy Northwest in order to provide moneys to meet any payment or transfer from such fund or account. The Trustee shall not be liable or responsible for any loss resulting from any such investment, sale, liquidation or presentation for investment made in the manner provided above.

Subject to the foregoing limitations, any moneys held by Energy Northwest or the Trustee under a particular Electric Revenue Bond Resolution may be pooled in order to make any purchase of Investment Securities or deposit of moneys held under such Electric Revenue Bond Resolution, which purchases or deposits are otherwise permitted thereunder; provided, however, that Energy Northwest and the Trustee shall at all times keep accurate and complete records of the Investment Securities so purchased and deposits so made in sufficient detail as will permit the application of such Investment Securities and



deposits, and the proceeds thereof, solely for the purposes, at the times and in the manner provided in each Electric Revenue Bond Resolution.

#### **Certain Covenants (Article VII)**

Energy Northwest covenants and agrees with the purchasers and owners of all Electric Revenue Bonds issued pursuant to the Electric Revenue Bond Resolutions as follows:

*Compliance with Resolution Nos. 769, 640 and 775.* So long as any of the Project 1 Prior Lien Bonds, the Columbia Prior Lien Bonds or the Project 3 Prior Lien Bonds are outstanding, Energy Northwest shall comply in all respects with each of the provisions, covenants and agreements of or contained in Resolution Nos. 769, 640 and 775, respectively.

*Concerning the Agreements and Resolution Nos. 769, 640 and 775.* So long as any of the Electric Revenue Bonds are outstanding, Energy Northwest will not (i) voluntarily consent to or permit any rescission of or consent to any amendment to or otherwise take any action under or in connection with any of the Net Billing Agreements which will reduce the payments provided for therein or which will in any manner impair or adversely affect the rights of Energy Northwest or of the owners from time to time of the Electric Revenue Bonds or (ii) voluntarily consent to or permit any rescission of or consent to any amendment to or modification of or otherwise take any action under or in connection with, each Project Agreement in the case of Columbia, each Assignment Agreement, each Property Disposition Agreement or each 1989 Letter Agreement which will in any manner impair or adversely affect the rights of Energy Northwest or of the owners from time to time of the Electric Revenue Bonds; and Energy Northwest shall perform all of its obligations under said Agreements and shall take such actions and proceedings from time to time as shall be necessary to protect and safeguard the security for the payment of the Electric Revenue Bonds afforded by the provisions of said Agreements. Energy Northwest will not, so long as any Project 1, Columbia or Project 3 Prior Lien Bonds remain outstanding, consent to or agree to any change, amendment or modification of Resolutions 769, 640 and 775, respectively, which would in any way or manner prejudice or affect adversely the rights or interests of the owners of the Electric Revenue Bonds.

*Encumbrance or Disposition of Project Properties; Termination of Projects.* On and after the date on which the Prior Lien Bonds are no longer outstanding, Energy Northwest will not sell, mortgage, lease or otherwise dispose of any properties of the related Project, or permit the sale, mortgage, lease or other disposition thereof, except as provided below.

(i) Energy Northwest may sell, lease or otherwise dispose of all or any portion of the works, plants and facilities of a Project and any real and personal property comprising a part thereof which is unserviceable, inadequate, obsolete, worn-out or unfit to be used or no longer required for use in connection with the operation of a Project, provided, however, that if the original costs of the properties so to be disposed of was in excess of \$5,000,000, an Engineer shall first certify that the properties to be disposed of are unserviceable, inadequate, obsolete, worn-out or unfit to be used or no longer required for use in connection with the operations of a Project; provided, however, no such certification shall be required if such sale or other disposition takes place after a Project has been terminated. Monies received by Energy Northwest as the proceeds of any such sale, lease or other disposition of all or any portion of the properties of a Project shall be used for the purchase or redemption of Electric Revenue Bonds and thereafter, any excess shall be deposited in the respective General Revenue Fund; provided, however, that if such sale, lease or other disposition of all or any portion of the properties of a Project is in connection with the replacement of such properties, all moneys received from such partial disposition of property may be transferred to the respective General Revenue Funds.

(ii) Energy Northwest may sell, lease or otherwise dispose of fuel for a price not less than the lesser of the cost to Energy Northwest thereof or the fair market value thereof at the time of such sale, lease or other disposition; provided, that any moneys received by Energy Northwest as proceeds of any such sale, lease or purchase shall be either transferred to the respective General Revenue Funds or used for the purchase or redemption of Electric Revenue Bonds.

(iii) In the event that the ownership of the properties of a Project or any part thereof shall be transferred from Energy Northwest through the operation of law, any moneys received by Energy Northwest as a result of any such transfer shall be used for the purchase or redemption of Electric Revenue Bonds and thereafter, any excess shall be deposited in the respective General Revenue Funds.

(iv) Energy Northwest may terminate a Project at any time. Any moneys received by Energy Northwest from the disposition of the properties of a Project so terminated may be applied to the payment of the cost of decommissioning such Project including the cost of restoring the site thereof, and any amounts so received not required to pay such costs shall be applied as provided in paragraph (iii) above or in each Electric Revenue Bond Resolution.

Nothing contained in the Electric Revenue Bond Resolutions shall be construed to prevent Energy Northwest from constructing as a separate utility system any additional generating unit or units on or near the site of any Project, and using facilities of a Project in connection with the construction or operation therewith without compensation therefor; provided, however, that an Engineer shall certify to Energy Northwest and the Trustee that such use will not adversely affect the operations of the applicable Project or interfere with the performance by Energy Northwest of its obligations under the Electric Revenue

Bond Resolutions; and provided further, however, that any compensation received by Energy Northwest on account of any such use shall be paid into the respective General Revenue Funds.

Notwithstanding the provisions of subsection (a) of Section 707 of each Electric Revenue Bond Resolution, moneys received by Energy Northwest as a result of any sale, lease, transfer or other disposition specified in such subsection (a) and which are in excess of the amounts required for decommissioning and site restoration costs may be transferred to such funds or accounts determined by Energy Northwest or used to purchase or redeem Electric Revenue Bonds.

*Insurance.* Energy Northwest shall, to the extent available at reasonable cost with responsible insurers, keep, or cause to be kept, the works, plants and facilities comprising the properties of the related Project and the operation thereof insured, with policies payable to Energy Northwest for the benefit of Energy Northwest, the Participants and Bonneville, as their interests may appear, against risks of direct physical loss, damage to or destruction of such properties or any part thereof, and against accidents, casualties, or negligence, including liability insurance and employer's liability, at least to the extent that similar insurance is usually carried by electric utilities operating like properties, and such other insurance as may be agreed upon by the parties to the Columbia Project Agreement. To the extent such insurance is being maintained by Energy Northwest pursuant to the Prior Lien Resolutions, no such insurance need be maintained under the related Electric Revenue Bond Resolution. In the case of loss, including loss of revenue, caused by suspension or interruption of generation or transmission of power and energy by a Project, the proceeds of any insurance policy or policies covering such loss received by Energy Northwest, prior to the retirement of the related Prior Lien Bonds, shall be paid into the related Revenue Fund, and thereafter, shall be paid into the related General Revenue Fund. Within sixty (60) days after the end of each fiscal year, Energy Northwest shall file, or cause to be filed, with the Trustee a certificate of an Engineer describing in reasonable detail the insurance on the Projects then in effect pursuant to the requirements of the related Electric Revenue Bond Resolution and stating whether, in its opinion, such insurance then in effect reasonably complies with the provisions hereof. Prior to the retirement of the Project 1, Columbia or Project 3 Prior Lien Bonds, the filing of such a certificate pursuant to the related Prior Lien Resolutions shall satisfy the requirement of the preceding sentence.

*Books of Account; Annual Audit.* Energy Northwest shall keep proper books of account for each Project, showing as a separate utility system the accounts of each Project in accordance with the rules and regulations prescribed by any governmental agency authorized to prescribe such rules, including the Division of Municipal Corporations of the State Auditor's office of the State of Washington, or other state department or agency succeeding to such duties of the State Auditor's office, and in accordance with the Uniform System of Accounts prescribed from time to time by the Federal Energy and Regulatory Commission, or any successor federal agency having jurisdiction over electric public utility companies owning and operating properties similar to each Project, whether or not Energy Northwest is required by law to use such system of accounts. Within one hundred twenty (120) days after the end of each fiscal year, Energy Northwest shall cause such books of account to be audited by independent certified public accountants of national reputation licensed, registered or entitled to practice and practicing as such under the laws of the State of Washington who, or each of whom, is in fact independent and does not have any interest, direct or indirect, in any contract with Energy Northwest other than his contract of employment to audit books of account of Energy Northwest, and who is not connected with Energy Northwest as an officer or employee of Energy Northwest. A copy of each audit report, annual balance sheet and income and expense statement showing in reasonable detail the financial condition of each Project as of the close of each fiscal year and summarizing in reasonable detail the income and expenses for such year, including the transactions relating to the funds and accounts and the amounts expended for maintenance and for renewals, replacements and gross capital additions to each Project shall be filed promptly with the Trustee and sent to any Bondholder filing with Energy Northwest a written request for a copy thereof. Each such audit report shall state therein that the auditor has examined and is familiar with the provisions of the related Electric Revenue Bond Resolution and each Supplemental Electric Revenue Bond Resolution relating to the matters set forth above, and that as to such matters Energy Northwest is in compliance therewith or, if not in compliance therewith, the details of such failure to comply and the action to be taken by Energy Northwest to be in compliance therewith.

*Consulting Engineer.* To the extent required by a Supplemental Electric Revenue Bond Resolution, Energy Northwest will, as prescribed in the Electric Revenue Bond Resolutions, retain a nationally recognized independent engineer or engineering firm (the "Consulting Engineer") on a continuous basis for the purpose of providing Energy Northwest immediate and continuous engineering counsel with respect to each Project; provided, however, that no Consulting Engineer need be retained so long as Energy Northwest retains a "Consulting Engineer" pursuant to the Prior Lien Resolutions.

*Protection of Security; Additional Parity Indebtedness.* Energy Northwest is duly authorized under all applicable laws to create and issue the Electric Revenue Bonds and to adopt the Electric Revenue Bond Resolutions and to pledge the revenues and other moneys, securities and funds purported to be pledged by the Electric Revenue Bond Resolutions in the manner and to the extent provided in the Electric Revenue Bond Resolutions. The 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 Electric Revenue Bond Resolutions, so long as any of the Project 1, Columbia or Project 3 Prior Lien Bonds remain outstanding, except for the lien and pledge of the Prior Lien Resolutions, and all corporate action on the part of Energy Northwest to that end has been duly and validly taken. The Electric Revenue Bonds and the provisions of the Electric Revenue Bond Resolutions are and will be valid and legally enforceable obligations of Energy Northwest in accordance with their terms and the terms of the Electric Revenue Bond Resolutions. Energy Northwest shall at all times, to the extent

permitted by law, defend, preserve and protect the pledge of the revenues and other moneys, securities and funds pledged under the Electric Revenue Bond Resolutions and all the rights of the Bondholders under the Electric Revenue Bond Resolutions or any issuer of a Credit Facility pursuant to a Supplemental Electric Revenue Bond Resolution against all claims and demands of all persons whomsoever.

Subject to the provisions of the Prior Lien Resolutions, Energy Northwest will not hereafter create any other special fund or funds for the payment of bonds, warrants or other obligations or issue any bonds, warrants or other obligations payable out of or secured by a pledge of revenues or create any additional obligations which will rank on a parity with or in priority over the pledge and lien of such revenues created under the Electric Revenue Bond Resolutions, except that Energy Northwest may issue bonds, notes or other obligations, under a separate resolution or resolutions, which are payable from or secured by a pledge of the revenues and may create or cause to be created any lien or charge on such revenues, ranking on a parity with the pledge and lien created by the Electric Revenue Bond Resolutions, for any one or more of the purposes provided in the Electric Revenue Bond Resolutions or may create Parity Reimbursement Obligations. However, Energy Northwest shall not issue any such additional bonds, notes or other obligations or create Parity Reimbursement Obligations unless, on the date of issue of such bonds, the certain contracts or agreements described in the Electric Revenue Bond Resolutions are in full force and effect and no Event of Default under the Electric Revenue Bond Resolutions shall have occurred and be continuing.

*Further Assurances.* Energy Northwest will at any and all times, insofar as it may be authorized so to do by law, pass, make, do, execute, acknowledge and deliver all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for the better assuring, conveying, granting, assigning and confirming all and singular the rights, revenues and other funds pledged or assigned to the payment of the obligations issued by Energy Northwest payable from the revenues of each Project, including the Electric Revenue Bonds or intended so to be, or which Energy Northwest may hereafter become bound to pledge or assign.

*Tax Covenants.* Energy Northwest covenants with the owners from time to time of the Electric Revenue Bonds that (i) throughout the term of the Electric Revenue Bonds and (ii) through the date that the final rebate, if any, must be made to the United States in accordance with Section 148 of the Code it will comply with the provisions of Sections 103 and 141 through 150 of the Code and all regulations proposed and promulgated thereunder that must be satisfied in order that interest on the Electric Revenue Bonds shall be and continue to be excluded from gross income for federal income tax purposes.

Energy Northwest shall not permit at any time or times any of the proceeds of the Electric Revenue Bonds or any other funds of Energy Northwest to be used directly or indirectly to acquire any securities or obligations the acquisition of which would cause any Electric Revenue Bond to be an “arbitrage bond” as defined in Section 148 of the Code, or any successor provision of law.

Energy Northwest shall not permit at any time or times any proceeds of any Series of Electric Revenue Bonds or any other funds of Energy Northwest to be used, directly or indirectly, in a manner which would result in the exclusion of any Electric Revenue Bond from the treatment afforded by Section 103(a) of the Code.

Anything contained in the three preceding paragraphs to the contrary notwithstanding, Energy Northwest reserves the right to issue, from time to time, one or more Series of Electric Revenue Bonds the interest on which is includable in the gross income of the recipient thereof for federal income tax purposes (“Taxable Bonds”), provided that the issuance of any such Series of Taxable Bonds does not adversely affect the federal tax exemption of the interest on any other Series of Electric Revenue Bonds.

#### **Events of Default and Remedies (Section 801)**

The occurrence of one or more of the following events shall constitute an “Event of Default” under the Electric Revenue Bond Resolution to which such Event of Default relates:

- (1) if payment of principal or the redemption price of any related Electric Revenue Bond shall not punctually be made when due and payable, whether at the stated maturity thereof, upon redemption or otherwise;
- (2) if payment of the interest on any related Electric Revenue Bond shall not punctually be made when due;
- (3) if payment of any related Parity Reimbursement Obligation shall not be punctually made when due;
- (4) if Energy Northwest shall fail to duly and punctually perform or observe any other of the covenants, agreements or conditions contained in the applicable Electric Revenue Bond Resolution or in the related Electric Revenue Bonds, on the part of Energy Northwest to be performed (other than the covenant relating to compliance with Resolution Nos. 769, 640 and 775, as the case may be), and such failure shall continue for ninety (90) days after written notice thereof from the Trustee or the owners of not less than twenty-five percent (25%) of the related Electric Revenue Bonds then outstanding; provided that, if such failure cannot be corrected within such ninety (90) day period, it shall not constitute an Event of Default if corrective action is instituted within such period and diligently pursued until the failure is corrected; and provided further that the exclusion of the covenant relating to

compliance with Resolution Nos. 769, 640 and 775, as the case may be, shall not be construed to prevent the Trustee from enforcing any remedy it may have, at law or in equity, for a breach of such covenant;

(5) if an order, judgment, or decree shall be entered by any court of competent jurisdiction, with the consent or acquiescence of Energy Northwest, or if such order, judgment or decree, having been entered without the consent or acquiescence of Energy Northwest, shall not be vacated or set aside or discharged or stayed (or in case custody or control is assumed by said order, such custody or control shall not otherwise be terminated) within ninety (90) days after the entry thereof, and if appealed, shall not thereafter be vacated or discharged: (i) appointing a receiver, trustee or liquidator for Energy Northwest; or (ii) assuming custody or control of the whole or any substantial part of the applicable Project under the provisions of any law for the relief or aid of debtors; or (iii) approving a petition filed against Energy Northwest under the provisions of 11 USC 901-946, as amended (the "Bankruptcy Act"); or (iv) granting relief to Energy Northwest under any amendment to said Bankruptcy Act, or under any other applicable Bankruptcy Act, which shall give relief substantially similar to that afforded by Chapter IX thereof; and

(6) if Energy Northwest shall (i) admit in writing its inability to pay its debts generally as they become due; or (ii) file a petition in bankruptcy or seeking a composition of indebtedness; or (iii) make an assignment for the benefit of its creditors; or (iv) file a petition or any answer seeking relief under the Bankruptcy Act referred to in the preceding clause, or under any amendment thereto, or under any other applicable bankruptcy act which shall give relief substantially the same as that afforded by Chapter IX of said act; or (v) consent to the appointment of a receiver of the whole or any substantial part of the applicable Project; or (vi) consent to the assumption by any court of competent jurisdiction under the provisions of any other law for the relief or aid of debtors of custody or control of Energy Northwest or of the whole or any substantial part of the applicable Project.

Upon the occurrence of an Event of Default described in the preceding paragraphs, and in each and every such case, so long as such Event of Default shall not have been remedied, unless the principal of all the related Electric Revenue Bonds shall have already become due and payable, the Trustee may, and upon the written request of the owners of not less than 25% of all related Electric Revenue Bonds then outstanding shall, proceed to enforce by such proceedings at law or in equity as it deems most effectual the rights of related Bondholders, and either the Trustee (by notice in writing to Energy Northwest), or the owners of not less than 25% in principal amount of the related Electric Revenue Bonds outstanding (by notice in writing to Energy Northwest and the Trustee), may declare the principal of all the related Electric Revenue Bonds then outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and be immediately due and payable; provided, however, that so long as any of the Prior Lien Bonds of the related Project remain outstanding, no such declaration may be made unless the principal of all the Prior Lien Bonds of the related Project then outstanding, and the interest accrued thereon, shall have been declared to be due and payable immediately pursuant to Section 12.1 of Resolution No. 769, Section 11.1 of Resolution No. 640 or Section 11.1 of Resolution No. 775, as the case may be. The Trustee shall not be obligated to notify Energy Northwest of its intent to make such a declaration prior to making such declaration. The right of the Trustee or of the owners of not less than 25% in principal amount of the related Electric Revenue Bonds to make any such declaration, however, shall be subject to the condition that if, at any time after such declaration, but before the related Electric Revenue Bonds shall have matured by their terms, all overdue installments of interest upon the related Electric Revenue Bonds, together with interest on such overdue installments of interest to the extent permitted by law and the reasonable and proper charges, expenses and liabilities of the Trustee (including reasonable fees and expenses of counsel to the Trustee), and all other sums then payable by Energy Northwest under the related Electric Revenue Bond Resolution (except the principal of, and interest accrued since the next preceding Payment Date on, the related Electric Revenue Bonds due and payable solely by virtue of such declaration) shall either be paid by or for the account of Energy Northwest or provision satisfactory to the Trustee shall be made for such payment, and all defaults under the related Electric Revenue Bonds or under the related Electric Revenue Bond Resolution (other than the payment of principal and interest due and payable solely by reason of such declaration) shall either be cured or provision shall be made therefor, then and in every such case the owners of a majority in principal amount of the related Electric Revenue Bonds outstanding, by written notice to Energy Northwest and to the Trustee, may rescind such declaration and annul such default in its entirety, or, if the Trustee shall have acted itself, and if there shall not have been theretofore delivered to the Trustee written directions to the contrary by the owners of a majority in principal amount of the related Electric Revenue Bonds then outstanding, then any such declaration shall *ipso facto* be deemed to be annulled, but no such rescission and annulment shall extend to or affect any subsequent default or impair or exhaust any resulting right or power.

#### **Notice to Bondholders of an Event of Default (Section 802)**

The Trustee, within twenty-five (25) days after the occurrence of an Event of Default, shall give to the Bondholders of the related Electric Revenue Bonds, in the manner provided in the applicable Electric Revenue Bond Resolution, notice of all defaults known to the Trustee, and shall give prompt written notice thereof to Energy Northwest, unless such defaults shall have been cured before the giving of such notice.

#### **Accounting and Examination of Records After Default (Section 803)**

Energy Northwest covenants that if an Event of Default shall have happened and shall not have been remedied, the books of record and account of Energy Northwest relating to the related Project and all other records relating thereto shall at all times be subject to the inspection and use of the Trustee and any persons holding at least twenty-five percent (25%) of the

principal amount of the related Electric Revenue Bonds outstanding and of their respective agents and attorneys or of any committee therefor.

Energy Northwest covenants that if an Event of Default shall have happened and shall not have been remedied, Energy Northwest will continue to account, as a trustee of an express trust, for all revenues and other moneys, securities and funds pledged under the related Electric Revenue Bond Resolution.

#### **Application of Revenues in an Event of Default (Section 804)**

Energy Northwest covenants that if an Event of Default shall have happened and shall not have been remedied, upon demand of the Trustee, Energy Northwest shall pay over to the Trustee (i) forthwith, all moneys, securities and funds, if any, then held by Energy Northwest and pledged under the related Electric Revenue Bond Resolution, and (ii) subject to the provisions of Resolution Nos. 769, 640 or 775, as the case may be, as promptly as practicable after receipt thereof, all revenues of the related Project (provided that if other Parity Debt is outstanding Energy Northwest shall pay over to the Trustee the Trustee's pro rata share of such revenues).

Subject to the provisions of Resolution Nos. 769, 640 and 775, respectively, during the continuance of an Event of Default, the revenues and other moneys of the related Project received by the Trustee shall be applied by the Trustee: first to the payment of the reasonable and necessary cost of operation, maintenance, repair and replacement of the related Project, including the costs of decommissioning and site restoration, if any, and all other proper disbursements or liabilities made or incurred by the Trustee (including the fees and expenses of counsel to the Trustee); and second, to the then due and overdue payments into the related Debt Service Fund and the due and overdue payments on any related Parity Reimbursement Obligations and the due and overdue payments of any other obligation of Energy Northwest for which the Revenues are pledged on a parity with the pledge under Section 202(a) of the related Electric Revenue Bond Resolution pursuant to a Supplemental Electric Revenue Bond Resolution ("Other Parity Obligations"); and lastly, for any lawful purpose in connection with the related Project.

In the event that at any time the funds held by the Trustee shall be insufficient for the payment of the principal of, premium, if any, and interest then due on the related Electric Revenue Bonds and payments then due on any related Parity Reimbursement Obligations and Other Parity Obligations, such funds (other than funds held for the payment or redemption of particular Electric Revenue Bonds or Parity Reimbursement Obligations or Other Parity Obligations, including, without limiting the generality of the foregoing, amounts held in any Reserve Account for a particular Series of Electric Revenue Bonds) and all revenues of Energy Northwest and other moneys received or collected for the benefit or for the account of owners of the Electric Revenue Bonds and any Parity Reimbursement Obligations and Other Parity Obligations by the Trustee shall be applied as follows:

- (1) Unless the principal of all of the related Electric Revenue Bonds shall have become due and payable,

*First*, to the payment of all necessary and proper operating expenses of the applicable Project and all other proper disbursements or liabilities made or incurred by the Trustee;

*Second*, to the payment to the persons entitled thereto of all installments of interest then due on the related Electric Revenue Bonds (including any interest on overdue principal) in the order of the maturity of such installments, earliest maturities first, and on any related Parity Reimbursement Obligations and Other Parity Obligations and if the amounts available shall not be sufficient to pay in full any installment or installments of 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

*Third*, to the payment to the persons entitled thereto of the principal and premium, if any, due and unpaid upon the related Electric Revenue Bonds and on any related Parity Reimbursement Obligations and Other Parity Obligations at the time of such payment without preference or priority of any related Electric Revenue Bond or related Parity Reimbursement Obligation or Other Parity Obligation over any other Electric Revenue Bond or related Parity Reimbursement Obligation or Other Parity Obligation, and if the amounts available therefor shall not be sufficient to pay in full any principal and premium, if any, due and unpaid upon the related Electric Revenue Bonds and on any related Parity Reimbursement Obligations and Other Parity Obligations at such time, then to the payment thereof, ratably, according to the amounts due respectively for principal and redemption premium, without any discrimination or preference.

- (2) If the principal of all of the related Electric Revenue Bonds shall have become due and payable,

*First*, to the payment of all necessary and proper operating expenses of the related Project and all other proper disbursements or liabilities made or incurred by the Trustee; and

*Second*, to the payment of the principal and interest then due and unpaid upon the related Electric Revenue Bonds and any related Parity Reimbursement Obligations and Other Parity Obligations without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any related Electric Revenue Bond or related Parity Reimbursement Obligation or Other Parity Obligation over any other Electric Revenue Bond or related Parity

Reimbursement Obligation or Other Parity Obligation, ratably, according to the amounts due respectively for principal and interest, to the persons entitled thereto without any discrimination or preference.

Whenever moneys are to be applied as described in the preceding paragraphs, such moneys shall be applied by the Trustee, at such times, and from time to time, as it in its sole discretion shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future.

If and whenever all overdue installments of interest on all Electric Revenue Bonds and any related Parity Reimbursement Obligations and Other Parity Obligations, together with the reasonable and proper charges, expenses, and liabilities of the owners of the Electric Revenue Bonds or the obligees of such Parity Reimbursement Obligation or Other Parity Obligation, as applicable, their respective agents and attorneys, and all other sums payable by Energy Northwest under the related Electric Revenue Bond Resolution including the Principal Installment or redemption price of all Electric Revenue Bonds which shall then be payable, shall either be paid in full by or for the account of Energy Northwest or provision satisfactory to the Trustee shall be made for such payment, and all defaults under the applicable Electric Revenue Bond Resolutions or the related Electric Revenue Bonds shall be made good and secured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate therefor, the Trustee shall pay over to Energy Northwest all of its monies, securities, funds and revenues then remaining unexpended in the hands of the Trustee (except moneys, securities, funds or revenues deposited or pledged, or required by the terms of the applicable Electric Revenue Bond Resolution to be deposited or pledged, with the Trustee), control of the business and possession of the property of the applicable Project shall be restored to Energy Northwest, and thereupon Energy Northwest and the Trustee shall be restored to their former positions and rights under the applicable Electric Revenue Bond Resolution, and all revenues shall thereafter be applied as provided in Article V of the applicable Electric Revenue Bond Resolution. No such payment to Energy Northwest by the Trustee or resumption of this application of revenues as provided in Article VI of the applicable Electric Revenue Bond Resolution shall extend to or affect any subsequent default under the applicable Electric Revenue Bond Resolution or impair any right consequent thereon.

#### **Remedies Not Exclusive (Section 809)**

No remedy by the terms of either of the Electric Revenue Bond Resolutions conferred upon or reserved to the owners of the related Electric Revenue Bonds is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative and shall be in addition to any other remedy given to the owners of the related Electric Revenue Bonds or now or hereafter existing at law or in equity or by statute.

#### **Supplemental Electric Revenue Bond Resolutions (Article IX)**

*Supplemental Electric Revenue Bond Resolutions Effective Without Consent of Owners of Bonds.* Energy Northwest, from time to time and at any time and without the consent or concurrence of any owner of any Electric Revenue Bond, may adopt a resolution amendatory of each Electric Revenue Bond Resolution or supplemental to each Electric Revenue Bond Resolution (i) for the purpose of providing for the issuance of Electric Revenue Bonds pursuant to the provisions of Article II of each Electric Revenue Bond Resolution; or (ii) if the provisions of such Supplemental Electric Revenue Bond Resolutions shall not adversely affect the rights of the owners of the Electric Revenue Bonds of each Series or, if a Series consists of two or more Subseries, of each Subseries thereof, affected by such Supplemental Electric Revenue Bond Resolutions then outstanding, for any one or more of the following purposes:

- (1) to make any changes or corrections in the Electric Revenue Bond Resolutions as to which Energy Northwest shall have been advised by counsel that the same 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 Electric Revenue Bond Resolutions, or to insert in the Electric Revenue Bond Resolutions such provisions clarifying matters or questions arising under the Electric Revenue Bond Resolutions as are necessary or desirable;
- (2) to add additional covenants and agreements of Energy Northwest for the purpose of further securing the payment of the Electric Revenue Bonds;
- (3) to surrender any right, power or privilege reserved to or conferred upon Energy Northwest by the terms of the Electric Revenue Bond Resolutions;
- (4) 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 provisions of the Electric Revenue Bond Resolutions;
- (5) to grant or to confer upon the owners of the Electric Revenue Bonds any additional rights, remedies, powers, authority or security that lawfully may be granted to or conferred upon them, or to grant to or to confer upon the Trustee for the benefit of the owners of the Electric Revenue Bonds any additional rights, duties, remedies, powers, authority or security or to provide for one or more Credit Facilities;
- (6) to make any appointment or to add any provision, in either case, required or permitted by the Electric Revenue Bond Resolutions to be so made or added pursuant to a Supplemental Electric Revenue Bond Resolution;
- (7) to enter into Payment Agreements; and

(8) to make any other change which Energy Northwest deems necessary or desirable and which does not adversely affect the rights of the Bondholders.

*Supplemental Electric Revenue Bond Resolutions Effective With Consent of Bondholders.* At any time or from time to time, Supplemental Electric Revenue Bond Resolutions may be adopted subject to consent by Bondholders in accordance with and subject to the provisions of each Electric Revenue Bond Resolution, which Supplemental Electric Revenue Bond Resolutions, upon the filing with the Trustee of a copy thereof certified by an authorized officer of Energy Northwest and upon compliance with the provisions of Article X of each Electric Revenue Bond Resolution, shall become fully effective in accordance with its terms as provided in said Article.

#### **Powers of Amendment (Section 1002)**

Any modification or amendment of the Electric Revenue Bond Resolutions or of the rights and obligations of Energy Northwest and of the owner of the Electric Revenue Bonds thereunder, in any particular, may be made by Supplemental Electric Revenue Bond Resolutions, with the written consent given as provided in each Electric Revenue Bond Resolution, (i) of the owners of not less than a majority in principal amount of the related Electric Revenue Bonds outstanding at the time such consent is given and (ii) in case less than all of the several Series of Electric Revenue Bonds or, if any Series consists of two or more Subseries, the Subseries thereof, then outstanding are affected by the modification or amendment, of the owners of not less than a majority in principal amount of the Electric Revenue Bonds of such Series or Subseries, as the case may be, so affected and outstanding at the time such consent is given; except that if such modification or amendment will, by its terms, not take effect so long as any Electric Revenue Bonds of any specified like Series, Subseries, if applicable, and maturity remain outstanding, the consent of the owners of such Electric Revenue Bonds shall not be required and such Electric Revenue Bonds shall not be deemed to be outstanding for the purpose of any calculation of outstanding Electric Revenue Bonds under this provision of each Electric Revenue Bond Resolution. No such modification or amendment shall permit a change in the terms of redemption or maturity of the principal of any outstanding Electric Revenue Bond or of any installment of interest thereon or a reduction in the principal amount or the redemption price thereof or in the rate of interest thereon without the consent of the owner of such Electric Revenue Bond, or shall reduce the percentages or otherwise affect the classes of Electric Revenue Bonds the consent of the owners of which is required to effect any such modification or amendment, or permit a preference or priority of any Electric Revenue Bond over any other or shall change or modify any of the rights or obligations of any fiduciary without its written assent thereto. For the purposes of this provision of each Electric Revenue Bond Resolution, a Series or Subseries, as the case may be, shall be deemed to be affected by a modification or amendment of each Electric Revenue Bond Resolution if the same adversely affects or diminishes the rights of the owners of Electric Revenue Bonds of such Series or Subseries, respectively. The Trustee may in its discretion determine whether or not in accordance with the foregoing powers of amendment of the Electric Revenue Bonds of any particular Series, Subseries, if applicable, or maturity would be affected by any modification or amendment of the Electric Revenue Bond Resolutions and any such determination shall be binding and conclusive on Energy Northwest and all owners of Electric Revenue Bonds. For the purposes of this Section, the owners of the Electric Revenue Bonds may include the initial owners thereof, regardless of whether such Electric Revenue Bonds are being held for immediate resale.

#### **Defeasance (Article XI)**

Except as otherwise provided in Supplemental Electric Revenue Bond Resolutions authorizing the issuance of variable rate Electric Revenue Bonds, the obligations of Energy Northwest under the Electric Revenue Bond Resolutions and the liens, pledges, charges, trusts, covenants and agreements of Energy Northwest made or provided for in the Electric Revenue Bond Resolutions, shall be fully discharged and satisfied as to any related Electric Revenue Bond and such related Electric Revenue Bond shall no longer be deemed to be outstanding hereunder,

(i) when such related Electric Revenue Bond shall have been canceled, or shall have been surrendered for cancellation or is subject to cancellation, or shall have been purchased by the Trustee from moneys held under the related Electric Revenue Bond Resolutions; or

(ii) as to any related Electric Revenue Bond not canceled or surrendered for cancellation or subject to cancellation or so purchased, when payment of the principal of and premium, if any, on such related Electric Revenue Bond, plus interest on such principal to the due date thereof (whether such due date be by reason of maturity or upon 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 for by irrevocably depositing with the trustee or a paying agent for such Electric Revenue Bond, in trust, and irrevocably appropriating and setting aside exclusively for such payment, either (1) moneys sufficient to make such payment or (2) Defeasance Obligations maturing, or redeemable at the option of the owner thereof, as to principal and interest in such amount and at such times as will insure the availability of sufficient moneys to make such payment, or a combination thereof, whichever Energy Northwest deems to be in its best interest, and all necessary and proper fees, compensation and expenses of the Trustee and the paying agents pertaining to the Electric Revenue Bond with respect to which such deposit is made shall have been paid or the payment thereof provided for to the satisfaction of the Trustee and said paying agents.

At such time as an Electric Revenue Bond shall be deemed to be no longer outstanding under the related Electric Revenue Bond Resolution, such Electric Revenue Bond shall no longer be secured by or entitled to the benefits of the related Electric Revenue Bond Resolution, except for the purposes of any payment from such moneys or Defeasance Obligations.

Notwithstanding the foregoing, in the case of an Electric Revenue Bond which is to be redeemed or otherwise prepaid prior to its stated maturity, no deposit under clause (B) of subparagraph (ii) above shall constitute such payment, discharge and satisfaction as aforesaid until such Electric Revenue Bond shall have been irrevocably designated for redemption or prepayment and proper notice of such redemption or prepayment shall have been previously published in accordance with each Electric Revenue Bond Resolution or in accordance with the provisions of the Supplemental Electric Revenue Bond Resolutions which authorized the issuance of the Electric Revenue Bonds being refunded or provision satisfactory to the Trustee shall have been irrevocably made for the giving of such notice.

Any such moneys so deposited with the trustee or paying agents for the Electric Revenue Bonds as provided in the Electric Revenue Bond Resolutions may at the direction of Energy Northwest also be invested and reinvested in Defeasance Obligations, maturing in the amounts and times as hereinbefore set forth. All income from all Defeasance Obligations in the hands of the trustee or paying agents pursuant to Section 1101 which is not required for the payment of the Electric Revenue Bonds and interest and premium thereon with respect to which such moneys shall have been so deposited, shall be paid to Energy Northwest for deposit in the respective General Revenue Funds. Likewise, whenever all of the Electric Revenue Bonds of a Series shall be deemed to be no longer outstanding under the related Electric Revenue Bond Resolution, as aforesaid, the amounts, if any, remaining on deposit to the credit of the Reserve Accounts established for such Series shall be paid to Energy Northwest for deposit in the respective General Revenue Funds.

Any provision contained in the Electric Revenue Bond Resolutions to the contrary notwithstanding, all moneys and Defeasance Obligations set aside and held in trust pursuant to the provisions of Section 1101 for the payment of Electric Revenue Bonds shall be applied to and used solely for the payment of the particular Electric Revenue Bond with respect to which such moneys and Defeasance Obligations have been so set aside in trust.

Anything in the Electric Revenue Bond Resolutions to the contrary notwithstanding, if moneys or Defeasance Obligations have been deposited or set aside with the trustee or a paying agent pursuant to Section 1101 for the payment of a specific Electric Revenue Bond and such Electric Revenue Bond shall be deemed to have been paid and to be no longer outstanding as provided in Section 1101, but such Electric Revenue Bond shall not have in fact been actually paid in full, no amendment to the provisions of either of the Electric Revenue Bond Resolutions shall be made without the consent of the owner of each Electric Revenue Bond affected thereby.

Energy Northwest may at any time surrender to the Trustee for cancellation by it any Electric Revenue Bonds previously executed and delivered, which Energy Northwest may have acquired in any manner whatsoever, and such Electric Revenue Bonds upon such surrender for cancellation shall be deemed to be paid and no longer outstanding under either of the Electric Revenue Bond Resolutions.

Neither the obligations of Energy Northwest under the Electric Revenue Bond Resolutions and the liens, pledges, charges, trusts, covenants and agreements of Energy Northwest made or provided for in the Electric Revenue Bond Resolutions, nor any Supplemental Resolutions authorizing Parity Reimbursement Obligations and/or Other Parity Obligations, shall be discharged or satisfied with respect to such Parity Reimbursement Obligations or Other Parity Obligations, respectively, until such Parity Reimbursement Obligations shall have been paid in accordance with their terms.

#### **Summary of the Supplemental Electric Revenue Bond Resolutions**

*Debt Service Account.* Each Supplemental Electric Revenue Bond Resolution creates and establishes a special trust account of the Debt Service Fund which shall be held by the Trustee subject to the lien of the related Project's Electric Revenue Bond Resolution. The Debt Service Accounts shall be funded as provided in the related Electric Revenue Bond Resolution and amounts therein shall be used and applied as provided in the related Supplemental Electric Revenue Bond Resolution and in the related Electric Revenue Bond Resolution.



## SUMMARY OF CERTAIN PROVISIONS OF PRIOR LIEN RESOLUTIONS NOS. 769, 640 AND 775

The following summary is a brief outline of certain provisions contained in the Project 1 Prior Lien Resolution, the Columbia Prior Lien Resolution and the Project 3 Prior Lien Resolution as amended and supplemented (collectively referred to in this Appendix G-2 as the "Prior Lien Resolutions"), and is not to be considered as a full statement thereof. This summary is qualified by reference to and is subject to the Prior Lien Resolutions, copies of which may be examined at the principal offices of Energy Northwest and the respective Bond Fund Trustees and Paying Agents for the Project 1, Columbia and Project 3 Prior Lien Bonds.

### Subsequent Series of Prior Lien Bonds

Under the Supplemental Resolutions adopted by the Executive Board of Energy Northwest on March 9, 2001, Energy Northwest has covenanted with the owners from time to time of the Electric Revenue Bonds not to issue any further Prior Lien Bonds or any other bonds, warrants or obligations having a lien on Revenues on a parity with the Prior Lien Bonds.

### Effect of Amendments Adopted September 14, 1989 and March 16, 1990 (Project 1, Columbia and Project 3)

*Amendments Effective Immediately:* Resolution No. 548 (the "Project 1 1989A Supplemental Resolution") and Resolution No. 549 (the "Project 3 1989A Supplemental Resolution" and, together with the Project 1 1989A Supplemental Resolution, the "1989A Supplemental Resolutions"), each adopted by the Executive Board of Energy Northwest on September 14, 1989, and Resolution No. 583 (the "Columbia 1990A Supplemental Resolution"), adopted by the Executive Board of Energy Northwest on March 15, 1990, amend the Project 1 Prior Lien Resolution, the Columbia Prior Lien Resolution and the Project 3 Prior Lien Resolution, respectively, to add the Property Disposition Covenants described in this Official Statement under "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements." The 1989A Supplemental Resolutions and Columbia 1990A Supplemental Resolution also amend the Project 1 Prior Lien Resolution, the Columbia Prior Lien Resolution and the Project 3 Prior Lien Resolution to add a covenant of Energy Northwest that it shall take such actions as are necessary to enforce the provisions of the Assignment Agreements relating to Project 1, Columbia and Project 3, respectively, and the agreements of Bonneville with respect to the disposition of the respective Project 1, Columbia and Project 3 properties following a termination of such Projects. (See "SECURITY FOR THE NET BILLED BONDS — Net Billing Agreements" in this Official Statement for a description of such agreements.) Each of the Prior Lien Resolutions is also amended to add a covenant by Energy Northwest with respect to the Project 1 Prior Lien Bonds, Columbia Prior Lien Bonds and Project 3 Prior Lien Bonds issued prior to the date of adoption of the amending resolution to the effect that, in exercising any rights it may have to redeem such Bonds at par under the extraordinary redemption provisions relating to such Bonds in the event of a termination of the related Project, it will only redeem such Bonds from the proceeds, if any, received by Energy Northwest from the sale or other disposition of Project 1, Columbia or Project 3 properties, as the case may be, and, in the case of the Project 1 and Project 3 Prior Lien Bonds, from amounts, if any, then on deposit in the Construction Fund established under the Project 1 Prior Lien Resolution or the Project 3 Prior Lien Resolution, as the case may be. Such amendments became effective immediately upon effectiveness of the respective 1989A Supplemental Resolutions and Columbia 1990A Supplemental Resolution in accordance with their terms.

*Springing Amendments:* The Project 1 1989A Supplemental Resolution effects various amendments to the Project 1 Prior Lien Resolution which became effective when the Project 1 Prior Lien Bonds issued prior to the adoption of the Project 1 1989A Supplemental Resolution ceased to be outstanding. The Columbia 1990A Supplemental Resolution effects various amendments to the Columbia Prior Lien Resolution which became effective when the Columbia Prior Lien Bonds issued prior to the adoption of the Columbia 1990A Supplemental Resolution ceased to be outstanding.

The Project 3 1989A Supplemental Resolution effects various amendments to the Project 3 Prior Lien Resolution which became effective when the Project 3 Prior Lien Bonds issued prior to the adoption of the Project 3 1989A Supplemental Resolution ceased to be outstanding.

The 1989A Supplemental Resolutions and the Columbia 1990A Supplemental Resolution amend the Prior Lien Resolutions to add the defined terms summarized below to each such Prior Lien Resolution, such amendments to become effective as described above. As used below, the term "Bonds" refers to the Project 1 Prior Lien Bonds, the Columbia Prior Lien Bonds and the Project 3 Prior Lien Bonds.

*"Credit Facility"* means a letter of credit, revolving credit agreement, standby bond purchase agreement, surety bond, insurance policy or similar obligation or instrument which provides for payment of all or a portion of the Principal Installments or interest due on any Series of Bonds or provides funds for the purchase of such Bonds or portions thereof.

*"Qualified Credit Facility"* means a Credit Facility (A) which provides funds for (1) the direct payment of the Principal Installments of and interest on such Bonds when due or (2) the payment of the Principal Installments of and interest on such Bonds in the event amounts otherwise pledged to the payment thereof are not available when due

and (B) which (1) requires Energy Northwest to directly reimburse the issuer of such Credit Facility for amounts paid thereunder and (2) provides that such obligation is a Parity Reimbursement Obligation.

*“Financial Guaranties”* means one or more of the following: (A) letters of credit, lines of credit or other similar credit facilities issued by banking institutions the senior long-term debt obligations of which (or the holding company of any such banking institution) are (at the time of issue of such credit facility) rated in one of the two highest rating categories by Moody’s Investors Service Inc. and by Standard & Poor’s Corporation; or (B) a policy or policies of insurance or surety bond or bonds issued by municipal bond insurers the obligations insured by which are eligible for a rating in one of the two highest rating categories by Moody’s Investors Service Inc. and by Standard & Poor’s Corporation; in each case providing for the payment of sums for the payment of Principal Installments of and interest on Bonds in the manner provided in the supplemental resolution authorizing such Bonds.

*“Parity Reimbursement Obligation”* means a Reimbursement Obligation, the payment of which is secured by a lien on the revenues, receipts, profits, income and other moneys pledged by the applicable Prior Lien Resolution on a parity with the lien created by the applicable Prior Lien Resolution in favor of Bonds issued thereunder. *“Reimbursement Obligation”* means the obligation of Energy Northwest to directly reimburse the issuer of a Credit Facility for amounts paid by such issuer thereunder.

*“Principal Installment”* means, as of any date of calculation and with respect to any Series of Bonds, so long as any such Bonds are outstanding, (A) the principal amount (including (1) any amount designated in, or determined pursuant to, the applicable supplemental resolution as the “principal amount” with respect to any Bonds which do not pay full current interest for all or any part of their term, and (2) the principal amount of any Parity Reimbursement Obligation) of such Series of Bonds due on a certain future date for which no sinking fund payments for the retirement of term bonds in advance of maturity have been established, or (B) the unsatisfied balance of any such sinking fund payments due on a certain future date for Bonds of such Series, or (C) if such future dates coincide as to different Bonds of such Series, the sum of such principal amount of Bonds and of such unsatisfied balance of sinking fund payments due on such future date.

The 1989A Supplemental Resolutions and Columbia 1990A Supplemental Resolution also affect the amendments to the Prior Lien Resolutions, which take effect as described above and which are summarized below.

The Prior Lien Resolutions are amended to: (i) authorize the issuance of Project 1, Columbia and Project 3 Prior Lien Bonds, respectively, payable from and secured by a Qualified Credit Facility and to permit the creation of Parity Reimbursement Obligations with respect to such Qualified Credit Facility payable on a parity with the related Net Billed Bonds and secured by an equal charge and lien on the revenues of the related Net Billed Project; (ii) provide that no amount need be deposited in the Reserve Account for any Prior Lien Bonds the principal of and interest on which is payable from and secured by a Qualified Credit Facility; (iii) provide that the deposit required to be made into the reserve account established for any Prior Lien Bonds may be satisfied by depositing Financial Guaranties in such reserve account; and (iv) provide that, in connection with the issuance of any refunding Project 1, Columbia or Project 3 Prior Lien Bonds, the amount, if any, required to be deposited in the reserve account established for such Bonds may be accomplished through the transfer of all or a portion of the moneys on deposit in the reserve account for the Project 1, Columbia or Project 3 Prior Lien Bonds (as the case may be) being refunded, whether or not such Bonds being refunded constitute all of the remaining outstanding Project 1, Columbia or Project 3 Prior Lien Bonds of a Series of such Bonds.

Resolution No. 565 and Resolution No. 566, each adopted by the Board of Directors of Energy Northwest on December 7, 1989, and Columbia 1990A Supplemental Resolution provide that, unless Financial Guaranty Insurance Company consents to the deposit of a Financial Guaranty in a reserve account, certain requirements must be met as a condition to any such deposit.

The Prior Lien Resolutions are also amended to provide, in connection with the issuance of refunding Project 1, Columbia or Project 3 Prior Lien Bonds, that amounts on deposit in the Interest Account representing interest accrued on refunded Project 1, Columbia or Project 3 Prior Lien Bonds (as the case may be) no longer deemed outstanding under the applicable Prior Lien Resolution may be withdrawn on the date such refunded Bonds cease to be outstanding and may be transferred to a separate trust fund established with the applicable Bond Fund Trustee or Paying Agent to pay when due interest on such refunded Bonds.

The Prior Lien Resolutions each provide that upon the happening of an Event of Default thereunder, and prior to such Event of Default having been remedied, either the applicable Bond Fund Trustee or the holders of not less than 20% in principal amount of the Project 1 Prior Lien Bonds, the Columbia Prior Lien Bonds or the Project 3 Prior Lien Bonds (as the case may be) then outstanding under the applicable Resolution may declare the principal of all the Bonds then outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and be immediately due and payable. The Prior Lien Resolutions are amended to provide that the right of the applicable Bond Fund Trustee, or the holders of not less than 20% in principal amount of the related Prior Lien Bonds then outstanding, to declare the principal of all the related Prior Lien Bonds then outstanding, and the interest accrued thereon, to be due and payable immediately, as aforesaid, shall be available only if there shall occur and be continuing an Event of Default involving failure to pay amounts required to be

paid into the related Revenue Fund, failure to pay principal of, premium, if any, or interest on the related Prior Lien Bonds or the bankruptcy or insolvency of Energy Northwest, or appointment of a receiver for the properties of the related Net Billed Project. See “Events of Default; Remedies” in this Appendix G-2 for a description of the Events of Default under the Prior Lien Resolutions and the Events of Default to which such amendments are applicable.

The Prior Lien Resolutions are also amended to clarify the right of Energy Northwest, in the event of a termination of Project 1, Columbia or Project 3, to sell or otherwise dispose of the properties of such terminated Project without first having to provide for the payment of the outstanding related Prior Lien Bonds.

In addition, the Project 1 1989A Supplemental Resolution and Columbia 1990A Supplemental Resolution amend the Project 1 Prior Lien Resolution and Columbia Prior Lien Resolution, respectively, to permit the adoption of supplemental resolutions, with the consent of the Bond Fund Trustee for the related Project, to cure any ambiguity or defect or inconsistent provision in the related Prior Lien Resolution or to insert such provisions clarifying matters or questions arising under the related Prior Lien Resolution as are necessary or desirable and, in the case of the Project 1 Prior Lien Resolution, either (1) not contrary to or inconsistent with such Prior Lien Resolution as theretofore in effect or (ii) not adverse to the rights and interests of the holders of the Project 1 Prior Lien Bonds or, in the case of the Columbia Prior Lien Resolution, not adverse to the rights and interests of the holders of the Columbia Prior Lien Bonds.

In connection with the refunding of the balance of the Project 1 and 3 Prior Lien Bonds issued prior to 1989, and in connection with the Columbia Prior Lien Bonds issued prior to 1990, the Project 1, Columbia and Project 3 Prior Lien Resolutions were amended to provide that the applicable Bond Fund Trustee shall, after making the required transfers of investment income to the applicable Revenue Fund, transfer the balance remaining on deposit in the applicable Interest Account, Principal Account, Bond Retirement Account and the Reserve Account, as directed by Energy Northwest, to the trustee of the applicable trust fund established to pay the principal of, and redemption premium, if any, and interest on the related Prior Lien Bonds, for deposit into such separate trust fund or, to the extent not so transferred, to the applicable bond fund trustee of each bond fund established for bonds issued from and after 1989 and 1990, respectively, pursuant to the applicable Prior Lien Resolution and then outstanding, for deposit to the credit of the interest account therein in the same proportion as the amount of interest due on the next succeeding interest payment date of such series of bonds bears to the total amount of interest due on such next succeeding interest payment date on all such series of additional bonds.

#### **Construction Fund**

The Project 1 Prior Lien Resolution establishes an Energy Northwest Project No. 1 Construction Fund and a Construction Interest Account and a Fuel Account therein, to be held by the Construction Fund Trustee. U.S. Bank Trust National Association is Construction Fund Trustee under the Project 1 Prior Lien Resolution.

The Project 3 Prior Lien Resolution establishes an Energy Northwest Nuclear Project No. 3 Construction Fund to be held in trust by Energy Northwest.

The Project 3 Prior Lien Resolution provides that if working capital is not provided for by September 1, 1982, or if a Reserve and Contingency Fund requirement of \$3,000,000 is not provided for by the Date of Commercial Operation, through revenues received pursuant to the Project 3 Net Billing Agreements, such amounts will be provided from Project 3 Prior Lien Bond proceeds, including moneys then on deposit in the Project No. 3 Construction Fund.

The proceeds of sale of subsequent Series of Project 1 or Project 3 Prior Lien Bonds issued to pay the Cost of Construction of the related Net Billed Project will be applied as follows:

- (a) An amount equal to the interest accrued on such Series of Prior Lien Bonds from their date to the date of their delivery to the initial purchasers will be credited, in the case of Project 1 Prior Lien Bonds, to the interest Account in the Construction Fund for Project 1 or, in the case of Project 3 Prior Lien Bonds, to the Interest Account in the Bond Fund for Project 3;
- (b) Except as otherwise authorized pursuant to the amendments described under “Effect of Amendments Adopted September 4, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)” above, an amount equal to the largest amount of interest required to be paid on such Series of Prior Lien Bonds during any six-month period from the date of such Bonds to the final maturity date thereof will be credited to the Reserve Account in the Bond Fund for the related Net Billed Project if such amount is not funded by revenues of the related Net Billed Project;
- (c) In the case of Project 1 Prior Lien Bonds, such amounts as Energy Northwest determines will be credited to the Fuel Account in the Construction Fund for Project 1; and
- (d) The balance of such Bond proceeds will be deposited in the Construction Fund for the respective Net Billed Project, provided a part of such proceeds may be deposited in the Revenue Fund for such Net Billed Project as required for additional working capital.

Moneys in each Net Billed Project Construction Fund are to be used to pay Energy Northwest’s Cost of Construction of such Net Billed Project, which includes costs of constructing and acquiring such Project, obtaining permits and licenses and acquiring property and fuel, trustees’ and paying agents’ fees, taxes and insurance premiums, the cost of engineering services and

administrative and overhead expenses of Energy Northwest allocable to the acquisition and construction of such Project. The cost of acquiring fuel for each Net Billed Project will be paid from such Project's Fuel Fund.

Each Prior Lien Resolution prescribes certain procedures designed to safeguard payments or transfers from each Net Billed Project's Construction Fund, including, among others, certificates by the appropriate Construction Engineer and, for Project 1, a detailed itemization by Energy Northwest of the amounts to be paid and the purposes thereof.

Moneys remaining in a Net Billed Project Construction Fund after providing for the payment of all Costs of Construction, in the case of Project 1, and all of Energy Northwest's Costs of Construction, in the case of Project 3, and after required payments, if any, to other accounts, are to be transferred to such Project's Bond Retirement Account.

#### **Other Funds Established by the Prior Lien Resolutions; Flow of Revenues**

In addition to the Construction Fund, each Prior Lien Resolution establishes a separate Revenue Fund, Fuel Fund, and Reserve and Contingency Fund. Each Prior Lien Resolution also establishes a Bond Fund (including an Interest Account, a Principal Account, a Bond Retirement Account, and a Reserve Account) from which payments are to be made with respect to the related Prior Lien Bonds issued to pay the Cost of Construction of the related Net Billed Project. A separate bond fund, including an interest account, a principal account (if applicable), a bond retirement account (if applicable), and a reserve account, is required to be established for each Series of additional Prior Lien Bonds issued for purposes other than paying the Cost of Construction of the related Net Billed Project. All such funds are to be held by Energy Northwest, except for the Project No. 1 Construction Fund, the Project No. 1 Bond Fund, the Columbia Bond Fund, the Project No. 3 Bond Fund and the separate bond funds (collectively, the "Bond Funds"), each of which is to be held by the appropriate Bond Fund Trustee.

*Project No. 1 Revenue Fund:* All income, revenues, receipts, and profits derived by Energy Northwest from its ownership and operation of Project 1 are to be paid into the Project No. 1 Revenue Fund. Moneys in such Revenue Fund are to be used solely for the purpose of making required payments into the Hanford Project Revenue Fund, paying the principal of and premium, if any, and interest on the Project 1 Prior Lien Bonds, paying for the costs of operating and maintaining Project 1, making required payments into the Project No. 1 Fuel Fund and Reserve and Contingency Fund, making repairs, renewals, replacements, additions, betterments and improvements to and extensions of Project 1, and paying all other charges or obligations against the revenues pledged to the Project No. 1 Revenue Fund.

*Project No. 1 Bond Funds:* From the revenues theretofore paid into the Project No. 1 Revenue Fund, Energy Northwest is to pay monthly into the Project No. 1 Bond Funds, after making the required payments, if any, to the Hanford Project Revenue Fund, fixed amounts sufficient in the aggregate to pay the principal of and premium, if any, and interest on the Project 1 Prior Lien Bonds as the same become due and payable.

There is required to be paid into and maintained in the Project No. 1 Reserve Account, for each Series of outstanding Project 1 Prior Lien Bonds issued to pay costs of construction, and in separate reserve accounts, for each Series of outstanding Project 1 Prior Lien Bonds issued for other purposes, an amount equal to the largest amount of interest on such Bonds during any six-month period from the date of such Bonds to the final maturity date thereof. Energy Northwest is required to maintain the required amount in the reserve accounts by payments from the Project No. 1 Revenue Fund. See "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)" in this Appendix G-2 for a description of amendments to certain of the provisions described above.

*Project No. 1 Fuel Fund:* Beginning on the Date of Commercial Operation, all payments for fuel for Project 1 will be made from the Project No. 1 Fuel Fund. After the Date of Commercial Operation, after making the required payments, if any, into the Hanford Project Revenue Fund and Project No. 1 Bond Funds and after paying or making provision for payment of the reasonable and necessary costs of operating and maintaining Project 1, including taxes or payments in lieu thereof, Energy Northwest will transfer from the Project No. 1 Revenue Fund to said Fuel Fund the following amounts:

- (i) the amount included in the annual budget for fuel adopted pursuant to the Project 1 Project Agreement,
- (ii) all amounts received by Energy Northwest as fuel credits, including the proceeds of the sale of fuel creditable to operations, and
- (iii) any additional amounts necessary to avoid a deficiency in the Project No. 1 Fuel Fund.

Upon termination of Project 1 in accordance with the Project 1 Project Agreement, the Project 1 Prior Lien Resolution required that the unobligated balance in the Project No. 1 Fuel Fund be transferred into the Project No. 1 Revenue Fund.

*Project No. 1 Reserve and Contingency Fund:* Since September 25, 1980, Energy Northwest has been required to pay monthly out of the Project No. 1 Revenue Fund into the Project No. 1 Reserve and Contingency Fund, after making the required payments, if any, into the Hanford Project Revenue Fund and the Project No. 1 Bond Funds, paying or making provision for payment of the reasonable and necessary costs of operating and maintaining Project 1, including taxes or payments in lieu thereof, and making the required payments in the Project No. 1 Fuel Fund, an amount equal to 10% of the aggregate of the

amounts required to be paid during such month into the Interest, Principal and Bond Retirement Accounts in the Project No. 1 Bond Funds.

*Columbia Revenue Fund:* All income, revenues, receipts, and profits derived by Energy Northwest from its ownership and operation of Columbia are to be paid into the Columbia Revenue Fund. Moneys in the Columbia Revenue Fund are to be used for the purpose of making required payments into the Columbia Bond Funds, paying for the costs of operating and maintaining Columbia, making required payments into the Columbia Fuel Fund and the Columbia Reserve and Contingency Fund, paying the costs of repairs, renewals, replacements, additions, betterments and improvements to and extensions of Columbia, and paying all other charges or obligations against the revenues pledged to the Columbia Revenue Fund.

*Columbia Bond Funds:* From the revenues theretofore paid into said Revenue Fund, Energy Northwest is to pay monthly into the Columbia Bond Funds fixed amounts sufficient in the aggregate to pay the principal of and premium, if any, and interest on Columbia Prior Lien Bonds as the same become due and payable.

There is required to be paid into and maintained in the Columbia Reserve Account, for each Series of outstanding Columbia Prior Lien Bonds issued to pay costs of construction, and in separate reserve accounts, for each Series of outstanding Columbia Prior Lien Bonds issued for other purposes, an amount equal to the largest amount of interest on such Bonds during any six-month period from the date of such Bonds to the final maturity date thereof. The reserve account requirement for additional Columbia Prior Lien Bonds shall be deposited from Columbia Prior Lien Bond proceeds or revenues available therefor at the time of issuance of such Bonds. Energy Northwest is required to maintain the required amount in said reserve accounts by payments from the Columbia Revenue Fund. See "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)" in this Appendix G-2 for a description of amendments to certain of the provisions described above, which amendments will become effective in the future.

*Columbia Fuel Fund:* All payments for fuel for Columbia have been made, since the Date of Commercial Operation of Columbia, and will continue to be made, from the Columbia Fuel Fund. After making the required payments into the Columbia Bond Funds and after paying or making provision for payment of the reasonable and necessary costs of operating and maintaining Columbia, including taxes or payments in lieu thereof, Energy Northwest will transfer from the Columbia Revenue Fund to said Fuel Fund the following amounts:

- (1) the amount included in the annual budget for fuel adopted pursuant to the Columbia Net Billing Agreement,
- (2) all amounts received by Energy Northwest from fuel credits, including the proceeds of the sale of fuel creditable to operations, and
- (3) any additional amounts necessary to avoid a deficiency in said Fuel Fund.

If Columbia is terminated pursuant to the Columbia Project Agreement, the Columbia Prior Lien Resolution requires that the balance in the Columbia Fuel Fund be transferred into the Columbia Revenue Fund.

*Columbia Reserve and Contingency Fund:* Since September 5, 1977, Energy Northwest has been required to pay monthly out of the Columbia Revenue Fund into the Columbia Reserve and Contingency Fund, after making the required payments into the Columbia Bond Funds, paying or making provisions for payment of the reasonable and necessary costs of operating and maintaining Columbia, and making the required payments into the Columbia Fuel Fund, an amount equal to 10% of the aggregate of the amounts required to be paid during such month from said Revenue Fund into the Interest, Principal, and Bond Retirement Accounts in the Columbia Bond Funds.

*Project No. 3 Revenue Fund:* All income, revenues, receipts, and profits derived by Energy Northwest from its ownership and operation of Project 3 are to be paid into the Project No. 3 Revenue Fund. Moneys in the Project No. 3 Revenue Fund are to be used for the purpose of making required payments into the Project No. 3 Bond Funds, paying for Energy Northwest's costs of operating and maintaining Project 3, making required payments into the Project No. 3 Fuel Fund and the Project No. 3 Reserve and Contingency Fund, paying Energy Northwest's costs of repairs, renewals, replacements, additions, betterments and improvements to and extensions of Project 3, and paying all other charges or obligations against the revenues pledged to the Project No. 3 Revenue Fund.

*Project No. 3 Bond Funds:* From the revenues theretofore paid into said Revenue Fund, Energy Northwest is to pay monthly into the Project No. 3 Bond Funds fixed amounts sufficient in the aggregate to pay the principal of and premium, if any, and interest on the Project 3 Prior Lien Bonds as the same become due and payable.

There is required to be paid into and maintained in the Project No. 3 Reserve Account, for each Series of outstanding Project 3 Prior Lien Bonds issued to pay costs of construction, and in separate reserve accounts, for each Series of outstanding Project 3 Prior Lien Bonds issued for other purposes, an amount equal to the largest amount of interest on such Bonds during any six month period from the date of such Bonds to the final maturity date thereof. Energy Northwest is required to maintain the required amount in the reserve accounts by payments from the Project No. 3 Revenue Fund. See "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)" in this Appendix G-2 for a description of amendments to certain of the provisions described above.

*Project No. 3 Fuel Fund:* Beginning on the Date of Commercial Operation, all payments for fuel for Project No. 3 will be made from the Project No. 3 Fuel Fund. After the Date of Commercial Operation, after making the required payments into the Project No. 3 Bond Funds and after paying or making provision for payment of Energy Northwest's reasonable and necessary costs of operating and maintaining Project 3, including taxes or payments in lieu thereof, Energy Northwest will transfer from the Project No. 3 Revenue Fund to said Fuel Fund the following amounts:

- (1) the amount included in the annual budget for fuel adopted pursuant to the Project 3 Project Agreement,
- (2) all amounts received by Energy Northwest from fuel credits, including the proceeds of the sale of fuel creditable to operations, and
- (3) any additional amounts necessary to avoid a deficiency in said Fuel Fund.

Upon termination of Project 3 pursuant to the Project 3 Project Agreement, the Project 3 Prior Lien Resolution required that the unobligated balance in the Project No. 3 Fuel Fund be transferred into the Project No. 3 Revenue Fund.

*Project No. 3 Reserve and Contingency Fund:* Since September 25, 1982, Energy Northwest has been required to pay monthly out of the Project No. 3 Revenue Fund into the Project No. 3 Reserve and Contingency Fund, after making the required payments into the Project No. 3 Bond Funds, paying or making provision for payment of Energy Northwest's reasonable and necessary costs of operating and maintaining Project 3, and making the required payments into the Project No. 3 Fuel Fund, an amount equal to 10% of the aggregate of the amounts required to be paid during such month from said Revenue Fund into the Interest, Principal and Bond Retirement Accounts in the Project No. 3 Bond Funds.

Moneys in each Net Billed Project's Reserve and Contingency Fund are required to be used to make up deficiencies in the respective Project's Bond Funds for which funds are not available in the respective Project's Construction Fund or Reserve Accounts. To the extent not required for any such deficiency, moneys in each Project's Reserve and Contingency Fund may be used after the respective Date of Commercial Operation for any one or more of the following purposes:

- (i) To pay the cost of renewals, replacements and normal additions to and extensions of such Net Billed Project; and
- (ii) To pay extraordinary operation and maintenance costs, including extraordinary costs of fuel and the cost of preventing or correcting any unusual loss or damage (including major repairs) to such Project.

*Investment of Funds:* The term "Investment Securities", as defined in the Project 1 Prior Lien Resolution, the Columbia Prior Lien Resolution and the Project 3 Prior Lien Resolution, means (i) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States of America; (ii) general obligation bonds of any state of the United States rated by a nationally recognized bond rating agency in either of the two highest rating categories assigned by such rating agency; (iii) bonds, debentures, notes or participation certificates issued by the Bank for Cooperatives, the Federal Intermediate Credit Bank, the Federal Home Loan Bank System, the Export-Import Bank of the United States, Federal Land Banks or the Federal National Mortgage Association or of any agency of or corporation wholly owned by the United States of America; (iv) in the case of the Project 1 Prior Lien Resolution and the Columbia Prior Lien Resolution, Public Housing Bonds or Project Notes issued by Public Housing Authorities and fully secured as to the payment of both principal and interest by a pledge of annual contributions to be paid by the United States of America or any agency thereof and, in the case of the Project 3 Prior Lien Resolution, New Housing Authority Bonds or Project Notes issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a pledge of annual contributions to be paid by the United States of America or any agency thereof; (v) bank time deposits evidenced by certificates of deposit, and, in the case of the Project 1 Prior Lien Resolution and the Project 3 Prior Lien Resolution, by bankers' acceptances, in each case, issued by any bank, trust company or national banking association authorized to do business in the State of Washington, which is a member of the Federal Reserve System, provided that the aggregate of such bank time deposits and, in the case of the Project 1 or Project 3 Prior Lien Resolution, bankers' acceptances issued by any bank, trust company or banking association do not exceed at any time, in the case of the Project 1 Prior Lien Resolution and the Project 3 Prior Lien Resolution, fifty per centum (50%) of the aggregate of the capital stock, surplus and undivided profits of such bank, trust company or banking association and, in the case of the Columbia Prior Lien Resolution, twenty-five per centum (25%) of the total of the capital stock and surplus of such bank, trust company or banking association; (vi) in the case of the Project 1 Prior Lien Resolution and the Project 3 Prior Lien Resolution, bank time deposits evidenced by certificates of deposit, and bankers' acceptances, issued by any bank, trust company or national banking association authorized to do business in any state of the United States of America other than the State of Washington, which is a member of the Federal Reserve System, provided that the aggregate of such bank time deposits and bankers' acceptances issued by any bank, trust company or banking association do not exceed at any one time twenty-five per centum (25%) of the aggregate of the capital stock, surplus and undivided profits of such bank, trust company or banking association and provided further that such capital stock, surplus and undivided profits shall not be less than Fifty Million Dollars (\$50,000,000); and (vii) in the case of the Project 1 Prior Lien Resolution, evidences of indebtedness issued by any corporation organized and existing under the laws of any state of the United States of America rated by any nationally recognized bond rating agency in either of the two highest rating categories assigned by such rating agency.

Moneys in the Project No. 1 Revenue Fund not required for immediate disbursement are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable at or prior to the estimated time for disbursement of such moneys. Moneys in the Project No. 1 Interest Accounts, Principal Accounts and Bond Retirement Accounts are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable on or before the respective dates when such moneys will be required for the purposes intended. Except as otherwise described below, moneys in the Project No. 1 Reserve Accounts not required for immediate disbursement are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable within seven years from the date of investment (but maturing prior to the final maturity date of the Project 1 Prior Lien Bonds). Moneys in the Project No. 1 Fuel Fund and Reserve and Contingency Fund not required for immediate disbursement are to be invested in Investment Securities maturing or redeemable within seven years from the date of investment (but maturing prior to the final maturity date of the Project 1 Prior Lien Bonds). Moneys in the Project No. 1 Construction Fund are to be invested by the Project No. 1 Construction Fund Trustee in Investment Securities maturing or redeemable within five years of the date of investment.

Moneys in the Columbia Revenue Fund not required for immediate disbursement are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable at or prior to the estimated time for the disbursement of such moneys. Moneys in the Columbia Interest Accounts, Principal Accounts and Bond Retirement Accounts are to be invested in Investment Securities described in clauses (i) through (iv) above maturing on or before the respective dates when such moneys will be required for the purposes intended. Except as otherwise described below, moneys in the Columbia Reserve Accounts not required for immediate disbursement are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable within seven years from the date of investment (but maturing prior to the final maturity date of the Columbia Prior Lien Bonds). Moneys in the Columbia Fuel Fund and Reserve and Contingency Fund not required for immediate disbursement are to be invested in Investment Securities maturing or redeemable within two years from the date of investment with respect to the Fuel Fund and within seven years from the date of investment with respect to the Reserve and Contingency Fund (but in each case maturing prior to the final maturity date of the Columbia Prior Lien Bonds).

Moneys in the Project No. 3 Revenue Fund not required for immediate disbursement are to be invested in Investment Securities maturing or redeemable at or prior to the estimated time for the disbursement of such moneys. Moneys in the Project No. 3 Interest Accounts, Principal Accounts and Bond Retirement Accounts are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable on or before the respective dates when such moneys will be required for the purposes intended. Except as otherwise described below, moneys in the Project No. 3 Reserve Accounts not required for immediate disbursement are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable within seven years from the date of investment (but maturing prior to the final maturity date of the Project 3 Prior Lien Bonds). Moneys in the Project No. 3 Fuel Fund and Reserve and Contingency Fund not required for immediate disbursement are to be invested in Investment Securities maturing or redeemable within seven years from the date of investment (but maturing prior to the final maturity date of the Project 3 Prior Lien Bonds). Moneys in the Project No. 3 Construction Fund are to be invested in Investment Securities maturing or redeemable within seven years of the date of investment.

In the case of certain Refunding Bonds, the supplemental resolutions authorizing such Refunding Bonds provide that moneys on deposit in the related Project's reserve account in the bond fund established for such Refunding Bonds and not required for immediate disbursement are to be invested in Investment Securities described in clauses (i) through (iv) above maturing or redeemable at the option of the holder thereof on or prior to the final maturity date of such Refunding Bonds.

*Excess Moneys:* Moneys and the value of Investment Securities in each Project's Reserve and Contingency Fund in excess of \$3,000,000 plus the commitments or obligations incurred by, or the requirements of Energy Northwest for, any of the purposes for which such Reserve and Contingency Funds may be used constitute "excess moneys" in respect of such Fund; and moneys and the value of Investment Securities described in clauses (i) through (iv) in this Appendix G-2 under "Investment of Funds" in each Project's Reserve Accounts in excess of the amounts required to be maintained in said Reserve Accounts constitute "excess moneys" in respect of such Accounts.

If as of any June 30, excess moneys exist in the Reserve and Contingency Fund for any Net Billed Project, such moneys shall be paid proportionately into such Project's Reserve Accounts, to the extent of any deficiency therein, and the balance of such excess moneys shall be paid into such Project's Revenue Fund.

If as of any June 30, excess moneys exist in the Reserve Account in the Bond Fund for any Net Billed Project, such moneys shall be paid proportionately into such Project's other reserve accounts in the separate bond funds, to the extent of any deficiency therein, and the balance of such excess moneys shall be paid into such Project's Revenue Fund.

If as of June 30, there shall exist in any Net Billed Project's Revenue Fund, after giving effect to any transfer of excess moneys from such Project's Reserve Account and Reserve and Contingency Fund to such Fund, an amount which exceeds Energy Northwest's required amount of working capital for such Project, the amount of such excess is to be applied to reduce annual power costs under the related Net Billing Agreements. The "required amount of working capital" shall be \$3,000,000 or, in the case of the Project 1 and 3 Prior Lien Resolutions, such greater amount, and, in the case of the Columbia Prior Lien Resolution, such lesser amount (but not less than \$2,000,000) or such greater amount, as may be decided upon by Energy Northwest and Bonneville with the approval of the Consulting Engineer. In addition, if Energy Northwest and Bonneville agree, all or any part of such excess over required working capital for a Net Billed Project may be applied to the making of repairs,

renewals, replacements, additions, betterments and improvements to, and extensions of, such Project, the purchase or redemption of Bonds for such Project or for other purposes in connection with such Project.

#### **Certain Covenants**

Certain covenants of Energy Northwest with the holders of the Prior Lien Bonds are summarized as follows:

*The Hanford Project:* Under the Project 1 Prior Lien Resolution, Energy Northwest covenants that it (a) will not issue any evidences of indebtedness under Resolution No. 178 so long as the obligations of said resolution are satisfied under the Project 1 Prior Lien Resolution, (b) will discharge all of its duties and obligations under Resolution No. 178, (c) will make all payments and deposits to be made under the provisions of Resolution No. 178 from moneys to be provided pursuant to the Project 1 Prior Lien Resolution if and to the extent such obligations are not otherwise provided for, (d) will, on each December 31, apply any excess of amounts in the Hanford Project Revenue Fund over the required amount of working capital to reduce the amounts required by the Project 1 Prior Lien Resolution to be deposited in the Hanford Project Revenue Fund, and (e) will not amend Resolution No. 178 in any manner which adversely affects the rights of Bondholders under the Project 1 Prior Lien Resolution.

*The Net Billed Projects:* Energy Northwest covenants that it will, subject to the Project Agreements for each of the Net Billed Projects, complete construction of the Net Billed Projects at the earliest practicable time, operate such Projects and the business in connection therewith in an efficient manner and at reasonable cost, maintain such Projects in good condition and make all necessary and proper repairs, renewals, replacements, additions, extensions and betterments to such Projects.

*Rates:* Energy Northwest covenants that it will dispose of all capability of and power and energy from Project 1 solely for the benefit and account of such Project and pursuant to the provisions of the Project 1 Net Billing Agreements; and Energy Northwest covenants that it will maintain and collect rates and charges for capability, power and energy and other services, facilities and commodities sold, furnished or supplied through such Project, which will be adequate, whether or not the generation or transmission of power by such Project is suspended, interrupted or reduced for any reason whatever, to provide revenues sufficient, among other things, (i) to make the required payments into the Hanford Project Revenue Fund, (ii) to pay the expenses of operating and maintaining Project 1, (iii) to make the required payments into the Project No. 1 Bond Funds and (iv) to make the required payments into the Project No. 1 Fuel Fund and Project No. 1 Reserve and Contingency Fund.

Energy Northwest covenants that it will dispose of all capability of and power and energy from Columbia solely for the benefit and account of such Project and pursuant to the provisions of the Columbia Net Billing Agreements; and Energy Northwest covenants that it will maintain and collect rates and charges for power and energy, including capability, and other services, facilities, and commodities sold, furnished, or supplied through such Project, which will be adequate, whether or not the generation or transmission of power by the Project is suspended, interrupted, or reduced for any reason whatever, to provide revenues sufficient, among other things, (i) to pay the expenses of operating and maintaining such Project, (ii) to make the required payments into the Columbia Bond Funds, and (iii) to make the required payments into the Columbia Fuel Fund and the Columbia Reserve and Contingency Fund.

Energy Northwest covenants that it will dispose of all capability of and power and energy from Project 3 solely for the benefit and account of such Project and pursuant to the provisions of the Project 3 Net Billing Agreements and the Project 3 Power Sales Agreement; and Energy Northwest covenants that it will maintain and collect rates and charges for power and energy, including capability, and other services, facilities and commodities sold, furnished or supplied by such Project, which will be adequate, whether or not the generation or transmission of power by the Project is suspended, interrupted or reduced for any reason whatever, to provide revenues sufficient, among other things, (i) to pay Energy Northwest's expenses of operating and maintaining such Project, (ii) to make the required payments into the Project No. 3 Bond Funds, and (iii) to make the required payments into the Project No. 3 Fuel Fund and Project No. 3 Reserve and Contingency Fund.

*Net Billing Agreements and Project Agreements:* Energy Northwest covenants that it will not voluntarily consent to any amendment or permit any rescission of or take any action under or in connection with any of the Project Agreements or the Net Billing Agreements which will in any manner impair or adversely affect the rights of Energy Northwest or any of its Bondholders, or take any action under or in connection with the Net Billing Agreements which will reduce the payments provided for therein.

*Disposition of Properties:* Energy Northwest covenants that it will not sell, mortgage, lease or otherwise dispose of any properties of Project 1 except that (a) Energy Northwest may sell, lease or otherwise dispose of such properties if simultaneous provision is made for the payment of cash into the Hanford Project Revenue Fund and the Project No. 1 Bond Funds sufficient to retire all of the Project 1 Prior Lien Bonds and the Hanford Project Bonds and to pay interest accrued thereon or (b) Energy Northwest may sell, lease or otherwise dispose of any portion of the works, plants, and facilities of Project 1 and any real or personal property comprising a part thereof which is unserviceable, inadequate, obsolete or no longer required for use in connection with the operation of Project 1, in which case \$100,000 of the moneys received therefor is to be transferred to the Project No. 1 Reserve and Contingency Fund and the balance is to be paid proportionately into the Project No. 1 Bond Retirement Accounts unless such disposition is in connection with the replacement of such properties or the disposition of fuel, in which case all moneys received from such disposition are to be transferred to the Project No. 1 Reserve and Contingency Fund or the Project No. 1 Fuel Fund, respectively, or (c) in the event that the ownership of such properties in whole or in part is



transferred by operation of law, moneys received therefor are to be paid proportionately into the Project No. 1 Bond Retirement Accounts.

Energy Northwest covenants that it will not sell, mortgage, lease or otherwise dispose of any properties of Columbia except that (a) Energy Northwest may sell, lease or otherwise dispose of such properties if simultaneous provision is made for the payment of cash into the Columbia Bond Funds sufficient to retire all of the Columbia Prior Lien Bonds and to pay interest accrued thereon or (b) Energy Northwest may sell, lease or otherwise dispose of any portion of the works, plants, and facilities of Columbia and any real or personal property comprising a part thereof which is unserviceable, inadequate, obsolete or no longer required for use in connection with the operation of Columbia, in which case \$50,000 of the moneys received therefor is to be transferred to the Columbia Reserve and Contingency Fund and the balance is to be paid proportionately into the Columbia Bond Retirement Accounts unless such disposition is in connection with the replacement of such properties or the disposition of fuel, in which case all moneys received from such disposition are to be transferred to the Columbia Reserve and Contingency Fund or the Columbia Fuel Fund, respectively, or (c) in the event that the ownership of such properties in whole or in part is transferred by operation of law, moneys received therefor are to be paid proportionately into the Columbia Bond Retirement Accounts.

Energy Northwest covenants that it will not sell, mortgage, lease or otherwise dispose of any properties of Project 3 except that (a) Energy Northwest may sell, lease or otherwise dispose of such properties if simultaneous provision is made for the payment of cash into the Project No. 3 Bond Funds sufficient to retire all of the Project 3 Prior Lien Bonds and to pay interest accrued thereon or (b) Energy Northwest may sell, lease or otherwise dispose of any portion of the works, plants, and facilities of Project 3 and any real and personal property comprising a part thereof which is unserviceable, inadequate, obsolete or no longer required for use in connection with the operation of Project 3, in which case \$100,000 of the moneys received therefor is to be transferred to the Project No. 3 Reserve and Contingency Fund and the balance is to be paid proportionately into the Project No. 3 Bond Retirement Accounts, unless such disposition is in connection with the replacement of such properties or the disposition of fuel, in which case all moneys received from such disposition are to be transferred to the Project No. 3 Reserve and Contingency Fund or the Project No. 3 Fuel Fund, respectively, or (c) in the event that the ownership of such properties in whole or in part is transferred by operation of law, moneys, received therefor are to be paid proportionately into the Project No. 3 Bond Retirement Accounts.

In the case of Project 1 and Project 3, notwithstanding the provisions of clauses (b) and (c) above with respect to said Project, moneys received by Energy Northwest prior to the Date of Commercial Operation for a Net Billed Project as a result of any sale, lease, transfer or other disposition specified therein shall be transferred to such Project's Construction Fund.

See "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)" in this Appendix G-2 for a description of covenants relating to the disposition of properties of a Net Billed Project following termination of such Project.

Energy Northwest covenants that it will keep Project 1, Columbia and Project 3 insured, to the extent such insurance is available at reasonable cost, against risks of direct physical loss or damage to or destruction of each such Project, at least to the extent that similar insurance is usually carried by electric utilities operating like properties, and against accidents, casualties, or negligence, including liability insurance and employer's liability, in the case of Project 1 and Project 3, at least to the extent that similar insurance is usually carried by electric utilities operating like properties.

In the event that any loss or damage to the properties of any Net Billed Project occurs during the period of construction of such Project, Energy Northwest is to transfer the insurance proceeds, if any, in respect of such loss or damage to such Project's Construction Fund; any insurance proceeds received by Energy Northwest in respect of such loss or damage occurring thereafter are to be transferred into such Project's Reserve and Contingency Fund, or, in the case of insurance covering loss or damage to fuel, to such Project's Fuel Fund.

*Books of Account:* Energy Northwest covenants that it will keep proper books of account, showing Project 1, Columbia and Project 3 as separate utility systems in accordance with the rules and regulations of the Division of Municipal Corporations of the State Auditor's office of the State of Washington and in accordance with the Uniform System of Accounts prescribed by the Federal Power Commission. Such books of account are to be audited annually by a firm of independent certified public accountants of national reputation. Bondholders may obtain copies of the annual financial statements showing the financial condition of the Project and the annual audit report by sending a written request therefor to Energy Northwest.

*Consulting Engineer:* Energy Northwest will retain a nationally recognized independent consulting engineer or engineering firm to render continuous engineering counsel in the operation of each Net Billed Project. In addition to his other duties, the Consulting Engineer shall prepare, not later than 18 months after the respective Date of Commercial Operation of each Net Billed Project, and each three years thereafter, a report for each such Project based upon a survey of such Project and the operation and maintenance thereof. Each report is to show, among other things, whether Energy Northwest has satisfactorily performed and complied with certain covenants in the related Prior Lien Resolution. The Consulting Engineer is also required to report to the respective Bond Fund Trustee and Energy Northwest upon the economic soundness and feasibility of all contemplated renewals, replacements, additions, betterments and improvements to, and extensions of, Project 1, Columbia and Project 3 involving an expenditure of, in the case of Projects 1 and 3, \$500,000 or more, and, in the case of Columbia, \$100,000 or more. The Consulting Engineer is also required to file annually a certificate with each Bond Fund Trustee describing the

insurance then in effect for the respective Project and stating whether or not such insurance complies with the requirements of the related Prior Lien Resolution. In the event of any loss or damage, in the case of Projects 1 and 3, in excess of \$500,000, and, in the case of Columbia, in excess of \$100,000, whether or not covered by insurance, the Consulting Engineer is to ascertain the amount of such loss or damage and deliver to Energy Northwest a certificate setting forth the amount and nature of such loss or damage, together with recommendations as to whether or not such loss or damage should be replaced or repaid. Copies of any such triennial report, annual certificate as to insurance or certificate in respect of any such loss or damage will be sent to Bondholders filing with Energy Northwest written requests therefor.

#### **Events of Default; Remedies**

Under each Prior Lien Resolution, the happening of one or more of the following events constitutes an Event of Default: (i) default in the performance of any obligation with respect to payments into the respective Revenue Fund; (ii) default in the payment of the principal of and premium, if any, or default for 30 days in the payment of interest on any of the respective Prior Lien Bonds or any sinking fund installment on any Project 1 or Columbia Prior Lien Bonds; (iii) default for 90 days in the observance and performance of any other of the covenants, conditions and agreements of Energy Northwest in the respective Prior Lien Resolution; (iv) the sale or conveyance of any properties of the respective Net Billed Project except as permitted by the respective Net Billed Resolution or the voluntary forfeiture of any license, franchise, permit or other privilege necessary or desirable in the operation of such Project; (v) the entering by any court of competent jurisdiction of an order, judgment or decree (a) appointing a receiver, trustee or liquidator for Energy Northwest or the whole or any substantial part of the respective Net Billed Project, (b) approving a petition filed against Energy Northwest under Federal bankruptcy laws, or (c) assuming custody or control of Energy Northwest or of the whole or any substantial part of the respective Net Billed Project under the provisions of any other law for the relief or aid of debtors and such order, judgment or decree shall not be vacated or set aside or stayed (or, in case custody or control is assumed by said order, such custody or control shall not be otherwise terminated), within 60 days from the date of the entry of such order, judgment or decree; or (vi) Energy Northwest (a) admits in writing its inability to pay its debts incurred in the ownership and operation of the respective Net Billed Project generally as they become due, (b) files a petition in bankruptcy or seeking a composition of indebtedness, (c) consents to the appointment of a receiver of its creditors, (d) consents to the appointment of a receiver of the whole or any substantial part of the respective Net Billed Project, (e) files a petition or an answer seeking relief under Federal bankruptcy laws, or (f) consents to the assumption by any court of competent jurisdiction under the provisions of any other law for the relief or aid of debtors of custody or control of Energy Northwest or of the whole or any substantial part of the respective Net Billed Project.

If an Event of Default shall have occurred and shall not have been remedied, the respective Bond Fund Trustee or the holders of not less than 20% in principal amount of the respective Prior Lien Bonds then outstanding under the related Prior Lien Resolution, may declare the principal of all such Bonds and the interest accrued thereon to be immediately due and payable, but such declaration may be annulled under certain circumstances.

As described in this Appendix G-2 under "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)," the 1989A Supplemental Resolutions and Columbia 1990A Supplemental Resolution amend the Prior Lien Resolutions to provide that the applicable Bond Fund Trustee or the holders of not less than 20% in principal amount of Project 1 Prior Lien Bonds, Columbia Prior Lien Bonds or Project 3 Prior Lien Bonds (as the case may be) shall have the right to declare the Project 1 Prior Lien Bonds, Columbia Prior Lien Bonds or Project 3 Prior Lien Bonds immediately due and payable only upon the occurrence and continuance of an Event of Default described in clauses (i), (ii), (v), or (vi) in the second preceding paragraph. Such amendments became effective in the case of the Project 1 and Project 3 Prior Lien Resolutions when the Project 1 and Project 3 Prior Lien Bonds issued prior to the adoption of the 1989A Supplemental Resolutions ceased to be outstanding and may become effective in the future in the case of the Columbia Prior Lien Resolution, as described under "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)."

After the occurrence of an Event of Default and prior to the curing of such Event of Default, the Bond Fund Trustee of the Net Billed Project in default may, to the extent permitted by law, take possession and control of such Net Billed Project and operate and maintain the same, prescribe rates for capability or power sold or supplied through the facilities of such Project, collect the gross revenues resulting from such operation and perform all of the agreements and covenants contained in any contract which Energy Northwest is then obligated to perform. Such gross revenues, after payment of reasonable and proper charges, expenses and liabilities paid or incurred by the Bond Fund Trustee and operating expenses of the related Net Billed Project, and, in the case of Project 1, after additional payment of the amounts required by the Project 1 Prior Lien Resolution to be paid into the Hanford Project Revenue Fund, shall be applied to the payment of principal of and interest on the defaulting Net Billed Project's Bonds. Each Prior Lien Resolution provides that, in the event that at any time the funds held by the applicable Bond Fund Trustee and the Paying Agents for Prior Lien Bonds in default shall be insufficient for the payment of the principal of and premium, if any, and interest then due on such Prior Lien 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 holders of such Bonds by the applicable Bond Fund Trustee shall be applied as follows:

- (1) Unless the principal of all such Bonds shall have become or have been declared due and payable,

*First*, to the payment of all installments of interest then due in the order of the maturity of such installments and, if the amount available shall not be sufficient to pay in full any installment or installments of interest maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon; and

*Second*, to the payment of the unpaid principal and premium, if any, of any such Bonds which shall become due, whether at maturity or by call for redemption, in the order of their due dates and, if the amount available shall not be sufficient to pay in full all amounts due on any date, then to the payment thereof ratably, according to the amounts of principal and premium, if any, due on such date.

(2) If the principal of all of such Bonds shall have become or have been declared due and payable, to the payment of the principal and interest then due and unpaid upon such Bonds without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond over any other Bond, ratably, according to the amounts of principal and interest due.

After all sums then due in respect of such Bonds have been paid, and after all Events of Default have been cured or secured to the satisfaction of the defaulting Net Billed Project's Bond Fund Trustee, such Bond Fund Trustee is required to relinquish possession and control of such Net Billed Project to Energy Northwest.

The Prior Lien Resolutions empower each Bond Fund Trustee to file proofs of claims for the benefit of the holders of the defaulting Net Billed Project's Bonds in bankruptcy, insolvency or reorganization proceedings and to institute suit for the collection of sums due and unpaid in connection with such Bonds, to enforce specific performance of covenants contained in the Prior Lien Resolution governing the Net Billed Project in default or to obtain injunctive or other appropriate relief for the protection of the holders of such Net Billed Bonds.

The holders of a majority in principal amount of the defaulting Net Billed Project's Prior Lien Bonds at the time outstanding have the right to direct the time, method and place of conducting any proceeding for any remedy available to the defaulting Net Billed Project's Bond Fund Trustee, or exercising any trust or power conferred upon such Bond Fund Trustee, but such Bond Fund Trustee must be provided with reasonable security and indemnity and also may decline to follow any such direction if it shall be advised by counsel that the action or proceeding so directed may not lawfully be taken or if it in good faith determines that the action or proceeding so directed would involve it in personal liability or that the action or proceeding so directed would be unjustly prejudicial to the holders of such Bonds not parties to such direction. No holder of any Prior Lien Bond has any right to institute suit to enforce any provision of the respective Prior Lien Resolution or the execution of any trust thereunder (except to enforce the payment of principal or interest installments as they mature), unless the respective Bond Fund Trustee has been requested by the holders of not less than 20% in aggregate principal amount of such Bonds then outstanding to exercise the powers granted it by such Resolution or to institute such suit and unless such Bond Fund Trustee has failed or refused to comply with the aforesaid request.

#### **Amendments; Supplemental Resolutions**

Any amendment to a Prior Lien Resolution in any particular, except the percentage of Bondholders the approval of which is required to approve such amendment, may be made by Energy Northwest with the consent of the holders of  $66\frac{2}{3}\%$  in principal amount of the Prior Lien Bonds issued pursuant to such Resolution then outstanding and with the consent of the holders of  $66\frac{2}{3}\%$  in principal amount of such outstanding Bonds which are adversely affected by an amendment which does not equally affect all other such outstanding Bonds, provided that no such amendment shall permit a change in the date of payment of principal or of any installment of interest on any such Bond or a reduction in the principal or redemption price thereof or the rate of interest thereon without the consent of each such Bondholder so affected.

Without the consent of any Bondholder, Energy Northwest may adopt supplemental resolutions: (i) to authorize the issuance of subsequent Series of Project 1, Columbia or Project 3 Prior Lien Bonds; (ii) to add to the covenants of Energy Northwest contained in, or to surrender any rights reserved to or conferred upon it by, a Prior Lien Resolution; (iii) to add to the restrictions contained in a Prior Lien Resolution upon the issuance of additional indebtedness; (iv) to confirm as further assurance any pledge under a Prior Lien Resolution of the revenues of the respective Net Billed Project or other moneys; (v) otherwise to modify any of the provisions of a Prior Lien Resolution (but no such modification may be effective while any of the Prior Lien Bonds theretofore issued pursuant to such Resolution are outstanding); or (vi) to cure any ambiguity or defect or inconsistent provision in such Resolution or to insert such provisions clarifying matters or questions arising under such Resolution as necessary or desirable in the event any such modifications are not contrary to or inconsistent with such Resolution or, in the case of the Project 3 Prior Lien Resolution, not adverse to the rights and interests of the holders of the Project 3 Prior Lien Bonds, provided that the appropriate Bond Fund Trustee shall consent thereto.

As described in this Appendix G-2 under "Effect of Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3)," the Project 1 1989A Supplemental Resolution, Columbia 1990A Supplemental Resolution and Project 3 1989A Supplemental Resolution amend the Project 1 Prior Lien Resolution, Columbia Prior Lien Resolution and Project 3 Prior Lien Resolution, respectively, to permit the adoption of supplemental resolutions for purposes described in clause (vi) of the preceding paragraph if such modifications are not adverse to the rights and interests of the holders of the Project 1 Prior Lien Bonds, Columbia Prior Lien Bonds or Project 3 Prior Lien Bonds, as the case may be. Such amendments became effective in the case of the Project 1 and Project 3 Prior Lien Resolutions when the Project 1 and Project 3 Prior Lien Bonds

issued prior to the adoption of the 1989A Supplemental Resolutions ceased to be outstanding and may become effective in the future in the case of the Columbia Prior Lien Resolution, as described under “Amendments Adopted September 14, 1989 and March 15, 1990 (Project 1, Columbia and Project 3).”

**Defeasance**

The obligations of Energy Northwest under a Prior Lien Resolution shall be fully discharged and satisfied as to any related Prior Lien Bond, and such Bond shall no longer be deemed to be outstanding thereunder when payment of the principal of and the applicable redemption premium, if any, on such Bond plus interest to the due date thereof (a) shall have been made or caused to be made in accordance with the terms thereof, or (b) shall have been provided by irrevocably depositing with the Bond Fund Trustee or the Paying Agents therefor in trust solely for such payment (i) moneys sufficient to make such payments or (ii) Investment Securities described in clauses (i) through (iv) under “Investment of Funds” in this Appendix G-2 maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient moneys to make such payment, and, except for the purposes of such payment, such Bond shall no longer be secured by or entitled to the benefits of such Prior Lien Resolution; provided that, with respect to Prior Lien Bonds which by their terms may be redeemed or otherwise prepaid prior to the stated maturities thereof but are not then redeemable, no deposit under (b) above shall constitute such discharge and satisfaction unless such Bonds shall have been irrevocably called or designated for redemption on the first date thereafter such Bonds may be redeemed in accordance with the provisions thereof and notice of such redemption shall have been given or irrevocable provision shall have been made for the giving of such notice.

**BOOK-ENTRY ONLY SYSTEM**

The Series 2002-A Bonds will be available to the ultimate purchasers in book-entry form only, in denominations of \$5,000 and integral multiples thereof. Purchasers of the Series 2002-A Bonds will not receive certificates representing their interests in the Series 2002-A Bonds purchased, except as described below.

The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the 2002-A Bonds. The 2002-A 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 bond certificate will be issued for each maturity of the Series 2002-A Bonds in the aggregate principal amount of such maturity, and will be deposited with DTC. If, however, the aggregate principal amount of any maturity exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

DTC 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 securities that its participants (“Direct Participants”) deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants’ accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). The Rules applicable to DTC and its Direct and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of 2002-A Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2002-A Bonds on DTC’s records. The ownership interest of each actual purchaser of each 2002-A 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, but Beneficial Owners are 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 2002-A 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 2002-A Bonds, except in the event that use of the book-entry system for the 2002-A Bonds is discontinued.

To facilitate subsequent transfers, all 2002-A 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 2002-A Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2002-A Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such 2002-A 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 2002-A Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the 2002-A Bonds, such as redemptions, tenders, defaults, and proposed amendments to the security documents. Beneficial Owners of 2002-A Bonds may wish to ascertain that the nominee holding the 2002-A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the 2002-A 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 such other DTC nominee) will consent or vote with respect to the 2002-A Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer 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 the 2002-A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the 2002-A 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 Issuer or Agent 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, Agent, or Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividends to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of Issuer or Agent, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the 2002-A Bonds at any time by giving reasonable notice to Issuer or Agent. Under such circumstances, in the event that a successor securities depository is not obtained, 2002-A Bond certificates are required to be printed and delivered.

Issuer may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, 2002-A Bond certificates will be printed and delivered.

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

## SUMMARY OF THE CONTINUING DISCLOSURE AGREEMENT

In order to assist the Underwriters in complying with Rule 15c2-12, Energy Northwest, Bonneville and the Trustee will enter into a written agreement (the “Agreement”) for the benefit of the holders of the Series 2002-A Bonds to provide continuing disclosure.

In addition to the definitions set forth in the Net Billed Resolutions which apply to any capitalized term used in the Agreement, the following capitalized terms shall have the following meanings:

“BPA Annual Information” shall mean financial information and operating data of the type included in the final Official Statement for the Series 2002-A Bonds in the following tables under the heading “THE BONNEVILLE POWER ADMINISTRATION”: “Federal System Statement of Revenues and Expenses,” “Statement of Non-Federal Project Debt Service Coverage and United States Treasury Payments” (under the “Actual” columns only) and “Statement of Net Billing Obligations and Expenditures” (under the “Actual” columns only) (provided that such financial information and operating data shall include such narrative explanation as may be necessary to avoid misunderstanding and to assist the reader in understanding the presentation of financial information and operating data and in judging the financial condition of Bonneville).

“Energy Northwest Annual Information” shall mean financial information and operating data of the type included in the final Official Statement for the Series 2002-A Bonds in the following tables under the heading “ENERGY NORTHWEST”: “Energy Northwest Revenue Bonds Outstanding as of February 1, 2002” under the subheading “— Energy Northwest Indebtedness” and “Statement of Operations” under the subheading “— The Columbia Generating Station-Annual Costs” (provided that such financial information and operating data shall include such narrative explanation as may be necessary to avoid misunderstanding and to assist the reader in understanding the presentation of financial information and operating data and in judging the financial condition of Energy Northwest).

“Energy Northwest Fiscal Year” shall mean the fiscal year ending each June 30 or, if such fiscal year end is changed, on such new date; provided that if the Energy Northwest Fiscal Year End is changed, Energy Northwest shall notify, in a timely manner, the Repository or the MSRB and the State Depository.

“FCRPS” shall mean the Federal Columbia River Power System.

“FCRPS Fiscal Year” shall mean the fiscal year ending each September 30 or, if such fiscal year end is changed, on such new date; provided that if the FCRPS Fiscal Year is changed, Bonneville shall notify, in a timely manner, the Repository or the MSRB and the State Depository.

“MSRB” shall mean the Municipal Securities Rulemaking Board established in accordance with the provisions of Section 15B(b)(1) of the Securities Exchange Act of 1934.

“Repository” shall mean each nationally recognized municipal securities information repository within the meaning of Rule 15c2-12. The name and address of each Repository shall be set forth in a list to be on file at the offices of Energy Northwest and Bonneville.

“Rule 15c2-12” shall mean Rule 15c2-12 under the Securities Exchange Act of 1934, as amended through the date of this Agreement, including any official interpretations thereof promulgated on or prior to the effective date of this Agreement.

“State Depository” shall mean any public or private repository or entity designated by the State of Washington as the state repository for the purpose of Rule 15c2-12 and recognized as such by the Securities and Exchange Commission.

“Trustee” shall mean BNY Western Trust Company, as trustee for the Series 2002-A Bonds.

“Underwriters” shall mean the underwriter or underwriters that have contracted to purchase the Series 2002-A Bonds from Energy Northwest upon initial issuance.

Bonneville will undertake for the benefit of the holders of the Series 2002-A Bonds to provide each Repository, on an annual basis no later than 180 days after the end of each FCRPS Fiscal Year, commencing the fiscal year ending September 30, 2002, the BPA Annual Information. Bonneville will undertake to provide each Repository audited financial statements of the FCRPS no later than 180 days after the end of each FCRPS Fiscal Year.

Energy Northwest will undertake for the benefit of the holders of the Series 2002-A Bonds to provide each Repository, on an annual basis no later than 180 days after the end of each Energy Northwest Fiscal Year, commencing the fiscal year ending June 30, 2002, Energy Northwest Annual Information. Energy Northwest will undertake to provide each Repository with Energy Northwest’s audited financial statements no later than 180 days after the end of each Energy Northwest Fiscal Year. In addition, Energy Northwest will undertake, for the benefit of the holders of the Series 2002-A Bonds, to provide to each such Repository or to the Municipal Securities Rulemaking Board (“MSRB”), and to State Information Depository, in a timely manner, the notices described below.

The notices described above include notices of any of the following events with respect to the Series 2002-A Bonds, if material: (1) principal and interest payment delinquencies; (2) nonpayment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the Series 2002-A Bonds; (7) modifications to the rights of holders of the Series 2002-A Bonds; (8) bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Series 2002-A Bonds; and (11) rating changes. In addition, Energy Northwest will undertake, for the benefit of the holders of the Series 2002-A Bonds, to provide to each Repository or the MSRB and to State Information Depository, in a timely manner, notice of any failure by Bonneville to provide the BPA Annual Information and annual financial statements, of the FCRPS by the date required in Bonneville's undertaking described above and notice of any failure by Energy Northwest to provide Energy Northwest Annual Information and annual financial statements of Energy Northwest by the date required in Energy Northwest's undertaking described above.

The sole and exclusive remedy for breach or default by Energy Northwest under the Agreement is an action to compel specific performance of the undertakings of Energy Northwest, and no person, including the holders of the Series 2002-A Bonds, may recover monetary damages thereunder under any circumstances. Specific performance is not available as a remedy against Bonneville. A Bondholder will have any rights available to him or her under law with respect to remedies against Bonneville. A breach or default under the Agreement shall not constitute an Event of Default under the Net Billed Resolutions or the Supplemental Resolution relating to the Series 2002-A Bonds. In addition, if all or any part of Rule 15c2-12 ceases to be in effect for any reason, then the information required to be provided under the Agreement, insofar as the provision of Rule 15c2-12 no longer in effect required the provision of such information, shall no longer be required to be provided.

The Agreement shall be governed by the laws of the State of Washington with respect to Energy Northwest and by federal law with respect to Bonneville.

The foregoing summary is intended to set forth a general description of the type of financial information and operating data that will be provided; the descriptions are not intended to state more than general categories of financial information and operating data; and where the Agreement calls for information that no longer can be generated or is no longer relevant because the operations to which it is related have been materially changed or discontinued, a statement to that effect will be provided. As a result, the parties to the Agreement do not anticipate that it often will be necessary to amend the informational undertakings. The Agreement, however, may be amended or modified under certain circumstances set forth therein. Copies of the Agreement when executed by the parties thereto at the Closing will be on file at the offices of Energy Northwest.





**FINANCIAL  
SECURITY  
ASSURANCE®**

# MUNICIPAL BOND INSURANCE POLICY

ISSUER:

BONDS:

Policy No.: -N

Effective Date:

Premium:

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the

United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud, whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By \_\_\_\_\_

By \_\_\_\_\_

Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.  
350 Park Avenue, New York, N.Y. 10022-6022

(212) 826-0100

Form 500NY (5/90)



## FINANCIAL GUARANTY INSURANCE POLICY

**MBIA Insurance Corporation**  
**Armonk, New York 10504**

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]  
 [LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

**MBIA Insurance Corporation**

\_\_\_\_\_  
 President

\_\_\_\_\_  
 Assistant Secretary

**SPECIMEN**

STATEMENT OF INSURANCE

MBIA Insurance Corporation (the "Insurer") has issued a policy containing the following provisions, such policy being on file at [INSERT NAME OF TRUSTEE OR PAYING AGENT, INCLUDING CITY, STATE].

The Insurer, in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [INSERT NAME OF TRUSTEE OR PAYING AGENT] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean: [INSERT LEGAL TITLE OF BONDS, CENTERED AS FOLLOWS:]

[\$ PAR AMOUNT]  
[ISSUER]  
[DESCRIPTION OF BONDS]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

MBIA INSURANCE CORPORATION

## PAYMENTS UNDER THE POLICY

A. In the event that, on the second Business Day, and again on the Business Day, prior to the payment date on the Obligations, the Paying Agent has not received sufficient moneys to pay all principal of and interest on the Obligations due on the second following or following, as the case may be, Business Day, the Paying Agent shall immediately notify the Insurer or its designee on the same Business Day by telephone or telegraph, confirmed in writing by registered or certified mail, of the amount of the deficiency.

B. If the deficiency is made up in whole or in part prior to or on the payment date, the Paying Agent shall so notify the Insurer or its designee.

C. In addition, if the Paying Agent has notice that any Bondholder has been required to disgorge payments of principal or interest on the Obligation to a trustee in Bankruptcy or creditors or others pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Bondholder within the meaning of any applicable bankruptcy laws, then the Paying Agent shall notify the Insurer or its designee of such fact by telephone or telegraphic notice, confirmed in writing by registered or certified mail.

D. The Paying Agent is hereby irrevocably designated, appointed, directed and authorized to act as attorney-in-fact for Holders of the Obligations as follows:

1. If and to the extent there is a deficiency in amounts required to pay interest on the Obligations, the Paying Agent shall (a) execute and deliver to State Street Bank and Trust Company, N.A., or its successors under the Policy (the "Insurance Paying Agent"), in form satisfactory to the Insurance Paying Agent, an instrument appointing the Insurer as agent for such Holders in any legal proceeding related to the payment of such interest and an assignment to the Insurer of the claims for interest to which such deficiency relates and which are paid by the Insurer, (b) receive as designee of the respective Holders (and not as Paying Agent) in accordance with the tenor of the Policy payment from the Insurance Paying Agent with respect to the claims for interest so assigned, and (c) disburse the same to such respective Holders; and

2. If and to the extent of a deficiency in amounts required to pay principal of the Obligations, the Paying Agent shall (a) execute and deliver to the Insurance Paying Agent in form satisfactory to the Insurance Paying Agent an instrument appointing the Insurer as agent for such Holder in any legal proceeding relating to the payment of such principal and an assignment to the Insurer of any of the Obligation surrendered to the Insurance Paying agent of so much of the principal amount thereof as has not previously been paid or for which moneys are not held by the Paying Agent and available for such payment (but such assignment shall be delivered only if payment from the Insurance Paying Agent is received), (b) receive as designee of the respective Holders (and not as Paying Agent) in accordance with the tenor of the Policy payment therefor from the Insurance Paying Agent, and (c) disburse the same to such Holders.

E. Payments with respect to claims for interest on and principal of Obligations disbursed by the Paying Agent from proceeds of the Policy shall not be considered to discharge the obligation of the Issuer with respect to such Obligations, and the Insurer shall become the owner of such unpaid Obligation and claims for the interest in accordance with the tenor of the assignment made to it under the provisions of this subsection or otherwise.

F. Irrespective of whether any such assignment is executed and delivered, the Issuer and the Paying Agent hereby agree for the benefit of the Insurer that:

1. They recognize that to the extent the Insurer makes payments, directly or indirectly (as by paying through the Paying Agent), on account of principal of or interest on the Obligations, the Insurer will be subrogated to the rights of such Holders to receive the amount of such principal and interest from the Issuer, with interest thereon as provided and solely from the sources stated in this Indenture and the Obligations; and

2. They will accordingly pay to the Insurer the amount of such principal and interest (including principal and interest recovered under subparagraph (ii) of the first paragraph of the Policy, which principal and interest shall be deemed past due and not to have been paid), with interest thereon as provided in this Indenture and the Obligation, but only from the sources and in the manner provided herein for the payment of principal of and interest on the Obligations to Holders, and will otherwise treat the Insurer as the owner of such rights to the amount of such principal and interest.

G. In connection with the issuance of additional Obligations, the Issuer shall deliver to the Insurer a copy of the disclosure document, if any, circulated with respect to such additional Obligations.

H. Copies of any amendments made to the documents executed in connection with the issuance of the Obligations which are consented to by the Insurer shall be sent to Standard & Poor's Corporation.

I. The Insurer shall receive notice of the resignation or removal of the Paying Agent and the appointment of a successor thereto.

J. The Insurer shall receive copies of all notices required to be delivered to Bondholders and, on an annual basis, copies of the Issuer's audited financial statements and Annual Budget.

Notices: Any notice that is required to be given to a holder of the Obligation or to the Paying Agent pursuant to the Indenture shall also be provided to the Insurer. All notices required to be given to the Insurer under the Indenture shall be in writing and shall be sent by registered or certified mail addressed to MBIA Insurance Corporation, 113 King Street, Armonk, New York 10504 Attention: Surveillance.