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RECIP. NAME	RECIPIENT AFFILIATION

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WASHINGTON PUBLIC POWER SUPPLY SYSTEM

P.O. Box 968 • Richland, Washington 99352-0968

December 12, 1996

GO1-96-0035

GO2-96-240

GO3-96-0162

Docket Nos: 50-460

50-397

50-508

U.S. Nuclear Regulatory Commission

Attn: Document Control Desk

Mail Station P1-37

Washington, D.C. 20555

Gentlemen:

Subject: **NUCLEAR PROJECTS 1, 2, & 3
ANNUAL FINANCIAL REPORT**

Enclosed for your information, as required by 10 CFR 50.71(b), are three copies of the Washington Public Power Supply System Annual Report 1996.

Should you have any questions or desire additional information regarding this matter, please call me or R. A. Bresnahan at (509) 372-5730.

Respectfully,



G. J. Kucera (Mail Drop 1396)

Vice President, Administration/Chief Financial Officer

AGC/lm

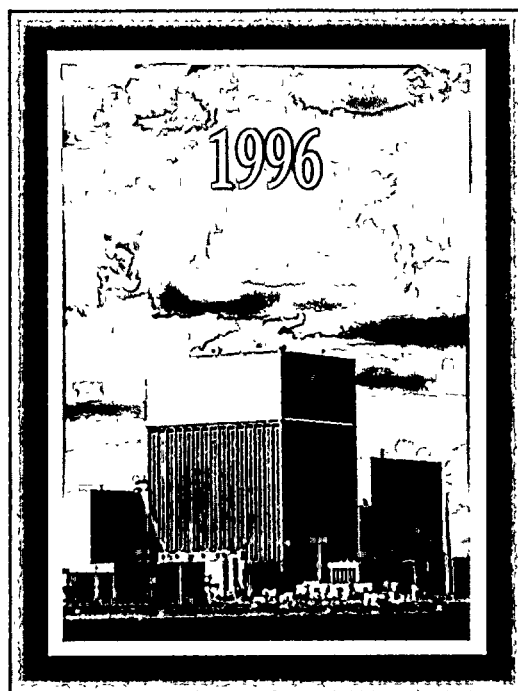
Enclosure: Washington Public Power Supply System Annual Report 1996

cc: LJ Callan - NRC RIV
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MM Mendonca - NRC w/o
NS Reynolds - Winston & Strawn w/o
DL Williams - BPA/399 w/o
NRC Sr. Resident Inspector - 927N

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ANNUAL REPORT

WASHINGTON PUBLIC POWER SUPPLY SYSTEM



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Financial Operating Highlights

For the year ended June 30, 1996

(Dollars in millions)

BONDS OUTSTANDING

Amount*/Weighted Average Coupon Rate

	FY 1996	FY 1995	CHANGE
WNP-1 amount	\$ 2,168.9	\$ 2,208.8	-1.8%
weighted average	6.4%	6.3%	1.1%
variable	146.3	149.9	-2.4%
average rate	3.7%	3.5%	5.1%
WNP-2 amount	2,505.7	2,603.7	-3.8%
weighted average	6.1%	6.1%	0
WNP-3 amount	1,509.3	1,701.5	-11.3%
weighted average	6.0%	6.0%	0
variable	194.3	198.3	-2.0%
average rate	3.7%	3.5%	4.8%

*Excludes Compounded Interest Bond Accretion

INVESTMENT PERFORMANCE

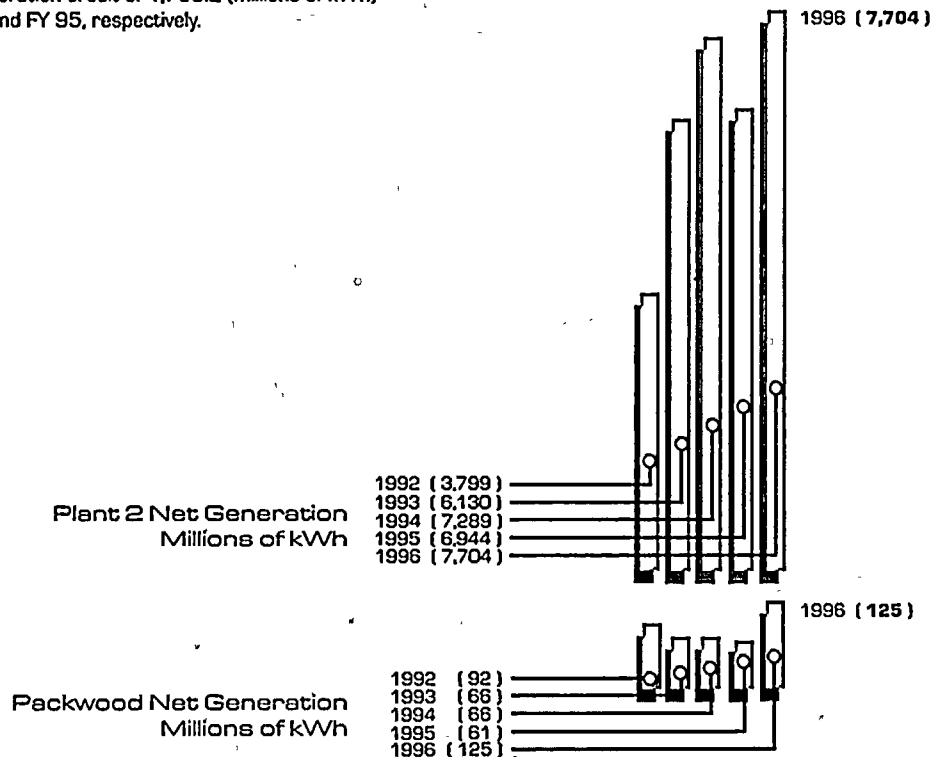
	FY 1996	FY 1995	CHANGE
Income	\$ 50.8	\$ 48.5	4.7%
Average Balance	853.8	899.4	-5.1%
Rate of Return	5.9%	5.4%	9.8%

OPERATING STATISTICS

	NUCLEAR PROJECT NO. 2			PACKWOOD LAKE PROJECT		
	FY 1996	FY 1995	CHANGE	FY 1996	FY 1995	CHANGE
Total production costs*	\$ 121.5	\$ 139.9	-13.2%	\$ 0.1	\$ 1.0	-90.0%
Net generation (millions of kWh)**	7,703.6	6,943.7	10.9%	125.4	60.7	106.6%
Cost in mills/kWh*	15.8	20.2	-21.8%	0.9	16.3	-94.5%
Plant availability	79.7%	75.0%	6.3%	90.1%	60.0%	33.4%
Plant capacity	58.7%	67.9%	-13.5%	47.6%	22.9%	107.9%

* Includes operation and maintenance costs per FERC report

** Includes BPA economic dispatch generation credit of 1,759.2 (millions of kWh) and 480 (millions of kWh) in FY 96 and FY 95, respectively.





Don Carter (Board Chairman)
Deputy City Manager for Utilities and
Physical Services
City of Richland, WA

Executive Board of Directors



Vera Claussen
(Board Assistant Secretary)
Commissioner, Grant County PUD
Ephrata, WA



Rudl Bertschi
Consultant, Economic & Technical
Analysis Group, Seattle, WA



Edward E. "Ted" Coates
(Board Secretary)
Retired Utility Executive, Tacoma, WA



John Cockburn
Retired bank executive
Seattle, WA



Dan Gunkel
Commissioner, Klickitat County PUD
Goldendale, WA



Parker Knight
Commissioner, Skamania County PUD
Carson, WA



Bob Royer
Partner, Royer/Katz Communications
Seattle, WA



Roger Sparks
Commissioner, Kittitas County PUD
Ellensburg, WA



Lou Winnard
(Board Vice Chairman)
Consultant, Windsor, CA

Executive Board Committees

Administrative and Public Responsibility Committee

Vera Claussen, Chairman
Ted Coates
John Cockburn
Dan Gunkel
Bob Royer
Don Carter, Ex Officio

Audit, Legal and Finance Committee

John Cockburn, Chairman
Rudi Bertschi
Vera Claussen
Bob Royer
Roger Sparks
Lou Winnard
Don Carter, Ex Officio

Operations and Construction Committee

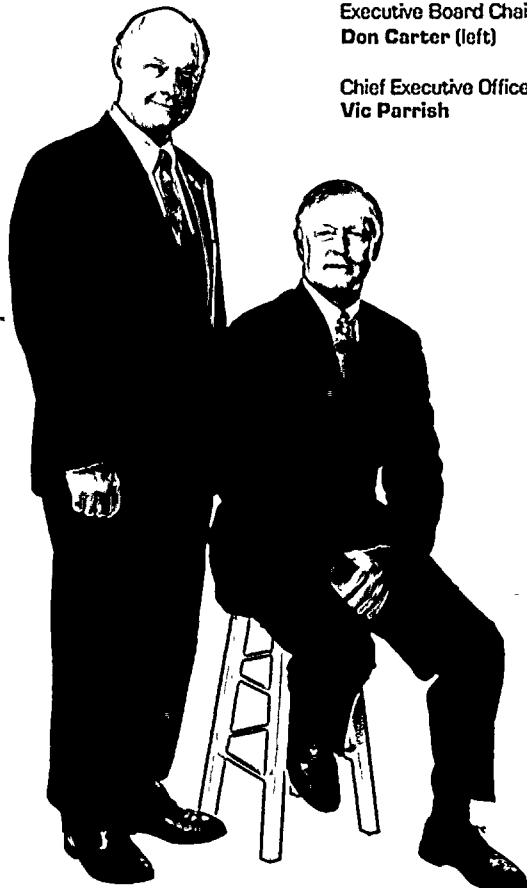
Parker Knight, Chairman
Ted Coates
Dan Gunkel
Roger Sparks
Lou Winnard
Don Carter, Ex Officio

Chief Executive Officer and Executive Board Chairman

We will remember fiscal year 1996 as a year of teamwork: among our employees, with our regulators, our members, regional utilities and our customer, the Bonneville Power Administration (BPA). As a team, we've faced challenges, supported our customer's needs, and investigated new business prospects.

Our teamwork was reflected in the 242 days of continuous operation, second only to our record of 257 days achieved between August 1993 and April 1994. It was Plant 2's first-ever operations period between refueling outages with no unplanned shutdowns. Our only threat of a shutdown was avoided in early February when employees successfully plugged a leaking tube in the plant's main condenser while the plant remained on line. We were particularly proud of that effort because in the plant's previous 11 years of operation, it had been taken off line several times for similar repairs.

Plant 2's uninterrupted generation was especially appreciated by BPA since operation of the hydroelectric system had been restricted at that time due to potential flooding in some areas of the Columbia River.



Executive Board Chairman
Don Carter (left)

Chief Executive Officer
Vic Parrish

Our ability to support BPA with flood control and load-following continued until March 2 when we were asked to shut down the plant to assist BPA in economically operating the regional power distribution system. Unusually high river flows through the Federal Columbia River Power System in early 1996 allowed for an abundance of low-cost electricity to be generated by the region's hydroelectric plants. The start-date for our annual refueling and maintenance outage remained April 13, and we used the down time to prepare, stage for, and in some cases complete, outage work.

Although economic dispatch precluded us from operating before July 3, 1995, or after March 2, 1996, (with the exception of about four days at the end of June) Plant 2 still provided 5.8 billion kilowatt-hours of electricity to BPA. Economic dispatch is a term used to describe when the value of electricity on the open market is less than the incremental cost of operating the plant. Our ability to respond to BPA's needs is a reflection of our team's strength; but to stay in the game, we must continue to lower our cost of power.

The key variables in reducing the cost of power are lowering costs and increasing electrical generation. We have no control over Mother Nature and the excess water she may bring to the Pacific Northwest, but we can control our costs. Cost reductions have been accomplished by eliminating unnecessary work and reducing overtime. Unfortunately, it has also required reducing our staffing levels, from about 1,590 in July 1995 to about 1,200 in June 1996. Together these actions have enabled us to produce power at a cost of 2.6 cents per kilowatt-hour, beating our target of 2.7 cents per kilowatt-hour. That power cost must decrease even further for the Supply System to become competitive with other lower-cost electricity suppliers throughout the region.

To assure the cost of power from Plant 2 is competitively priced, we've challenged ourselves to reduce our cost of power to less than 2.5 cents per kilowatt-hour by mid-1997. The Supply System will continue to look for

Vice Presidents and Chief Counsel

ways to lower its cost of power by increasing its reliability and revising its processes to maintain quality at a lower cost. To achieve that goal, our annual operating budget for Plant 2 has been reduced to \$190 million for fiscal year 1997, which began July 1, 1996. In general, cost reductions that total about \$21 million less than the current fiscal year budget have been identified to help achieve the \$190 million target. That breaks down to a \$9 million reduction in project-related expenses such as outside services and products; a \$4 million decrease in dollars spent for other level-of-effort cutbacks such as fees to regulators and dues for associations and organizations of which we're currently members; and an \$8 million reduction in labor costs. All changes were carefully reviewed to ensure that safety will not be compromised.

We also worked this year to improve our relationship with our regulator, the Nuclear Regulatory Commission (NRC). Last year we took a good, hard look at the NRC's less-than-favorable view of Plant 2's past performance, and took steps to better measure up to its standards.

We began an in-depth process of self-assessment during which

Supply System employees and groups responsible for performing specific work processes determined whether they were using the simplest and most direct approaches to accomplish the work. It's not an easy process. For most of us, the concept of self-assessment inherently goes against human nature. It required that we identify areas needing improvement and areas of strength so we could more accurately and effectively plan where to use our limited resources.

Through self-assessment, we developed our Performance Enhancement Strategy, a comprehensive working document that identified initiatives for improvement and helped us to track and trend progress toward meeting the Supply System's objective of achieving superior operating performance.

We have also focused on improving the working relationships with our member utilities and regional utility organizations. Our alliance with the regional energy community is extremely important in serving the needs of our partners in the Pacific Northwest.

We are destined to expand our role in the energy arena, and our team—our people—are the lifeblood of our success. By working together to respond to our regulator, customer, and regional utilities, we will continue to be an important player in the Pacific Northwest's electrical system.

From left:

Vice President
Operations Support/
Public Information Officer
Rod Webring

Vice President
Nuclear Operations
Paul Bemis

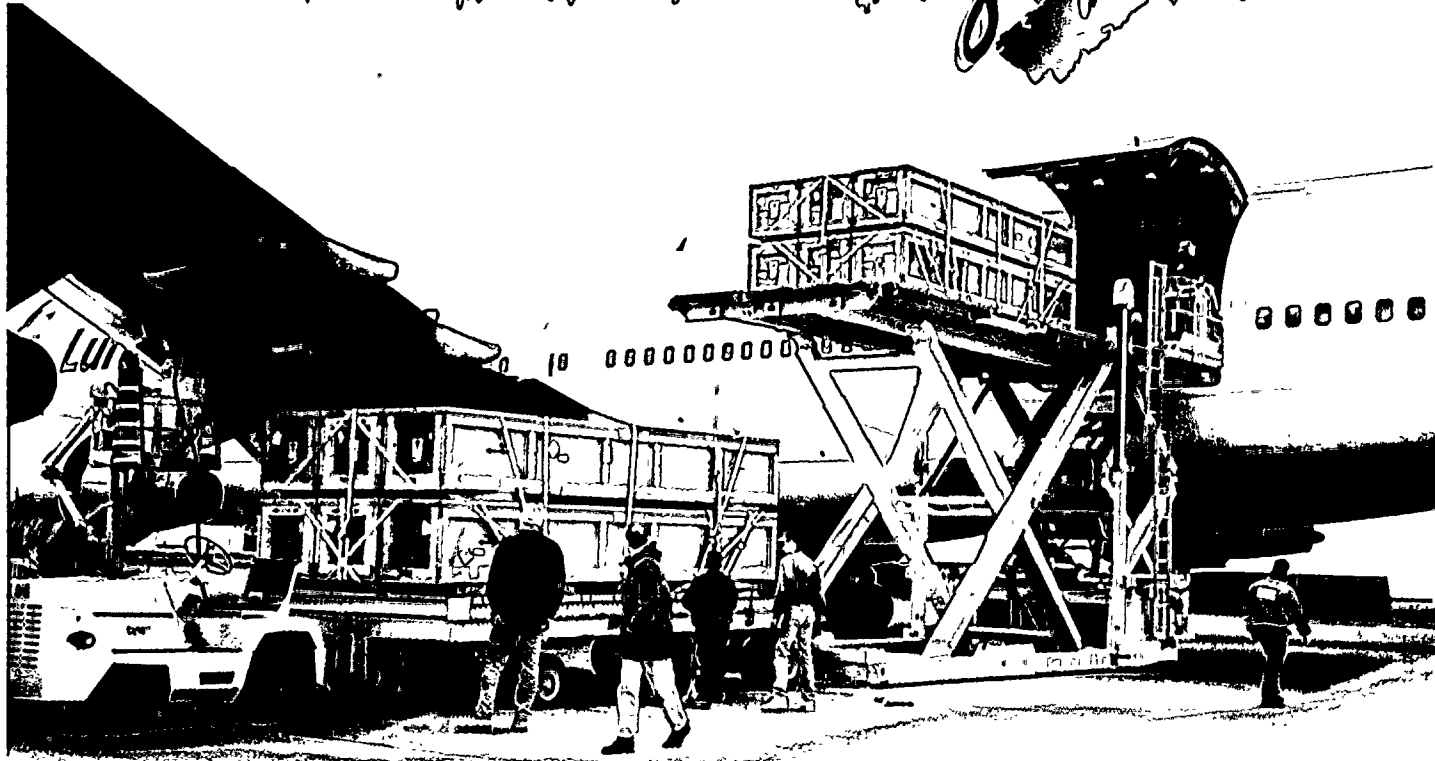
Vice President
Administration/
Chief Financial Officer
Jerry Kucera

Chief Counsel
Al Mouncer

Vice President
Resource Development
Jack Baker



Teamwork and a Bright Future



Fuel assemblies from Asea-Brown Boveri were transported from Sweden via a Lufthansa 747 Cargo plane.

team • work n. joint action by a group of people, in which individual interests are subordinated to group unity and efficiency.

Teamwork was the defining element of the Supply System's success in fiscal year 1996. Examples of this teamwork were reflected in the record-breaking electricity generated by the Packwood Lake Hydroelectric Project and the near-record continuous operational run at nuclear power Plant 2.

The Packwood Lake Hydroelectric Project generated 125,410,000 kilowatt-hours of electricity—more electricity than at any time in its 32-year history.



This new record far surpasses its lifetime average of 87 million kilowatt-hours and previous best generation of 122,197,000 produced in fiscal year 1973.

Plant 2 began its operating cycle July 3, 1995, and generated electricity for the Bonneville Power Administration (BPA) for 242 consecutive days—15 days shy of a new record generating run—until it was shut down on March 2, 1996, to support BPA's efforts to economically operate its regional power distribution system.

During this cycle, which marked Plant 2's first-ever operations period between refueling outages with no unplanned shutdowns, another first was accomplished by a team of Supply System employees and Raytheon contractors. The team was able to plug a leaking tube in the plant's main condenser while the plant remained on line, a repair that had caused the plant to be shut down several times during its 11-year operating history.

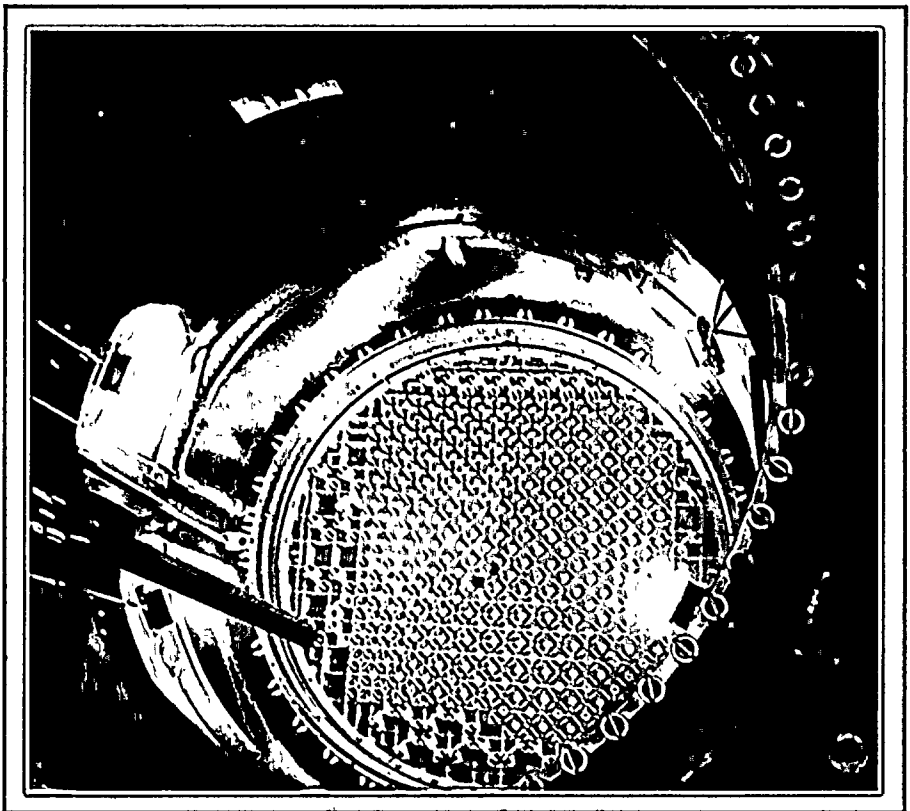
Plant 2's refueling and maintenance outage also demonstrated the teamwork that led to the year's success. Outage-related activities began in January 1996 when the first shipment of new fuel from Asea-Brown Boveri (ABB), whose fabrication facility is located in Västerås, Sweden, was received for inspection. The 104 fuel assemblies placed into Plant 2 during the outage represent ABB's first full refuel load for a U.S. commercial nuclear power plant.

Other outage activities included installing reactor recirculation pump adjustable speed drives designed to provide greater control and flexibility during changes in plant operating conditions; installing computerized controls for the steam turbines

that drive two large reactor feedwater pumps; and underwater installation of 80 new clamps to provide further bracing for jet pump sensing lines that monitor coolant flow through the reactor. In addition, 20 control rod drive mechanisms that control reactor power level were replaced in record time and with 56-percent

less radiation exposure to employees performing the task in previous years.

The outage, which officially began April 13, 1996, was originally scheduled for 55 days. Due to the complexity of the work and the number of tasks performed, the outage was completed in 70 days.



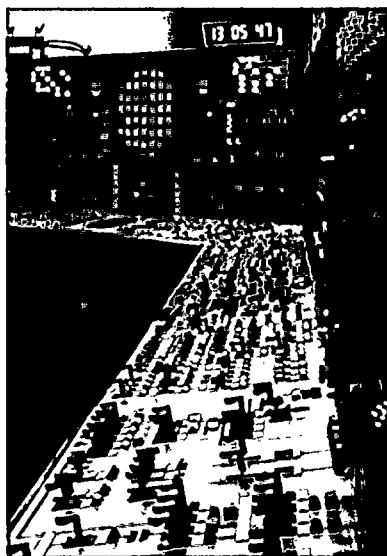
Teamwork and a Bright Future

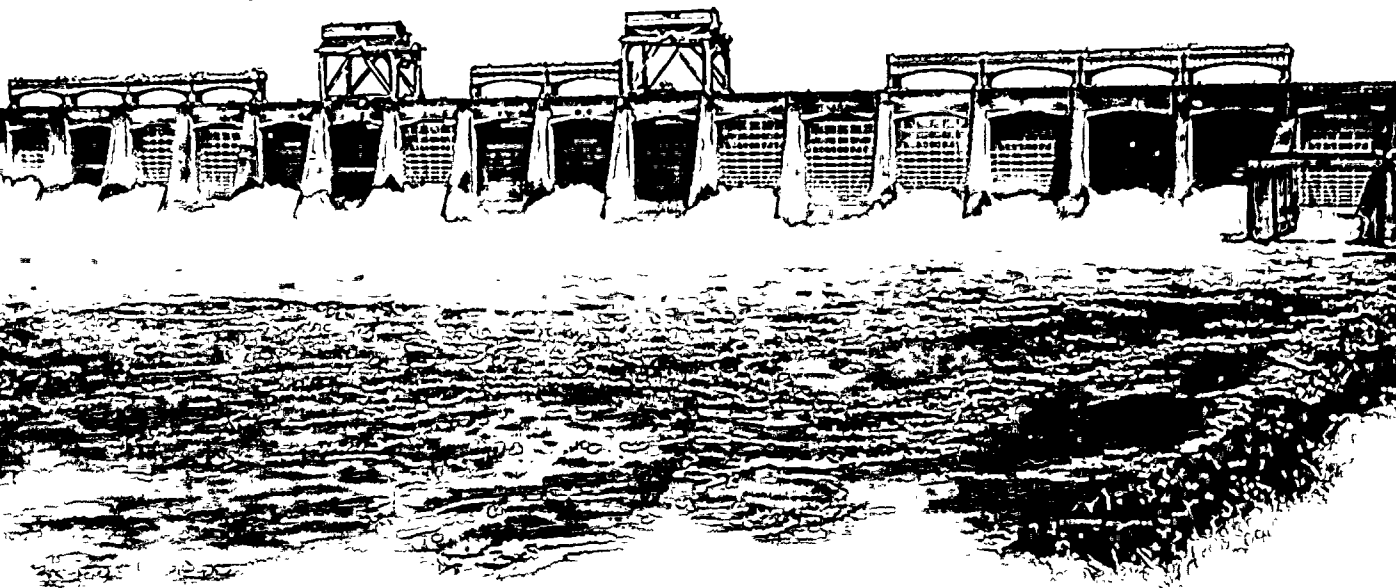
The spirit of teamwork extended to our customer, the Bonneville Power Administration (BPA), as the Supply System worked to help BPA economically operate its regional distribution system. Unusually high river flows through the Federal Columbia River Power System during several months of this fiscal year prompted BPA to request that Plant 2 be placed in "economic dispatch" in late 1995, and early and mid-1996. Economic dispatch means that the plant operates at a lower power level or not at all when the value of electricity on the open power market is less than the incremental cost of operating the plant.

During this fiscal year, Plant 2 demonstrated the ability to "load follow" — increase and decrease power level according to BPA's power load demands. Plant 2 operated at full power during the high demand periods on weekdays, and reduced power levels on weeknights and weekends when power demands are much lower. The adjustable speed drives installed during the outage will further improve the plant's load-following capability by increasing flexibility in adjusting the rotational speed of the plant's two reactor recirculation pumps responsible for circulating cooling water through the fuel core. Control of this flow is used to control reactor power level.

In early 1996, excessive rainfall and unseasonably warm winter temperatures that affected the snow pack in the mountains caused flooding throughout much of the Pacific Northwest. To aid with flood control, the Corps of Engineers substantially decreased the flow of water in the Columbia River, dramatically reducing the amount of electrical generation available from the river's vast hydroelectric system. Plant 2 operated at 100-percent power throughout this period, supplying the much needed electricity to meet BPA's power requirements.

The Supply System also aided BPA by lowering the cost of Plant 2's power in fiscal year 1996. This helped BPA stay competitive in a market becoming crowded with independent power producers that do not share BPA's responsibilities for fish enhancement, energy conservation, and transmission system construction and maintenance.





Bonneville Dam, which does not have a large retention capacity, spilled water during high river flows in fiscal year 1996.
Photo courtesy of The Army Corps of Engineers

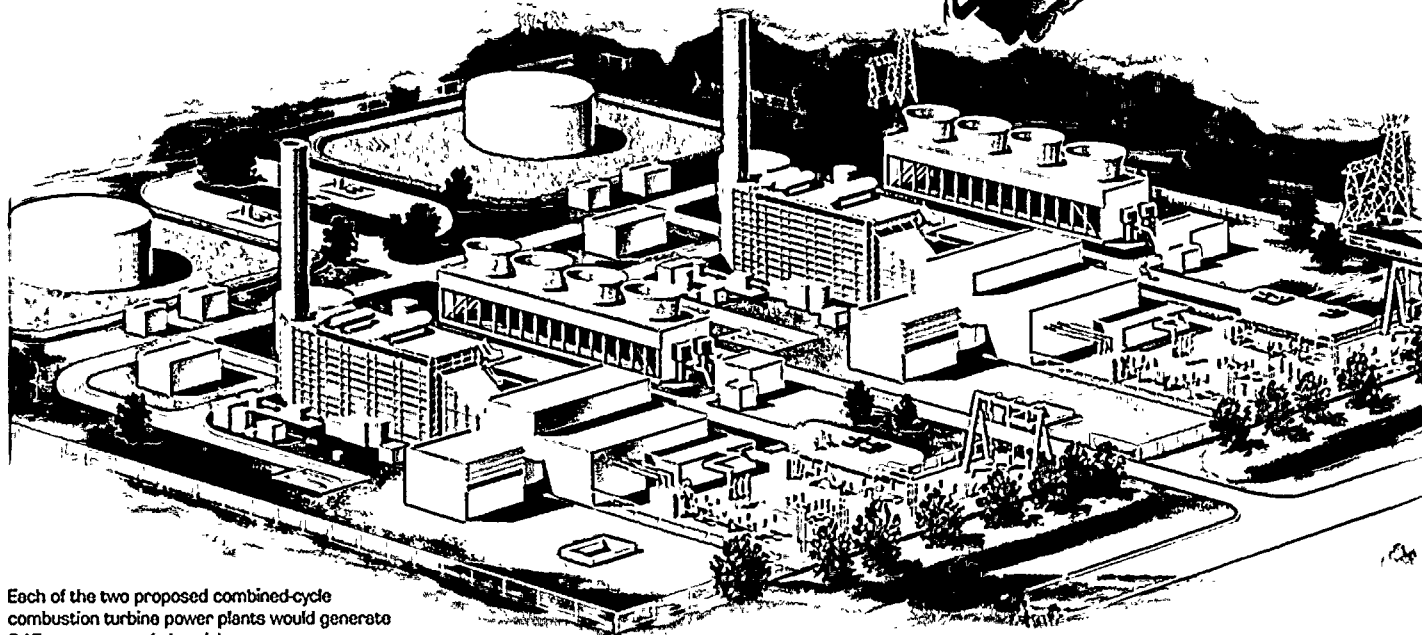
Achieving a cost of power of 2.6 cents per kilowatt-hour (regional perspective) this fiscal year demonstrates our commitment to remaining a viable energy resource. The goal is to be at 2.4 cents per kilowatt-hour by the end of fiscal year 1997.

In addition to a lower cost of power, Plant 2's capability factor (the amount of electricity that could have been generated had the plant not been placed in economic dispatch and had operated continuously at full-power for the fiscal year) was 76.3 percent.

Power supplied to BPA during fiscal year 1996 totaled more than six billion kilowatt-hours of electricity, which includes generation from Plant 2 and a record-setting year for the Packwood Hydroelectric Project. It is estimated that more than seven billion kilowatt-hours would have been generated had it not been for the periods of economic dispatch.



Teamwork and a Bright Future



Each of the two proposed combined-cycle combustion turbine power plants would generate 245 megawatts of electricity.

As the Supply System continues to evolve as an organization, it is working with outside agencies to expand its role and provide additional value. During fiscal year 1996, attention was also devoted to the following initiatives:

Mixed-oxide fuel (MOX).

The Supply System has actively promoted Plant 2 since 1993 as a prime facility to use mixed-oxide fuel, referred to as MOX, which contains both plutonium and uranium oxides fabricated into reactor fuel. By using Plant 2, which will require no hardware modifications to the reactor and plant systems to use MOX, the Supply System could help solve the pressing national problem of surplus weapons-usable fissile material. And if the federal government supplies the MOX, the cost of power generated at

the plant could be lowered significantly. The National Academy of Science has issued two reports on plutonium disposition, and has specifically mentioned Plant 2 as a suitable reactor for this function.

In August 1995, the Supply System provided a proposal to the Department of Energy (DOE) to test several MOX fuel assemblies in Plant 2. This testing is needed to gather information for the licensing of MOX fuel assemblies in U.S. reactors. In January 1996, the Supply System officially responded to DOE's request for "Expressions of Interest" from nuclear utilities interested in using MOX fuel.

The DOE is expected to issue its Record of Decision on the method(s) selected for surplus plutonium disposition by late 1996.

Combustion turbines. The Satsop Combustion Turbine Project, which would be located on a portion of the Supply System's Satsop power plant site, has completed all required environmental studies and permit applications for two units. Each combined-cycle combustion turbine power plant would generate 245-megawatts of electricity and operate on natural gas supplied through a 48-mile pipeline routed in Thurston and Grays Harbor Counties in western Washington state.

One of the units is committed to the Bonneville Power Administration's resource contingency program under a 10-year option period. The second plant is available for a combination of public and/or private utilities.

There is no assurance if and when the output of either of the two units will be needed, but the permits will be maintained for 10 years.

Satsop Adaptive Reuse Team. During 1995, a group from Grays Harbor County interested in economic development formed the Satsop Adaptive Reuse Team. The Team introduced legislation with the state of Washington to enable local governments to transfer ownership of all or a portion of the site on which WNP-3 exists to local government entities. The legislation, which was approved and signed by Gov. Mike Lowry on March 7, 1996, also provides for the local government entities to assume regulatory responsibilities for site restoration requirements and control of water rights.

The local government entity includes representatives from Grays Harbor PUD, the County, and the Port of Grays Harbor. An inter-local agreement to coordinate activities and negotiate for their interests has been drafted.

The Supply System and BPA have entered discussions with this



Under the leadership of Bill Council, Supply System Managing Director April 1993 - January 1996, the Supply System launched its initiative to use mixed oxide fuel in Plant 2.

group to consider possible alternate uses for the WNP-3 Project site. By transferring a portion of the site, the residents of Grays Harbor County could benefit through economic development and the Supply System's obligation for site restoration could be reduced.

The Supply System has deferred the issuance of a formal "Request for Proposals" for the demolition/site restoration contract while these discussions are ongoing.

Advanced Process Engineering Laboratory (APEL). The Supply System is working in cooperation with the Port of Benton and Pacific Northwest National Laboratory in eastern Washington state to develop and operate the APEL, which will be housed in a Supply System facility in the Tri-Cities Science and Technology Park in Richland. The APEL's mission is to provide high quality laboratory and validation testing facilities and associated offices for pilot scale research, development, testing of new processes and products including—but not limited to—environmental restoration; chemical waste treatment; and energy conservation. The express purpose of the APEL is to foster the deployment of new technology-based businesses, product lines, and jobs.

APEL is intended as an "incubator" facility that will encourage and facilitate the formation of new or expanded companies which use the new processes or products developed in the laboratory to become independent, self-supporting businesses that are encouraged to remain in the Tri-Cities.

The facility is funded through a grant from the U.S. Department of Energy's Office of Worker and Community Transition, with additional money coming from Tri-Cities community institutions. It is expected to begin operation in the fall of 1997.

Board of Directors



From left to right:

Tom Casey

Commissioner, Grays Harbor County PUD

William Kuehno

Commissioner, Ferry County PUD

Robert Graves (Board President)

Commissioner, Benton County PUD

Don Carter

Deputy City Manager for Utilities and Physical Services, City of Richland

Parker Knight

Commissioner, Skamania County PUD

Dan Gunkel

Commissioner, Klickitat County PUD

Beverly Cochran Fitzgerald (Board Vice President)

Commissioner, Franklin County PUD

Roger Sparks

Commissioner, Kittitas County PUD

Vera Claussen (Board Secretary)

Commissioner, Grant County PUD

Darrel Bunch

Commissioner, Okanogan County PUD

Arne Torget (Board Assistant Secretary)

Commissioner, Wahkiakum County PUD

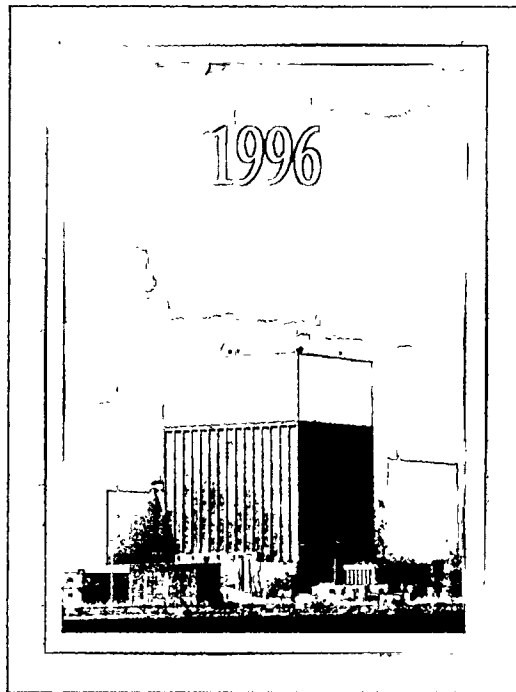
Not pictured:

Mark Crisson

Director of Utilities, Tacoma Public Utilities

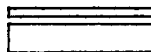
Gary Zarker

Superintendent, Seattle City Light



Financial Information

WASHINGTON PUBLIC POWER SUPPLY SYSTEM



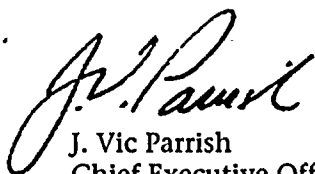
MANAGEMENT REPORT ON RESPONSIBILITY FOR FINANCIAL REPORTING

The management of the Supply System is responsible for preparing the accompanying financial statements and for their integrity. The statements were prepared in accordance with generally accepted accounting principles applied on a consistent basis, and include amounts that are based on management's best estimates and judgments.

The financial statements have been audited by Deloitte & Touche LLP, the Supply System's independent auditors. Management has made available to Deloitte & Touche LLP all financial records and related data, and believes that all representations made to Deloitte & Touche LLP during its audit were valid and appropriate.

Management has established and maintains internal control procedures that provide reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. These control procedures provide for appropriate division of responsibility and are documented by written policies and procedures.

The Supply System maintains an ongoing internal auditing program that provides for independent assessment of the effectiveness of internal controls, and for recommendations of possible improvements thereto. In addition, Deloitte & Touche LLP has considered the internal control structure in order to determine their auditing procedures for the purpose of expressing an opinion on the financial statements. Management has considered recommendations made by the internal auditor and Deloitte & Touche LLP concerning the control procedures and has taken appropriate action to respond to the recommendations. Management believes that, as of June 30, 1996, internal control procedures are adequate.



J. Vic Parrish
Chief Executive Officer



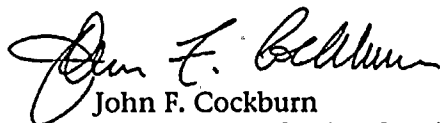
G. J. Kucera
Vice President, Administration/
Chief Financial Officer

AUDIT, LEGAL AND FINANCE COMMITTEE CHAIRMAN'S LETTER

The Executive Board's Audit, Legal and Finance Committee is composed of six independent directors. Members of the Committee are John F. Cockburn, Chairman; Rudi Bertschi; Vera Claussen; Bob Royer; Roger Sparks; Lou Winnard and Don Carter, Ex Officio. The Committee held 12 meetings during the fiscal year ended June 30, 1996.

The Committee oversees the Supply System's financial reporting process on behalf of the Executive Board. In fulfilling its responsibility, the Committee discussed with the internal auditor and the independent auditors the overall scope and specific plans for their respective audits, and reviewed the Supply System's financial statements and the adequacy of the Supply System's internal controls.

The Committee met regularly with the Supply System's internal auditor and independent auditors to discuss the results of their examinations, their evaluations of the Supply System's internal controls, and the overall quality of the Supply System's financial reporting. The meetings were designed to facilitate any private communication with the Committee desired by the internal auditor or independent auditors.



John F. Cockburn
Chairman, Audit, Legal and Finance Committee

INDEPENDENT AUDITORS' REPORT

Executive Board
Washington Public Power Supply System
Richland, Washington

We have audited the accompanying individual balance sheets of Washington Public Power Supply System's (the Supply System) Nuclear Project No. 2, Packwood Lake Hydroelectric Project, Hanford Generating Project, Nuclear Project No. 1, Nuclear Project No. 3, and Nuclear Projects Nos. 4 and 5 as of June 30, 1996, and the related statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the Supply System's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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, such financial statements present fairly, in all material respects, the financial position of the Supply System's individual projects at June 30, 1996, and the results of their operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Seattle, Washington
August 23, 1996 (September 18, 1996 as to Note E)

BALANCE SHEETS

As of June 30, 1996

Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	HANFORD GENERATING PROJECT#	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#	NUCLEAR PROJECTS NOS. 4/5*#
ASSETS						
UTILITY PLANT (NOTE B)						
In service	\$3,446,058	\$12,553				
Allowance for depreciation	(1,216,167)	(9,681)				
	2,229,891	2,872				
Nuclear fuel, net of accumulated amortization	141,535					
Construction work in progress	15,434					
	2,386,860	2,872				
RESTRICTED ASSETS (NOTE B)						
Special funds						
Cash	160	3		\$ 4,941	\$ 1,114	\$ 130
Available-for-sale investments	62,413	297		129,224	18,459	
Accounts and other receivables	684			924	5,553	
Due from other projects				29,620	123	9
Due from other funds					17,674	
Prepayments and other				25	71	
Debt service funds						
Cash	117	12		454	340	
Available-for-sale investments	152,931	720		197,689	165,822	
Other receivables	2,672			2,013	1,491	
	218,977	1,032		364,890	210,647	139
LONG-TERM RECEIVABLE (NOTE B)						
	38,011					
CURRENT ASSETS						
Cash	1,154	146	\$ 9	92	34	
Available-for-sale investments	33,139	1,884	8,907	4,428	4,648	
Accounts and other receivables	8,389	387		27	1	
Due from participants	2				56	
Due from other projects	59	22		24		
Due from other funds	27,342	38		23,773		
Materials and supplies	55,792					
Prepayments and other	769	1				
Nuclear fuel held for sale				12,403		
Plant & equipment held for sale			3,900	10,137	6,573	
	126,646	2,478	12,816	50,884	11,312	
DEFERRED CHARGES						
Costs in excess of billings		3,589		1,992,367	1,775,940	
Unamortized regulatory studies	17,227					
Unamortized debt expense	15,904	8		21,488	17,570	
Other deferred charges	203					
	33,334	3,597		2,013,855	1,793,510	
TOTAL ASSETS	\$2,803,828	\$ 9,979	\$12,816	\$2,429,629	\$2,015,469	\$ 139

* Supply System's ownership share (Note A)

Project recorded on a liquidation basis

See notes to financial statements

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	HANFORD GENERATING PROJECT#	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#	NUCLEAR PROJECTS NOS. 4/5*#
LIABILITIES						
DEFICIENCY IN ASSETS						\$(92,345)
BILLINGS IN EXCESS OF COSTS	\$ 112,340		\$ 5,525			
UNREALIZED INVESTMENT GAINS (LOSSES)	(436)	\$ (1)	3 \$	(1,967)	\$ (1,653)	
LONG-TERM DEBT (NOTE E)						
Revenue bonds payable	2,568,890	7,221		2,315,210	2,264,625	
Unamortized discount on bonds - net	(95,913)	(31)		(29,420)	(354,117)	
	2,472,977	7,190		2,285,790	1,910,508	
DEBT IN DEFAULT, CURRENTLY PAYABLE (NOTES E & F)						16,113
LIABILITIES PAYABLE FROM RESTRICTED ASSETS (NOTE B)						
Special funds						
Accounts payable and accrued expenses	38,923	6		51,301	42,795	3,206
Due to other funds	21,492	13		18,655		
Debt service funds						
Accrued interest payable	76	91		69,420	45,765	61,742
Accounts payable						11,423
Due to other funds	5,851	26		5,118	5,016	
	66,342	136		144,494	93,576	76,371
OTHER NONCURRENT LIABILITIES						
Other noncurrent liabilities	11,960	7				
Due to other projects	12,709					
	24,669	7				
CURRENT LIABILITIES						
Current maturities of long-term debt	68,390	230				
Accounts payable and accrued expenses	41,589	137	7,285			
Due to participants	820	2,220		1,312	372	
Due to other funds					12,658	
Due to other projects	17,137		3		8	
	127,936	2,587	7,288	1,312	13,038	
DEFERRED CREDITS						
Deferred gain on redemption of revenue bonds		60				
COMMITMENTS AND CONTINGENCIES (NOTE F)						
TOTAL LIABILITIES	\$2,803,828	\$9,979	\$12,816	\$2,429,629	\$2,015,469	\$139

STATEMENTS OF OPERATIONS

For the year ended June 30, 1996 Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	HANFORD GENERATING PROJECT#	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#	NUCLEAR PROJECTS NOS. 4/5*#
OPERATING REVENUES	\$ 437,396	\$1,370				
OPERATING EXPENSES						
Nuclear fuel	23,218					
Fuel disposal fee	5,636					
Decommissioning	5,580					
Depreciation and amortization	106,822	366				
Operations and maintenance	107,660	712				
Administrative & general	42,614	128				
Generation tax	2,639	9				
Total operating expenses	294,169	1,215				
NET OPERATING INCOME	143,227	155				
OTHER INCOME & EXPENSE						
Non-operating revenues - net			\$ (257)	\$ 130,249	\$ 113,218	\$ 45
Investment income	21,485	127	505	19,006	9,600	1,379
Gain on current bond redemption	32					
Interest expense and discount amortization	(165,188)	(282)		(147,432)	(116,625)	(70,430)
Plant preservation and termination costs			(59)	(4,030)	(4,078)	(1,500)
Settlement gain/(loss)					(4,650)	181
Gain on sale of nuclear fuel				1,877		
Joint owners' share					2,062	
Other	444		(189)	330	473	
NET REVENUES (EXPENSES)	0	0	0	0	0	(70,325)
EXTRAORDINARY ITEM						
Gain on write-off of liabilities (Note F)						4,273,468
NET INCOME	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 4,203,143

* Supply System's ownership share (Note A)

Project recorded on a liquidation basis

See notes to financial statements

STATEMENTS OF CASH FLOWS

For the year ended June 30, 1996 Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	HANFORD GENERATING PROJECT#	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#	NUCLEAR PROJECTS NOS. 4/5*#
CASH FLOWS FROM OPERATING AND OTHER ACTIVITIES						
Operating revenue receipts	\$ 379,351	\$ 3,656				
Cash payments for operating expenses	(171,332)	(1,444)				
Non-operating revenue receipts				\$ 157,226	\$ 130,747	
Cash payments for preservation and termination costs				(3,204)	(2,671)	(1,443)
Cash payments for other expenses	428		\$ (21)		(747)	
Cash payments for cost sharing settlement				(26,500)	(26,500)	55,000
Distributions of operating and non-operating surplus		(360)				
Net cash provided/(used) by operating and other activities	208,447	1,852	(21)	127,522	100,829	53,557
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Payment for bond issuance and financing costs				(789)	(326)	
Escrow restructuring receipts				479		
Capital and nuclear fuel acquisitions	(23,988)	(10)				
Cash payments for deferred programs	(696)					
Interest paid on revenue bonds	(155,604)	(281)		(144,616)	(98,867)	(53,570)
Principal paid on revenue bond maturities	(52,583)	(331)		(43,500)	(41,760)	(54,010)
Net cash used by capital and related financing activities	(232,871)	(622)	0	(188,426)	(140,953)	(107,580)
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of investment securities	(1,668,921)	(11,900)	(8,526)	(922,119)	(753,997)	(379,995)
Sales of investment securities	1,666,166	10,736	8,289	951,792	779,392	431,883
Interest on investments	20,481	73	267	17,412	10,228	2,124
Receipts from sales of plant assets and fuel				18,300	1,314	
Net cash provided by investing activities	17,726	(1,091)	30	65,385	36,937	54,012
NET INCREASE/(DECREASE) IN CASH	(6,698)	139	9	4,481	(3,187)	(11)
CASH AT JUNE 30, 1995	8,129	22	0	1,006	4,675	141
CASH AT JUNE 30, 1996 (NOTE B)	\$ 1,431	\$ 161	\$ 9	\$ 5,487	\$ 1,488	\$ 130

* Supply System's ownership share (Note A)

Project recorded on a liquidation basis

See notes to financial statements

STATEMENTS OF CASH FLOWS (continued)

For the year ended June 30, 1996

Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	HANFORD GENERATING PROJECT#	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#	NUCLEAR PROJECTS NOS. 4/5*#
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING AND OTHER ACTIVITIES						
CASH FLOWS FROM OPERATING AND OTHER ACTIVITIES						
Net operating income	\$ 143,226	\$ 155				
Adjustments to reconcile net operating income to cash provided by operating activities:						
Amortized revenues	(58,045)	(332)				
Depreciation and amortization	126,216	354				
Decommissioning	5,580					
Other	444					
Change in operating assets and liabilities:						
Accounts receivable	(5,789)	62				
Materials and supplies	(761)	2				
Prepaid and other assets	104					
Due from/to other projects, funds and participants	(274)	1,910				
Accounts payable	(2,254)	(300)				
Non-operating revenue receipts				\$ 157,226	\$ 130,747	
Cash payments for preservation and termination expenses				(3,204)	(3,418)	(1,443)
Cash payments for other expenses			\$ (21)			
Cash payments for cost sharing settlement				(26,500)	(26,500)	55,000
Net cash provided/(used) by operating and other activities	\$ 208,447	\$ 1,851	\$ (21)	\$ 127,522	\$ 100,829	\$ 53,557

* Supply System's ownership share (Note A)

Project recorded on a liquidation basis

See notes to financial statements

OUTSTANDING LONG-TERM DEBT

As of June 30, 1996

Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
NUCLEAR PROJECT NO. 2 REVENUE BONDS						
1973	6-26-73	5.65%	100	5.70%	7-1-2012	\$ 106,450
						<u>106,450</u>
1976A	11-18-76	5.86	(B) 100 99.50	5.70-5.75 6.00 6.00	7-1-97/2000 7-1-2007 7-1-2012	24,170 44,815 60,990
						<u>129,975</u>
1981A	9-4-81	14.67	100 59.958	14.375 8.25	7-1-2001 7-1-2003	30,000 100,000
						<u>130,000</u>
1990A	3-15-90	7.77	99.75 97.125	7.25 7.25	7-1-2003 7-1-2006	73,705 35,790
						<u>109,495</u>
1990B	6-7-90	7.69	94.135	7.00	7-1-2012	200,840
						<u>200,840</u>
1990C	11-1-90	7.84	(B) (B)	7.00-7.50 (C)	7-1-97/2003 7-1-2004/05	204,870 18,054
						<u>222,924</u>
1991A	9-26-91	6.81	(B) 90.375 (B)	5.90-6.60 6.00 (C)	7-1-97/2005 7-1-2012 7-1-2006/07	131,000 105,940 13,431
						<u>250,371</u>
1992A	10-2-92	6.19	(B) 97.230 98.875 (B)	4.80-6.30 6.25 6.30 (C)	7-1-97/2009 7-1-2012 7-1-2012 7-1-2010/11	178,515 66,780 50,000 9,084
						<u>304,379</u>
1993A	5-20-93	5.76	(B) 96.404	4.50-6.00 5.75	7-1-97/2010 7-1-2012	197,520 42,105
						<u>239,625</u>
1993B	7-15-93	5.64	(B) 100 97.775	4.30-5.65 5.55 5.625	7-1-97/2008 7-1-2010 7-1-2012	113,265 51,000 43,455
						<u>207,720</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1996

(E) Includes amounts due July 1, 1996

(F) The estimated fair value shown has been reported to meet the disclosure requirements of SFAS 107 and does not purport to represent the amounts at which these obligations would be settled.

OUTSTANDING LONG-TERM DEBT (continued)

As of June 30, 1996

Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
NUCLEAR PROJECT NO. 2 REVENUE BONDS (Continued)						
1994A	1-27-94	5.31%	(B)	3.75-6.00%	7-1-97/2011	\$ 544,330
			100	5.40	7-1-2012	100,200
			100	(C)	7-1-2009	4,776
						<u>649,306</u>
<i>Compound interest bonds accretion</i>						<u>86,195</u>
<i>Revenue bonds payable</i>						<u>\$2,637,280 (D)</u>
<i>Estimated fair value at June 30, 1996</i>						<u>\$2,594,070 (F)</u>
PACKWOOD LAKE PROJECT REVENUE BONDS						
1962	3-20-62	3.66	99.425	3.625	3-1-2012	5,661
1965	11-4-65	3.76	100.5	3.75	3-1-2012	1,790
<i>Revenue bonds payable</i>						<u>\$ 7,451</u>
<i>Estimated fair value at June 30, 1996</i>						<u>\$ 6,585 (F)</u>
NUCLEAR PROJECT NO. 1 REVENUE BONDS						
1989A	9-14-89	7.76	100	7.00-7.30	7-1-1996/2002	22,780
			98.185	7.00	7-1-2004	27,385
			99.017	7.50	7-1-2007	62,105
			97.759	7.50	7-1-2011	116,195
			82.083	6.00	7-1-2017	95,110
						<u>323,575</u>
1989B	12-7-89	7.44	100	6.70-7.25	7-1-1996/2003	31,095
			98.375	7.00	7-1-2005	2,100
			100	7.40	7-1-2009	5,180
			98.533	7.125	7-1-2016	41,070
						<u>79,445</u>
1990A	3-15-90	7.73	(B)	6.80-7.60	7-1-1996/2005	67,730
			92.75	7.00	7-1-2011	56,770
			81.75	6.00	7-1-2017	55,635
						<u>180,135</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1996

(E) Includes amounts due July 1, 1996

(F) The estimated fair value shown has been reported to meet the disclosure requirements of SFAS 107 and does not purport to represent the amounts at which these obligations would be settled.

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
NUCLEAR PROJECT NO. 1 REVENUE BONDS (Continued)						
1990B	6-7-90	7.75%	(B)	7.00-7.20%	7-1-1999/2003	\$ 24,495
			99.979	7.25	7-1-2009	72,770
			98.913	7.25	7-1-2012	56,000
						<u>153,265</u>
1990C	9-27-90	7.85	(B)	7.10-7.75	7-1-1996/2003	140,845
			99.50	7.75	7-1-2008	22,085
						<u>162,930</u>
1991A	9-26-91	7.02	(B)	5.80-6.80	7-1-1996/2008	50,470
			98.375	6.875	7-1-2017	92,965
						<u>143,435</u>
1992A	10-2-92	6.51	(B)	4.65-6.40	7-1-1996/2011	35,835
			99.375	6.50	7-1-2015	137,820
			98	6.25	7-1-2017	78,815
						<u>252,470</u>
1993A	5-20-93	5.86	(B)	4.20-7.00	7-1-1996/2008	196,880
			100	5.75	7-1-2011	80,000
			99.75	6.05	7-1-2012	35,705
			96.306	5.75	7-1-2013	37,970
			96.566	5.70	7-1-2017	176,180
						<u>526,735</u>
1993B	7-15-93	5.64	(B)	4.10-7.00	7-1-1996/2010	86,510
			98.138	5.60	7-1-2015	94,885
						<u>181,395</u>
1993C	9-10-93	5.47	(B)	3.75-5.30	7-1-1996/2010	23,435
			100	5.40	7-1-2012	66,400
			98.166	5.375	7-1-2015	75,650
						<u>165,485</u>
1993-1A	12-15-93	NA	NA	Variable	7-1-1996/2017	146,340
						<u>146,340</u>

Revenue bonds payable

\$2,315,210 (E)

Estimated fair value at June 30, 1996

\$2,348,653 (F)

OUTSTANDING LONG-TERM DEBT (continued)

As of June 30, 1996

Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
NUCLEAR PROJECT NO. 3 REVENUE BONDS						
1989A	9-14-89	7.43%	100	7.00-7.30%	7-1-1996/2002	\$ 22,100
			(B)	(C)	7-1-2003/14	18,668
			84.75	6.00	7-1-2018	54,570
						<u>95,338</u>
1989B	12-7-89	7.39	100	6.70-7.15	7-1-1996/2001	73,615
			(B)	(C)	7-1-2004/14	71,321
			98.375	7.00	7-1-2005	85,690
			100	7.40	7-1-2009	29,235
			98.533	7.125	7-1-2016	76,145
			79.755	5.50	7-1-2017	62,560
			79.525	5.50	7-1-2018	65,905
						<u>464,471</u>
1990B	6-7-90	7.57	(B)	6.90-7.25	7-1-1996/2000	82,735
			(B)	(C)	7-1-2001/10	39,211
			98.923	7.375	7-1-2004	55,920
						<u>177,866</u>
1991A	9-26-91	6.97	(B)	5.80-6.80	7-1-1996/2008	48,960
			97.75	6.75	7-1-2011	20,790
			94.552	6.50	7-1-2018	66,065
						<u>135,815</u>
1992A	10-2-92	4.86	100	4.65-5.10	7-1-1996/1998	7,745
						<u>7,745</u>
1993B	7-15-93	5.64	(B)	4.10-7.00	7-1-1996/2010	133,825
			97.775	5.625	7-1-2012	28,295
			98.138	5.60	7-1-2015	49,095
			98.058	5.60	7-1-2017	37,795
			97.719	5.70	7-1-2018	20,605
						<u>269,615</u>
1993C	9-10-93	5.47	(B)	3.75-7.50	7-1-1996/2010	173,505
			100	5.40	7-1-2012	105,000
			(B)	(C)	7-1-2013/18	25,248
			98.166	5.375	7-1-2015	188,355
			99.5	5.50	7-1-2018	20,805
						<u>512,913</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1996

(E) Includes amounts due July 1, 1996

(F) The estimated fair value shown has been reported to meet the disclosure requirements of SFAS 107 and does not purport to represent the amounts at which these obligations would be settled.

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<u>NUCLEAR PROJECT NO. 3 REVENUE BONDS (Continued)</u>						
1993-3A	12-15-93			Variable	7-1-1996/2018	\$ <u>194,280</u> <u>194,280</u>
<i>Compound interest bonds accretion</i>						<u>406,582</u>
<i>Revenue bonds payable</i>						<u>\$2,264,625 (E)</u>
<i>Estimated fair value at June 30, 1996</i>						<u>\$1,936,525 (F)</u>

DEBT-SERVICE REQUIREMENTS

As of June 30, 1996 Dollars in thousands

NUCLEAR PROJECT NO. 2

PACKWOOD LAKE PROJECT

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
6/30/96						
Balance*	\$ 0	\$ 0	\$ 0	\$ 115	\$ 91	\$ 206
1997	68,390	153,297	221,687	357	268	625
1998	72,050	149,283	221,333	387	255	642
1999	120,375	144,981	265,356	422	241	663
2000	131,390	136,979	268,369	473	226	699
2001	168,235	127,944	296,179	499	208	707
2002	92,835	116,371	209,206	523	190	713
2003	212,190	110,467	322,657	548	171	719
2004	158,249	107,591	265,840	573	151	724
2005	115,395	111,007	226,402	598	130	728
2006	131,896	93,685	225,581	623	108	731
2007	165,470	86,217	251,687	648	86	734
2008	192,780	64,101	256,881	674	62	736
2009	189,086	59,365	248,451	572	37	609
2010	202,629	52,719	255,348	274	16	290
2011	166,750	41,674	208,424	122	6	128
2012	363,365	21,904	385,269	43	2	45
2013						
2014						
2015						
2016						
2017						
2018						
Adjustment**	86,195	(86,195)				
	\$ 2,637,280	\$ 1,491,390	\$ 4,128,670	\$ 7,451	\$ 2,248	\$ 9,699

* 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

NUCLEAR PROJECT NO. 1

NUCLEAR PROJECT NO. 3

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
6/30/96 Balance*	\$ 46,565	\$ 69,420	\$ 115,985	\$ 47,475	\$ 99,327	\$ 146,802
1997	50,770	142,092	192,862	36,490	96,563	133,053
1998	53,020	139,117	192,137	34,555	94,524	129,079
1999	67,275	135,965	203,240	68,150	92,615	160,765
2000	71,325	131,737	203,062	73,025	88,247	161,272
2001	76,105	127,203	203,308	71,585	90,107	161,692
2002	75,705	122,205	197,910	76,257	86,234	162,491
2003	66,375	117,220	183,595	78,522	84,568	163,090
2004	78,065	113,019	191,084	62,396	96,206	158,602
2005	70,345	108,016	178,361	63,621	94,365	157,986
2006	87,770	103,463	191,233	64,457	92,640	157,097
2007	93,630	97,693	191,323	59,381	92,903	152,284
2008	100,135	91,265	191,400	61,196	91,181	152,377
2009	104,070	84,282	188,352	63,648	88,827	152,475
2010	111,285	77,352	188,637	66,117	86,461	152,578
2011	135,355	70,067	205,422	84,464	75,450	159,914
2012	144,565	61,213	205,778	98,062	71,717	169,779
2013	156,210	52,609	208,819	95,410	74,630	170,040
2014	165,535	43,397	208,932	98,355	71,817	170,172
2015	175,530	33,534	209,064	129,220	41,108	170,328
2016	186,925	23,423	210,348	133,834	36,663	170,497
2017	198,650	11,848	210,498	142,027	28,643	170,670
2018				149,796	21,047	170,843
Adjustment**				406,582	(406,582)	
	\$2,315,210	\$1,956,140	\$4,271,350	\$2,264,625	\$1,389,261	\$3,653,886

NOTES TO FINANCIAL STATEMENTS

Note A - General

ORGANIZATION

The Washington Public Power Supply System (Supply System), 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, 1996, its membership consisted of 10 public utility districts and the cities of Richland, Seattle, and Tacoma. Chelan County PUD No.1 withdrew from the Supply System in July 1995. All members own and operate electric systems within the State of Washington. The Supply System has no taxing authority.

SUPPLY SYSTEM PROJECTS

The Supply System operates Nuclear Project No. 2, a 1,153 MWe (Design Electric Rating net) generating plant completed in 1984, and the Packwood Lake Hydroelectric Project (Packwood), a 27.5 MWe plant completed in 1964.

The Hanford Generating Project (HGP), an 860 MWe plant, previously used by-product steam from the Department of Energy's (DOE) dual-purpose New Production Reactor (N-Reactor) and has not operated since the shutdown of the N-Reactor in 1987. As a result of the Secretary of Energy's decision to place the N-Reactor in permanent shutdown, the Supply System has evaluated alternative energy uses for the plant and anticipates eventual termination of HGP and subsequent removal and site restoration (see Note F - Hanford Generating Project).

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, the Supply System's Board of Directors adopted resolutions terminating Nuclear Projects Nos. 1 and 3. (see Note F - Nuclear Projects Nos. 1 and 3 Termination). The Supply System has explored alternative uses for Nuclear Projects Nos. 1 and 3. However, no viable alternatives have been identified (see Note F - Nuclear Projects Nos. 1 and 3 Termination). Asset disposition plans and amended budgets, which included asset disposition activities, were adopted by the Executive Board on January 26, 1995. On March 6, 1996, the Internal Revenue Service confirmed the Supply System's interpretation of certain complex tax laws and regulations applicable to revenue generated from sale of assets originally purchased with the proceeds of tax exempt municipal bonds. The favorable ruling has two-fold benefit: it allows the Supply System to continue refinancing the debt issued in connection with the Nuclear

Projects Nos. 1, 2, and 3; and to proceed with the sale of major assets at Nuclear Project No. 3. Nuclear Project No. 1 is wholly-owned by the Supply System. Nuclear Project No. 3 is jointly-owned, 70 percent by the Supply System and 30 percent by four investor-owned utilities (PacifiCorp, Portland General Electric Company, Puget Sound Power & Light Company, and The Washington Water Power Company).

Nuclear Projects Nos. 4 and 5 were terminated in January 1982, and substantially all of the utility plant assets have been sold. Eighty-eight project participants in Nuclear Projects Nos. 4 and 5 were originally obligated by contract to pay annual costs of Nuclear Projects Nos. 4 and 5, including debt service, whether or not the projects were completed. However, these contracts were declared invalid by the Washington State Supreme Court. Nuclear Project No. 4 is wholly-owned by the Supply System. Nuclear Project No. 5 is jointly-owned, 90 percent by the Supply System and 10 percent by PacifiCorp (see Note F - Nuclear Projects Nos. 4 and 5 Litigation Settlements).

Each Supply System project is financed and accounted for as a utility system separate from all other current or future projects with the exception of Nuclear Projects Nos. 4 and 5, which are treated as one utility system.

All electrical energy produced by Supply System projects is 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 electrical utility systems throughout the Northwest, including participants in Supply System projects, for ultimate distribution to consumers. BPA is obligated by law to establish rates for electric power which will recover the cost of acquisition and BPA's other operating costs. See Note E, Security - Nuclear Projects Nos. 1, 2 and 3, for discussion of BPA's obligations with respect to Nuclear Projects Nos. 1, 2 and 3. BPA has no obligations with respect to Nuclear Projects Nos. 4 and 5.

Note B - Summary of Significant Accounting Policies

BASIS OF ACCOUNTING

The Supply System has adopted accounting policies and practices that are in accordance with generally accepted accounting principles applicable to governmental utilities. Accounts are maintained in accordance with the uniform system of accounts of the Federal Energy Regulatory Commission. Separate funds and books of account are maintained for each utility system. Payment of obligations of one utility system with funds of another utility system is prohibited, and would constitute violation of bond resolution covenants.

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," the Supply System has elected to apply all Financial Accounting Standards Board Statements and Interpretations except for those that conflict with or contradict GASB pronouncements. Accordingly, the Supply System has implemented Statements of Financial Accounting Standards No. 107 "Disclosures about Fair Value of Financial Instruments," and No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and No. 121, "Accounting for the Impairment Of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of."

The financial statements of Nuclear Project No. 3 reflect the Supply System's 100 percent ownership share except for the balance sheet account of plant and equipment held for sale which reflects 70 percent Supply System ownership.

The preparation of the Supply System financial statements in conformity with generally accepted accounting principles necessarily require management to make estimates and assumptions that directly affect the reported amounts of assets, liabilities, revenues and expenses.

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.

During the normal construction phase of a project, the Supply System's policy is to capitalize all costs relating to the project; including interest expense (net of interest income), and administrative and general expense.

HGP has been reduced to its net realizable value in anticipation of project termination (see Note F - Hanford Generating Project). Nuclear Projects Nos. 1 and 3 have been reduced to their net realizable values due to termination. Plant and equipment held for sale includes management's best estimate for the net realizable value of the remaining inventories, buildings, equipment, tools, materials and consumables, common and operational spares, moveable equipment and land. Interest expense, termination expenses and asset disposition costs for Nuclear Projects Nos. 1 and 3 are charged to current operations.

NUCLEAR FUEL

All expenditures related to the purchase of nuclear fuel, 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 used in the production of energy) is \$89 million as of June 30, 1996, for Nuclear Project No. 2. Current period operating expense for

Nuclear Project No. 2 includes a charge for future spent nuclear fuel storage and disposal to be provided by DOE in accordance with the Nuclear Waste Policy Act of 1982, and a charge by DOE for clean-up of its nuclear enrichment facilities, in accordance with the Energy Policy Act of 1992. No provision has been made in fiscal year 1996 for additional storage and disposal costs which may be incurred by the Supply System prior to the transfer of spent fuel to DOE; such amounts are not determinable at this time.

The Supply System executed a contract in June 1996 to sell 261,285 pounds of uranium for Nuclear Project No. 1 for \$4.8 million. This sale is reflected in the accompanying financial statements.

The Supply System has entered into an agreement with General Electric Company to transfer enriched uranium in exchange for equivalent amounts of uranium at reload enrichments in future years and usage/loan fees. The Supply System has transferred approximately 630,000 pounds of UF₆ and 113,503 SWU of Nuclear Project No. 2 uranium. The exchange agreement has been secured by an irrevocable letter of credit issued in the amount of the replacement value, adjusted semi-annually. The cost of this uranium, \$18.9 million, is included in the carrying amount of Nuclear Project No. 2 Nuclear Fuel.

RESTRICTED ASSETS

In accordance with project bond resolutions, related agreements, or state law, separate restricted funds have been established for each project. The assets held in these funds are restricted for specific uses including construction, debt service, capital additions, extraordinary operation and maintenance, termination, decommissioning, and workers' compensation claims.

LONG-TERM RECEIVABLE

The long-term receivable includes minimum guaranteed amounts pertaining to future discounts for certain goods and services to be provided to Nuclear Project No. 2 as the result of a litigation settlement.

DECOMMISSIONING

Estimated Nuclear Project No. 2 decommissioning costs are accrued based on current funding requirements. Payments are made into a sinking fund which, with accumulated interest, is expected to be adequate to fund decommissioning costs at the end of the 40-year plant operating life. Decommissioning costs are currently estimated at \$357 million (in 1987 dollars). Payments to the decommissioning fund for the year ended June 30, 1996, aggregated \$3.4 million and the balance of the fund at June 30, 1996 was \$36.3 million. The Supply System intends to transfer the management of the investments of the Decommissioning Trust Fund to BPA in fiscal year 1997.

MATERIALS AND SUPPLIES

Materials and supplies are valued at cost, using weighted-average methods.

FINANCING EXPENSE, BOND DISCOUNT, AND DEFERRED GAIN

Financing expense, bond discounts, and deferred gain on redemption of revenue bonds are amortized over the terms of the respective bond issues using the bonds outstanding method.

REGULATORY STUDIES

Expenses associated with regulatory studies for Nuclear Project No. 2 are deferred and amortized by the straight-line method over the estimated operating life of the plant.

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.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments has been estimated using available market information and appropriate valuation methodologies. 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 receivable, accounts payable and accrued expenses, other noncurrent liabilities and due to and from participants, other projects and other funds. The fair value of investments and revenue bonds payable have been estimated based on quoted market prices for such instruments or similar instruments.

REVENUES

With the exception of Nuclear Projects Nos. 4 and 5, the Supply System recovers, through various agreements, actual cash requirements for operations and debt service for each project over the life of that project. Accordingly, the Supply System recognizes revenues equal to operating costs for each period. No net income or loss is recognized, and no equity is accumulated.

The difference between cumulative revenues received and cumulative operating costs is recorded as either billings in excess of costs (liability) or as costs in excess of billings (asset), as appropriate. Such amounts will be recognized as revenues, or costs, during future operating periods.

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 utility system are separately maintained. The Supply System's deposits are insured by federal depository insurance or through the Washington Public Deposit Protection Commission. Supply System investment policies limit investment authority to obligations of the United States Treasury, Federal National Mortgage Association, and Federal Home Loan Banks, as well as repurchase agreements. Collateral for repurchase agreements must be authorized investments under Supply System investment policies. The Supply System did not invest in repurchase agreements during fiscal year 1996. All investments are held in the Supply System's name by safekeeping agents, custodians, or trustees.

Investments are classified as available-for-sale and are stated at fair value with unrealized gains and losses excluded from earnings and reported on the balance sheet as unrealized investment gains/(losses). The Supply System's investments are categorized (see chart on page 31) to give an indication of the types and amounts of investments held by each project at year-end.

Note D - Retirement Benefits

Substantially all Supply System full-time employees participate in the statewide local government Public Employees' Retirement System (PERS). PERS is a contributory multi-employer cost-sharing retirement system established by the Washington State Legislature and administered by the State of Washington through the Department of Retirement Systems. For the year ended June 30, 1996, the Supply System's payroll covered under PERS was \$76.3 million, representing 91 percent of total payroll. PERS contains two plans. Plan I members (employed on or before September 30, 1977) may retire with full benefits at age 60 with at least five years of credited service, at age 55 with 25 years of service, or upon reaching 30 years of service regardless of age. Plan II members (employed after September 30, 1977) may retire with full benefits at age 65 with at least five years of credited service, or with actuarially reduced benefits at age 55 with 20 years of service. The annual pension benefits are generally based on a percentage of final average salary.

Required employer contributions for both plans, and PERS II employee contributions, are determined each biennium by the Legislature. Employee contribution rates for Plan I are established by legislative statute. Employer rates for Plan I are not necessarily adequate to fully fund the system. The employer and employee contribution rates for Plan II are developed by the Office of State Actuary to fully fund the system. The methods used to

AVAILABLE FOR SALE INVESTMENTS
(Dollars in thousands)

	Amortized Cost	Fair Value	Unrealized Gains	Unrealized Gains
NUCLEAR PROJECT NO. 2				
U.S. Government Securities	\$ 137,649	\$ 138,121	\$ 1,840	\$ (1,368)
U.S. Government Agencies	111,270	110,362	182	(1,090)
Total	248,919	248,483	2,022	(2,458)
PACKWOOD LAKE PROJECT				
U.S. Government Securities	2,902	2,901	0	(1)
HANFORD GENERATING PROJECT				
U.S. Government Securities	8,904	8,907	3	0
NUCLEAR PROJECT NO. 1				
U.S. Government Securities	126,680	125,795	456	(1,341)
U.S. Government Agencies	206,628	205,546	224	(1,306)
Total	333,308	331,341	680	(2,647)
NUCLEAR PROJECT NO. 3				
U.S. Government Securities	77,643	76,274	345	(1,714)
U.S. Government Agencies	112,939	112,655	2	(286)
Total	190,582	188,929	347	(2,000)

determine the contribution requirements were established under state statute.

As of December 31, 1994 (the latest actuarial valuation date per the Department of Retirement Systems), the pension benefit obligation of PERS, which is the actuarial present value of credited projected benefits adjusted for the effects of projected salary increases, was \$11.549 billion and the value of net assets available to satisfy present and future pension benefit obligations was \$9.8 billion. The pension benefit obligation is a standardized measure which enables readers of financial statements to assess the funding status of each system and progress made in accumulating sufficient assets to pay benefits when due, and to make comparisons with other retirement systems. The standardized disclosure method is independent of the actuarial funding method used to determine contributions.

Supply System contributions for the year ended June 30, 1996, expressed both in dollar amounts and percentages of current-year covered payroll are stated below:

	Plan I		Plan II	
	Rate	Amount	Rate	Amount
Employer Contributions				
Actuarially determined requirement	7.48%	\$ 833,166	7.48%	\$4,871,254
Actual Supply System contributions	7.61%	\$ 847,819	7.62%	\$4,964,421
Employee Contributions				
Actuarially determined requirement	6.00%*	\$ 668,341	5.06%	\$3,295,260
Actual employee contributions	6.00%	\$ 668,341	5.06%	\$3,292,327
* Fixed at 6.00%				

The Supply System's actuarially determined employer contribution requirement represents approximately 1.6 percent

of the total for all employers covered by PERS.

Historical trend information showing PERS' progress in accumulating sufficient assets to pay benefits when due is presented in the State of Washington's June 30, 1995, comprehensive annual financial report.

In addition to the pension benefits available through PERS, the Supply System offers post-employment life insurance benefits to retirees who are eligible to receive pensions under PERS Plan I and Plan II. Currently, 219 retirees are eligible to receive life insurance benefits and 152 retirees have elected to participate in this insurance. 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. For non-bargaining employees retiring after December 31, 1995, the benefit is limited to \$45,000. The life insurance benefit is based on one-half of the employee's annual rate of salary at retirement with a \$20,000 maximum benefit for bargaining employees. Employees who retire prior to January 1, 1995, contribute \$6.60 per \$1,000 of coverage while employees who retire on or after January 1, 1995, contribute \$26.52 per \$1,000 of coverage. The Supply System funds the death benefit claims on a pay-as-you-go basis.

At the time each employee retires, the Supply System accrues a liability for the actuarial present value of estimated claims, net of retiree contributions. The total liability recorded at June 30, 1996, was \$3 million for these benefits.

During fiscal year 1996, pension costs for Supply System employees and post-employment life insurance benefit costs for retirees were calculated and allocated to each project based on direct labor dollars. Approximately 96 percent of all such costs were allocated to Nuclear Project No. 2 during fiscal year 1996.

Note E - Long-Term Debt

Except for Nuclear Projects Nos. 4 and 5, which were financed together as one utility system, each Supply System project is financed separately. The resolutions of the Supply System authorizing issuance of revenue bonds for each project provide that such bonds are payable solely from the revenues of that project.

In prior fiscal years, the Supply System defeased certain revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the financial statements. Including the fiscal year 1996 defeasements, approximately \$700.2 million, \$800.6 million, and \$675.5 million of bonds outstanding are considered defeased at June 30, 1996, for Nuclear Projects Nos. 1, 2 and 3, respectively.

The Supply System expects to continue the refunding of high-interest bonds when economically feasible. In September 1996, the Supply System issued a total of \$630.9 million in refunding revenue bonds, Series 1996A and 1996B for Nuclear Projects Nos. 1 (\$387 million), 2 (\$211.4 million) and 3 (\$32.5 million). The proceeds of the bonds will be used to refund \$362.6 million, \$200.8 million and \$29.2 million for Nuclear Projects Nos. 1, 2 and 3 bonds, respectively.

Outstanding revenue bonds of the various projects as of June 30, 1996, are presented on pages 21 through 25, and debt service requirements for these bonds are presented on pages 26 and 27.

SECURITY - NUCLEAR PROJECTS NOS. 1, 2 AND 3

Project participants and five investor-owned utilities for Nuclear Project No. 1 have purchased all of the project capability of Nuclear Projects Nos. 1 and 2 and the Supply System's 70 percent ownership share of project capability of Nuclear Project No. 3. BPA has in turn acquired the entire project capability from the project participants under contracts referred to as net-billing agreements. Under the net-billing agreements for each of the projects, project participants are obligated to pay the Supply System their pro rata share of total annual costs of the respective projects, including debt service on bonds relating to each project, 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 project 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. The validity of the net-billing agreements was challenged in November 1982. In May 1983, the U.S. District Court of Oregon declared that the net-billing agreements were binding, and this decision was upheld on appeal.

On May 13, 1994, the Supply System'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. The Supply System 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 the Supply System, Puget Sound Power & Light Company, PacifiCorp, Portland General Electric Company and The Washington Water Power Company remains in effect following termination.

SECURITY - NUCLEAR PROJECTS NOS. 4 AND 5

In connection with the issuance of the generating facilities revenue bonds for Nuclear Projects Nos. 4 and 5, the Supply System pledged the revenues to be derived under participants' agreements with 88 utilities operating principally in the Northwest. The participants' agreements provided that each participant pay its respective share of annual costs, including debt service on the bonds, whether or not the projects were completed, operable, or operating and notwithstanding the suspension, interruption, interference, reduction or curtailment of the projects' output. Payments from the participants for Nuclear Projects Nos. 4 and 5 termination costs and debt service were due beginning on January 25, 1983. As a result of a ruling by the Washington State Supreme Court declaring the participants' agreements invalid, payments due under the participants' agreements were not made and an event of default, as defined in the bond resolution, occurred on July 22, 1983 (see Note F - Nuclear Projects Nos. 4 and 5 Litigation Settlements).

SECURITY - PACKWOOD LAKE HYDROELECTRIC PROJECT

Under power sales agreements, 12 public utility districts have purchased all of the project capability of Packwood. The purchasers are obligated to pay annual costs of the project including debt service, whether or not the project is operable, until 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

On May 13, 1994, the Supply System's Board of Directors adopted a resolution terminating Nuclear Project No. 1. Since that date, the Supply System has been planning for the demolition of Nuclear Project No. 1 and restoration of the site in light of the fact that there is no market for the sale of the Project in its entirety and no viable alternative use has been found. 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. The Supply System has reduced the assets to their estimated net realizable value and has accrued for the estimated cost of removal and site restoration.

NUCLEAR PROJECT NO. 3 TERMINATION

On May 13, 1994, the Supply System's Board of Directors adopted a resolution requesting that Nuclear Project No. 3's Owners Committee declare the termination of the Project. The Project's Owners Committee voted unanimously to terminate the Project in June 1994. Since that date, the Supply System has been planning for the demolition of the Project and restoration of the site under its obligations to the State of Washington if no bona fide purchase offers were found. 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. The Supply System has reduced the assets to their estimated net realizable value and has accrued for the estimated cost of removal and site restoration.

COST-SHARING LITIGATION

In 1982, litigation was commenced by Nuclear Projects Nos. 4 and 5 bondholders against the Supply System, BPA, and all of the utilities participating in Nuclear Projects Nos. 1, 2, 3, 4 and 5 alleging costs shared between Nuclear Projects Nos. 1 and 4 and Nuclear Projects Nos. 3 and 5 had been misallocated to the detriment of Nuclear Projects Nos. 4 and 5. In 1983, Chemical Bank, as trustee for the Nuclear Projects Nos. 4 and 5 bondholders, intervened on behalf of the bondholders.

On July 6, 1995, a settlement agreement was executed between the Supply System, Chemical Bank, BPA, and all public and private utilities involved in Nuclear Projects Nos. 1, 2, and 3, except PacifiCorp. The terms of the settlement provided for payments of \$55 million to Chemical Bank for the benefit of Nuclear Projects Nos. 4 and 5 bondholders. All parties to the settlement agreement agreed to release all claims against the Supply System relating to Nuclear Projects Nos. 4 and 5, except those utilities which made "Bridge and Termination" loans to Nuclear Projects Nos. 4 and 5 (see page 34). Chemical Bank further agreed to extinguish its \$2.25 billion judgment obtained against the Supply System in the MDL-551 litigation in exchange for the issuance of a warrant payable only against the Nuclear Projects Nos. 4 and 5 bond fund. The settlement agreement further provided that Nuclear Projects Nos. 4 and 5 assets and properties may, at some time in the future, be transferred to Nuclear Projects Nos. 1 and 3 at the direction of BPA and the Supply System, and Chemical Bank

assigned all rights to proceeds from sales of such assets and properties to BPA. On July 26, 1995, an order was entered in the District Court approving the settlement.

On November 9, 1995, a final distribution was made to the Nuclear Projects Nos. 4 and 5 bondholders. The Supply System has written off the remaining balance of revenue bonds and accrued interest payable.

HANFORD GENERATING PROJECT

HGP, completed in 1966, previously used by-product steam from DOE's N-Reactor, and has not operated since the shutdown of the N-Reactor in 1987. The federal government's decision to place the N-Reactor in permanent shutdown eliminated it as an energy source for HGP. The Supply System has evaluated alternative energy uses for the plant to no avail. Current options include a transfer to DOE for removal and site restoration, or removal and site restoration by the Supply System. At this time, it is unknown what the eventual disposition of HGP will be. The Supply System has reduced the assets of HGP to their net realizable value and has accrued for the estimated cost of removal and site restoration.

NUCLEAR PROJECTS NOS. 4 AND 5 LITIGATION SETTLEMENTS

On January 22, 1982, the Supply System's Executive Board and Board of Directors adopted resolutions terminating Nuclear Projects Nos. 4 and 5. The Supply System had previously issued \$2.25 billion aggregate principal amount of Nuclear Project Nos. 4 and 5 to pay the costs of the Projects. On July 22, 1983, the Supply System defaulted on the Project bonds.

Thereafter, and for more than a decade, the Supply System was party to a substantial number of lawsuits to the termination of Nuclear Projects Nos. 4 and 5 and the default on the Project bonds. Generally, these lawsuits involved three types of claims: (1) claims by or on behalf of current and former bondholders against the Supply System, its members, its directors, certain of its officers, the Nuclear Project Nos. 4 and 5 participants, architect-engineers, and the underwriters, law firms, accountants, credit rating agencies and miscellaneous other entities associated with the sale of Project bonds; (2) claims by and between the Supply System, BPA, the Project participants and certain investor-owned utilities with ownership interests in Nuclear Project No. 5 or in the net-billed projects adversely affected by the termination of Nuclear Projects Nos. 4 and 5 and/or the default on the Project bonds; and (3) claims against the Supply System by unpaid Nuclear Projects Nos. 4 and 5 construction contractors.

All of the litigation described in the preceding paragraph has been either settled with prejudice and finality or reduced to judgments against the Supply System, the collection of which is limited to available funds of Nuclear Projects Nos. 4 and 5. There is no current litigation related to or arising out of the termination of Nuclear Projects Nos. 4 and 5 or the default on the Project bonds.

pending or, to the knowledge of the Supply System, threatened, which assert claims against the revenues or assets of the net-billed projects. Notwithstanding the foregoing, the most significant lawsuits related to the termination of Nuclear Projects Nos. 4 and 5 or the default on the Project bonds are herein described.

SECURITIES LITIGATION

Following default on the Nuclear Project Nos. 4 and 5 Bonds, a number of lawsuits were filed in federal court against the Supply System and numerous other defendants by current and former Project bondholders alleging violations of various federal securities laws. The actions were consolidated in a single multidistrict proceeding in the United States District Court for the Western District of Washington under the caption *In re Washington Public Power Supply System Securities Litigation, MDL 551 ("MDL 551")*. This action has been settled and concluded with finality.

NUCLEAR PROJECTS NOS. 4 AND 5 BRIDGE AND TERMINATION LOANS

In late 1981, 68 Nuclear Projects Nos. 4 and 5 participants and others loaned the Supply System \$60 million to pay project costs until an alternative source of financing could be found. None was found, and after the projects were terminated in January 1982, 42 Nuclear Projects Nos. 4 and 5 participants loaned the Supply System additional amounts of approximately \$8 million to pay termination costs. The first set of loans were called bridge loans, and the second termination loans. All of these loans were subordinate to the \$2.25 billion of bonds payable, and were payable solely from the revenues of Nuclear Projects Nos. 4 and 5. The Supply System defaulted on all of the loans at the same time it defaulted on Nuclear Projects Nos. 4 and 5 bonds in 1983.

Most of the lenders have sued the Supply System and have been reduced to judgment. The Washington State Supreme Court has held that the terms of the loans limited the source of recovery to funds and assets of Nuclear Projects Nos. 4 and 5. The Supply System has written off the principal and accrued interest for bridge and termination loans for which the statute of limitations has expired. Interest on the remaining loans in the amount of approximately \$66.7 million remains accrued and unpaid at June 30, 1996. Pursuant to the terms of the settlement agreement in the Cost Sharing litigation, the parties thereto agreed to the entry of judgments against Nuclear Projects Nos. 4 and 5 in favor of Puget Sound Power and Light and The Washington Water Power Company for bridge loans made to the Supply System by those utilities. Additionally, all settling defendants released each other and agreed *inter alia* not to assert said bridge or termination loans against any of the other settling defendants, except for purposes of an offset against claims made with respect to Nuclear Project Nos. 4 and 5.

INTER-PROJECT CLAIMS AGAINST REVENUES AND OTHER ASSETS

Some creditors of Nuclear Projects Nos. 4 and 5 have attempted, and others have threatened to attempt, to obtain payment from the physical assets of other projects of the Supply System or from the revenues pledged as security for the Supply System bonds issued in connection with, and revenues pledged for the payment of costs of, such other projects. Such creditors include present and former holders of the Nuclear Projects Nos. 4 and 5 bonds and others who may assert claims in the future against the Supply System and/or its projects.

The Supply System's management and legal counsel are of the opinion that such creditors will only be able to realize upon the net assets of Nuclear Projects Nos. 4 and 5 and will not be able to realize upon any net assets or future revenues of the Supply System and/or its other projects.

NUCLEAR PROJECT NO. 5 TERMINATION CLAIM

In August 1983, PacifiCorp, owner of 10 percent of Nuclear Project No. 5, filed claims against the Supply System in the Cost Sharing Litigation asserting that termination of Nuclear Project No. 5 was a breach of the Project Ownership Agreement between PacifiCorp and the Supply System. This claim survived the Cost Sharing Litigation Agreement. On August 12, 1996, the Supply System and PacifiCorp executed a settlement agreement resolving all claims between the parties in any way arising out of the construction, termination and future site restoration of the Project. By order dated August 19, 1996, the court approved the settlement and dismissed the action with prejudice.

NUCLEAR PROJECTS NOS. 1, 3, 4 AND 5 SITE RESTORATION

Site restoration requirements for Nuclear Projects Nos. 1, 3, 4 and 5 are governed by site certification agreements between the Supply System and the State of Washington; regulations adopted by the Washington Energy Facility Site Evaluation Council (EFSEC); and for Nuclear Projects Nos. 1 and 4, a lease agreement with DOE. The Supply System submitted a site restoration plan to EFSEC on March 8, 1995, which complied with EFSEC requirements to remove the assets and restore the site by demolition, burial, entombment, or other techniques such that the sites pose minimal hazard to the public. EFSEC recognized that there is uncertainty associated with the Supply System's proposed plan. Accordingly, EFSEC's conditional approval provided for additional reviews once the details of the plan are finalized.

Based on current estimates for site restoration, the Supply System has accrued liabilities of \$46 million for Nuclear Project No. 1 and \$36 million for Nuclear Project No. 3. Funding for these liabilities will be provided by BPA. No source of funding has been identified for site restoration on Nuclear Project No. 4 which is

located approximately one-half mile from Nuclear Project No. 1. No source of funding has been identified for site restoration of Nuclear Project No. 5 which is adjacent to Nuclear Project No. 3, sharing a turbine-generator building on the same site. The Supply System believes that although Nuclear Projects Nos. 1 and 3 have no legal obligation to fund Projects Nos. 4 and 5, respectively, it is possible that claims may be asserted against Nuclear Projects Nos. 1 and 3 to pay the costs of site restoration for Nuclear Projects Nos. 4 and 5, respectively. The Supply System currently estimates that the cost of site restoration for Nuclear Projects Nos. 4 and 5 are \$30 million and \$14 million, respectively.

During 1995, a group from Grays Harbor County, Washington, which is interested in economic development, formed the Satsop Adaptive Reuse Team. The Satsop Adaptive Reuse Team introduced legislation with the State of Washington under Senate Bill No. 6427, which passed and was signed by the Governor of the State of Washington on March 7, 1996. The legislation enables local governments and the Supply System to negotiate an arrangement allowing such local governments to assume an interest in the site on which Nuclear Project No. 3 exists for economic development by transferring ownership of all or a portion of the site to local government entities. This legislation also provides for the local government entities to assume regulatory responsibilities for site restoration requirements and control of water rights.

The Supply System has entered discussions with representatives of Grays Harbor County about possible alternate uses for the site on which Nuclear Project No. 3 exists. This may benefit Grays Harbor County in economic development and may reduce the Supply System's obligation for site restoration. The Supply System has deferred the issuance of a formal Request for Proposals for the demolition/site restoration contract while these discussions are ongoing.

FUEL CONTRACTS - NUEXCO BANKRUPTCY

The Supply System has for several years engaged in uranium purchase, sale and loan transactions with Nuexco Trading Corporation (Nuexco), a corporation owned by Oren L. Benton ("Benton"). On February 23, 1995 (the "Petition Date"), Nuexco, Benton and several related entities filed chapter 11 bankruptcy cases in the U.S. Bankruptcy Court for the District of Colorado (the "Bankruptcy Case"). Prior to commencement of the Bankruptcy Case, the Supply System had outstanding three uranium loan or sale contracts (two contracts relating to Nuclear Project No. 1 and one contract relating to Nuclear Project No. 2). Nuexco had secured these contracts with a letter of credit and a pledge of uranium in various forms.

A few months before the Bankruptcy Case commenced, Nuexco had defaulted to the Supply System on a significant payment for the purchase of uranium relating to Nuclear Project No. 1. The Supply System drew on its letter of credit in partial satisfaction of such payment and, pursuant to the terms of a subsequent settle-

ment agreement (the "Settlement Agreement"), Nuexco transferred to the Supply System all of Nuexco's right, title and interest in the uranium pledged to the Supply System. In addition, Nuexco, together with certain guarantors of Nuexco's obligations, including Benton, agreed to pay a deficiency claim in the amount of \$14,500,000. The Supply System anticipates collecting from the Bankruptcy Case only a small percentage of this deficiency amount. As such, the Supply System has fully reserved against the \$11.9 million receivable from Nuexco.

Approximately \$21.4 million of uranium collateral (approximately \$2.7 million of Nuclear Project No. 1 materials and \$18.7 million of Nuclear Project No. 2 materials) turned over to the Supply System under the Settlement Agreement is located at Siemens Power Corporation's (Siemens) storage and fabrication facility in Richland, Washington. Several utilities with similar accounts at Siemens, together with other parties in interest in the Bankruptcy Case, are seeking to establish entitlement to the fuel in their various accounts transferred to them by Nuexco. Siemens has indicated it will not make any of the material available to the Supply System or these other parties until the disputes between the parties are settled or the bankruptcy court orders otherwise. The Supply System, together with the other utilities with Nuexco-related accounts, recently commenced litigation in the Nuexco bankruptcy case to obtain their respective shares of the uranium located at Siemens. Although the parties are asserting conflicting claims to this material at Siemens, the Supply System believes that its entitlement to the material at Siemens will be upheld.

RAYTHEON V. SUPPLY SYSTEM

Following termination of Nuclear Project No. 3 in 1994, the Supply System terminated a contract with Raytheon Engineering and Constructors, Inc. (Raytheon), the successor to Ebasco Services, Inc., which was the architect/engineer and construction manager for Nuclear Project No. 3. In September 1995, Raytheon filed an action for breach of contract against the Supply System in U.S. District Court of the Western District of Washington. Raytheon claims that it is entitled to additional payments of approximately \$19 million under the terms of the contract. Approximately one-half of the total amount claimed is for prejudgment interest. Raytheon's claim is based on a claim of entitlement to incentive fees allegedly earned prior to 1984. A small portion of the claim relates to amounts allegedly due on account of employee severance costs incurred by Raytheon. The Supply System and Raytheon have filed several motions for summary judgment with respect to the various theories of liability. Discovery has commenced. Management cannot predict the outcome of this litigation.

SIEMENS POWER CORPORATION

On June 30, 1996, the Supply System entered into a settlement agreement with Siemens Power Corporation for a claim of a

termination fee arising from the alleged termination of a Nuclear Project No. 3 nuclear fuels requirements contract. The agreement includes a \$4.65 million settlement with payment due on October 1, 1996. This settlement is included in the accompanying financial statements under accrued expenses.

OTHER LITIGATION AND COMMITMENTS

The Supply System is involved in various claims, legal actions and contractual commitments not mentioned above as both plaintiff and a defendant 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 projects or the Supply System as a whole. The estimated cost of the projects, however, may either be increased or decreased as a result of the outcome of these matters.

NUCLEAR LICENSING AND INSURANCE

The Supply System 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 over \$8.7 billion per incident, which is covered by a combination of commercial nuclear insurance and mandatory industry self-insurance. The Supply System 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 110) may be assessed up to \$75.5 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 the Supply System and BPA. The total amount of insurance purchased is currently \$1.06 billion. The deductible for this coverage is \$10 million per occurrence.

POSSIBLE FUTURE SUPPLY SYSTEM PROJECTS - SATSOP CT PROJECT

In 1990, the Board of Directors of the Supply System voted to study the siting of a combustion turbine power plant at the Nuclear Projects Nos. 3 and 5 site. Such a combustion turbine, if ultimately determined to be feasible and constructed, would be developed consistently with the resource planning requirements of member utilities and BPA. Any such projects would be separate and distinct from all other Supply System Projects.

Beginning in 1992, the Supply System submitted a series of proposals to BPA in response to their solicitations for new generating resources. In June 1993, BPA notified the Supply System that the Supply System's combustion turbine, known as the Satsop CT Project, was selected as one of three combustion turbine power plants to be developed (designed and permitted) and held as an "option" under Bonneville's Resource Contingency Program.

The Satsop CT Project has completed all required environmental studies and permit applications for two combustion turbine power plant units, and only final permit approvals are required before it could proceed. Final permit approvals are anticipated by September 1996. There can be no assurance if and when the output of either of the two units will be needed, but the permits will be maintained for 10 years.

For the year ended June 30, 1996 (unaudited)

BOND RATINGS - SUPPLY SYSTEM

Fitch Investors Service LP
Moody's Investors Service, Inc. (Moody's)
Standard and Poor's Corporation (S & P)

FY 1996

AA-
Aa1*
AA-

FY 1995

AA
Aa
AA

OUTLOOK

Stable

Stable

VARIABLE RATE LETTER OF CREDIT BANKS

Long Term

Series 1993-1A/3A-1
Series 1993-1A/3A-2
Series 1993-1A/3A-3

S & P

AA-
AA-
AA

MOODY'S

Aa3
Aa3
Aa2

Short Term

Series 1993-1A/3A-1
Series 1993-1A/3A-2
Series 1993-1A/3A-3

A-1+
A-1+
A-1+

VMIG1
VMIG1
VMIG1

* Rating changed from Aa on August 23, 1996