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WASHINGTON PUBLIC POWER SUPPLY SYSTEM

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

January 8, 1998

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50-397
50-508

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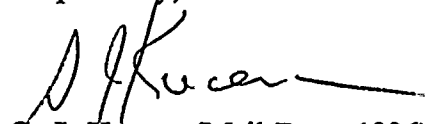
Gentlemen:

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 1997.

Should you have any questions or desire additional information regarding this matter, please call me or R. A. Bresnahan at (509) 377-5730.

Respectfully,



G. J. Kucera (Mail Drop 1396)
Vice President, Administration/Chief Financial Officer

AGC/lw

Enclosure: Washington Public Power Supply System Annual Report 1997

cc: EW Merschoff - NRC RIV
C Poslusny, Jr. - NRR w/o
MM Mendonca - NRC w/o
PD Robinson - Winston & Strawn w/o
DL Williams - BPA/399 w/o
NRC Sr. Resident Inspector - 927N

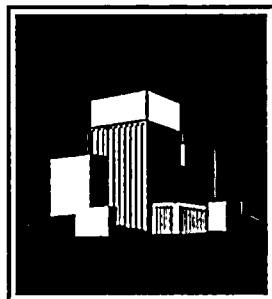
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High Standards,
Set and Met

*High Standards
Set and Met*



ANNUAL REPORT
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Table of contents

Financial and Operating Highlights

1

Executive Board

2-3

High Standards, Set and Met

Don Carter, Executive Board Chairman

Vic Parrish, Chief Executive Officer, and

4

Vice Presidents

5

"Meeting Our Power Customer's Needs"

6-7

"Operational Highlights"

8-9

"Business Initiatives"

10-11

Board of Directors

12

Financial Information

13-36

Financial Operating Highlights

For the year ending June 30, 1997 (Dollars in millions)

OPERATING STATISTICS

NUCLEAR PROJECT NO. 2

	FY 1997	FY 1996	FY 1995	FY 1994	FY 1993
Total production costs*	\$ 119.5	\$ 133.3	\$ 139.9	\$ 155.9	\$ 138.6
Net generation (millions of kWh)**	6,965.3	7,703.6	6,942.7	7,288.8	6,129.7
Cost in mills/kWh*	17.2	17.3	20.2	21.4	22.6
Plant availability***	83.7%	79.7%	75.0%	79.5%	68.8%
Plant capacity****	60.0%	61.3%	67.9%	76.6%	63.7%

PACKWOOD LAKE PROJECT

	FY 1997	FY 1996	FY 1995	FY 1994	FY 1993
Total production costs*	\$ 0.4	\$ 0.1	\$ 1.0	\$ 0.4	\$ 0.3
Net generation (millions of kWh)	123.1	125.4	60.7	65.6	65.8
Cost in mills/kWh*	3.3	0.9	16.3	6.7	4.4
Plant availability***	88.5%	90.1%	60.0%	90.0%	100.0%
Plant capacity****	51.1%	51.9%	22.9%	27.3%	27.3%

INVESTMENT PERFORMANCE

	FY 1997	FY 1996	CHANGE
Income	\$ 41.4	\$ 50.8	-18.5%
Average Balance	701.3	853.8	-17.9%
Rate of Return	5.9%	5.9%	0.0%

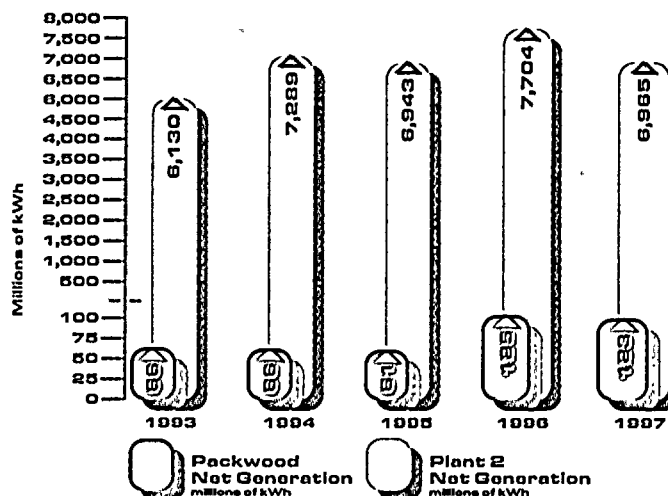
BONDS OUTSTANDING

Amount # /Weighted Average Coupon Rate

	FY 1997	FY 1996	CHANGE
WNP-1 fixed	\$ 2,160.6	\$ 2,168.9	-0.4%
weighted average	6.0%	6.4%	-6.3%
variable	142.6	146.3	-2.5%
average rate	3.5%	3.7%	-5.4%
WNP-2 fixed	2,491.7	2,551.0	-2.3%
weighted average	6.0%	6.1%	-1.7%
WNP-3 fixed	1,623.8	1,663.7	-2.4%
weighted average	6.0%	6.0%	0.0%
variable	190.0	194.3	-2.2%
average rate	3.5%	3.7%	-5.4%
Packwood fixed	7.1	7.4	-4.1%
weighted average	3.7%	3.7%	0.0%

#Excludes compound interest bond accretion

- * Includes operating, maintenance, and fuel amortization costs per FERC report
- ** Includes BPA economic dispatch generation (millions of kWh) credit of 1,150.9; 1,759.2; and 480 in FY 97, FY 96 and FY 95, respectively
- *** Plant availability is defined as the ratio of the sum of source hours and reserve shut down hours to total period hours
- **** Plant capacity factor is the ratio of the actual energy production over a given period of time to the maximum energy production capability



Executive Board Washington Public Power Supply System

Executive Board Committees

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

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John Cockburn, Chairman
Rudi Bertschi
Vera Claussen
Bob Royer
Roger Sparks
Lou Winnard

Don Carter, Ex Officio

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



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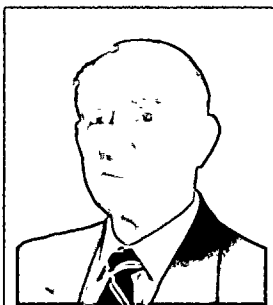
DON CARTER (Board Chairman)
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City of Richland, WA

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Consultant, Economic & Technical Analysis Group,
Seattle, WA

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Commissioner, Grant County PUD, Ephrata, WA

EDWARD E. "TED" COATES (Board Secretary)
Retired Utility Executive, Tacoma, WA

JOHN COCKBURN
Retired Bank Executive, Seattle, WA



Bottom row from left to right

DAN GUNKEL
Commissioner, Klickitat County PUD, Goldendale, WA

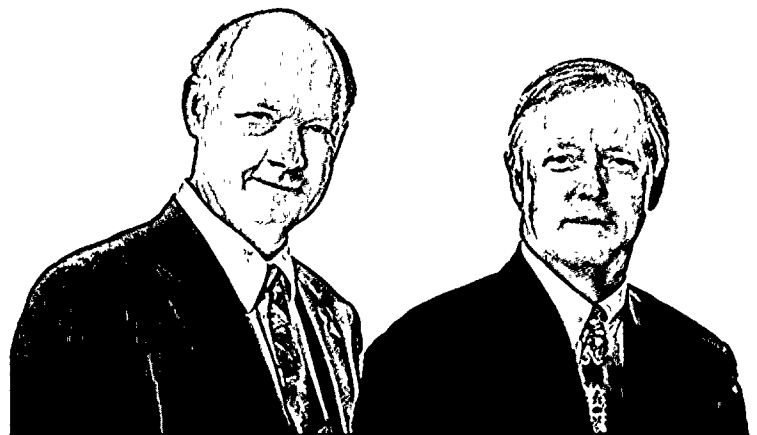
PARKER KNIGHT
Commissioner, Skamania County PUD, Carson, WA

ROGER SPARKS
Commissioner, Kittitas County PUD, Ellensburg, WA

BOB ROYER
Partner, Royer/Katz Communications, Seattle, WA

LOU WINNARD (Board Vice Chairman)
Consultant, Windsor, CA

*High Standards,
Set and Met*



Executive Board Chairman
Don Carter

Chief Executive Officer
Vic Parrish

The Supply System began fiscal year 1997 committed to improved performance standards for Plant 2 and its work force. By a number of measures, these standards were met or surpassed.

To our sole customer — the Bonneville Power Administration — improved Plant 2 performance means a reduction in the dollars spent by the federal power marketing agency for safe and reliable operation of this 1,200-megawatt electrical generating station. Competition is mounting as deregulation of the electrical industry looms, and Plant 2 must be ready to accommodate BPA's needs for low-cost, reliable electricity.

To our member utilities, it means benefiting from involvement in Supply System operations and activities. The 13 utilities that are Supply System members are critical to our future, and we're dedicated to strengthening our understanding and connection with these organizations, and capitalizing on ways to provide them with additional services and benefits.

And to the ratepayers of the Pacific Northwest, it means a return on their investment and safe, reliable, low-cost electricity.

Most significant among this year's performance improvements were a 270 - continuous day record operating run, a new plant record for Availability Factor, and a cumulative employee radiation exposure well under anticipated targets.

Lowering radiation exposure was a trend that began in fiscal year 1995, and continues to be emphasized throughout the organization. Annual goals for collective radiation exposure during the last several years have been coupled with annual goals for Plant 2 unit capability and quarterly goals for human performance, in our "Share the Savings" employee incentive program.

Most employees received payouts for human performance goal achievement in three of the four quarters this fiscal year, and an annual incentive payout in recognition of achieving all or substantial parts of the goals.

The success of our effort to work to higher standards has been noted by our federal regulator, the Nuclear Regulatory Commission, and by peer reviewers, including the Institute of Nuclear Power Operations. INPO, in fact, has lengthened the intervals between its conduct of comprehensive evaluations of Plant 2 performance, signifying increased confidence in our ability to operate safely and reliably.

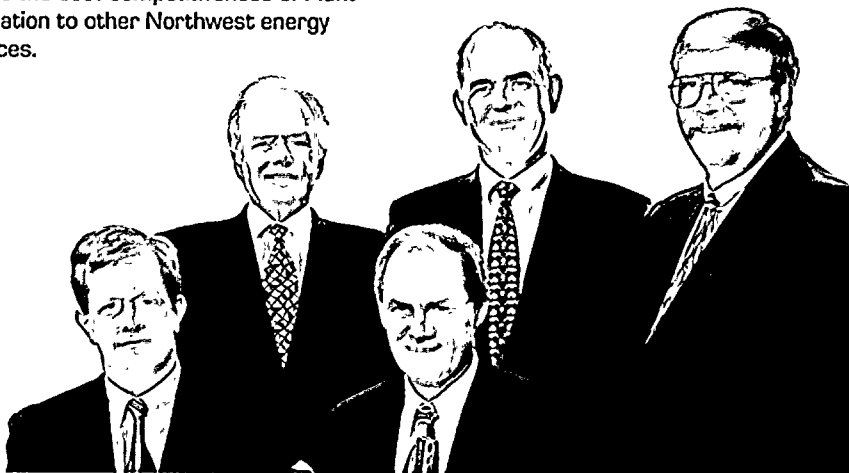
During the year, we reinforced the focus of each of our employees on achieving the overall Supply System strategic objectives of Safety, Cost Competitiveness, Human Performance, Public Confidence, Trust & Stewardship, Business Development and Material Condition.

Our latest strategic plan sets even higher standards and more challenging goals. For example, the "regional cost" for Plant 2 decreased from \$251 million in FY 1994 to \$171.6 million in FY 1997. We use the regional cost measurement, which includes operations, maintenance, fuel, capital, administrative and general, to evaluate the cost competitiveness of Plant 2 in relation to other Northwest energy resources.

Our planning target in FY 1997 was to have that cost down to \$150 million in FY 2000. Some steps we're taking to achieve this lowered budget include further staffing efficiencies, controlling capital expenses and overtime, and reducing outside services.

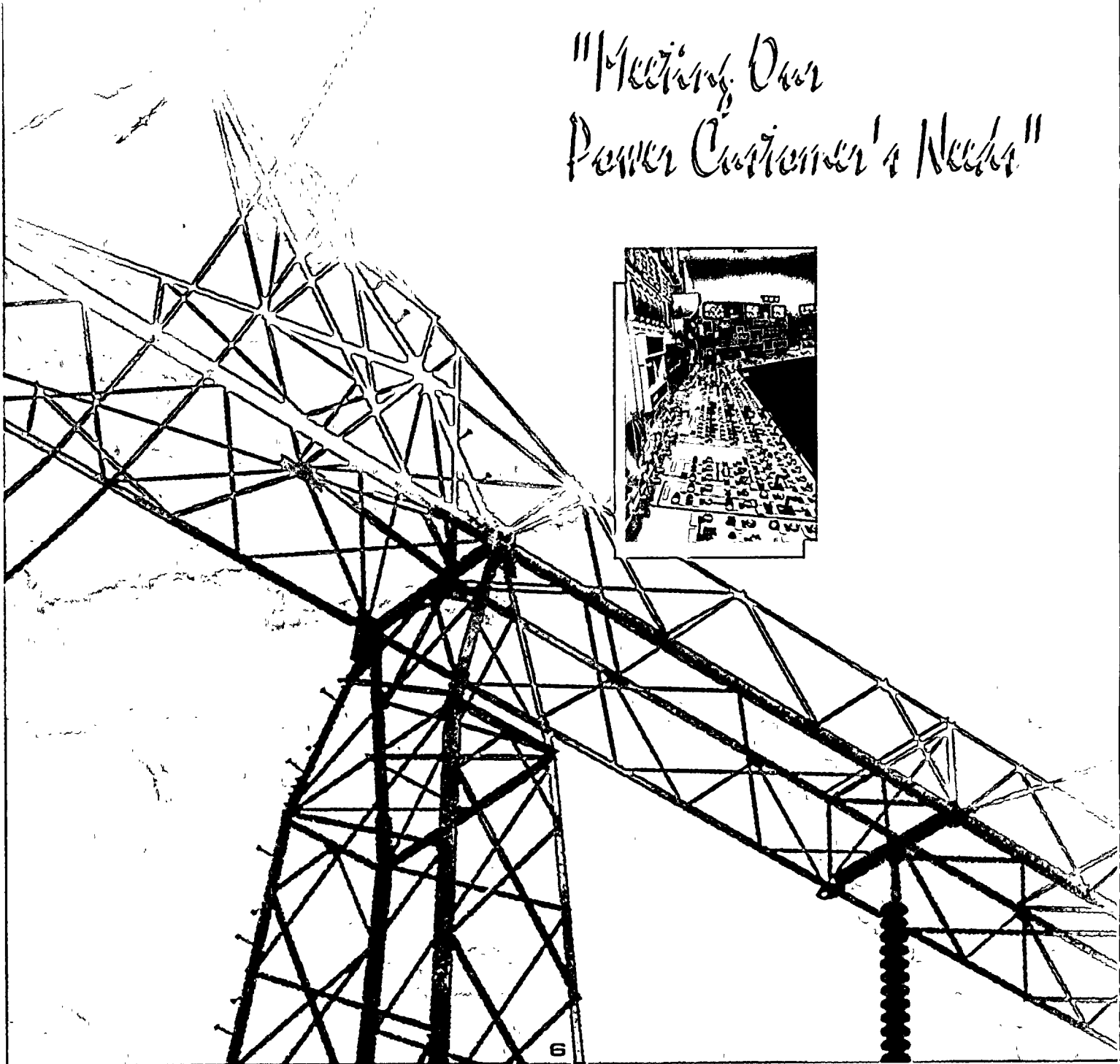
We expect this reduction in operating budget to be accompanied by a corresponding reduction in regional cost of power generated at the plant—from a cost of 2.46 cents per kilowatt-hour in FY 1997 to less than 2 cents per kilowatt-hour in FY 2000.

Fiscal year 1997 continued our trend of improving our standards and meeting our goals. Our challenge now is to further our efforts to improve performance and explore other business opportunities so that we will continue to play a lead role in the regional electrical industry.



From left:
Vice President Operations Support/Public Information Officer
Rod Webring
Vice President Nuclear Operations
Paul Bomis
Vice President Administration/Chief Financial Officer
Jerry Kucora
Chief Counsel
Al Mouncer
Vice President Resource Development
Jack Baker

*"Meeting Our
Power Customer's Needs"*





The Plant 2 operating cycle that began in the summer of 1996 and concluded at the end of March 1997 was notable for the amount of load cycling the plant did in response to the power needs of Bonneville Power Administration, the customer for our generation. In February 1997, BPA officially expressed appreciation for the Supply System's demonstrated ability "to safely and effectively integrate Plant 2 into the operation of the FCRPS (Federal Columbia River Power System) by load cycling."

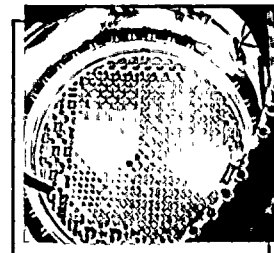
This phrase is used to describe the practice of operating Plant 2 at varying power levels on a daily and weekly basis. For example, for several days in early January 1997 we operated the plant at 100 percent power from 7 a.m. to 9 p.m., decreased power to 70 percent and stayed at that level until 5 a.m. the following morning, and then returned to 100 percent power. After decreasing to 70 percent power on Friday evening, that power level was maintained through the weekend, with return to full power on Monday morning. That approximates the typical pattern of electricity use, with maximum demand occurring during the day on weekdays and decreasing late night-early morning and on weekends.

Load cycling was done in July 1996, and in January, February, and March 1997. This flexibility brought several benefits to BPA and other federal agencies involved in operation of the FCRPS. First, it increased their flexibility in regulating river flow for any of several reasons, including fish migration, flood control, and electricity generation. Second, it gave BPA the ability to maximize the economic benefits of Plant 2 operation.

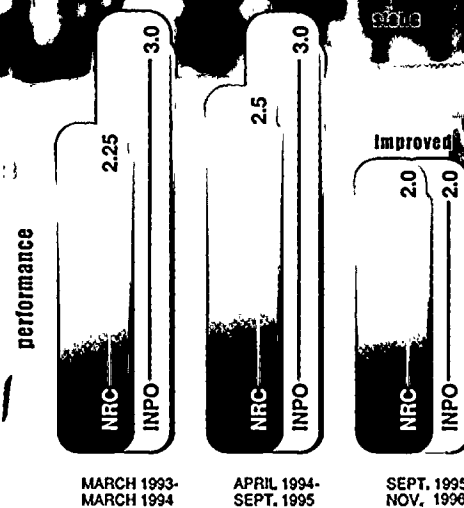
The key to the increased use of Plant 2 for load cycling operation is the new Adjustable Speed Drive/Digital Feedwater combination of systems that was operational at the plant for the first time during this fiscal year. When it resumed operation in July 1996, Plant 2 became the first nuclear power plant in the United States with this combination of computerized controls for adjusting plant power level and feedwater flow into the reactor vessel. While there were problems with components of both systems during this past operating cycle, they did fulfill their promise by making it easier for operators to change reactor power level on demand. For further discussion of the new systems, see the "Operational Highlights" section of this report.

In addition to the periods of load cycling, power generation at Plant 2 also was affected by two periods during which the plant was placed in economic dispatch by BPA. These occurred before and after the spring 1997 annual plant refueling outage. Economic dispatch means that a plant is not operated because there is a surplus of electric power driving the market price below the cost of production.

In total, the Supply System transmitted nearly 6 billion kilowatt-hours of electricity to BPA during FY 1997. This included generation from Plant 2 and from our Packwood Lake Hydroelectric Project. The cost of this power was 2.46 cents per kilowatt-hour for Plant 2 and 0.8 cents per kilowatt-hour for the Packwood Project (both regional basis). The cost of power for Plant 2 includes correction for load cycling and economic dispatch, which brings the credited generation for FY 1997 to nearly 7 billion kilowatt-hours.



"Operational Highlights"



Note: Lower numerical values indicate improved performance.

Plant 2

The Supply System operates a single-unit nuclear power station—Plant 2. Some unusual challenges are associated with this key segment of our business. Our success during FY 1997 is a good indication of the high skill level, flexibility and innovative talent of our staff.

We have one customer for the power Plant 2 generates—Bonneville Power Administration. More than 80 percent of the electricity that BPA sells is generated at hydroelectric facilities, a circumstance that has influenced Plant 2 to stay on an annual refueling cycle in which refueling and maintenance outages coincide with springtime high water flows in the Pacific Northwest's rivers. During this past annual operating cycle, Plant 2 also was the first commercial nuclear power plant in the United States to operate with a combination of digital feedwater controls and adjustable speed drives for its reactor recirculation pumps.

And what an operating year it was! For one thing, it was non-stop—270 days of continuous operation, beginning on June 29, 1996, for the longest operating run in the plant's 12-year history. The availability factor that went along with that record operating run was 83.7 percent, another Plant 2 record. The availability factor measures what percent of the entire year the plant was either operating or available to operate. The month of December during that operating run was a standout, with Plant 2 transmitting 850,855 megawatt-hours of electricity to BPA, the highest single month's generation in the plant's operating history.

"Plant 2's ability to achieve consistent and long operation lengths during the past four cycles despite various challenges to plant systems and components has enhanced its reputation as a reliable resource," said Ed Brost, BPA's Contract Generating Resources manager.

That 270-day record operating run might have been longer but for the impact of hydroelectric system operation on Plant 2. The request to shut down came from BPA in late March 1997 because excess water and lower power demands were resulting in "spilling" water at hydroelectric dams throughout the Federal Columbia River Power System (FCRPS). The plant shutdown reduced spilling, which is detrimental to fish.

Those unusually high water flows in the Columbia and Snake River systems led BPA to request extensive load cycling by Plant 2 beginning during the week of Feb. 10 and continuing until plant shutdown in late March. The combination of Adjustable Speed Drive and Digital Feedwater systems, unique to Plant 2, made it more convenient for operators to vary plant power level in response to requests from BPA. The downpowers during load cycling, power reductions during intermittent problems with the new ASD and Digital Feedwater systems, and periods of economic dispatch both prior to and following the 270 days of operation resulted in transmission of a total of 5.8 billion kilowatt-hours of electricity to BPA during fiscal year 1997. Electricity transmission otherwise might well have exceeded 7 billion kilowatt-hours.

BPA expressed appreciation for Plant 2's demonstrated ability to load cycle, pointing out that this has enabled more efficient and economical integration of the plant into the FCRPS. "Supply System staff should be proud of Plant 2 performance, and its achievement as the leader in the nuclear industry for successful integration of a nuclear plant with a hydro-based system," said BPA's Ed Brost.

Another key success during the 1996-97 operating cycle was achievement of our goal to further reduce the cost of Plant 2 power. The Supply System began FY-1997 with the Plant 2 regional cost budget set at \$190 million, a sizeable reduction from the previous year's regional cost of \$197 million. The actual regional cost for FY 1997 was \$171.6 million. Jerry Kucera, the Supply System's Vice President, Administration/CFO, noted that the final cost represented a multimillion dollar direct cash savings to BPA and Pacific Northwest ratepayers. The FY 1997 cost number would have been even lower, but the Supply System chose to make a \$7 million pay-down on an amount due for previous nuclear fuel purchases. The cost of power for FY 1997, on a regional basis, was 2.46 cents per kilowatt-hour. In FY 1996 the comparable figure was 2.57 cents per kilowatt-hour.

Some other highlights of the year for Plant 2 were:

- Early in the 1996-97 operating cycle, Plant 2 twice helped stabilize the regional electrical distribution grid during disturbances—on July 2 and Aug. 10, 1996. In both instances, electricity transmission interties between the Pacific Northwest and California shut down, generating facilities at hydroelectric projects and elsewhere dropped off-line, and the entire Pacific Northwest grid broke into "islands." Plant 2 continued operating through both transients.
- In October and November of 1996 a team of nuclear industry peers under the auspices of the Institute of Nuclear Power Operations (INPO) conducted an extensive evaluation of Plant 2 Operations, Training, other aspects of plant operation, plant Maintenance and Engineering, and human performance. The results of the INPO evaluation indicated that the overall performance was exemplary, industry standards of excellence were met in many areas, and no significant weaknesses were noted.
- Safety System Functional (SSF) and Maintenance Rule Inspections were conducted at Plant 2 in November, December, and January by Nuclear Regulatory Commission (NRC) teams. NRC is the federal agency that regulates Plant 2 operation. The SSF inspection at Plant 2 was the first in a series that the NRC has planned at nuclear power plants throughout the country during the next two years. During the inspection, no issues were identified that would raise an immediate operability question in any of the three plant safety systems examined in considerable depth. It was concluded that the three systems were capable of performing their required safety functions.
- In February 1997 the Supply System became the first U.S. utility with a nuclear power plant using a BWR-5 nuclear steam supply system to convert to Improved Technical Specifications. This major change culminated several years of work and was implemented smoothly.
- NRC Chairman Dr. Shirley Ann Jackson toured Plant 2 on March 20. In addition to Jackson's plant tour, she received briefings from Supply System management on performance improvement initiatives, efforts to reduce Plant 2's cost of power, plant performance to achieve electric transmission grid stability in the region, and proposed mixed-oxide fuel use at Plant 2.
- The NRC on April 3, 1997, distributed an assessment of the plant's performance between Sept. 3, 1995, and March 1,

1997, that showed "significant improvement" from the previous assessment.

- We accomplished a great deal of work during the R-12 maintenance and refueling outage, and it was done without significant error. Our expectation is that this work will improve the efficiency and reliability of the station. Among the major tasks performed during this year's outage were:
 - Replacement of 112 of the plant's 764 nuclear fuel assemblies;
 - Inspection of the low-pressure turbine and removal, cleaning, and reinstallation of one of its three sections;
 - Exchanging 18 control rod drive mechanisms that control reactor power level;
 - Replacing nine main steam safety relief valves;
 - Inspecting reactor vessel internals and the suppression pool; and
 - About 1,400 preventive maintenance tasks.
- Collective radiation exposure for Plant 2 workers during FY 1997 was 256.1 person-rems. This was less than the goal of 280 person-rems, and continues the downward trend that began in FY 1995. The cumulative radiation exposure to workers during this year's outage (194.6 person-rems) was the lowest at Plant 2 since Refueling Outage 1 in 1986!

Packwood Hydroelectric Project

For the Supply System's Packwood Lake Hydroelectric Project, FY 1997 was the second consecutive year of exceptionally high power output.

Packwood generated 123,135,000 net kilowatt-hours of electricity during fiscal year 1997. That's the second-best generating year for the 27.5-megawatt hydroelectric project in its 33 years of operation. It is 2.3 million net kilowatt-hours under the best generating year, which was fiscal year 1996.

The electrical output from the eastern Lewis County power station during these two years far surpassed the project's lifetime average annual generation of 93 million kilowatt-hours. Generation during May and June of this year was the highest for these months since the mid-1980s. Operating costs for the 27.5-megawatt project were about 0.8 cents per kilowatt-hour.

Power from the Packwood project is sold to the Bonneville Power Administration. This change from previous years' practice was authorized in January 1997 by the Supply System's Executive Board. Any revenue from power sales in excess of operating costs is shared by the 12 public utility districts participating in the project. This year's surplus, paid to the participants in September 1997, totaled about \$400,000.



"Business Initiatives"

APEL

The Applied Process Engineering Laboratory (APEL) in Richland, WA, was dedicated on June 20, 1997. It's a cooperative effort of the Supply System working with the Port of Benton and Pacific Northwest National Laboratory to establish an incubator facility from which new companies that use state-of-the-art technologies in the area of environmental cleanup will be spun off. The intent is to develop and test in APEL new processes and products that will generate new business and jobs in the local economy.

The laboratory and testing facility is located in the Supply System's former Richland Office Complex warehouse. The facility is expected to open its doors in the spring of 1998.

The Port of Benton invested \$1.5 million in project revenue bonds toward construction of APEL, and Battelle's Pacific Northwest National Laboratory pioneered the original APEL vision and will serve as an anchor tenant. Other APEL partners include the Department of Energy and its \$3.5 million economic development grant for the APEL facility construction; the Tri-City Industrial Development Council (TRIDEC), that worked with DOE to secure the economic development grant; and Washington State University Tri-Cities, the City of Richland, and a variety of entrepreneurs and startup companies.

Mixed Oxide Fuel

The Supply System has advocated using mixed-oxide (MOX) fuel at Plant 2 since 1994 as an avenue to effectively render surplus weapons plutonium safe from re-use as weapons, and to generate lower cost electricity.

The U.S. Department of Energy (DOE) in January 1997 determined it will fully develop two methods for disposing of 50 metric tons of U.S. surplus weapons plutonium, in keeping with the 1993 agreement between the United States and Russia for each nation to reduce its nuclear weapons stockpiles. The two methods involve (1) use of existing, domestic commercial reactors such as Plant 2 in which a portion of the present uranium oxide fuel would be replaced with a mixed-oxide fuel consisting of oxides of surplus weapons plutonium combined with uranium oxides, and (2) vitrification, in which plutonium would be mixed with glass frit and highly radioactive Cesium-137 to produce borosilicate glass logs.

Following DOE's January announcement, the Supply System joined a consortium of organizations ready to provide the DOE with start-to-finish comprehensive services for disposing of U.S. surplus weapons-grade plutonium. The consortium is led by the Siemens Power Corporation, and consists of the Supply System, Entergy Operations, Inc., Battelle Memorial Institute, Mason & Hanger Corporation, and Raytheon Engineers & Constructors.

The Supply System elected to join this consortium because the members possess the skills, expertise, and leadership needed to meet the nation's objective for treating this material, such as fuel fabrication, security and safeguards, and of course reactor operations. If successful in the bid to make and use mixed-oxide fuel, Siemens would contract with the government, and the Supply System would receive the MOX fuel from Siemens.

In July of 1997 the DOE issued its draft proposed acquisition strategy for contracting for MOX fuel services. The proposed schedule anticipates a request for proposals next May with award of a contract in September of 1998. The winning consortium must be able to load the first reload of MOX fuel as early as 2005 but no later than 2007.

The consortium will bid on the full scope of the proposed DOE MOX program for surplus weapons plutonium disposition, to include: designing, constructing, licensing, and operating a MOX fuel fabrication facility; fabricating the MOX fuel; testing several MOX fuel assemblies in Plant 2, and full-core use of the fuel in U.S. commercial nuclear power plants. Those plants are: the Supply System's Plant 2, and two Entergy Operations, Inc. boiling water reactor plants, Grand Gulf and River Bend. Additional reactors may be added to the program depending on the government's desired rate of surplus plutonium disposition through MOX fuel use.

In the summer of 1996, the concept of using commercial nuclear reactors for disposal of the nation's surplus weapons-grade plutonium and the Supply System's proposal to use Plant 2 for testing of MOX fuel assemblies to collect data for U.S. licensing purposes were endorsed by the American Public Power Association's Legislative and Resolutions Committee.

Satsop Combustion Turbines

Washington State Gov. Mike Lowry and Supply System CEO Vic Parrish in May 1996 signed an amendment to the state site certification agreement for the Supply System's Satsop power plant site in southwestern Washington. The amendment covers construction of two proposed natural gas-fired combustion turbine power plants at the site in Grays Harbor County.

Each combined-cycle combustion turbine power plant would generate 245 megawatts of electricity and use natural gas supplied through a 48-mile pipeline that would be routed in Thurston and Grays Harbor Counties. The Supply System has been working with the U.S. Army Corps of Engineers to acquire the permit needed for construction of this pipeline.

One of the power plants is committed to the Bonneville Power Administration's resource contingency program under a 10-year option period. The second plant would serve the emerging energy needs of the Pacific Northwest, with the output available to public and/or private utilities.

Satsop Redevelopment Project

The Supply System acquired the Satsop Site in southwestern Washington state as

the intended location for two large nuclear power plants. Neither of these projects was completed, but the significant construction effort resulted in the 1,600-acre site now having warehousing facilities, office space, utilities, and water treatment capabilities. About 400 acres are available for development.

Over the past several years the Supply System has had discussions with representatives from the Grays Harbor County area to consider potential redevelopment of the Satsop Projects' site. Concurrent with these discussions, the Supply System has addressed the potential role of the site in supporting its long-term objectives and its continuing obligations associated with ownership.

To conduct formal discussions with the Supply System and with BPA, the Grays Harbor representatives formed the Satsop Redevelopment Project (SRP). The SRP is a coalition of governments established by interlocal agreement between Grays Harbor County, the Port of Grays Harbor, and the Grays Harbor Public Utility District No. 1.

In the fall of 1996, the SRP contracted for the preparation of a Redevelopment Plan on which possible negotiations would be based. The Plan includes the alternative development patterns for use of the land and infrastructure with an emphasis on maximizing the use of existing structures and utilities with minimum costs and impacts; and general alternatives for demolition and restoration to protect the public from risks. The study, completed in June 1997, also addresses the economic aspects of a potential transfer and the subsequent costs of ownership and operation of the site.

In July of 1997, the Satsop Redevelopment Project submitted a preliminary set of conditions and expectations for transfer of the site from the Supply System and BPA. This submittal was the first step in a negotiation between the parties to establish a transfer that is equitable and beneficial to all parties.

Sale of Surplus Assets

The Supply System maintained a program during FY 1997 to sell assets it no longer needs at the sites of terminated nuclear projects WNP-1 and WNP-3. For sale is property the Supply System acquired during project construction, including pumps, tanks, valves, cable, tools, steel, construction and electrical materials, transformers, reactor equipment, and temporary storage buildings. Information on assets for sale is available from Malcom Chunn at the Supply System's Richland office, (509) 377-4517.



Board of Directors

Standing from left to right:

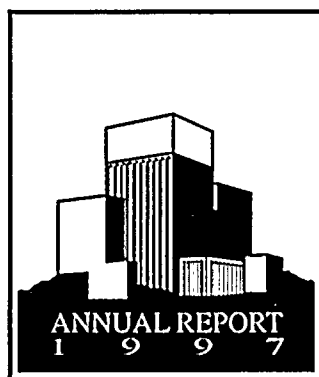
Roger Sparks
Commissioner, Kittitas County PUD
Robert Graves (Board President)
Commissioner, Benton County PUD
Parker Knight
Commissioner, Skamania County PUD
Tom Casey
Commissioner, Grays Harbor County PUD
Charles Buennagel
Commissioner, Wahkiakum County PUD

Seated from left to right:

Dan Gunkel
Commissioner, Klickitat County PUD
Beverley Cochrane Fitzgerald (Board Vice President)
Commissioner, Franklin County PUD
Don Carter
Deputy City Manager for Utilities
and Physical Services, City of Richland

Not pictured:

Darrel Bunch (Board Assistant Secretary)
Commissioner, Okanogan County PUD
Vera Claussen
Commissioner, Grant County PUD
Mark Crisson
Director of Utilities, Tacoma Public Utilities
Gordon McIntyre
General Manager, Ferry County PUD
Gary Zarker
Superintendent, Seattle City Light



Financial Information

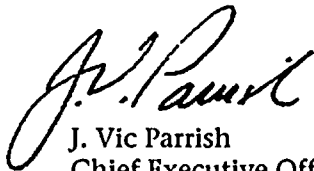
MANAGEMENT REPORT ON RESPONSIBILITY FOR FINANCIAL REPORTING

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 Price Waterhouse LLP, the Supply System's independent auditors. Management has made available to Price Waterhouse LLP all financial records and related data, and believes that all representations made to Price Waterhouse LLP during its audit were valid and appropriate.

Management has established and maintains internal control procedures that are intended to 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, Price Waterhouse 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 Price Waterhouse LLP concerning the control procedures and has taken appropriate action to respond to the recommendations. Management believes that, as of June 30, 1997, internal control procedures are adequate.



J. Vic Parrish
Chief Executive Officer



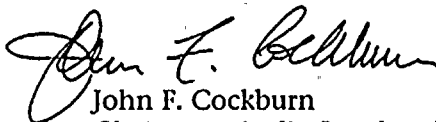
G. J. Kucera
Vice President, Administration/
Chief Financial Officer

AUDIT, LEGAL AND FINANCE COMMITTEE CHAIRMAN'S LETTER

The Executive Board's Audit, Legal and Finance Committee is composed of five independent directors. Members of the Committee are John F. Cockburn, Chairman; Rudi Bertschi; Vera Claussen; Roger Sparks; Louis Winnard and Don Carter, Ex Officio. The Committee held 18 meetings during the fiscal year ended June 30, 1997.

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

In our opinion, the accompanying individual balance sheets and the related statements of operations and of cash flows present fairly, in all material respects, the financial position of the Washington Public Power Supply System Nuclear Project No. 1, Nuclear Project No. 2, Nuclear Project No. 3 and Packwood Hydroelectric Project at June 30, 1997, and the results of their operations and their cash flows for the year then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Washington Public Power Supply System's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Portland Oregon
August 27, 1997 (Except for the final paragraph of Note F as to which the date is September 19, 1997)

BALANCE SHEETS

As of June 30, 1997 Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#
ASSETS				
UTILITY PLANT (NOTE B)				
In service	\$ 3,430,794	\$ 12,591		
Allowance for depreciation	(1,308,458)	(9,971)		
	2,122,336	2,620		
Nuclear fuel, net of accumulated amortization	127,997			
Construction work in progress	15,375			
	2,265,708	2,620		
RESTRICTED ASSETS (NOTE B)				
Special funds				
Cash	7	2	\$ 21	\$ 2,604
Available-for-sale investments	29,165	304	80,474	18,200
Accounts and other receivables	41,905		697	4,010
Due from other projects			9,043	272
Due from other funds				13,385
Prepayments and other			102	76
Debt service funds				
Cash	73	20	249	118
Available-for-sale investments	151,197	709	201,876	154,982
Other receivables	2,402		1,218	1,095
	224,749	1,035	293,680	194,742
LONG-TERM RECEIVABLES (NOTE B)				
	41,227			
CURRENT ASSETS				
Cash	590	11	332	573
Available-for-sale investments	24,482	1,182	4,971	4,026
Accounts and other receivables	4,830	318	23	198
Due from participants	85		2	56
Due from other projects		101	103	102
Due from other funds	27,908	30	23,378	
Materials and supplies	56,140			
Prepayments and other	1,088	32		
Nuclear fuel held for sale			12,403	
Plant & equipment held for sale			9,736	2,794
	115,123	1,674	50,948	7,749
DEFERRED CHARGES				
Costs in excess of billings		3,235	2,020,739	1,760,883
Unamortized regulatory studies	16,952			
Unamortized debt expense	16,192	7	24,115	16,617
Other deferred charges	399			
	33,543	3,242	2,044,854	1,777,500
TOTAL ASSETS	\$ 2,680,350	\$ 8,571	\$ 2,389,482	\$ 1,979,991

* Supply System's ownership share (Note B)

Project recorded on a liquidation basis

See notes to financial statements

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#
LIABILITIES				
BILLINGS IN EXCESS OF COSTS	\$ 65,140			
UNREALIZED INVESTMENT GAINS (LOSSES)	1,205		\$ (467)	\$ (461)
LONG-TERM DEBT (NOTE E)				
Revenue bonds payable	2,503,805	\$ 6,853	2,303,220	2,220,400
Unamortized discount on bonds - net	(78,634)	(27)	(14,112)	(334,702)
Unamortized loss on bond refunding	(19,762)		(42,394)	(2,489)
	2,405,409	6,826	2,246,714	1,883,209
LIABILITIES PAYABLE FROM RESTRICTED ASSETS (NOTE B)				
Special funds				
Accounts payable and accrued expenses	44,533	8	52,473	38,329
Due to other funds	22,887	15	18,806	
Debt service funds				
Accrued interest payable		87	65,655	44,427
Due to other funds	5,021	15	4,572	3,639
	72,441	125	141,506	86,395
OTHER NONCURRENT LIABILITIES				
Other noncurrent liabilities	11,000	9		
Due to other projects	2,778			
	13,778	9		
CURRENT LIABILITIES				
Current maturities of long-term debt	74,120	253		
Accounts payable and accrued expenses	39,424	850	255	171
Due to participants	2,014	452	1,474	907
Due to other funds				9,746
Due to other projects	6,819			24
	122,377	1,555	1,729	10,848
DEFERRED CREDITS				
Deferred gain on redemption of revenue bonds		56		
COMMITMENTS AND CONTINGENCIES (NOTE F)				
TOTAL LIABILITIES	\$ 2,680,350	\$ 8,571	\$ 2,389,482	\$ 1,979,991

STATEMENTS OF OPERATIONS

For the year ended June 30, 1997 Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#
OPERATING REVENUES	\$ 422,218	\$ 1,532		
OPERATING EXPENSES				
Nuclear fuel	21,434			
Fuel disposal fee	5,519			
Decommissioning	5,630			
Depreciation and amortization	110,689	364		
Operations and maintenance	103,481	899		
Administrative & general	29,608	99		
Generation tax	2,378	21		
Total operating expenses	278,739	1,383		
NET OPERATING REVENUES	143,479	149		
OTHER INCOME & EXPENSE				
Non-operating revenues			\$ 127,580	\$ 109,439
Investment income	17,503	95	17,068	7,694
Gain/(loss) on current bond redemption	(37)	25		
Interest expense and discount amortization	(161,516)	(269)	(141,950)	(114,626)
Plant preservation and termination costs			(2,112)	(3,111)
Fuel settlement	(77)		(1,073)	
Raytheon litigation				(1,517)
Joint owners' share of costs				1,259
Other	648		487	862
NET REVENUES	\$ 0	\$ 0	\$ 0	\$ 0

* Supply System's ownership share (Note B)

Project recorded on a liquidation basis

See notes to financial statements

STATEMENTS OF CASH FLOWS

For the year ended June 30, 1997 Dollars in thousands

	NUCLEAR PROJECT NO. 2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO. 1#	NUCLEAR PROJECT NO. 3*#
CASH FLOWS FROM OPERATING AND OTHER ACTIVITIES				
Net operating revenues	\$ 143,479	\$ 149		
Adjustments to reconcile net operating revenues to cash provided by operating activities:				
Amortized revenues	(50,331)	(329)		
Depreciation and amortization	126,436	352		
Decommissioning	5,630			
Transfer of decommissioning funds to BPA	(37,483)			
Other	572			
Change in operating assets and liabilities:				
Accounts receivable	3,820	69		
Materials and supplies	(348)			
Prepaid and other assets	(320)	(31)		
Due from/to other projects, funds and participants	1,745	(1,387)		
Accounts payable	(5,172)	582		
Increase in Working Capital		250		
Non-operating revenue receipts			\$ 99,546	\$ 127,730
Cash payments for preservation and termination expenses			(3,716)	(5,354)
Cash payments for litigation settlement				(4,650)
Cash payments for other expenses			92	36
Net cash provided/(used) by operating and other activities	188,028	(345)	95,922	117,762
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Proceeds from bond refundings	214,283		508,827	32,679
Refunded bonds escrow requirement	(215,682)		(506,757)	(31,568)
Payment for bond issuance and financing costs	(3,564)		(8,685)	(92)
Escrow restructuring receipts			588	938
Capital and nuclear fuel acquisitions	(27,183)	(5)		
Cash payments for deferred programs	(537)			
Interest paid on revenue bonds	(148,869)	(268)	(133,851)	(95,354)
Principal paid on revenue bond maturities	(69,917)	(320)	(46,565)	(47,475)
Net cash used by capital and related financing activities	(251,469)	(593)	(186,443)	(140,872)
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchases of investment securities	(1,263,483)	(10,510)	(958,455)	(690,910)
Sales of investment securities	1,305,756	11,218	1,004,997	703,601
Interest on investments	20,407	102	16,426	8,489
Receipts from sales of plant assets and fuel			22,668	3,737
Net cash provided by investing activities	62,680	810	85,636	24,917
NET INCREASE/(DECREASE) IN CASH	(761)	(128)	(4,885)	1,807
CASH AT JUNE 30, 1996	1,431	161	5,487	1,488
CASH AT JUNE 30, 1997 (NOTE B)	\$ 670	\$ 33	\$ 602	\$ 3,295

* Supply System's ownership share (Note B)

Project recorded on a liquidation basis

See notes to financial statements

OUTSTANDING LONG-TERM DEBT

As of June 30, 1997

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	\$ 102,220
						<u>102,220</u>
1976A	11-18-76	5.86	(B)	5.75	7-1-98/2000	18,645
			100	6.00	7-1-2007	44,815
			99.50	6.00	7-1-2012	60,990
						<u>124,450</u>
1981A	9-4-81	14.67	100	14.375	7-1-2001	24,000
			59.958	8.25	7-1-2003	100,000
						<u>124,000</u>
1990A	3-15-90	7.77	99.75	7.25	7-1-2003	73,705
			97.125	7.25	7-1-2006	35,790
						<u>109,495</u>
1990C	11-1-90	7.84	(B)	7.10-7.50	7-1-1998/2003	197,530
			(B)	(C)	7-1-2004/05	18,054
						<u>215,584</u>
1991A	9-26-91	6.81	(B)	6.00-6.60	7-1-1998/2005	126,495
			90.375	6.00	7-1-2012	105,940
			(B)	(C)	7-1-2006/07	13,431
						<u>245,866</u>
1992A	10-2-92	6.19	100	5.10-6.30	7-1-1998/2009	163,005
			97.230	6.25	7-1-2012	66,780
			98.875	6.30	7-1-2012	50,000
			(B)	(C)	7-1-2010/11	9,084
						<u>288,869</u>
1993A	5-20-93	5.76	(B)	4.625-6.00	7-1-1998/2010	187,420
			96.404	5.75	7-1-2012	42,105
						<u>229,525</u>
1993B	7-15-93	5.64	(B)	4.30-5.65	7-1-1998/2008	104,665
			100	5.55	7-1-2010	51,000
			97.775	5.625	7-1-2012	43,455
						<u>199,120</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1997 which were paid on June 30, 1997

(E) Includes amounts due July 1, 1997

(F) The estimated fair value shown has been reported to meet the disclosure requirements of the Statement of Financial Accounting Standards (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, 1997

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) 100 100	3.90-6.00% 5.40 (C)	7-1-1998/2011 7-1-2012 7-1-2009	\$ 537,750 100,200 4,776 <u>642,726</u>
1996A	9-13-96	5.72	(B)	5.00-6.00	7-1-1998/2012	<u>209,875</u> 209,875
Compound interest bonds accretion						<u>86,195</u>
Revenue bonds payable						<u>\$2,577,925 (D)</u>
Estimated fair value at June 30, 1997						<u>\$2,312,277 (F)</u>
PACKWOOD LAKE PROJECT REVENUE BONDS						
1962	3-20-62	3.66	99.425	3.625	3-1-2012	5,386
1965	11-4-65	3.76	100.5	3.75	3-1-2012	<u>1,720</u>
Revenue bonds payable						<u>\$ 7,106</u>
Estimated fair value at June 30, 1997						<u>\$ 6,457 (F)</u>
NUCLEAR PROJECT NO. 1 REVENUE BONDS						
1989A	9-14-89	7.76	100 82.083	7.10-7.30 6.00	7-1-1997/2002 7-1-2017	\$ 20,160 95,110 <u>115,270</u>
1989B	12-7-89	7.44	100 98.533	7.00-7.20 7.125	7-1-1999/2002 7-1-2016	21,060 41,070 <u>62,130</u>
1990A	3-15-90	7.73	(B) 81.75	7.00-7.50 6.00	7-1-1997/2002 7-1-2017	39,845 55,635 <u>95,480</u>
1990B	6-7-90	7.75	(B) 97.979	7.00-7.20 7.25	7-1-1999/2003 7-1-2009	24,495 72,770 <u>97,265</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1997 which were paid on June 30, 1997

(E) Includes amounts due July 1, 1997

(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, 1997 Dollars in thousands

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)						
1990C	9-27-90	7.85%	(B)	7.25-7.75%	7-1-1997/2003	\$ 130,190 <u>130,190</u>
1991A	9-26-91	7.02	(B)	5.90-6.80	7-1-1997/2008	49,985 <u>49,985</u>
1992A	10-2-92	6.51	(B) 99.375 98	4.80-6.40 6.50 6.25	7-1-1997/2011 7-1-2015 7-1-2017	32,185 137,820 78,815 <u>248,820</u>
1993A	5-20-93	5.86	(B) 100 99.75 96.306 96.566	4.50-7.00 5.75 6.05 5.75 5.70	7-1-1997/2008 7-1-2011 7-1-2012 7-1-2013 7-1-2017	186,025 80,000 35,705 37,970 176,180 <u>515,880</u>
1993B	7-15-93	5.64	(B) 98.138	4.30-7.00 5.60	7-1-1997/2010 7-1-2015	82,530 94,885 <u>177,415</u>
1993C	9-10-93	5.47	(B) 100 98.166	4.00-5.30 5.40 5.375	7-1-1997/2010 7-1-2012 7-1-2015	22,175 66,400 75,650 <u>164,225</u>
1993-1A	12-15-93	NA	NA	Variable	7-1-1997/2017	142,595 <u>142,595</u>
1996A	9-10-96	5.77	(B)	4.50-6.00	7-1-1997/2012	356,570 <u>356,570</u>
1996B	9-13-96	5.72	(B)	4.50-6.00	7-1-1997/2005	30,460 <u>30,460</u>
1996C	10-07-96	5.71	(B) 96.170	4.50-6.00 5.50	7-1-1997/2015 7-1-2017	92,075 24,860 <u>116,935</u>
Revenue bonds payable						\$2,303,220 (E)
Estimated fair value at June 30, 1997						<u>\$2,360,240 (F)</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1997 which were paid on June 30, 1997

(E) Includes amounts due July 1, 1997

(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, 1997

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	7.10-7.30%	7-1-1997/2002	\$ 19,555
			(B)	(C)	7-1-2003/14	18,668
			84.75	6.00	7-1-2018	54,570
						<u>92,793</u>
1989B	12-7-89	7.39	100	6.80-7.15	7-1-1997/2001	65,180
			(B)	(C)	7-1-2004/14	71,322
			98.375	7.00	7-1-2005	85,690
			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>426,802</u>
1990B	6-7-90	7.57	(B)	7.00-7.25	7-1-1997/2000	64,810
			(B)	(C)	7-1-2001/10	39,210
			98.923	7.375	7-1-2004	55,920
						<u>159,940</u>
1991A	9-26-91	6.97	(B)	5.90-6.80	7-1-1997/2008	48,375
			97.75	6.75	7-1-2011	20,790
			94.552	6.50	7-1-2018	66,065
						<u>135,230</u>
1992A	10-2-92	4.86	100	4.80-5.10	7-1-1997/98	5,290
						<u>5,290</u>
1993B	7-15-93	5.64	(B)	4.30-7.00	7-1-1997/2010	127,745
			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>263,535</u>
1993C	9-10-93	5.47	(B)	4.00-7.50	7-1-1997/2010	168,295
			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>507,703</u>
1993-3A	12-15-93	NA	NA	Variable	7-1-1997/2018	190,040
						<u>190,040</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1997 which were paid on June 30, 1997

(E) Includes amounts due July 1, 1997

(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, 1997**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 (Continued)						
1996A	9-10-96	5.71%	(B)	4.50-6.00%	7-1-1997/2009	\$ <u>32,485</u>
						<u>32,485</u>
<i>Compound interest bonds accretion</i>						<u>406,582</u>
<i>Revenue bonds payable</i>						\$ <u>2,220,400</u> (E)
<i>Estimated fair value at June 30, 1997</i>						\$ <u>1,923,656</u> (F)

(A) Based on original issue

(B) Various prices

(C) Compound Interest bonds

(D) Excludes amounts due July 1, 1997 which were paid on June 30, 1997

(E) Includes amounts due July 1, 1997

(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.

DEBT-SERVICE REQUIREMENTS

As of June 30, 1997 Dollars in thousands

FISCAL YEAR	NUCLEAR PROJECT NO. 2			PACKWOOD LAKE		
	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
6/30/97						
Balance*	\$	\$	\$	\$ 127	\$ 87	\$ 214
1998	74,120	147,208	221,328	387	255	642
1999	122,550	142,802	265,352	422	241	663
2000	133,670	134,692	268,362	473	226	699
2001	170,630	125,543	296,173	498	208	706
2002	93,620	113,930	207,550	523	190	713
2003	213,015	107,986	321,001	548	171	719
2004	159,129	105,063	264,192	573	151	724
2005	116,035	108,716	224,751	598	130	728
2006	132,136	91,447	223,583	623	108	731
2007	165,530	84,153	249,683	648	86	734
2008	192,680	62,199	254,879	674	62	736
2009	188,806	57,645	246,451	572	37	609
2010	201,969	51,277	253,246	274	16	290
2011	165,780	40,546	206,326	122	6	128
2012	362,060	21,110	383,170	44	2	46
Adjustment**	86,195	(86,195)				
	\$ 2,577,925	\$ 1,308,122	\$ 3,886,047	\$ 7,106	\$ 1,976	\$ 9,082

* Bond fund account balances less accrued investment income

** Adjustment for compound interest bonds accretion; compound interest bonds are reflected at their face amount less discount on the balance sheet

DEBT-SERVICE REQUIREMENTS (continued)

As of June 30, 1997 Dollars in thousands

FISCAL YEAR	NUCLEAR PROJECT NO. 1			NUCLEAR PROJECT NO. 3		
	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
6/30/97						
Balance*	\$ 53,165	\$ 65,655	\$ 118,820	\$ 36,630	\$ 44,427	\$ 81,057
1998	57,410	133,770	191,180	34,790	94,192	128,982
1999	71,875	130,403	202,278	68,395	92,272	160,667
2000	76,170	125,937	202,107	73,285	87,891	161,176
2001	81,195	121,152	202,347	71,860	89,737	161,597
2002	78,335	115,891	194,226	76,547	85,850	162,397
2003	69,135	110,775	179,910	78,827	84,169	162,996
2004	80,510	106,883	187,393	62,716	95,791	158,507
2005	72,500	102,174	174,674	63,956	93,933	157,889
2006	89,900	97,990	187,890	64,812	92,190	157,002
2007	95,405	92,580	187,985	59,666	92,523	152,189
2008	101,495	86,567	188,062	61,361	90,919	152,280
2009	104,950	80,059	185,009	63,688	88,691	152,379
2010	111,550	73,749	185,299	66,117	86,461	152,578
2011	134,630	67,451	202,081	84,464	75,450	159,914
2012	142,585	59,854	202,439	98,062	71,717	169,779
2013	156,400	51,806	208,206	95,410	74,630	170,040
2014	165,605	42,713	208,318	98,355	71,816	170,171
2015	175,465	32,985	208,450	129,220	41,108	170,328
2016	186,700	23,038	209,738	133,834	36,663	170,497
2017	198,240	11,644	209,884	142,027	28,643	170,670
2018				149,796	21,047	170,843
Adjustment**				406,582	(406,582)	
	\$2,303,220	\$1,733,076	\$4,036,296	\$2,220,400	\$1,233,538	\$3,453,938

* Bond fund account balances less accrued investment income

** Adjustment for compound interest bonds accretion; compound interest bonds are reflected at their face amount less discount on the balance sheet

NOTES TO FINANCIAL STATEMENTS

Note A - General

ORGANIZATION

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, 1997, its membership consisted of 10 public utility districts and the cities of Richland, Seattle and Tacoma. All members own and operate electric systems within the State of Washington. The Supply System is exempt from federal income tax. 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 generating plant completed in 1964. The Supply System has obtained all permits and licenses required to operate Nuclear Project No. 2 including a Nuclear Regulatory Commission (NRC) operating license which expires in December 2023. Packwood operates under a fifty-year license from the Federal Energy Regulatory Commission (FERC) that expires on February 28, 2010.

Nuclear Project No. 1, a 1,250 MWe plant, was placed in extended construction delay status in 1982, when it was 65 percent complete. Nuclear Project No. 3, a 1,240 MWe plant, was placed in extended construction delay status in 1983, when it was 75 percent complete. On May 13, 1994, the Supply System's Board of Directors adopted resolutions terminating Nuclear Projects Nos. 1 and 3. 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 the sale of assets originally purchased with the proceeds of tax exempt municipal bonds. The favorable ruling has a two-fold benefit. It allows the Supply System to continue refinancing the debt issued in connection with Nuclear Projects Nos. 1, 2, and 3; and to proceed with the sale of major assets at Nuclear Projects Nos. 1 and 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).

Each Supply System project is financed and accounted for as a utility system separate from all other current or future projects. The combined financial statements include Nuclear Projects Nos. 1, 2, 3, and Packwood. The Hanford Generating Project is in termination status and has not operated since 1987. All litigation related to Nuclear Projects Nos. 4 and 5 has been settled and a final distribution was made to the bondholders in fiscal year 1996. The Supply System also wrote off the remaining balance of revenue bonds and accrued interest payable in fiscal year 1996.

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 electrical energy acquired from the Supply System and other sources as well as BPA's other 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.

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. Accounts are maintained in accordance with the uniform system of accounts of FERC. 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.

The financial statements of Nuclear Project No. 3 reflect the Supply System's 100 percent ownership of the project assets and obligations. However, the balance sheet account of plant and equipment held for sale reflects 70 percent Supply System ownership.

The preparation of the Supply System financial statements in conformity with generally accepted accounting principles necessarily requires management to make estimates and assumptions that directly affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates. Certain incurred expenses are allocated to the projects based on specific allocation methods and management considers the allocation methods to be reasonable.

UTILITY PLANT

Utility plant is stated at original cost. Plant in service is depreciated by the straight-line method over the estimated useful lives of the various classes of plant, which range from five to 40 years.

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

Nuclear Projects Nos. 1 and 3 have been reduced to their net realizable values due to termination. A loss on the write-down of Nuclear Projects Nos. 1 and 3 was recorded in fiscal year 1995 and is included in Cost in Excess of Billings. Plant and equipment held for sale includes management's best estimate of 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 have been 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 in the reactor used in the production of energy) is \$93 million as of June 30, 1997, 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 the Department of Energy (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 provisions have been made for additional storage and disposal costs which may be incurred in the future by the Supply System prior to the transfer of spent fuel to DOE.

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 enrichment

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 of the loaned uranium product, adjusted semiannually. The cost of the loaned uranium, \$19.2 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 RECEIVABLES

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

DECOMMISSIONING

The Supply System, as the licensee and owner of Nuclear Project No. 2, is required to submit a plan to the NRC that provides assurances that funds will be available for the decommissioning of Nuclear Project No. 2. Pursuant to this requirement, the Supply System established on June 20, 1990, an external Nuclear Project No. 2 Decommissioning Trust Fund (the Fund) to meet the decommissioning and site restoration financial obligations and contracted for trustee and custodial services to manage the Fund. Based on a comprehensive cost study in 1987, the Supply System's currently estimated decommissioning costs are \$357 million (in 1987 dollars). This estimate includes decommissioning costs of \$286 million and site restoration costs of \$71 million. The estimate assumes a 40 year plant life, three years of preparation for storage and a 30 year protective storage period; a return on investment rate of 7 percent; a cost escalation rate of 4 percent; and a 7 percent present value factor to state escalated decommissioning costs in 2024 dollars. The Executive Board adopted a resolution in April 1996 approving the termination of the Fund and the transfer of all Nuclear Project No. 2 decommissioning and site restoration funds, investments and investment activities to a newly established Bonneville External Trust Fund (the External Trust). The Supply System and BPA signed an agreement in September 1996 wherein BPA assumed the Supply System's obligation to fund the External Trust at least in the amount required by NRC regulations and provided assurances that the obligations will be met on a continuing basis. BPA assumed the responsibility

for directly funding the External Trust and maintaining the investment policy that will guide the trustee's activities. This new fund allows all funds in the External Trust to be invested in equities which are expected to enhance the investment growth to meet NRC decommissioning requirements, and minimize required future contributions into the External Trust by BPA. All funds were transferred to BPA on September 30, 1996. Per agreement, BPA will make annual payments to the External Trust Fund based on the funding schedule (the schedule to accumulate funds for the estimated cost of decommissioning and the cost of site restoration). The funding schedule reflects a balance of \$41.9 million at June 30, 1997. The balance has been recorded in Accounts Payable and Accrued Expenses-Restricted, in the accompanying financial statements on a discounted basis. A receivable from BPA equal to the liability is reflected in the financial statements (Restricted Assets, Accounts and Other Receivables).

MATERIALS AND SUPPLIES

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

FINANCING EXPENSE, BOND DISCOUNT, AND DEFERRED GAIN AND LOSSES

Financing expense and bond discounts are amortized over the terms of the respective bond issues using the bonds outstanding method.

In accordance with the Statement of Governmental Accounting Standard No. 23 effective for periods after June 15, 1994, losses on debt refundings have been deferred and amortized as a component of interest expense over the shorter of the remaining life of the old or new debt. The balance sheet includes the deferred amount less the annual straight line amortization expense for debt issued in fiscal year 1997 as a valuation adjustment of the new debt.

REGULATORY STUDIES

Regulatory studies include programs designed to improve Nuclear Project No. 2's ability to show compliance with federal, state, and industry requirements associated with owning and operating a nuclear power plant. These programs include Design Requirements Documentation (DRD), \$8.1 million; Design Basis Reconstruction (DBR), \$6.2 million; Spare Parts Data Identification (Spares), \$2.3 million; and Plant Component/Equipment Database, \$0.4 million. The purpose of DRD is to improve retrieval of technical and licensing information needed for making safe, timely, and cost effective decisions relating to operation, maintenance, and configuration changes. The purpose of DBR is to provide administrative and technical support to regenerate design information that may be inaccurate, unretrievable or was not produced. The purpose of Spares is to review master equipment list data, correct errors and to develop detailed safety function data at the component level in support of the Core Integration Project.

Expenses associated with regulatory studies for Nuclear Project No. 2 are deferred and amortized by the straight-line method over the estimated remaining operating life of the plant. The Supply System expects the plant to operate until 2023.

CURRENT MATURITIES OF REVENUE BONDS

Current maturities of revenue bonds payable from restricted assets are reflected in Long-Term Debt. Current maturities of bonds for which funds have not yet been restricted are reflected in Current Liabilities.

ACCOUNTS PAYABLE

Accounts payable and accrued expenses include payroll and benefits related accruals for Nuclear Project No. 2 and Packwood of \$16.3 million and \$80,300, respectively. Nuclear Project No. 2 includes a Personal Time Bank accrual of \$9.6 million. Packwood includes an accrual for a refund to Lewis County (\$538,000) for sales for resale due to the new BPA contract and an accrual for a capital equipment purchase (\$136,000).

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 values of investments and revenue bonds payable have been estimated based on quoted market prices for such instruments or based on the fair value of financial instruments of similar nature and degree of risk.

REVENUES

The Supply System accounts for revenue on an accrual basis and recovers, through various agreements, actual cash requirements for operations and debt service for each project over the life of the project. Accordingly, the Supply System recognizes revenues equal to expenses for each period. No net income or loss is recognized, and no equity is accumulated.

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

AVAILABLE FOR SALE INVESTMENTS

(Dollars in thousands)

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
NUCLEAR PROJECT NO. 2				
U.S. Government Securities	\$ 106,484	\$ 1,599	\$ <521>	\$ 107,562
U.S. Government Agencies	97,155	229	<102>	97,282
Total	\$ 203,639	\$ 1,828	<623>	\$ 204,844
PACKWOOD LAKE PROJECT				
U.S. Government Securities	\$ 2,195			\$ 2,195
NUCLEAR PROJECT NO. 1				
U.S. Government Securities	\$ 87,064	\$ 487	\$ <620>	\$ 86,931
U.S. Government Agencies	200,724	316	<650>	200,390
Total	\$ 287,788	803	<1,270>	\$ 287,321
NUCLEAR PROJECT NO. 3				
U.S. Government Securities	\$ 54,292	\$ 488	\$ <1,004>	\$ 53,776
U.S. Government Agencies	123,377	106	<51>	123,432
Total	\$ 177,669	\$ 594	<1,055>	\$ 177,208

At June 30, 1997 the contractual maturities of available-for-sale investments are:

	< 1 Year	1 - 5 Years	6 - 10 Years	> 10 Years	Total
NUCLEAR PROJECT NO. 2					
U.S. Government Securities	\$ 18,565	\$ 21,717	\$ 26,185	\$ 41,095	\$ 107,562
U.S. Government Agencies	76,322	17,026		3,934	97,282
Maturities at Fair Value	\$ 94,887	\$ 38,743	26,185	\$ 45,029	204,844
PACKWOOD LAKE PROJECT					
U.S. Government Securities	\$ 2,195				\$ 2,195
Maturities at Fair Value	\$ 2,195				\$ 2,195
NUCLEAR PROJECT NO. 1					
U.S. Government Securities	\$ 37,362	\$ 25,441	\$ 11,728	\$ 12,400	\$ 86,931
U.S. Government Agencies	170,625	7,263	21,151	1,351	200,390
Maturities at Fair Value	\$ 207,987	32,704	\$ 32,879	\$ 13,751	\$ 287,321
NUCLEAR PROJECT NO. 3					
U.S. Government Securities	\$ 18,704	\$ 13,032	\$ 5,755	\$ 16,285	\$ 53,776
U.S. Government Agencies	107,378	11,800	2,182	2,072	123,432
Maturities at Fair Value	\$ 126,082	\$ 24,832	\$ 7,937	\$ 18,357	\$ 177,208

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. All investments are held for the benefit of the individual Supply System's projects 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). Available-for-sale investments are categorized (see chart above) 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, 1997, the Supply System's payroll covered under PERS was \$71.9 million, representing 94 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. 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 determine the contribution requirements were established under state statute.

As of December 31, 1995 (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 \$12.936 billion and the value of net assets available to satisfy present and future pension benefit obligations was \$12.349 billion. The pension benefit obligation is a standardized measure which enables readers of financial statements to assess the funding status of each system and the 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, 1997, expressed both in dollar amounts and percentages of current year covered payroll, were as follows:

	Plan I		Plan II	
	Rate	Amount	Rate	Amount
Employer Contributions				
Actuarially determined requirement	7.32%	\$ 776,582	7.32%	\$4,486,119
Actual Supply System contributions	7.62%	\$ 808,410	7.62%	\$4,669,973
Employee Contributions				
Actuarially determined requirement	6.00%*	\$ 636,543	4.65%	\$2,849,789
Actual employee contributions	6.00%	\$ 636,543	5.08%	\$3,113,309
* Fixed at 6.00%				

The Supply System's actuarially determined employer contribution requirement represents approximately 1.4 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, 1996, 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, 224 retirees are eligible to receive life insurance benefits and 152 retirees have elected to participate in this insurance. The Supply System's Board of Directors in 1994, approved provisions which continued the life insurance benefit to retirees at 25 percent of the premium for employees who retire prior to January 1, 1995 and charged the full 100 percent premium

to employees who retired after December 31, 1994. The Board also reduced the retiree life insurance amounts for employees who retired after December 31, 1994. The life insurance benefit is equal to the employee's annual rate of salary at retirement for non-bargaining employees retiring prior to January 1, 1995. For non-bargaining employees retiring after December 31, 1996, the benefit is limited to \$40,000. The life insurance benefit is based on one-half of the employee's annual rate of salary at retirement with an \$18,000 maximum benefit for bargaining employees. Employees who retired prior to January 1, 1995, contribute \$6.60 per \$1,000 of coverage while employees who retired on or after January 1, 1995, contribute \$26.52 per \$1,000 of coverage. The contributions are actuarially determined. 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, 1997, was \$3 million for these benefits.

During fiscal year 1997, 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 1997.

Note E - Long-Term Debt

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. All bonds issued under Resolution Nos. 769, 640 and 775 for Nuclear Projects Nos. 1, 2 and 3, respectively, have the same priority of payment within the projects. The variable rate debt issued for Nuclear Projects Nos. 1 and 3 is subordinate to the bonds stated above.

During the year ended June 30, 1997, the Supply System issued \$747.8 million in net-billed bonds with an average interest rate of 5.7 percent for Nuclear Projects Nos. 1, 2 and 3 to refund \$699.5 million of outstanding bonds with an average interest rate of 7.2 percent. The net proceeds of the new issues were deposited in separate irrevocable trusts under the control of escrow agents to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from long-term debt.

The change in the aggregate debt service payments for Nuclear Projects Nos. 1, 2 and 3 and changes to debt service reserve fund balances resulted in an economic gain (the difference between the present values of the debt service payments on the old and new debt) of \$45.5 million, \$16.1 million and \$3 million, respectively.

The advance refundings resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$44.4 million, \$20.6 million and \$2.6 million for Nuclear Projects Nos. 1, 2 and 3, respectively. The difference is amortized over the

life of the new debt (which is the same as the remaining life of the old debt) using the straight-line method.

A summary of fiscal year 1997 Series 1996A, 1996B, and 1996C bond refundings by project is presented below.

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 1997 defeasements, approximately \$859.5 million, \$916.2 million, and \$507 million of bonds outstanding are considered defeased at June 30, 1997, for Nuclear Projects Nos. 1, 2 and 3, respectively.

Outstanding revenue bonds of various projects as of June 30, 1997, are presented on pages 20 through 24, and debt service requirements for these bonds are presented on pages 25 and 26.

The Supply System expects to continue the refunding of higher interest bonds when economically feasible.

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 - PACKWOOD LAKE HYDROELECTRIC PROJECT

The Supply System and BPA entered into a Transmission and Exchange Agreement (Packwood Agreement) in October 1961, whereby BPA agreed to supply the 12 public utility district participants in Packwood with electric power and energy at specified points of delivery in exchange for BPA receiving the electric energy and peaking capacity of Packwood for inclusion in the government system. The project participants had certain rights under their respective Power Sales Contracts to take the project's energy and capacity and displace BPA sales. In June 1996, BPA published new Wholesale Power and Transmission Rate Schedules which adversely affected the values of the exchanged capacity and energy under the Packwood Agreement. The Supply System and BPA signed an amendatory agreement in April 1997 which became effective on October 1, 1996. The new agreement simplified the administration of the Packwood Agreement and provided a new payment mechanism for electric capacity and energy delivered from the project. The amendatory agreement is

FISCAL YEAR 1997 BOND REFUNDINGS (Dollars in thousands)

NUCLEAR PROJECT NO. 1	Series 1996A	Series 1996B	Series 1996C	All Series
Size of issue	\$ 356,570	\$ 30,460	\$ 116,935	\$ 503,965
Amount of bonds refunded	333,070	29,485	106,835	469,390
Deferred loss	32,952	2,543	8,952	44,447
Reduction in aggregate debt service	39,559	1,769	11,887	53,215
NUCLEAR PROJECT NO. 2				
Size of issue	211,400			211,400
Amount of bonds refunded	200,840			200,840
Deferred loss	20,641			20,641
Reduction in aggregate debt service	23,426			23,426
NUCLEAR PROJECT NO. 3				
Size of issue	32,485			32,485
Amount of bonds refunded	29,235			29,235
Deferred loss	2,645			2,645
Reduction in aggregate debt service	1,641			1,641

effective through July 1, 2001 and states that BPA will pay the Supply System in exchange for the project's total output of electric capacity and energy delivered from the project. BPA will pay 17.5 mills per kWh for the first 80,000,000 kWh delivered to the interconnections and 5 mills per kWh for any energy delivered to the interconnections in excess of 80,000,000 kWh during the fiscal year. In addition, BPA pays to the Supply System their Lewis County PUD No. 1 transmission costs and the Supply System receives generation credit for spill requested by BPA. The Packwood participants are obligated to pay annual costs of the project including debt service, whether or not the project is operable, until the outstanding bonds are paid or provision is made for the retirement in accordance with provisions of the bond resolution.

Note F - Commitments and Contingencies

NUCLEAR PROJECT NO. 1 TERMINATION

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 the Nuclear Project No. 3 Owners Committee declare the termination of the Project. The 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 received. 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.

SECURITIES LITIGATION

Following default on Nuclear Projects 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.

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. (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 on Nuclear Project No. 5. By order dated August 19, 1996, the court approved the settlement and dismissed the action with prejudice.) 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. 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 that all rights of Chemical Bank to proceeds from sales of such assets and properties be transferred 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.

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 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 Nuclear 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 costs of site restoration for Nuclear Projects Nos. 4 and 5 are \$20 million and \$10 million, respectively. As stated previously under "Cost Sharing Litigation," Nuclear Projects 4 and 5 assets may, at some future time, be transferred to Nuclear Projects Nos. 1 and 3, respectively.

During 1995, a group from Grays Harbor County, Washington, which is interested in economic development, formed the Satsop Redevelopment Project. The Satsop Redevelopment Project 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 settlement 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 \$14.5 million (93.3% was allocated to Nuclear Project No. 1 and 6.7% was allocated to Nuclear Project No. 2). The Supply System reserved the entire receivable in fiscal year 1995.

In September 1996, the Supply System agreed in principle to the terms of a proposed settlement agreement with the debtors and the Official Creditor's Committee. The terms of the proposed settlement were included in the debtors' Plan of Reorganization filed on October 18, 1996. The settlement agreement provides for the approval of the Supply System's unsecured claim against Nuexco and lesser amounts against the three other debtors. The Supply System expects to collect only its pro rata share of said claim amounts as assets of the debtors are liquidated. The settlement agreement also confirms the Supply System's ownership rights to uranium previously pledged as collateral

(\$21.4 million--approximately \$2.7 million of Nuclear Project No. 1 material and \$18.7 million of Nuclear Project No. 2 material) and also provides for a \$1.15 million cash payment by the Supply System to the bankrupt estates to settle any and all potential avoidance actions. On August 18, 1997, the Plan of Reorganization was approved by the Bankruptcy Court. The \$1.15 million has been accrued at June 30, 1997; \$1,073,000 was allocated to Nuclear Project No. 1 and \$77,000 was allocated to Nuclear Project No. 2 based on the split of the deficiency claim of \$14.5 million.

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 pre-judgment interest. Raytheon's claim is based on a claim of entitlement to incentive fees allegedly earned prior to 1984. Following an eight-day bench trial in March 1997 on liability issues, a judgment was rendered in favor of the Supply System on all issues. Raytheon has appealed this decision to the United States Court of Appeals for the Ninth Circuit. A briefing schedule has been established with a decision not expected until spring of 1998.

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 \$8.72 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 \$79.275 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 its 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 final State permit approvals have been obtained. 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 ten years.

ADVANCED PROCESS ENGINEERING LABORATORY

The Supply System, Port of Benton and Pacific Northwest National Laboratory are cooperatively developing and bringing into operation the Advanced Process Engineering Laboratory (APEL), to be housed in the Supply System's Richland Office Complex Warehouse. The mission of APEL is to provide high-quality laboratory and validation testing facilities and associated offices for pilot scale research, development and testing of new processes and products, including, but not limited to, environmental

restoration, chemical waste treatment and energy conservation.

APEL is intended to be an "Incubator" facility that will encourage and facilitate the formation of new or expanded companies. The Supply System will retain ownership of the warehouse and function as the landlord of APEL.

SUBSEQUENT EVENTS

In September 1997, the Supply System issued a total of \$721.9 million in refunding bonds, Series 1997A and 1997B, for Nuclear Projects Nos. 1 (\$278.5 million), 2 (\$327.3 million) and 3 (\$116.1 million). The proceeds of the bonds will be used to refund \$257.7 million, \$303.5 million and \$107.9 million of previously outstanding Nuclear Project Nos. 1, 2, and 3 bonds, respectively.

For the year ended June 30, 1997 (unaudited)

BOND RATINGS - SUPPLY SYSTEM

	<u>FY 1997</u>	<u>FY 1996</u>	<u>OUTLOOK</u>
Fitch Investors Service LP	AA-	AA-	Stable
Moody's Investors Service, Inc. (Moody's)	Aa1	Aa1	
Standard and Poor's Corporation (S & P)	AA-	AA-	Stable

VARIABLE RATE LETTER OF CREDIT BANKS

Long Term

	<u>S & P</u>	<u>MOODY'S</u>
Series 1993-1A/3A-1	AA-	Aa3
Series 1993-1A/3A-2	AA-	Aa3
Series 1993-1A/3A-3	AA	Aa2

Short Term

Series 1993-1A/3A-1	A-1+	VMIG1
Series 1993-1A/3A-2	A-1+	VMIG1
Series 1993-1A/3A-3	A-1+	VMIG1
