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WASHINGTON PUBLIC POWER SUPPLY SYSTEM

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

December 15, 1998

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Docket Nos: 50-460

50-397

50-508

U.S. Nuclear Regulatory Commission

Attn: Document Control Desk

Washington, DC 20555

Gentlemen:

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

Enclosed for your information, as required by 10 CFR 50.71(b), are three copies of the Washington Public Power Supply System Annual Report 1998.

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

Respectfully,



GJ Kucera

Vice President, Administration/Chief Financial Officer

Mail Drop 1396

Enclosure: As stated

220105

cc: EW Merschoff - NRC RIV  
C Poslusny, Jr. - NRR w/o  
MM Mendonca - NRC w/o  
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DL Williams - BPA/1399 w/o  
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1998  
*Annual  
Report*  
*A Journey to  
Excellence*



WASHINGTON PUBLIC POWER SUPPLY SYSTEM



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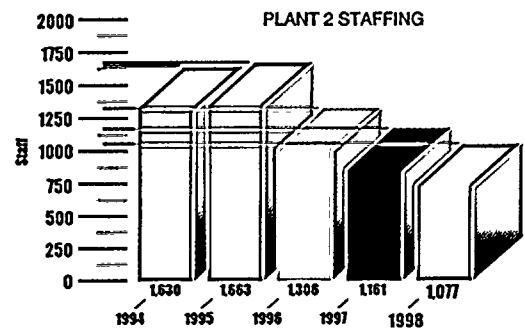
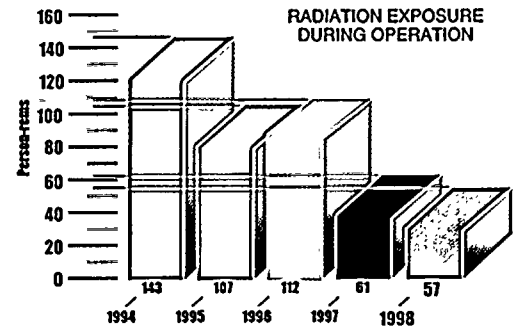
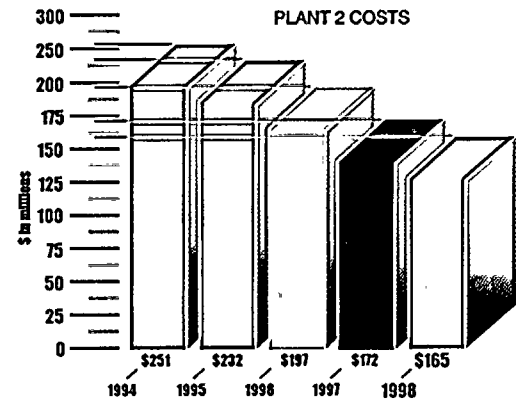
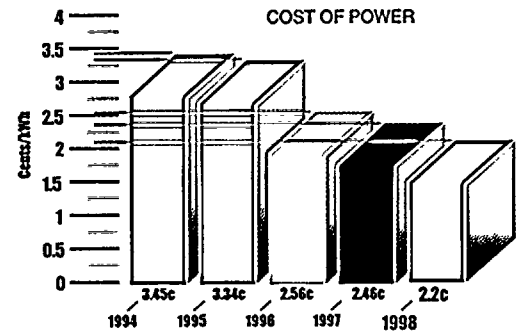
WASHINGTON PUBLIC POWER SUPPLY SYSTEM

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# Operating Highlights



Plant 2  
1,200 mwe





**Louis H. Winnard**  
**Chairman**  
Consultant  
Windsor, CA

# *Executive Board*

Washington Public Power Supply System

Administrative and Public Responsibility Committee

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Audit, Legal and Finance Committee

**John Cockburn**, Chairman

Operations and Construction Committee

**Parker Knight**, Chairman



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Consultant  
Economic & Technical  
Analysis Group  
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**Parker Knight**  
Commissioner  
Skamania County PUD  
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Kittitas County PUD  
Ellensburg, WA



# *A Journey to Excellence*



"Among our other successes are improved ratings from the Nuclear Regulatory Commission and the Institute of Nuclear Power Operations. The greatest endorsement we received this year came from the Northwest Power Planning Council's Cost Review Committee. Its regional study of the Bonneville Power Administration's costs gave us a strong endorsement as a vital component in the region's power system."

**Chief Executive Officer  
Joseph V. Parrish**



"The Supply System is committed to building on the success of the past five years. The successes outlined here, as well as the new business initiatives discussed in this Annual Report, foretell a bright future for the Supply System — and the Bonneville Power Administration as a whole — as the electric utility industry restructures itself."

**Executive Board Chairman  
Louis H. Winnard**

From its founding more than 40 years ago, through the turbulent 1970s and '80s and finally up to the present, the history of the Washington Public Power Supply System is a story of courage, hard work and dedication of its employees and public spirited policy makers.

Fifteen years ago few people would have given the Supply System much chance of surviving. Looking back at the events of 1983 — the failed construction program that saw one of five nuclear plants completed, the legal and financial crisis that spawned a \$2.25 billion default on our Project 4/5 bonds, and the loss of faith that destroyed our credit rating — it is a wonder the organization survived.

This legacy is not mentioned with any sense of perverse pride. It is stated for only one reason: It is impossible to chronicle a long journey — a journey to excellence — without describing where it began.

Five years ago our journey almost ended. Plant 2, our sole operating nuclear generating station, was over-staffed, over-priced, and under-productive. The cost of power was too high, at 3.45 cents per kilowatt-hour, to be competitive. The plant was unreliable, worker radiation exposure was too high and we were wasting far too much time working on the plant, rather than running it. Management was faced with a clear choice: Cut costs and increase reliability, or terminate the plant.

Here is what we've accomplished since 1994:

- Cut the cost of power from Plant 2 from 3.45 cents per kilowatt-hour to 2.2 cents in fiscal 1998. For fiscal 1999, our goal is to be below 2 cents a kilowatt-hour.
- Reduced the plant budget from \$251 million to \$165 million.
- Downsized our staff more than 35 percent while cutting overtime expenditures from \$10.9 million in fiscal 1994 to \$2.7 million in fiscal 1998.
- Increased plant reliability by virtually eliminating forced outages. There was a time when Plant 2 experienced five automatic shutdowns in as many days. In fiscal 1998 we had our first forced outage in three years.
- Cut worker radiation exposure, a key indicator of safety and efficiency, by 60 percent. Plant 2 is now among the best in the industry.

Among our other successes are improved ratings from the Nuclear Regulatory Commission and the Institute of Nuclear Power Operations, but the greatest endorsement we received this year came from the Northwest Power Planning Council's Cost Review Committee. Its regional study of the Bonneville Power Administration's costs resulted in a strong endorsement

of the Supply System as a vital component in the region's power system.

The study recognized our success in making Plant 2 power competitive through cost cuts and increased reliability. We are confident that we can meet the challenge to remain competitive in the future.

New initiatives, such as moving from a 12-month to a 24-month refueling cycle at Plant 2, will help meet that goal. We estimate that this efficiency improvement will save \$120 million over the remaining 25-year life of the plant.

The Supply System has been instrumental in Bonneville's resurgence as the region's preferred electricity provider. A few years ago critics predicted the demise of the federal agency. They said BPA was too expensive, too bureaucratic, and would be unable to meet its fish-recovery obligations without large increases in the wholesale price of electricity. They said Bonneville was doomed. Utilities began searching for other, lower-cost sources of power.

But the critics were wrong.

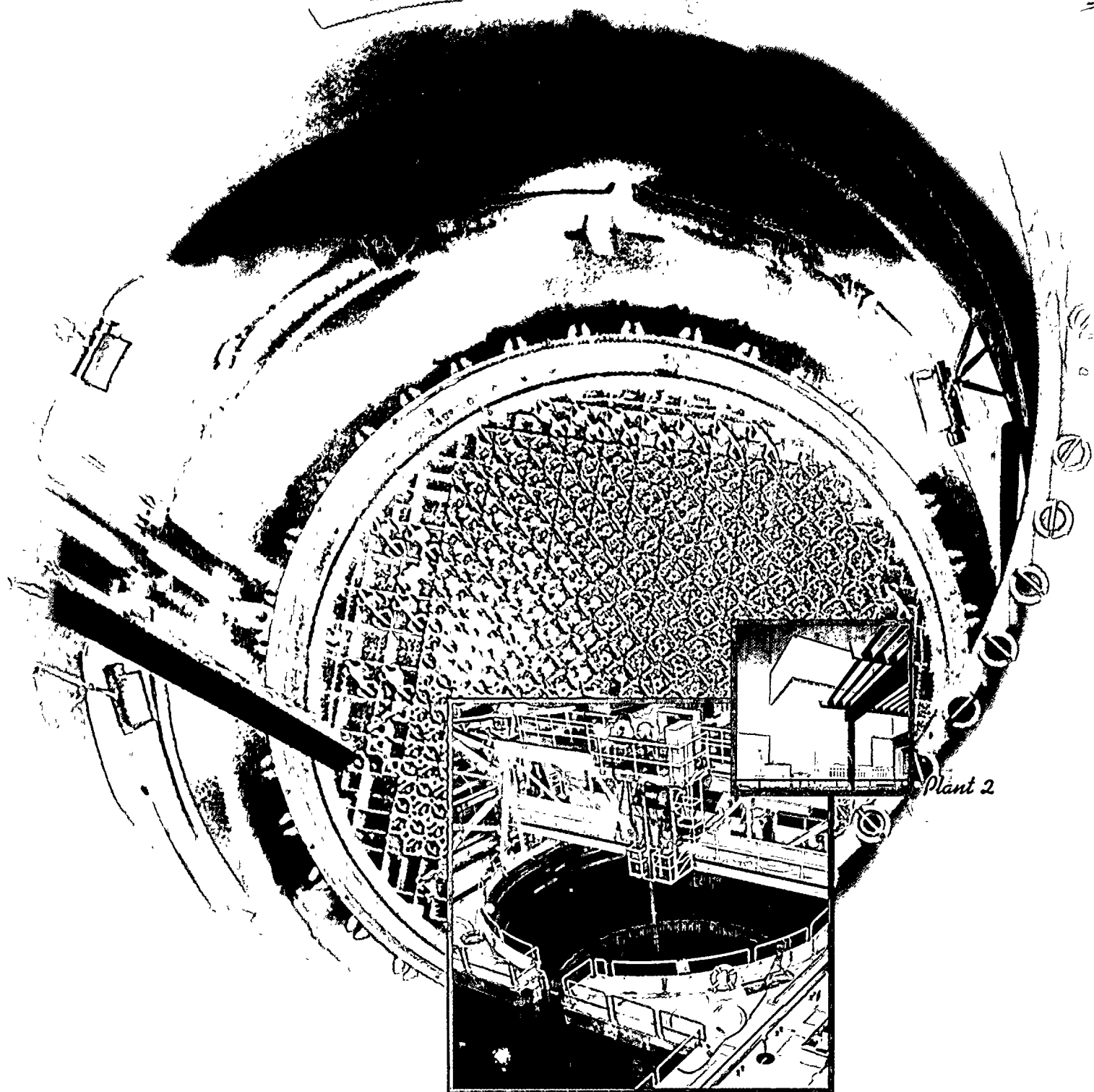
Bonneville tightened its belt and cut the wholesale price of electricity sold to its public power customers by 20 percent. Utilities that only two years ago were scrambling to abandon BPA now are pleading to come back. BPA's next series of five-year power supply contracts, to go into effect in 2001, are already projected to be over-subscribed.

Bonneville's progress has been helped by the Supply System's aggressive bond refinancing program. Early planning paid off handsomely as the Supply System, with Bonneville's cooperation, took advantage of favorable credit ratings and low interest rates, thereby cutting the average interest rate on billions of dollars in outstanding bonds nearly in half since 1989, from 10.5 percent to 5.3 percent.

The result: Northwest electricity consumers will save \$1.83 billion because of this successful refunding program.

The Supply System is committed to building on the success of the past five years. The successes outlined here, as well as the new business initiatives discussed in this Annual Report, foretell a bright future for the Supply System — and the Bonneville Power Administration as a whole — as the electric utility industry restructures itself.

The Supply System has come a long way since the dark days of 1983. While justifiably proud of our accomplishments, we are at the same time very cognizant of the challenges facing us. By keeping our costs in line and the price of our power competitive, we are looking toward new opportunities and a bright future.



Plant 2

Reactor refueling

## Nuclear Operations

The Washington Public Power Supply System is on a journey, a journey to excellence that began five years ago when the organization was struggling to survive, and will carry it into an unregulated future on a competitive footing.

The journey began in 1993 when the cost of power from Plant 2 was not competitive at 3.45 cents a kilowatt-hour; the operating budget was bloated at \$251 million a year and staffing had peaked at nearly 2,000 employees.

In contrast, in fiscal 1998 Plant 2 delivered more electricity to the Bonneville Power Administration than in any year in its 14-year operating history. And the price of that electricity, at 2.2 cents a kilowatt-hour, was competitive with other available resources.

Getting to this point of the journey was difficult. Gaining control of costs required setting priorities, fixing problems in the plant and removing excuses that kept the staff from realizing its potential. Cost cutting initiatives varied from the innovative to the mundane:

- Administrative costs were reduced \$5 million over three years.
- Staffing was cut by 35 percent.
- Overtime expenditures were slashed 75 percent.
- A \$200,000 investment in a hand-geometry access control system reduced the security force by several officers.
- A paper change in the plant's Nuclear Regulatory Commission operating license gained more than 50 megawatts in plant capacity. Plant 2 is now licensed to run at more than 1,200 megawatts.

Innovative ways were found to give employees incentives to take ownership for plant performance. A significant portion of their compensation is in the form of incentive payments based on meeting key Plant 2 cost and efficiency goals. The concept is simple: If Plant 2 runs well and remains within budget, employees are rewarded at the end of the year. If the plant fails to meet its goals, some or all of the incentive payment is forfeited.

In fiscal 1998 Plant 2 met its budget goal by underrunning its \$165 million annual budget. However, the plant fell short of meeting an ambitious goal for net electrical generation. And worker



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

radiation exposure, a key measurement of safety and efficiency, although lower than the year before was still higher than the established goal.

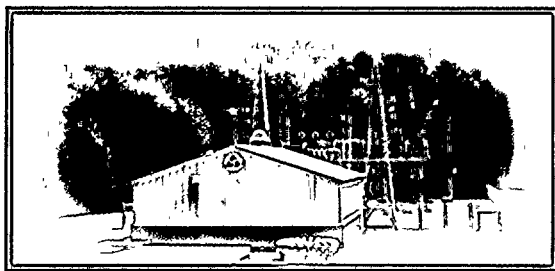
The plant was prevented from reaching its annual generation goal by two events: An unplanned outage in March caused by a minor equipment failure that ended a 243 day continuous generation run, and the extension of the spring maintenance and refueling outage caused by a broken valve in the plant's fire protection system.

These were Plant 2's only forced outages in more than three years.

With costs down and reliability up the Supply System is continuing to look for ways to increase efficiency. That's why the Supply System and Bonneville have agreed to transition Plant 2 to a 24-month refueling cycle.

Plant 2 is the only nuclear power plant in the nation still on a 12-month refueling cycle. Most plants operate on an 18-month cycle and about 20 percent run two years between refuelings. Because Plant 2 rests among some of the greatest hydroelectric producers in the world, the nuclear station has always followed the ebb and flow of the Columbia River. Each spring, when water was high and the region awash with hydroelectricity, Bonneville wanted Plant 2 offline and refueling. The plant simply couldn't compete with hydro power during periods of high water.

Now, with the incremental cost to Bonneville of running the 1,200 megawatt Plant 2 (that's the cost for fuel, generation taxes and contributions to the federal spent fuel fund) down to about a half-cent a kilowatt-hour, the economics have changed.



*Packwood powerhouse*

Changing to a 24-month refueling cycle is expected to save between \$100 million and \$120 million over the life of Plant 2. The transition will cost about \$22 million, but if Plant 2 skips an outage every other spring, the yearly average price for its power is likely to drop. And, by skipping every other outage, Plant 2 will save about \$15 million for each one missed.

Plant 2 has come a long way on its journey to excellence. It is a valued counterpoint to the Northwest's traditional reliance on low-cost hydro-power. With its costs in line and reliability no longer questioned, Plant 2 is competitive with new resources. And, as the Supply System continues its long journey, Plant 2 is increasingly competitive with traditional resources as well.

## *New Business Initiatives*

For the Supply System, restructuring of the electrical industry means great change, and great opportunity. After meeting the challenge of making Plant 2 more efficient and reliable, the Supply System is finding the opportunity to redefine itself.

### *• Packwood Project goes green*

The Supply System's 27-megawatt Packwood Lake Hydroelectric Project capped off a strong generating year on an environmentally friendly note when it became one of three regional generating projects chosen by the Bonneville Power Administration for its new Environmental Foundation.

The foundation is made up of three environmental groups teamed with Bonneville in a unique arrangement to market "green power" from Packwood, the Idaho Falls Hydroelectric Project and a Wyoming wind farm.

Northwest consumers will pay a premium for this green power, with most of the extra revenue going to the foundation to finance environmental

projects. If all Packwood's output is sold as "green," the foundation will gain about \$750,000 a year. The Supply System and its Packwood participants gain less, but it's significant — up to \$300,000 a year.

The Supply System is discussing a two-year contract with BPA that calls for an additional 2.5 mills per kilowatt-hour for any green power sold from the project. The contract would raise the ceiling for firm energy from Packwood from 80 gigawatt-hours to 86.75 gwh to allow more energy to be marketed at the higher firm-power rate. Bonneville also would pay the cost, including transmission losses, for transmitting Packwood power 50 miles to BPA's system.

Another benefit to Packwood may come down the road. The project is up for relicensing in 2010. Teaming up with potential intervenors, along with their recognition of Packwood as environmentally friendly, could pay future dividends during the relicensing process.

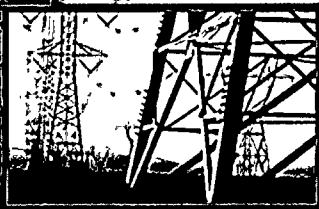
### *• APEL*

The Applied Process Engineering Laboratory (APEL) was dedicated last spring. The \$6 million lab is located in a former Supply System warehouse in Richland. The lab is the only high-tech business incubator of its kind in North America. It will create jobs in the Northwest and address some of the most vexing environmental problems facing our planet, such as disposal of toxic wastes. APEL is a joint venture of the Supply System, the Port of Benton, the Pacific Northwest National Laboratory, the Department of Energy and others.

### *• Hometown Connections*

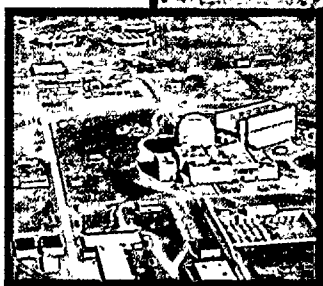
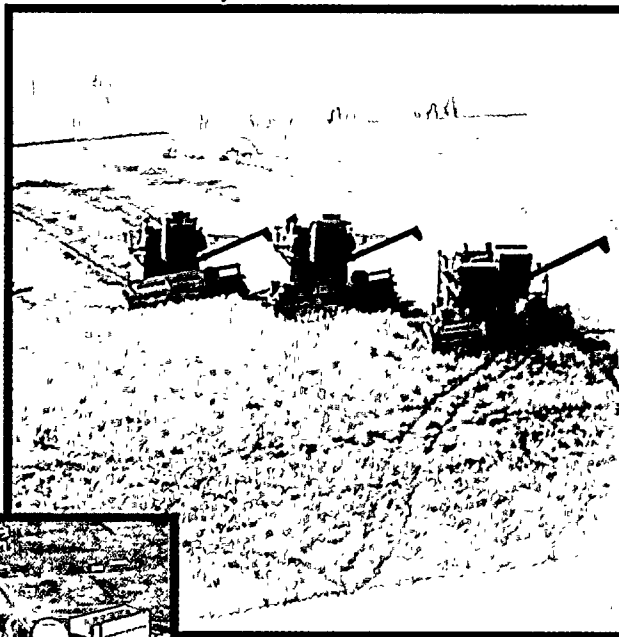
To expand into the energy services market, the Supply System in September became a marketing affiliate of Hometown Connections, the American Public Power Association's new subsidiary. Hometown Connections is a collection of services designed to make local public power retailing utilities more competitive by using combined buying power to leverage better arrangements from vendors. Initially, the Supply System will market such services and products as customer surveys, customer information software, advanced meter-reading products, workshops and energy services.

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*Packwood Lake*

*Eastern Washington wheat harvest*



*Project 1 & 4 site*

### • *Mixed-oxide fuel*

The Supply System is a vital component of a consortium seeking to help rid the nation of surplus plutonium by burning a portion of it in commercial power reactors. The Supply System, Raytheon Engineers and Constructors and Battelle Memorial Institute, which operates the Pacific Northwest National Laboratory, are members of the consortium, which is led by Siemens Power Corp.

There are about 55 tons of weapons-grade plutonium declared surplus in the United States. Of that, about 35 tons is suitable for mixing with uranium to produce mixed-oxide fuel. The National Academy of Sciences has said such surplus plutonium here and in the former Soviet Union is "a clear and present danger" to global peace and should be destroyed or made unsuitable for terrorists to use.

If mixed-oxide fuel is burned by the Supply System's Plant 2, it would mean a reduction in the cost of power in the Northwest because of less expensive fuel for the reactor or due to payments to the consortium for disposing of the plutonium. There are other proposed methods to make plutonium terrorist-proof, but the mixed-oxide route is the only one that would result in a substantial reduction in the amount of surplus plutonium.

### • *Projects 1 and 4*

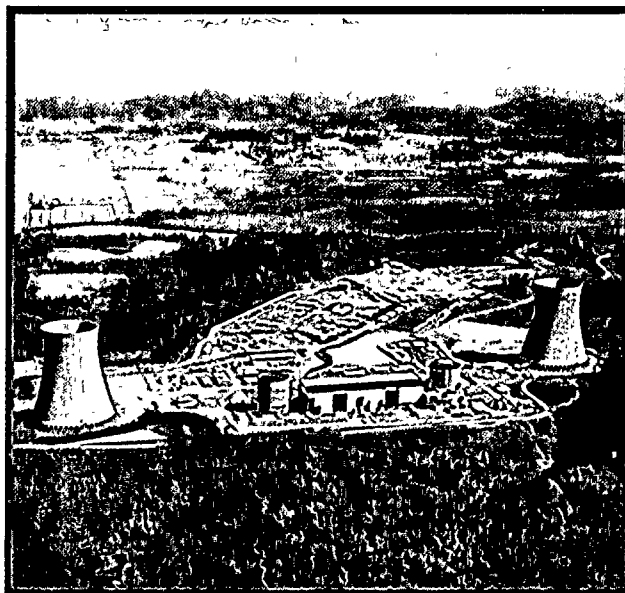
The Supply System has leased a 40,000 square-foot warehouse near Project 4 to Durametal Brake Co., a Portland, Oregon, company that manufactures brake drums for buses and large trucks. The company is expected to create about 50 new jobs in the area.

A site near Project 1 has been identified by Mid-Columbia economic development leaders as the community's best location for an aluminum smelter proposed by a company called Columbia Ventures. The Supply System site was one of three finalists accepted by the company. Other candidate sites are in Oregon and British Columbia.

### • *Satsop Redevelopment Project*

The Supply System continues to work with the Satsop Redevelopment Project (SRP) to transfer some assets and real estate of Projects 3 and 5 for economic development in Grays Harbor County, in coastal Washington state. The Supply System has offered to pay SRP \$15 million to take over the site. The payments will be far less than if the Supply System had retained ownership and was required, under terms of its Energy Facilities Site Evaluation Council license, to return the site to its natural state. In return, SRP is expected to assume all liability for the site.

Because of the complex nature of past ownership contracts, reaching a transfer agreement has been a complex matter, requiring time and great attention to detail. However, all parties have agreed the Supply System would retain ownership of sites projected for two natural gas-fired combustion turbines now licensed, but not yet built. One of the 245 megawatt plants turbines is committed to the Bonneville Power Administration for operation by the Supply System. The other, if built, would be operated by the Supply System to meet the emerging energy needs of the West.



*Satsop project site*





## *Board of Directors*

*(left to right)*

*Robert Graves (President)*

*Commissioner, Benton County PUD*

*Darrel Bunch (Assistant Secretary)*

*Commissioner, Okanogan County PUD*

*Charles Buennagel*

*Commissioner, Wahkiakum County PUD*

*James Todd*

*Seattle City Light*

*Beverley Cochran (Vice President)*

*Commissioner, Franklin County PUD*

*Roger Sparks*

*Commissioner, Kittitas County PUD*

*Vera Claussen (Secretary)*

*Commissioner, Grant County PUD*

*Dan Gunkel*

*Commissioner, Klickitat County PUD*

*Don Carter*

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

*Parker Knight*

*Commissioner, Skamania County PUD*

*Dale Bly*

*Commissioner, Ferry County PUD*

*Tom Casey*

*Commissioner, Grays Harbor County PUD*

*Not Pictured:*

*Mark Crisson*

*Director of Utilities, Tacoma Power*



One of the core values of the Washington Public Power Supply System is being a good local citizen by encouraging its 1,100 employees to become involved in community service. Among the many community activities employees support are the United Way, the March of Dimes and Head Start, an organization that offers preschool, health and social services to low-income children and their families.

Supply System employees have increased their per capita donations to the United Way each year for the past six years. The Supply System is one of the local agency's largest supporters.

Last year 77 Supply System employees raised nearly \$13,000 in the annual March of Dimes WalkAmerica.

Supply System employees also carried on a long tradition of making Christmas special by throwing parties and distributing gifts to 394 Head Start children, as well as providing Christmas dinner for 25 needy families and raising \$18,600 for a new building at the Children's Center.



**WASHINGTON PUBLIC POWER  
SUPPLY SYSTEM**

WASHINGTON PUBLIC POWER SUPPLY SYSTEM  
P.O. Box 968, Richland, Washington 99352 (509) 372-5000  
WEB1.WNP2.COM  
980260

# FINANCIAL OPERATING HIGHLIGHTS

For the year ending June 30, 1998 Dollars in millions

## OPERATING STATISTICS

### NUCLEAR PROJECT NO. 2

	FY 1998	FY 1997	FY 1996	FY 1995	FY 1994
Total production costs*	\$ 119.1	\$ 119.5	\$ 133.3	\$ 139.9	\$ 155.9
Net generation (millions of kWh)**	7,502.0	6,965.3	7,703.6	6,942.7	7,288.8
Cost in cents/kWh*	1.59	1.72	1.73	2.02	2.14
Plant availability***	77.9%	83.7%	79.7%	75.0%	79.5%
Plant capacity****	71.9%	60.0%	61.3%	67.9%	76.6%
Regional cost of power cents/kWh*****	2.20	2.46	2.56	3.34	3.45

### PACKWOOD LAKE PROJECT

	FY 1998	FY 1997	FY 1996	FY 1995	FY 1994
Total production costs*	\$ 0.3	\$ 0.4	\$ 0.1	\$ 1.0	\$ 0.4
Net generation (millions of kWh)	98.4	123.1	125.4	60.7	65.6
Cost in cents/kWh*	.25	.33	.09	1.63	.67
Plant availability***	92.2%	88.5%	90.1%	60.0%	90.0%
Plant capacity****	37.4%	51.1%	51.9%	22.9%	27.3%

## INVESTMENT PERFORMANCE

	FY 1998	FY 1997	CHANGE
Income	\$ 41.8	\$ 41.4	0.1%
Average Balance	\$ 627.6	\$ 701.3	-10.5%
Rate of Return	6.65%	5.9%	+12.7%

## BONDS OUTSTANDING

	FY 1998	FY 1997	CHANGE
WNP-1 fixed	\$ 2,137.3	\$ 2,160.6	-1.1%
weighted average	5.8%	6.0%	-3.4%
variable	\$ 138.7	\$ 142.6	-2.8%
average rate	3.6%	3.5%	+2.8%
WNP-2 fixed#	\$ 2,335.1	\$ 2,491.7	-6.3%
weighted average##	5.6%	6.0%	-6.7%
variable	\$ 120.9		
average rate	3.7%		
WNP-3 fixed #	\$ 1,605.6	\$ 1,623.8	-1.1%
weighted average##	5.7%	6.0%	-5.0%
variable	\$ 185.6	\$ 190.0	-2.4%
average rate	3.6%	3.5%	+2.8%
PACKWOOD			
fixed	\$ 6.7	\$ 7.1	-5.6%
weighted average	3.7%	3.7%	0.0%

# Excludes compound interest bonds accretion.

## Excludes compound interest bonds.

\* Includes operating, maintenance, and fuel amortization costs per FERC report.

\*\* Includes BPA economic dispatch generation (millions of kWh) credit of \$32; 1,150.9; 1,759.2; and 480 in FY 1998, FY 1997, FY 1996 and FY 1995, 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.

\*\*\*\*\* Regional cost of power uses a broader measure of cost and is primarily used by BPA and the Supply System to evaluate cost competitiveness.

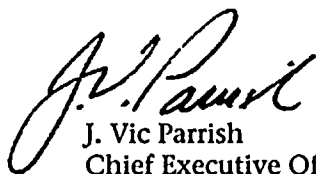
**MANAGEMENT REPORT ON  
RESPONSIBILITY FOR FINANCIAL REPORTING**

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 judgements.

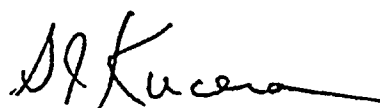
The financial statements have been audited by PricewaterhouseCoopers LLP, the Supply System's independent auditors. Management has made available to PricewaterhouseCoopers LLP all financial records and related data, and believes that all representations made to PricewaterhouseCoopers LLP during its audit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

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

The Supply System maintains an ongoing internal auditing program that provides for independent assessment of the effectiveness of internal controls, and for recommendations of possible improvements thereto. In addition, PricewaterhouseCoopers 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 PricewaterhouseCoopers LLP concerning the control procedures and has taken appropriate action to respond to the recommendations. Management believes that, as of June 30, 1998, internal control procedures are adequate.



J. Vic Parrish  
Chief Executive Officer



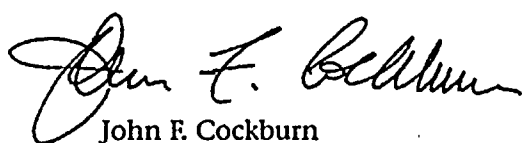
G.J. Kucera  
Vice President, Administration/  
Chief Financial Officer

**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, and Louis Winnard, Ex Officio. The Committee held 14 meetings during the fiscal year ended June 30, 1998.

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

## REPORT OF INDEPENDENT ACCOUNTANTS

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, 1998, 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.

*PricewaterhouseCoopers LLP*

Portland, Oregon  
August 27, 1998

# BALANCE SHEETS

As of June 30, 1998      Dollars in thousands

	NUCLEAR PROJECT NO.2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1 #	NUCLEAR PROJECT NO.3 **
<b>ASSETS</b>				
<b>UTILITY PLANT (NOTE B)</b>				
In service	\$ 3,457,488	\$ 12,788		
Allowance for depreciation	(1,414,922)	(10,428)		
	2,042,566	2,360		
Nuclear fuel, net of accumulated amortization	114,851			
Construction work in progress	3,958			
	2,161,375	2,360		
<b>RESTRICTED ASSETS (NOTE B)</b>				
Special funds				
Cash	3	5	\$ 5,264	\$ 303
Available-for-sale investments	31,132	305	91,043	21,628
Accounts and other receivables	52,275		340	3,945
Due from other projects			800	402
Due from other funds				14,016
Prepayments and other			31	76
Debt service funds				
Cash	416	7	104	127
Available-for-sale investments	149,557	723	197,606	150,049
Other receivables	1,356		1,189	1,296
	234,739	1,040	296,377	191,842
<b>LONG-TERM RECEIVABLES (NOTE B)</b>				
	35,620			
<b>CURRENT ASSETS</b>				
Cash	1,415	3	167	163
Available-for-sale investments	20,826	92	4,003	6,884
Accounts and other receivables	6,237	96		29
Due from participants	116		23	18
Due from other projects		575	195	120
Due from other funds	27,680	37	23,064	
Materials and supplies	57,227			
Prepayments and other	891	31		
Nuclear fuel held for sale			9,304	
Plant & equipment held for sale			5,997	100
	114,392	834	42,753	7,314
<b>DEFERRED CHARGES</b>				
Costs in excess of billings	9,431	3,109	1,979,826	1,748,354
Unamortized debt expense	17,300	6	21,435	15,670
Other deferred charges	730			
	27,461	3,115	2,001,261	1,764,024
<b>TOTAL ASSETS</b>	<b>\$ 2,573,587</b>	<b>\$ 7,349</b>	<b>\$ 2,340,391</b>	<b>\$ 1,963,180</b>

\* Supply System's ownership share (Note A)

# Project recorded on a liquidation basis

See notes to financial statements

	NUCLEAR PROJECT NO.2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1 #	NUCLEAR PROJECT NO.3 *#
<b>LIABILITIES</b>				
UNREALIZED INVESTMENT GAINS	\$ 2,642		\$ 1,619	\$ 825
LONG-TERM DEBT (NOTE E)				
Revenue bonds payable	2,397,505	\$ 6,459	2,275,920	2,196,255
Unamortized discount on bonds - net	(51,218)	(24)	(10,316)	(307,640)
Unamortized loss on bond refundings	(59,550)		(67,097)	(22,799)
	2,286,737	6,435	2,198,507	1,865,816
LIABILITIES- PAYABLE FROM RESTRICTED ASSETS (NOTE B)				
Special funds				
Accounts payable and accrued expenses	54,221	5	53,250	40,152
Due to other funds	25,402	23	19,542	
Debt service funds				
Accrued interest payable	317	82	62,814	41,922
Due to other funds	2,278	14	3,522	2,015
	82,218	124	139,128	84,089
OTHER NONCURRENT LIABILITIES	10,091	7		
CURRENT LIABILITIES				
Current maturities of long-term debt	144,670	267		
Accounts payable and accrued expenses	44,091	49	589	111
Due to participants	951	415	548	338
Due to other funds				12,001
Due to other projects	2,092			
	191,804	731	1,137	12,450
DEFERRED CREDITS				
Deferred gain on redemption of revenue bonds		52		
Other deferred credits	95			
	95	52	0	0
COMMITMENTS AND CONTINGENCIES (NOTE F)				
TOTAL LIABILITIES	\$ 2,573,587	\$ 7,349	\$ 2,340,391	\$ 1,963,180



# STATEMENTS OF OPERATIONS

For the year ended June 30, 1998 Dollars in thousands

	NUCLEAR PROJECT NO.2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1#	NUCLEAR PROJECT NO.3*#
OPERATING REVENUES	\$ 424,651	\$ 1,214		
OPERATING EXPENSES				
Nuclear fuel	24,037			
Fuel disposal fee	6,611			
Decommissioning	10,370			
Depreciation and amortization	106,587	352		
Operations and maintenance	101,102	583		
Administrative & general	24,858	101		
Generation tax	2,432	21		
Total operating expenses	275,997	1,057		
NET OPERATING REVENUES	148,654	157		
OTHER INCOME & EXPENSE				
Non-operating revenues			\$ 126,314	\$ 105,163
Investment income	17,452	71	14,145	8,755
Gain/(loss) on current bond redemption		28		(732)
Interest expense and discount amortization	(151,796)	(256)	(137,855)	(113,548)
Plant preservation and termination costs			(3,139)	(3,570)
Write-off deferred regulatory studies	(16,332)			
Loss on fuel sale			(459)	
Joint owners' share of costs				746
Other	2,022		994	3,186
NET REVENUES	\$ 0	\$ 0	\$ 0	\$ 0

\* Supply System's ownership share (Note A)

# Project recorded on a liquidation basis

See notes to financial statements

# STATEMENTS OF CASH FLOWS

For the year ended June 30, 1998 Dollars in thousands

	NUCLEAR PROJECT NO.2	PACKWOOD LAKE PROJECT	NUCLEAR PROJECT NO.1 #	NUCLEAR PROJECT NO.3 * #
<b>CASH FLOWS FROM OPERATING AND OTHER ACTIVITIES</b>				
Net operating revenues	\$ 148,654	\$ 157		
Adjustments to reconcile net operating revenues to cash provided by operating activities:				
Amortized revenues	(83,500)	(324)		
Depreciation and amortization	128,534	347		
Decommissioning	10,370			
Other	2,022			
Change in operating assets and liabilities:				
Accounts receivable	(903)	222		
Materials and supplies	(1,087)			
Prepaid and other assets	197	1		
Due from/to other projects, funds and participants	(3,106)	(126)		
Accounts payable	(4,737)	(672)		
Non-operating revenue receipts			\$ 166,298	\$ 117,774
Cash payments for preservation and termination expenses			(4,453)	(3,893)
Cash payments for other expenses			3,129	491
Net cash provided/(used) by operating and other activities	196,444	(395)	164,974	114,372
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>				
Proceeds from bond refundings	693,867		368,178	430,754
Refunded bonds escrow requirement	(679,246)		(367,410)	(427,349)
Payment for bond issuance and financing costs	(5,532)		(3,027)	(3,753)
Escrow restructuring receipts			1,028	3,188
Capital and nuclear fuel acquisitions	(22,530)	(135)		
Cash payments for deferred programs	(247)			
Interest paid on revenue bonds	(134,622)	(256)	(130,622)	(92,557)
Principal paid on revenue bond maturities	(75,225)	(356)	(53,165)	(40,312)
Net cash used by capital and related financing activities	(223,535)	(747)	(185,018)	(130,029)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Purchases of investment securities	(1,175,479)	(6,019)	(896,345)	(571,581)
Sales of investment securities	1,185,607	7,052	895,110	574,748
Interest on investments	18,127	91	15,111	8,221
Receipts from sales of plant assets & fuel			11,101	1,567
Net cash provided by investing activities	28,255	1,124	24,977	12,955
<b>NET INCREASE/(DECREASE) IN CASH</b>	1,164	(18)	4,933	(2,702)
<b>CASH AT JUNE 30, 1997</b>	670	33	602	3,295
<b>CASH AT JUNE 30, 1998 (NOTE B)</b>	\$ 1,834	\$ 15	\$ 5,535	\$ 593

\* Supply System's ownership share (Note A)

# Project recorded on a liquidation basis

See notes to financial statements

# OUTSTANDING LONG-TERM DEBT

As of June 30, 1998 Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 2 REVENUE BONDS</b>						
1990A	3-15-90	7.77%	97.125	7.25%	7-1-2006	\$ 35,790 <u>35,790</u>
1990C	11-01-90	7.84	(B) (B)	7.00-7.50 (C)	7-1-1999/2002 7-1-2004/2005	148,810 <u>18,054</u> <u>166,864</u>
1991A	9-26-91	6.81	(B) (B)	6.20-6.60 (C)	7-1-1999/2004 7-1-2006/2007	103,770 <u>13,431</u> <u>117,201</u>
1992A	10-02-92	6.19	(B) 97.230 98.875 (B)	5.30-6.30 6.25 6.30 (C)	7-1-1999/2009 7-1-2012 7-1-2012 7-1-2010/2011	146,790 14,525 50,000 <u>9,084</u> <u>220,399</u>
1993A	5-20-93	5.76	(B) 96.404	4.75-6.00 5.75	7-1-1999/2010 7-1-2012	176,860 <u>42,105</u> <u>218,965</u>
1993B	7-15-93	5.64	(B) 100 97.775	4.75-5.65 5.55 5.625	7-1-1999/2008 7-1-2010 7-1-2012	95,685 51,000 <u>43,455</u> <u>190,140</u>
1994A	1-27-94	5.31	(B) 100 100	4.125-6.00 5.40 (C)	7-1-1999/2011 7-1-2012 7-1-2009	530,925 100,200 <u>4,776</u> <u>635,901</u>
1996A	9-13-96	5.72	(B)	5.00-6.00	7-1-1999/2012	<u>207,805</u> <u>207,805</u>
1997A	9-11-97	5.18	(B)	5.00-5.50	7-1-1999/2012	<u>234,810</u> <u>234,810</u>
1997B	9-19-97	5.37	(B)	5.00-5.50	7-1-1999/2011	<u>76,155</u> <u>76,155</u>
1998A	12-18-97	5.1	(B)	4.50-5.75	7-1-1999/2012	<u>231,085</u> <u>231,085</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1998 which were paid on June 30, 1998

(E) Includes amounts due July 1, 1998

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

# OUTSTANDING LONG-TERM DEBT (continued)

As of June 30, 1998 Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 2 REVENUE BONDS</b>						
1997-2A-1,2	4-02-98	NA	NA	Variable	7-1-1999/2012	\$ 120,865 <u>120,865</u>
Compound interest bonds accretion						<u>86,195</u>
Revenue bonds payable						\$ 2,542,175(D)
Estimated fair value at June 30, 1998						\$ 2,696,613(F)
<b>PACKWOOD LAKE PROJECT REVENUE BONDS</b>						
1962	3-20-62	3.66%	99.425	3.625%	3-1-2012	\$ 5,096
1965	11-04-65	3.76	100.5	3.75	3-1-2012	<u>1,630</u>
Revenue bonds payable						\$ <u>6,726</u>
Estimated fair value at June 30, 1998						\$ <u>6,387(F)</u>
<b>NUCLEAR PROJECT NO. 1 REVENUE BONDS</b>						
1989A	9-14-89	7.76	100	7.10-7.30	7-1-1998/2001	\$ 13,385 <u>13,385</u>
1989B	12-07-89	7.44	100 98.533	7.00-7.15 7.125	7-1-1999/2001 7-1-2016	14,855 <u>41,070</u> <u>55,925</u>
1990A	3-15-90	7.73	(B)	7.10-7.50	7-1-1998/2002	<u>33,395</u> <u>33,395</u>
1990B	6-07-90	7.75	(B) 97.979	7.00-7.20 7.25	7-1-1999/2003 7-1-2009	24,495 <u>72,770</u> <u>97,265</u>
1990C	9-27-90	7.85	(B)	7.25-7.75	7-1-1998/2003	<u>113,765</u> <u>113,765</u>
1991A	9-26-91	7.02	(B)	6.00-6.60	7-1-1998/2004	<u>22,620</u> <u>22,620</u>
1992A	10-02-92	6.51	(B) 98	5.10-6.25 6.25	7-1-1998/2007 7-1-2017	17,105 <u>68,015</u> <u>85,120</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1998 which were paid on June 30, 1998

(E) Includes amounts due July 1, 1998

(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, 1998 Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 1 REVENUE BONDS</b>						
1993A	5-20-93	5.86%	(B) 100 99.75 96.306 96.566	4.625-7.00% 5.75 6.05 5.75 5.70	7-1-1998/2008 7-1-2011 7-1-2012 7-1-2013 7-1-2017	\$ 174,655 80,000 35,705 37,970 176,180 <u>504,510</u>
1993B	7-15-93	5.64	(B) 98.138	4.30-7.00 5.60	7-1-1998/2010 7-1-2015	78,375 94,885 <u>173,260</u>
1993C	9-10-93	5.47	(B) 100 98.166	4.10-5.30 5.40 5.375	7-1-1998/2010 7-1-2012 7-1-2015	20,865 66,400 75,650 <u>162,915</u>
1993-1A-1,2,3	12-15-93	NA	NA	Variable	7-1-1998/2017	138,660 <u>138,660</u>
1996A	9-10-96	5.77	(B)	5.00-6.00	7-1-1998/2012	354,935 <u>354,935</u>
1996B	9-13-96	5.72	(B)	5.00-6.00	7-1-1998/2005	30,250 <u>30,250</u>
1996C	10-07-96	5.71	(B) 96.170	4.50-6.00 5.50	7-1-1998/2015 7-1-2017	91,525 24,860 <u>116,385</u>
1997A	9-11-97	5.18	(B)	4.75-6.00	7-1-1999/2008	20,905 <u>20,905</u>
1997B	9-19-97	5.37	(B)	4.50-5.125	7-1-1998/2017	257,615 <u>257,615</u>
1998A	12-18-97	5.10	(B)	4.50-5.75	7-1-1998/2017	95,010 <u>95,010</u>
Revenue bonds payable						<u>\$ 2,275,920(E)</u>
Estimated fair value at June 30, 1998						<u>\$ 2,413,649(F)</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1998 which were paid on June 30, 1998

(E) Includes amounts due July 1, 1998

(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, 1998 Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 3 REVENUE BONDS</b>						
1989A	9-14-89	7.43%	100 (B)	7.20-7.30% (C)	7-1-1998/2001 7-1-2003/2014	\$ 12,985 18,668 <u>31,653</u>
1989B	12-07-89	7.39	100 (B) 98.533 79.755 79.525	6.90-7.15 (C) 7.125 5.50 5.50	7-1-1998/2001 7-1-2004/2014 7-1-2016 7-1-2017 7-1-2018	60,800 71,321 76,145 62,560 65,905 <u>336,731</u>
1990B	6-07-90	7.57	(B) (B) 98.923	7.10-7.25 (C) 7.375	7-1-1998/2000 7-1-2001/2010 7-1-2004	54,830 38,684 55,920 <u>149,434</u>
1991A	9-26-91	6.97	(B)	6.00-6.60	7-1-1998/2004	25,430 <u>25,430</u>
1992A	10-02-92	4.86	100	5.10	7-1-1998	2,710 <u>2,710</u>
1993B	7-15-93	5.64	(B) 97.775 98.138 98.058 97.719	4.30-7.00 5.625 5.60 5.60 5.70	7-1-1998/2010 7-1-2012 7-1-2015 7-1-2017 7-1-2018	121,400 28,295 49,095 37,795 20,605 <u>257,190</u>
1993C	9-10-93	5.47	(B) 100 (B) 98.166 99.5	4.10-7.50 5.40 (C) 5.375 5.50	7-1-1998/2010 7-1-2012 7-1-2013/2018 7-1-2015 7-1-2018	160,890 105,000 25,248 188,335 20,805 <u>500,278</u>
1993-3A-3	12-15-93	NA	NA	Variable	7-1-1998/2018	26,080 <u>26,080</u>
1996A	9-10-96	5.71	(B)	5.00-6.00	7-1-1998/2009	32,345 <u>32,345</u>
1997A	9-11-97	5.18	(B)	4.50-6.00	7-1-1998/2018	112,030 <u>112,030</u>
1997B	9-19-97	5.37	101.888	5.00	7-1-2002	4,075 <u>4,075</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1998 which were paid on June 30, 1998

(E) Includes amounts due July 1, 1998

(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, 1998 Dollars in thousands

SERIES	DATE OF SALE	TRUE INTEREST COST (A)	INITIAL OFFERING PRICES	COUPON RATE	SERIAL OR TERM MATURITIES	AMOUNT
<b>NUCLEAR PROJECT NO. 3 REVENUE BONDS</b>						
1998A	12-18-97	5.10%	(B)	4.50-5.125%	7-1-1998/2018	\$ <u>153,690</u> <u>153,690</u>
1998-3A	4-02-98	NA	NA	Variable	7-1-1999/2018	<u>159,500</u> <u>159,500</u>
Compound interest bonds accretion						<u>405,109</u>
Revenue bonds payable						\$ <u>2,196,255 (E)</u>
Estimated fair value at June 30, 1998						\$ <u>2,193,456 (F)</u>

(A) Based on original issue

(B) Various prices

(C) Compound interest bonds

(D) Excludes amounts due July 1, 1998 which were paid on June 30, 1998

(E) Includes amounts due July 1, 1998

(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, 1998 Dollars in thousands

## NUCLEAR PROJECT NO. 2

## PACKWOOD LAKE PROJECT

FISCAL YEAR 6/30/98	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
Balance*	\$	\$ 317	\$ 317	\$ 133	\$ 82	\$ 215
1999	144,670	134,008	278,678	422	241	663
2000	142,630	126,296	268,926	473	226	699
2001	178,580	118,074	296,654	498	208	706
2002	96,750	107,349	204,099	524	190	714
2003	155,225	101,858	257,083	548	171	719
2004	163,609	105,079	268,688	573	151	724
2005	124,340	108,623	232,963	599	130	729
2006	140,186	91,291	231,477	623	108	731
2007	168,645	83,619	252,264	648	85	733
2008	195,865	61,560	257,425	674	62	736
2009	197,001	56,946	253,947	572	37	609
2010	210,174	50,273	260,447	274	16	290
2011	173,680	39,542	213,222	122	6	128
2012	364,625	20,138	384,763	43	2	45
2013						
2014						
2015						
2016						
2017						
2018						
Adjustment **	86,195	(86,195)				
	\$ 2,542,175	\$ 1,118,778	\$ 3,660,953	\$ 6,726	\$ 1,715	\$ 8,441

\* 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, 1998 Dollars in thousands

## NUCLEAR PROJECT NO. 1

## NUCLEAR PROJECT NO. 3

FISCAL YEAR 6/30/98	PRINCIPAL	INTEREST	TOTAL	PRINCIPAL	INTEREST	TOTAL
Balance*	\$ 59,490	\$ 62,814	\$ 122,304	\$ 32,370	\$ 41,922	\$ 74,292
1999	74,660	127,611	202,271	71,225	89,398	160,623
2000	79,090	123,009	202,099	76,240	84,888	161,128
2001	84,255	118,083	202,338	74,950	86,596	161,546
2002	79,635	112,668	192,303	78,457	82,803	161,260
2003	70,280	107,709	177,989	80,057	81,645	161,702
2004	81,710	103,760	185,470	63,311	93,904	157,215
2005	73,765	98,991	172,756	64,471	92,125	156,596
2006	91,195	94,850	186,045	65,392	90,567	155,959
2007	96,495	89,425	185,920	60,176	90,969	151,145
2008	102,580	83,414	185,994	63,330	87,906	151,236
2009	106,360	76,917	183,277	64,163	87,142	151,305
2010	113,015	70,553	183,568	66,572	84,932	151,504
2011	136,120	64,227	200,347	84,829	74,012	158,841
2012	144,100	56,605	200,705	98,322	70,380	168,702
2013	157,820	48,653	206,473	95,565	73,381	168,946
2014	166,340	40,245	206,585	98,435	70,663	169,098
2015	175,380	31,332	206,712	129,215	40,061	169,276
2016	175,460	21,746	197,206	133,689	35,734	169,423
2017	208,170	11,459	219,629	141,502	27,845	169,347
2018				148,875	20,641	169,516
Adjustment **				405,109	(405,109)	
	\$ 2,275,920	\$ 1,544,071	\$ 3,819,991	\$ 2,196,255	\$ 1,102,405	\$ 3,298,660

\* 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

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### 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, 1998, 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 (see Note F - Nuclear Projects Nos. 1 and 3 Termination). 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.

All electrical energy produced by Supply System projects is ultimately delivered to electrical distribution facilities owned and operated by the Bonneville Power Administration (BPA) as part of the Federal Columbia River Power System. BPA in turn distributes the electricity to electric utility systems throughout the Northwest, including participants in Supply System projects, for ultimate distribution to consumers. Participants in Supply System projects consist of 104 publicly-owned

utilities and rural electric cooperatives located in the western United States who have entered into net-billing agreements with the Supply System and BPA for participation in one or more of the Supply System projects. BPA is obligated by law to establish rates for electric power which will recover the cost of electric 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 the 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. Specifically, Statement of Governmental Accounting Standard No. 7 and No. 23 conflict with Statement of Financial Accounting Standard No. 125. As such, the guidance under Statement of Governmental Accounting Standard No. 7 and No. 23 is followed.

The financial statements presented in this annual report reflect the Supply System's 70 percent ownership of Nuclear Project No. 3 plant and equipment held for sale. Assets, other than plant and equipment held for sale, and obligations of Nuclear Plant No. 3 in these financial statements reflect the 100 percent 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 and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these

estimates. Certain incurred expenses 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 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 \$96.1 million as of June 30, 1998 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 in fiscal year 1998 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 to transfer enriched uranium to General Electric Company in exchange for equivalent amounts of uranium at reload enrichments in future years and usage/loan fees. The Supply System has transferred approximately 629,609 pounds of UF<sub>6</sub> 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, \$19.0 million, is included in the carrying amount of Nuclear Project No. 2 Nuclear Fuel.

In fiscal year 1998, Nuclear Project No. 2 purchased 95,500 pounds of UF<sub>6</sub> and 23,700 SWU from Nuclear Project No. 1. The purchase price was \$1.2 million for the UF<sub>6</sub> and \$1.9 million for SWU, for a total of \$3.1 million.

#### *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*

Long-term receivables include 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 established a decommissioning fund for Nuclear Project No. 2 and moneys are being deposited each year in accordance with an established funding plan. The Supply System's current estimate of Nuclear Project No. 2 decommissioning costs is approximately \$357 million (in 1987 dollars). The plan continues to be based on the safe storage method of decommissioning. This current estimate continues to be based primarily on a draft report which was published in 1988 in connection with a study commissioned by the NRC.

The funding plan requires annual deposits through fiscal year 2024, the estimated end of commercial operation of Nuclear Project No. 2. The plan for subsequent annual deposits calls for incremental increases of 5% per year. The plan assumes that such deposits will grow at a 3% real rate of return and that the Project will be placed in a 30 year safe storage until 2055, at which time decontamination and dismantlement will be initiated. Over the life of the fund, deposits and the earnings related to the reinvestment thereof, are expected to provide sufficient funds to cover the cash flow requirements to decommission Nuclear Project No. 2. This plan will be reexamined every year and modified to assure that the projected fund balance complies with the then current estimates and NRC requirements. Payments to the decommissioning fund have been made since January 1985, and the balance of cash and investment securities in the fund as of June 30, 1998 totaled approximately \$52.3 million. Since July 1990 these amounts have been held in an external decommissioning trust fund in accordance with NRC requirements.

## ***Materials and Supplies***

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

## ***Financing Expense, Bond Discount, and Deferred Gain and Losses***

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

In accordance with the Statement of Governmental Accounting Standard No. 23 effective for periods after June 15, 1994, losses on debt refundings have been deferred and amortized as a component of interest expense over the shorter of the remaining life of the old or new debt. The balance sheet includes the original deferred amount less recognized amortization expense and is included as a reduction to the new debt.

## ***Current Maturities of Revenue Bonds***

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

## ***Accounts Payable***

Accounts payable and accrued expenses include payroll and benefits related accruals for Nuclear Project No. 2 of \$23.6 million. Nuclear Project No. 2 includes a Personal Time Bank accrual of \$10 million. Packwood includes an accrual for FERC Administrative charges of \$25,000. Nuclear Project No. 2 includes an accrual for \$3.4 million for Arbitrage Rebate and \$9.5 million for operating and capital expenses.

## ***Fair Value of Financial Instruments***

The fair value of financial instruments has been estimated using available market information and certain assumptions. Considerable judgment is required in interpreting market data to develop fair value estimates and such estimates are not necessarily indicative of the amounts that could be realized in a current market exchange. The following methods and assumptions were used to estimate the fair value of each of the following financial instruments.

Financial instruments for which the carrying value is considered a reasonable approximation of fair value include: cash, accounts 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 a 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 that 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 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.

## ***Concentration of Credit Risk***

Financial instruments which potentially subject the Supply System to concentrations of credit risk consist of available-for-sale investments, accounts receivable, other receivables, long-term receivables and costs in excess of billings. The Supply System invests exclusively in U.S. Government securities and agencies. The Supply System's accounts receivable and costs in excess of billings are concentrated with project participants and BPA through the net billing agreements. See Note E, Security - Nuclear Projects Nos. 1, 2, and 3 and Security - Packwood Lake Hydroelectric Project. The long-term receivable is with a large and stable company which the Supply System considers to be financially strong. Other receivables are secured through the use of letters of credit and other similar security mechanisms or are with large and stable companies which the Supply System considers to be financially strong. As a consequence, the Supply System considers the exposure of the projects to concentration of credit risk to be limited.

## ***Statements of Cash Flows***

For purposes of the statements of cash flows, cash includes unrestricted and restricted cash balances. Short-term, highly liquid investments are not considered cash equivalents.

## ***NOTE C - CASH AND INVESTMENTS***

Cash and investments for each 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 resolutions and investment policies limit investment authority to obligations of the United States Treasury, Federal National Mortgage Association and Federal Home Loan Banks. All investments are held for the benefit of the individual Supply System 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 below to give an indication of the types and amounts of investments held by each project at year end. (See table below)

**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, 1998, the Supply System's payroll covered under PERS was \$71.7 million, representing 95 percent of total payroll.

**AVAILABLE-FOR-SALE INVESTMENTS**

*(Dollars in Thousands)*

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b><u>Nuclear Project No. 2</u></b>				
U.S. Government Securities	\$ 53,409	\$ 1,461	\$ 0	\$ 54,870
U.S. Government Agencies	145,464	1,201	<20>	146,645
Total	\$ 198,873	\$ 2,662	\$ <20>	\$ 201,515
<b><u>Packwood Lake Project</u></b>				
U.S. Government Securities	\$ 1,120	\$ 0	\$ 0	\$ 1,120
U.S. Government Agencies	0	0	0	0
Total	\$ 1,120	\$ 0	\$ 0	\$ 1,120
<b><u>Nuclear Project No. 1</u></b>				
U.S. Government Securities	\$ 50,710	\$ 1,407	\$ <38>	\$ 52,079
U.S. Government Agencies	240,323	293	<43>	240,573
Total	\$ 291,033	\$ 1,700	\$ <81>	\$ 292,652
<b><u>Nuclear Project No. 3</u></b>				
U.S. Government Securities	\$ 35,416	\$ 431	\$ <8>	\$ 35,839
U.S. Government Agencies	\$ 142,320	\$ 423	\$ <21>	\$ 142,722
Total	\$ 177,736	\$ 854	\$ <29>	\$ 178,561

At June 30, 1998, the contractual maturities of available-for-sale investments are:

	< 1 Year	1-5 Years	6-10 Years	> 10 Years	TOTAL
<b><u>Nuclear Project No. 2</u></b>					
U.S. Government Securities	\$ 3,237	\$ 31,484	\$ 4,768	\$ 15,381	\$ 54,870
U.S. Government Agencies	\$ 83,615	\$ 46,146	\$ 0	\$ 16,884	\$ 146,645
Maturities at Fair Value	\$ 86,852	\$ 77,630	\$ 4,768	\$ 32,265	\$ 201,515
<b><u>Packwood Lake Project</u></b>					
U.S. Government Securities	\$ 1,120				\$ 1,120
Maturities at Fair Value	\$ 1,120				\$ 1,120
<b><u>Nuclear Project No. 1</u></b>					
U.S. Government Securities	\$ 15,395	\$ 13,627	\$ 17,341	\$ 5,716	\$ 52,079
U.S. Government Agencies	\$ 215,170	\$ 16,182	\$ 7,739	\$ 1,482	\$ 240,573
Maturities at Fair Value	\$ 230,565	\$ 29,809	\$ 25,080	\$ 7,198	\$ 292,652
<b><u>Nuclear Project No. 3</u></b>					
U.S. Government Securities	\$ 10,613	\$ 19,186	\$ 6,039	\$ 0	\$ 35,838
U.S. Government Agencies	\$ 115,061	\$ 20,327	\$ 5,002	\$ 2,333	\$ 142,723
Maturities at Fair Value	\$ 125,674	\$ 39,513	\$ 11,041	\$ 2,333	\$ 178,561

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 Plan 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 by state statute.

As of December 31, 1996 (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 \$17.1 billion and the value of net assets available to satisfy present and future pension benefit obligations was \$14.4 billion. The pension benefit obligation is a standardized measure which enables readers of financial statements to assess the funding status of each system and progress made in accumulating sufficient assets to pay benefits when due, and to make comparisons with other retirement systems. The standardized disclosure method is independent of the actuarial funding method used to determine contributions.

Supply System contributions for the year ended June 30, 1998, expressed both in dollar amounts and percentages of current year covered payroll, were as follows:

	Plan I		Plan II	
	Rate	Amount	Rate	Amount
<b>Employer Contributions</b>				
Actuarially determined requirement	7.32%	\$754,672	7.32%	\$4,513,352
Actual Supply System contributions	7.5%	\$773,230	7.5%	\$4,624,337
<b>Employee Contributions</b>				
Actuarially determined requirement	N/A	N/A	4.65%	\$2,909,999
Actual employee contributions	6.00%*	\$616,624	4.65%	\$2,909,999
* Fixed at 6.00%				

The Supply System's actuarially determined employer contribution requirement represents approximately 0.7 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, 1997 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. One hundred forty-seven 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 life insurance benefit is equal to the employee's annual rate of salary at retirement for non-bargaining employees retiring prior to January 1, 1995. The cost of coverage for employees who retired prior to January 1, 1995 is \$2.33 per \$1000 of coverage. Employees who retired prior to January 1, 1995 contribute \$.58 per \$1,000 of coverage while the Supply System pays the remainder.

At the time each employee retires, the Supply System accrues a liability for the actuarial present value of estimated future premiums, net of retiree contributions. The total liability recorded at June 30, 1998 was \$3 million for these benefits.

During fiscal year 1998, 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 95 percent of all such costs were allocated to Nuclear Project No. 2 during fiscal year 1998.

#### 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, 2 and 3 is subordinate to the bonds stated above.

During the year ended June 30, 1998, the Supply System issued \$1,202.8 million in fixed rate bonds with an average interest rate of 5.22 percent which refunded \$1,120.9 million of outstanding bonds with an average interest rate of 6.83 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 Supply System also issued \$120.9 million of variable rate bonds that have weekly floating rates which refunded \$120.9 million of fixed rate outstanding bonds with an average interest rate of 5.71 percent. A second variable rate bond issue of \$159.5 million was issued to refund \$159.5 million of outstanding variable rate bonds and was executed to replace the underlying Letter of Credit facilities of the refunded bonds with new credit enhancements.

**FISCAL YEAR 1998 BOND REFUNDINGS (Dollars in Thousands)**

**Bond Series**

<b><u>NUCLEAR PROJECT NO. 1</u></b>	<b>1997A</b>	<b>1997B</b>	<b>1998A</b>	<b>1997-2A</b>	<b>1998-3A</b>	<b>Combined</b>
Size of issue	\$ 20,905	\$ 257,615	\$ 95,010	-	-	\$ 373,530
Amount of bonds refunded	20,770	236,900	89,995	-	-	347,665
Deferred loss	1,776	18,382	8,956	-	-	29,114
Reduction in aggregate debt service	1,908	21,828	8,192	-	-	31,928
<b><u>NUCLEAR PROJECT NO. 2</u></b>						
Size of issue	248,815	78,430	232,240	120,865	-	680,350
Amount of bonds refunded	229,805	73,705	216,500	120,865	-	640,875
Deferred loss	20,147	5,324	17,611	322	-	43,404
Reduction in aggregate debt service	<3,989>	<3,157>	7,165	19,840	-	19,859
<b><u>NUCLEAR PROJECT NO. 3</u></b>						
Size of issue	112,030	4,075	153,690	-	159,500	429,295
Amount of bonds refunded	104,095	3,850	145,325	-	159,500	412,770
Deferred loss	10,665	222	10,220	-	496	21,603
Reduction in aggregate debt service	10,821	167	10,140	-	-	21,128

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 \$16.8 million, \$23.1 million and \$13.7 million, respectively. The advance refundings resulted in a larger reacquisition price versus the net carrying amount of the old debt of \$29.1 million, \$43.4 million and \$21.6 million for Nuclear Projects Nos. 1, 2 and 3, respectively. This 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 1998 Series 1997A, 1997B, 1998A, 1997-2A, and 1998-3A bond refundings by project is presented above.

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 1998 defeasements, approximately \$1,317.3 million, \$1,321.0 million and \$735.0 million of refunded bonds were not called or had not matured at June 30, 1998 for Nuclear Projects Nos. 1, 2 and 3, respectively.

Outstanding revenue bonds of the various projects as of June 30, 1998, 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 rate bonds when economically feasible.

***Security - Nuclear Projects Nos. 1, 2 and 3***

Project participants 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.

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 signed an agreement in April 1997 which became effective on October 1, 1996 for the period 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 megawatt hours delivered to the interconnections and 5 mills per kWh for any energy delivered to the interconnections in excess of 80,000 megawatt hours 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 recognizing 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 are 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. For further discussion, see information contained under Note F ("Nuclear Project Nos. 1, 3, 4, and 5 Site Restoration"). 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.

#### *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 and regulations adopted by the Washington Energy Facility Site Evaluation Council (EFSEC), and additionally for Nuclear Projects Nos. 1 and 4, by 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 sites by demolition, burial, entombment, or other techniques such that the sites pose minimal hazard to the public. EFSEC approved the Supply System's site restoration plan on June 12, 1995. In its approval, 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 recorded 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 of 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 cost of site restoration for Nuclear Projects Nos. 4 and 5 is \$20 million and \$10 million, respectively. As stated previously under "Cost Sharing Litigation," Nuclear Projects Nos. 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 into 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.

#### *Other Litigation and Commitments*

The Supply System is involved in various claims, legal actions and contractual commitments not mentioned above 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 future annual 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 of 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.

#### *"Year 2000" [Unaudited]*

The Supply System recognizes the need to ensure its operations will not be adversely affected by the impact of the "Year 2000" on both Information Technology and Non-information Technology resources. Failure of certain of the Supply System's resources due to processing errors potentially arising from calculations using the year 2000 date are a known risk. The Supply System has developed a detailed plan for addressing the "Year 2000" issue and has made satisfactory progress towards completing conversions, replacements and temporary resolutions such that management expects all critical systems and most important systems will be corrected prior to processing problems occurring as a result of the year 2000.

A Task Force continues to meet regularly to monitor the status of the efforts of the Supply System's assigned staff and contractors in identifying, testing and remediating "Year 2000" related issues. The Task Force is addressing additional "Year 2000" related issues including, but not limited to, testing procedures and business continuation and other contingency planning. In addition, the Supply System is participating in a consortium of utilities, including BPA, to coordinate efforts and issues arising from the year 2000.

On or around June 1999, the Supply System plans to have completed conversions, replacements and temporary resolutions for all critical systems and plans to have completed testing of "Year 2000" compliance for all major systems. This target date may be impacted by integration testing plans and scheduled generation outage decisions. The costs to address the Supply System's "Year 2000" issues are estimated to be between \$15 million and \$18 million through fiscal year 2000. This total cost includes hardware, software system updates and replacements, embedded system updates and replacements, outside

consultants, and labor. Total costs in fiscal year 1998 have been approximately \$2.7 million. The Supply System is working with major third party entities regarding their preparedness for the year 2000 and has identified no exposures which it believes create material probable exposure to Supply System operations. The Supply System will form a contingency planning team prior to the year 2000 to address unanticipated events for higher risk internal and external originated threats

associated with mission critical and known non-compliant resources.

The cost or consequences of a material incomplete or untimely resolution of the "Year 2000" problem could adversely affect future operations; however, any costs related to such results would remain obligations of the project participants and BPA as discussed in Note E, Security - Nuclear Projects Nos. 1, 2, and 3.

BOND RATINGS (Unaudited)			
<u>SUPPLY SYSTEM (Long-Term)</u>	<u>FY 1998</u>	<u>FY1997</u>	<u>OUTLOOK</u>
Fitch ICBA, INC.	AA-	AA-	Stable
Moody's Investors Service, Inc. (Moody's)	Aa1	Aa1	
Standard and Poor's Rating Services (S & P)	AA-	AA-	Stable
<u>VARIABLE RATE DEBT (FY 1998)</u>		<u>S &amp; P</u>	<u>MOODY'S</u>
Letter of Credit Banks			
Bank of America			
Long-Term		AA-	Aa3
Short-Term		A-1	VMIG1
Morgan Guaranty Trust Company			
Long-Term		AA+	Aa1
Short-Term		A-1+	VMIG1
Bond Insurance (Long-Term)			
MBIA Insurance Corporation		AAA	Aaa
Bank Credit Facility (Short-Term)			
Credit Suisse First Boston		A-1+	VMIG1