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November 22, 1983

Hon. John Spellman
Governor of the State of Washington
Legislative Building
Olympia, WA 98504

Hon. Victor Atiyeh
Governor of the State of Oregon
Capitol Building
Salem, OR 97310

Dear Governor Spellman and Governor Atiyeh:

We enclose our report and recommendations for solutions to the major problems involving or arising from the Washington Public Power Supply System. They call for both federal and state legislation which, if enacted, would in our judgment make it possible for our region, without a federal "bailout," to achieve the objectives you set forth in our instructions.

As explained in our report, we are convinced that a compromise settlement with the investors in WPPSS Units 4/5 bonds is desirable, possible, and much less costly to the ratepayers of our region than the bitter and protracted litigation that is the only alternative. We are convinced, also, that for reasons of fairness as well as practicality the cost of such a settlement should be shared on a region-wide basis.

The settlement we recommend would cost the average ratepayer in the Pacific Northwest, who uses 1200 kWh per month, approximately 72 cents per month. The litigation alternative almost certainly would cost most ratepayers far more than this. Years of lawsuits over the rights of the 4/5 bondholders could make it impossible to finance completion of Units 1 and 3, in which ratepayers already have invested more than \$5 billion; moreover it is conceivable that the Unit 4/5 bondholders could win the lawsuits. Legal expenses alone will cost ratepayers tens of millions of dollars. On top of all these direct costs, the litigation alternative would impose substantial indirect costs on all types of public agencies throughout the Pacific Northwest by damaging the credit of our region.

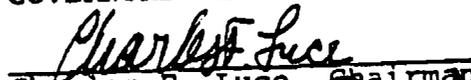
For reasons set forth in our report we have recommended that a new federal corporation, with regional directors, be created to take over the nuclear program from WPPSS, and to assume both its assets and its liabilities. It would also assume the defense of, and seek to settle, the litigation against WPPSS, the 23 public agencies represented on the board of WPPSS, the 88 participants in Units 4 and 5, and the commissioners, councilmen, directors, and other members of their governing bodies who have been sued by the bondholders. The new corporation would pursue vigorously all claims against third parties who may have responsibility for the losses associated with the WPPSS nuclear program.

There are, of course, parts of our recommendations with which particular organizations can be expected to disagree, and the Congress and the legislatures may well decide to make some changes in the recommendations. We believe, however, that our recommendations offer a broad framework on which to construct a comprehensive solution to the many WPPSS related problems.

If this difficult period in the Northwest's energy history can be put behind the region, and the associated costs widely distributed on a fair and practicable basis, the region as a whole surely will benefit. And, in the decades ahead, the Pacific Northwest -- with its great Columbia River, fuel-efficient steam generating stations, and large potential for low cost conservation -- will continue to have the most economical supply of electric energy in the nation.

Sincerely,

GOVERNORS' ADVISORY PANEL


Charles E. Luce, Chairman


Edward E. Carlson


Herbert M. Schwab

CFL/cwb

Enclosure

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Recommendations for Solutions to the
Major Problems Involving, or Arising From,
The Washington Public Power Supply System

A Report to Governor John Spellman of Washington
and Governor Victor Atiyeh of Oregon from
The Governors' WPPSS Advisory Panel

In the framing of our recommendations for solutions to the major problems involving, or arising from, the difficulties associated with the Washington Public Power Supply System ("WPPSS") you instructed us as follows:

In framing your recommendations, we ask that you keep three objectives uppermost:

1. The interest of consumers in the lowest practicable electric rates consistent with sound business practice;
2. The interest of the Pacific Northwest in a reliable power supply to support economic growth and to increase job opportunities; and
3. The interest of all states in the region and the national interest in protecting the credit of state and municipal agencies and their access to capital markets to finance needed public improvements.

Your recommendations should be made to the Northwest Governors, to the Congressional delegations within the region, and to the Federal Administration.

We realize the many complications of this assignment and the careful balancing of

interests that will be required. We ask that, insofar as possible, your recommendations achieve equity and fairness among consumers, investors, the public, cooperative and private utilities, and all other interested parties.

We hope that your recommendations will take a long-range view of the above objectives and will include a description of any state or Federal legislation, regulations, or policies that you believe necessary to carry out your recommendations.

We ask that you consult widely the citizens and organizations affected by, or interested in the resolution of, the Supply System's difficulties as well as elected and appointed public officials in order to get their views on proper recommendations. We also ask that you use your best efforts to complete your recommendations within 90 days.

To the best of our ability we have followed these instructions. We have consulted interested parties, legislators, public officials, and opinion leaders throughout the Pacific Northwest, as well as many from other parts of our country. A list of individuals and organizations whose views we formally solicited is attached as Appendix 1a. A list of organizations with some of whose representatives we met personally is included in Appendix 1b. Sources of the many unsolicited written suggestions received by us are included in Appendix 1c.

Our approach has been to focus on the future and not on the past -- to seek solutions to the problems our

region faces today, rather than to dig into the past to try to fix blame for what went wrong.

Although we have in this report recommended a combination of specific solutions to today's problems, we have also at several places in the report identified other options that might be substituted for specific recommendations we make.

Before setting forth our analysis and recommendations, we will briefly summarize the origins and background of WPPSS and WPPSS related problems, and the present situation.

Origins and Background of WPPSS Problems

1957-1969

The Washington Public Power Supply System ("WPPSS") is a Joint Operating Agency created in 1957 by a group of municipal utilities under the statutes of the State of Washington. Its 23 members are:

- Public Utility District No. 1 of Benton County
- Public Utility District No. 1 of Chelan County
- Public Utility District No. 1 of Clallam County
- Public Utility District No. 1 of Clark County
- Public Utility District No. 1 of Cowlitz County
- Public Utility District No. 1 of Douglas County
- City of Ellensburg

Public Utility District No. 1 of Ferry County
Public Utility District No. 1 of Franklin County
Public Utility District No. 2 of Grant County
Public Utility District No. 1 of Grays Harbor County
Public Utility District No. 1 of Kittitas County
Public Utility District No. 1 of Klickitat County
Public Utility District No. 1 of Lewis County
Public Utility District No. 3 of Mason County
Public Utility District No. 1 of Okanogan County
Public Utility District No. 2 of Pacific County
City of Richland
City of Seattle
Public Utility District No. 1 of Skamania County
Public Utility District No. 1 of Snohomish County
City of Tacoma
Public Utility District No. 1 of Wahkiakum County

The main purpose of WPPSS was to pool the resources of its members to build generating facilities too large for individual members to build.

From its creation until 1981, WPPSS was governed by a board to which each utility member designated one member. Most, though not all, of the WPPSS board members were elected members of the governing bodies of the utilities they represented.

Prior to 1967, WPPSS constructed two power projects, a small hydroelectric project (Packwood Lake, 27.5 MW) and a steam turbine-generator system attached to a federally owned reactor designed to produce weapons material (Hanford Generating Project, 800 MW). The two projects cost a total of approximately \$135 million. Both were financed with WPPSS revenue bonds, and both are integrated with the

Bonneville transmission grid. Payment of the \$122 million of bonds issued to finance the Hanford Generating Project was secured by the Bonneville Power Administration ("Bonneville") through exchange arrangements with the public and private utilities which purchased shares of its output.

Both Packwood Lake and the Hanford Generating Project were completed prior to 1970, and have been successful. The revenue bonds issued to finance them are being paid on schedule, although Moody's and Standard and Poor's have suspended ratings on the bonds because of uncertainties hereinafter described.

1970-1980

Beginning in 1970, as forecasts of Pacific Northwest electric load growth began to exceed the potential of undeveloped hydro-electric sites, WPPSS embarked upon an additional, very ambitious, nuclear construction program. It did so with the encouragement of public power agencies of the Northwest, direct service industrial customers of Bonneville, and Bonneville itself; and in reliance upon projections of growth in the regional demand for electricity compiled by the Pacific Northwest Utilities Conference Committee ("PNUCC"). This Committee is comprised of the

public and private utilities of the Pacific Northwest, and includes the large electro-process customers of Bonneville. Load growth projections of the Northwest utilities made in 1968 showed the need for 20 new large thermal plants to be completed by 1990.

For its part in meeting the perceived need for this large number of new thermal plants, WPPSS in the early 1970's authorized the construction of two large nuclear generating stations at Hanford, Washington, near the Hanford Generating Project. These projects, herein called Units 1 and 2, were financed with WPPSS revenue bonds secured by the expected revenues from the projects, and also by "hell or high water" contracts for the purchase of shares of the expected output signed by approximately 100 participating public agency and cooperative utilities. These contracts obligate the participants to pay for the cost of the plants proportionately to the share of the expected output purchased by each regardless of what the cost might be and whether or not the plants ever produce any output. ["Hell or high water contracts" are not peculiar to WPPSS. In the Pacific Northwest variations of such contracts have been used in the financing of many successful power projects such as Trojan, Packwood, and Wanapum and Priest Rapids Dams; and they are used

extensively by public power and cooperatively owned utilities elsewhere in the United States to finance large projects.]

As an inducement to the participants signing these contracts, and as further security for the revenue bonds issued by WPPSS to finance Units 1 and 2, Bonneville agreed to assume the risk of cost overruns that the two units might experience, as well as the risk that the plants might never produce power. Bonneville did this with Congressional approval through "net billing" contractual agreements with each participant.

"Net billing" is a contractual arrangement by which prior to the start of construction the participant in a proposed generating project assigns its contractual share of the project's expected output to Bonneville in return for Bonneville's promise to assume the risks imposed by the contract, and to allow a credit on the participant's wholesale power bill equal to the participant's share of the cost of the project. Thus if the participant's power bill from Bonneville for a given month were \$100,000, and the participant's share of the construction cost of Units 1 and 2 for that month were \$50,000, Bonneville would "net bill" the participant for only \$50,000 that month. The participant would pay the other \$50,000 to WPPSS.

Also involved in the complex of agreements for the WPPSS "net billed" plants were provisions whereby WPPSS granted Bonneville certain authority to disapprove WPPSS budgets for Units 1 and 2, its procurement procedures for these units, its financing, etc.

In 1975, WPPSS authorized the construction of a third large nuclear unit, this one at Satsop, Washington, herein called Unit 3. Seventy percent of its financing was based upon net billing arrangements approved by the Congress of the same type as underlay the financing of Units 1 and 2. The remaining thirty per cent of the financing was undertaken by the four investor-owned companies constituting the "West Group" of Pacific Northwest investor-owned utilities, which purchased shares in the ownership of the plant as follows:

Pacific Power & Light Company	("Pacific")	10%
Portland General Electric Company	("PGE")	10%
Puget Sound Power & Light Company	("Puget")	5%
The Washington Water Power Company	("Water Power")	5%

The four investor-owned companies financed their shares of Unit 3 in the same way they would finance the construction of a plant they wholly owned, that is, by the sale of equity and debt securities.

In early 1977, WPPSS again expanded its nuclear program, this time by authorizing the construction of Unit 4 at Hanford as a "twin" of Unit 1, and of Unit 5 at Satsop as a "twin" of Unit 3. The financing of Unit 4 and 90% of Unit 5 was based upon the same type of hell or high water contracts as employed in the financing of Units 1 and 2, and 70% of 3. However, Bonneville did not net bill these plants. Thus, the risks of cost overruns and of the possible failure of the plants to produce power fell entirely on the 88 publicly and cooperatively owned utilities that participated by signing contracts to purchase shares of the plants' output, and upon Pacific which contracted to purchase 10% of Unit 5. Appendix 2 contains a list of the 88 participants arranged according to the state where each does business.

A number of participants in Units 1, 2 or 3 -- most notably Seattle City Light and the Eugene Water and Electric Board -- declined to participate in Units 4 and 5. The utilities that did participate in Units 4 and 5 were granted limited oversight powers regarding budgets and major contracts for the projects to be exercised through a committee elected by the participants. The ten per cent of Unit 5 not financed through WPPSS was purchased and financed by Pacific under arrangements similar to those by which Pacific and three other

investor-owned utilities had purchased and financed thirty per cent of Unit 3 at Satsop.

Named as trustee for the purchasers of the revenue bonds to be issued by WPPSS to finance Units 4 and 5 was the Chemical Bank of New York.

As a further part of the efforts of Pacific Northwest utilities to meet the electric load growth which they expected, the four investor-owned companies in the "West Group Area" of the Northwest Power Pool (Pacific, PGE, Puget and Water Power) also became involved in nuclear projects other than WPPSS projects. In 1969, PGE led a consortium of private and public utilities to begin construction of the Trojan Nuclear Plant at St. Helens, Oregon, 30% of which was "net billed" by Bonneville; the plant was successfully completed and is today in operation. In 1974, Puget and a consortium began the Skagit two unit nuclear project, originally to be sited in Skagit County, Washington, but later planned to be sited on the Hanford reservation in Washington. In 1976, PGE and a similar consortium of investor-owned companies began the Pebble Springs two unit nuclear project near Arlington, Oregon. Neither Skagit nor Pebble Springs ever reached the construction stage of breaking ground, but large sums

of money were spent on engineering and equipment purchases.

[In addition to these many nuclear projects -- ten in all -- the investor-owned companies serving the Pacific Northwest, together with a few public agencies, also sponsored and invested in a number of coal fired plants in the 1960's and 1970's -- Centralia in Washington, Boardman in Oregon, Jim Bridger in Wyoming, Colstrip in Montana, Valmy in Nevada, Huntington in Utah, and Creston in Washington. All of these plants have either been completed or seem assured of completion except Water Power's Creston plant. Water Power regards Creston as still a live proposal, although it has not yet broken ground.]

From their inception until 1981, construction on the five WPPSS nuclear units went forward. So, also, did the engineering and planning for the four investor-owned Pebble Springs and Skagit nuclear projects. Trojan, as noted, was completed.

1981-1983

Then, in 1981, the wheels began to come off. The economic recession and conservation cut electricity consumption in the Pacific Northwest, especially by heavy

power using industries such as aluminum and paper. Regional load forecasts, which in 1980 had shown a need for all five WPPSS plants by 1987, turned sharply downward. The estimated cost of the five WPPSS plants, originally approximately \$6.67 billion, had risen to approximately \$24 billion -- of which approximately \$12 billion was the re-estimated cost of Units 4 and 5.

A 1981 investigation of WPPSS construction programs by the Washington State Legislature laid much of the blame for higher costs upon mismanagement.

In the legislative sessions of 1981 and 1982, the Washington legislature changed the governance of WPPSS by transferring almost all of its power to an executive board of 11 members, of whom 3 outside directors are appointed by the Governor and 3 by the 23 person WPPSS board. The full 23 person board retains only the authority to select 8 members of the executive board -- 3 "outside" directors plus 5 "inside" directors selected from its own members -- and to authorize new projects and to terminate old ones.

In the spring of 1981, WPPSS was notified by the Wall Street firms managing its financing that no additional revenue bonds could be sold for Units 4 and 5 unless the participants would agree to pay the interest on outstand-

ing and future Units 4 and 5 bonds ("4/5 bonds") from current revenues. Under the revenue bond indenture for Units 4 and 5, interest payable on outstanding bonds was to be "capitalized" until 1988, that is, paid by selling more bonds. Therefore, in 1981 the customers of the 4/5 participants had not yet felt any rate impact from the financing of Units 4 and 5.

Similarly, the interest on the revenue bonds issued to finance Units 1, 2, and 3 had been capitalized during the early years of those projects. Not until those projects were well into construction did interest on outstanding bonds have to be paid from current revenues; thus until 1979 Bonneville rates did not begin to reflect heavy interest costs from the net billing of Units 1, 2, and 3. The impact of including this interest in Bonneville rates has been largely responsible for its steep rate increases since 1979. For example, the revenue requirements underlying Bonneville's most recent request for rate increases includes "net billed" interest costs for Units 1, 2, and 3 in the annual amount of \$589 million, equivalent to 7.6 mills per kWh of the total charge to preference customers of 22 mills per kWh.

Faced with all these adverse developments, WPPSS in mid-1981 stopped construction of Units 4 and 5. There-

after, not only did WPPSS fail to persuade the 88 participants in Units 4 and 5 to finance the preservation ("mothballing") of the units, but a number of the participants began litigation to challenge the enforceability of their hell or high water contracts for Units 4 and 5. In early 1982 WPPSS officially declared Units 4 and 5 terminated.

In mid-1982, at Bonneville's request, WPPSS also stopped construction of Unit 1, and mothballed it for an estimated five years. Also in 1982, PGE terminated the Pebble Springs project.

In mid-1983, WPPSS began a planned mothballing of Unit 3 for an estimated three years. This action was again at Bonneville's request, after WPPSS investment bankers advised they would not undertake an underwriting of bonds for net billed projects, and Bonneville elected not to finance Unit 3 from its current revenues. This action was taken over the objections of the four investor-owned companies with a 30% interest in Unit 3.

Also in 1983, the investor-owned companies with shares in Skagit called it quits on that project.

Thus, of the ten nuclear plants that WPPSS and the West Group of investor-owned utilities started to build, one (Trojan) has been completed, another (WPPSS Unit 2) is near energization, two (WPPSS Units 1 and 3) have been mothballed, and the other five have been terminated.

The WPPSS "dry hole" costs of Units 4 and 5 are approximately \$2.5 billion; (including \$2.25 billion in outstanding bonds, approximately \$100-\$150 million in WPPSS 4/5 contract claims and \$70-\$100 million in termination and bridge loans.) The "dry hole" costs of Pebble Springs are \$334 million; of Skagit, \$452 million; and of Pacific's 10% interest in Unit 5, \$82 million. Details showing the allocation of these costs among the owners of the projects are presented in Appendix 3.

The Present Situation

During the past six months, WPPSS problems have reached a crisis stage.

In April 1983, the Northwest Power Planning Council ("Council") created in 1981 under the Pacific Northwest Power Planning and Conservation Act published its first Twenty Year Plan. As required by the Act, the Council's plan estimates the growth of electrical demand over the

next 20 years and recommends the resource acquisitions it believes will best meet this growth. The Council's first plan includes WPPSS Units 1, 2, and 3, but does not include WPPSS Units 4 and 5, Pebble Springs, or Skagit. Appendix 4 is an excerpt from the Twenty Year Plan which shows the Council's assumed on-line dates for Units 1, 2, and 3.

In May 1983, WPPSS did not meet its obligation to pay the sums into the bond fund required by the bond indenture for Units 4 and 5. This occurred because the participants refused to pay to WPPSS sums required by the participants' agreements, although many of the participants did make provision for payments by deposits in escrow.

On June 15, 1983, the Supreme Court of Washington astounded almost everyone by deciding that Washington Public Utility Districts ("PUD's") and cities did not have statutory authority to enter into the "hell or high water" participants' agreements for Units 4 and 5, thus wiping out most of the remaining security that lay behind the 4/5 bonds. The bondholders are entitled to the physical assets of projects themselves, but the scrap value of Units 4 and 5 may be little, if any, more than the cost of removing the structures and restoring the sites to their original condition.

On August 9, 1983, the Superior Court of the State of Washington for King County ruled that, in light of the Washington Supreme Court's decision relieving the Washington PUD's and cities of contractual liability to perform their hell or high water contracts, the remainder of the other 88 parties were also relieved of their contractual obligation. The purpose of the project had been frustrated, the court held, by the Supreme Court's decision excusing the Washington municipal component of the participant group which constituted about 70% of the total guarantee behind the 4/5 bonds.

On August 18, 1983, the Chemical Bank as trustee for the 4/5 bondholders demanded immediate payment of all principal and interest due on the outstanding \$2.25 billion of 4/5 bonds. Of course WPPSS could not pay. Thus came to pass the largest municipal bond default in the history of the United States.

Subsequent to the default, the Supreme Court of Idaho has held that Idaho municipal utilities, which were among the 88 participants in Units 4 and 5, lacked authority to enter into hell or high water contracts. The Idaho ruling is based upon the Court's conclusion that Idaho law requires that such contracts be approved by referendum.

There is pending before the Supreme Court of Oregon an appeal from a decision of the Circuit Court of the State of Oregon for Lane County which held that, for various reasons, the Oregon cities that were participants in Units 4 and 5 also lacked authority to enter into the hell or high water contracts.

The impact of the 4/5 bond default is already being felt in the Pacific Northwest and elsewhere. The market price for 4/5 bonds has fallen to a small fraction of their original cost. Presently they are selling at discounts approximately 85 full percentage points below their face value. (See Appendix 5 for a table of recent changes in the market value of 4/5 bonds.) Even the bonds issued to finance Units 1, 2, and 3 -- bonds indirectly backed by the credit of Bonneville -- had their AAA rating downgraded to A+, then suspended entirely. Presently they are selling at discounts of 30 or more full percentage points below the price of AAA bonds with similar coupon rates and maturities. (See Appendix 6 for a table of recent changes in the market value of the Units 1, 2, and 3 bonds ("1, 2, 3 bonds")).

The four investor-owned companies involved in Unit 3 were placed on credit watch by Standard and Poor's, but now have been removed. The Snohomish County PUD, which

had purchased the largest share of Units 4 and 5, has had its Moody over-all bond rating downgraded from A-1 to A; and Standard & Poor's over-all rating from A+ to A. Snohomish PUD's recent issue of \$240 million of revenue bonds to finance its Sultan hydroelectricity project was rated by Moody's as Baal and Standard and Poor's at BBB+ ; and apparently sold at 130 basis points above the market for an A rated revenue bond -- a total extra cost of \$122 million over the 30 year life of the bonds.

The State of Washington, which sold \$150 million of general obligation bonds on August 8, 1983, apparently paid 76 basis points above the market for that type bond -- a total extra cost of \$18 million over the twenty-five year life of the bonds. In another more recent sale of \$131 million bonds, the State of Washington apparently paid a penalty of 55 basis points -- a total extra cost of almost \$12 million.

Outside the Pacific Northwest, public power agencies that finance with revenue bonds believe that the WPPSS default is costing them 50 or more basis points on new issues, and several proposed revenue bond issues of public power agencies similar to WPPSS were withdrawn because of the market impact of the WPPSS default. At least one of these large public power agencies has stated its intention to seek Congressional action to undo the damage it be-

believes the WPPSS default has caused it. It is circulating among other publicly owned joint utility operating agencies a draft of a bill that, if enacted, would require Bonneville to pay the 4/5 bonds.

The Spawn of Litigation

The litigation spawned by these and related events is so complex it is difficult to describe. Claims running into the billions of dollars have been filed in various federal courts including the United States Court of Claims, and in the courts of five states. Suits on behalf of the thousands of present and former 4/5 bondholders have been brought in assorted class actions, and by the Chemical Bank of New York as trustee for present bondholders. Inevitably these suits will involve the thousands of Units 1, 2, and 3 bondholders as the 4/5 bondholders assert claims against all the assets of WPPSS and its members. Various utilities are suing each other. PUD commissioners, city councilmen, Bonneville, consulting engineers, underwriters, lawyers -- all are caught in a net of litigation that may take as long as ten years or more to untangle, and with results that are virtually unpredictable.

Within less than two months after the Washington Supreme Court held invalid most of the participants' hell or high water contracts that underlay the security for the 4/5 bonds, Chemical Bank filed suit in the United States District Court for the Western District of Washington seeking damages and other relief from the 88 participants and others. The suit is based primarily upon allegations of fraud, misrepresentation, violation of federal and state securities laws, negligence, and unjust enrichment. It joins as defendants some 630 individuals and municipal and private corporations -- not only WPPSS and 87 participants, (Orcas Power & Light, a small cooperative, then in bankruptcy, was not joined), but also all public agencies represented on the WPPSS board, the Bonneville Power Administration, and the individuals who are serving or have served on the boards of WPPSS, the members of WPPSS, and the participants in Units 4 and 5. For good measure the Chemical Bank suit includes 100 "John Doe" defendants.

In addition to the Chemical Bank's omnibus suit, a number of class actions have been filed on behalf of present and former bondholders, seeking damages not only from the defendants named in the Chemical suit, but also from bond underwriters, credit rating agencies, and the many lawyers who had provided legal opinions that the

participants had authority to enter into the security arrangements underlying the 4/5 bonds.

The possibility can not be taken lightly that in the end this litigation will result in judgments against the 87 participants, the members of WPPSS, and others for the full amount of the \$2.25 billion bonds issued to finance Units 4 and 5, and possibly for even a larger sum. Such judgments would likely be joint and several, resulting in enormous potential burden on utilities with financial ability to respond.

The Chemical Bank also asserts that, to the extent that WPPSS and the 88 participants do not pay the amount of the 4/5 bonds, it will seek payment from Units 1, 2, and 3 and from any assets of the members of WPPSS such as Seattle, and Grant, Chelan and Douglas PUD's. Similar assertions can be expected from the plaintiffs in the various class actions filed on behalf of the purchasers of 4/5 bonds.

Appendix 7 sets forth details of the pending litigation. Additional suits are certain to be filed. Defending the litigation will cost the utilities and ratepayers of the Pacific Northwest millions of dollars each year. During the long period in which these cases are pending,

the possibility and magnitude of adverse judgments will probably have to be disclosed in these utilities' financial statements.

Appendix 8 analyzes the legal theories that lie behind the present suits on behalf of 4/5 bondholders, and the Chemical Bank's assertion that the 4/5 bondholders can reach all WPPSS assets, including Units 1, 2, and 3, and also can reach the assets of all 23 members of WPPSS. It also discusses the law of bankruptcy as it might be applied to WPPSS.

Most of the pending cases involve, in one way or another, attempts by the 4/5 bondholders to recover their losses, or by 4/5 participants to pass to other parties such as Bonneville any liability they might have to pay the bonds. However, some cases involve other issues.

A case on appeal from the United States District Court for the District of Oregon tests the validity of the net billing contracts that are part of the financial underpinning for Units 1, 2, and 3. The argument against validity says that if, as held by the Washington, Oregon, and Idaho courts, the participants had no authority to enter into hell or high water contracts with WPPSS for Units 4 and 5, then the participants had no authority to

enter into such contracts for Units 1, 2, and 3. Thus, it is argued, the participants who assigned their hell or high water contracts to Bonneville for Units 1, 2, and 3 as an essential part of their net billing agreements with Bonneville had only an invalid contract to assign, and Bonneville acquired no rights or obligations with regard to Units 1, 2, and 3.

A case on appeal from the United State District Court for the Western District of Washington tests whether a judgment creditor which supplied fuel for Units 4 and 5 can seek to collect its judgment from any assets of WPPSS.

The four investor-owned companies who own 30% of Unit 3 are suing WPPSS and Bonneville, alleging that the investor-owned utilities are prepared to finance the completion of their 30% share of Unit 3, and that Bonneville has the legal duty through net billing or the direct use of its current revenues either to finance completion of the other 70% share in the plant or to pay to the investor-owned utilities the \$737 million they have invested in Unit 3.

The participants in Units 4 and 5 and the Chemical Bank are seeking to recover from WPPSS, Bonneville, and the four investor-owned companies involved in Unit 3 sums

as large as \$400 million as a reallocation of shared costs of the "twinned" Units 1/4 and 3/5.

Some participants in Units 4 and 5 have sued WPPSS to recover "bridge" and "termination" loans of some \$68 million that they made in connection with 1981 and 1982 efforts to preserve Units 4 and 5. There are also various other suits commenced by, or against, WPPSS involving claims that arise from construction or procurement contracts related to Units 4 and 5.

For convenience of administration, the principal cases arising out of or related to the WPPSS bond default have been consolidated in whole or in part in the United States District Court for the Western District of Washington before Judge Richard M. Bilby. Nevertheless, the prospect is for many, many years of costly and bitter litigation involving most of the utilities in the Pacific Northwest, dozens of law firms (some as advocates, others as defendants), consulting engineers, bond underwriters, hundreds of individuals who have served as officers and directors of these utilities over the past seven years, and representatives of thousands of bondholders seeking to recover or to protect the investment they made in WPPSS bonds.

Indicative of the complexity of the litigation spawned by WPPSS's difficulties is the fact that the U.S. Justice Department is establishing a special office in Portland for the purpose of defending the suits against Bonneville. Staffing the office will be at least four lawyers and eight to ten paralegals. To assist them in trial preparation, some 1.1 million Bonneville documents from government warehouses throughout the Pacific Northwest are being microfilmed and put into a computer; and it is estimated that, in addition, they will have assembled and will examine 4-5 million WPPSS documents. Lawyers joining this office are being told to expect to stay in Portland at least four years.

Litigation's Result: WPPSS
is Foreclosed from Credit Markets

As matters stand, WPPSS is foreclosed from the bond market and cannot even borrow money from commercial banks. It can complete Unit 2 only because Bonneville has agreed to provide the \$150 million or more required for completion through its current revenues.

Unless some way is found to finance their completion, Units 1 and 3 will also become "dry holes" into which there will have been sunk respectively, \$2.6 billion and

\$2.5 billion. All of this \$5.1 billion will have to be repaid by Northwest consumers in their electric bills. Eventually alternative energy projects, presumably coal, will be substituted for them at costs far higher than the cost of completing those units. The long range effect on Northwest power rates and power supply will be severe. Indeed if Bonneville and the public power agencies lose access on reasonable terms to the nation's capital markets, it may be impossible to carry out much of the Council's Twenty Year Plan, including the multi-billion dollar investments contemplated in conservation and small hydro.

Perhaps the most serious effect of a Northwest utility industry entangled in a decade of litigation is the distraction of utility managements away from their main mission of providing safe, economical, and plentiful energy. Managerial decision making, the Governors' Panel was told by a knowledgeable utility official, has passed from professional energy managers to lawyers. The function of lawyers is not to plan for the region's energy future; it is, rather, to plan the best litigation strategy. If the strangling net of litigation cannot be cut away, our region will suffer in neglected or inadequate long range planning and development of its basic energy supply. And, in the end, it is entirely possible that the

WPPSS members, the utility participants in Units 4 and 5, and Bonneville -- together with an assortment of bond underwriters, engineering consultants, lawyers, etc. -- could be required by the federal courts to pay the 4/5 bondholders full value or more.

Discussion and Analysis

A Way Should be Found to Finance the Completion of Units 1 and 3

As previously noted, the Council has included Units 1, 2, and 3 in its Twenty Year Plan, but has not included Units 4 and 5 nor any other new nuclear plants. Everyone who expressed a view to our Panel assumed that Unit 2, now almost ready for fuel loading, should be completed. Bonneville says it can finance completion from current revenues. We agree that it is essential that Unit 2 be completed and placed in operation as soon as possible.

Our Panel believes, also, that it must accept the planning decision of the Council and Bonneville that Units 1 and 3 should be completed. Our Panel is not a planning body. Our main purpose, as we see it, is to recommend ways to finance the completion of Units 1 and 3 if and when it is decided they should be completed; and,

concurrently, to recommend ways to expeditiously settle the billions of dollars in claims arising from the Units 4 and 5 bond default. We note that Units 1 and 3, as well as Unit 2, have been included by the Congress in the Federal Base System; that the federal government through Bonneville already has approximately \$4.4 billion invested in these plants (\$2.6 in Unit 1, and \$1.8 in Unit 3) and that four investor-owned companies have an additional \$737 million invested in Unit 3.

Regional Need for Output of Units 1, 2, and 3

The Council's staff recommendation as to the regional need for WPPSS Units 1, 2, and 3, approved by the full Council on November 2, 1983, reads as follows:

- ° WNP 1, 2, and 3 are cost-effective resources.
- ° WNP 2 is needed in all load forecasts and should be completed on its current schedule.
- ° WNP 1 and 3 are needed in three out of the four load forecasts. If these plants are lost and loads grow at the high, med-high, or med-low rates, additional thermal resources would be needed to replace their energy.
- ° Because WNP 3 is cost-effective and needed in three out of four load forecasts, the region needs to secure the ability to finance completion of the project. Based on consultations with interested parties, the staff has con-

cluded that the Supply System does not have access to conventional financing. An alternative financing approach would require action by the Congress, the courts and the Bonneville Power Administration. A mechanism for financing to completion of the project is needed independent of the decision of when to restart construction.

- Immediate restart of WNP 3 is approximately the same cost as delayed restart where the plant is built precisely when needed in each load forecast. Other factors that cannot be evaluated quantitatively must be a part of the Council's decision on the importance of an early restart.

Acting upon this staff recommendation, the Northwest Power Planning Council on November 3, 1983, adopted the following resolution:

Preamble

On April 27, 1983, the Council adopted its Northwest Conservation and Electric Power Plan pursuant to P.L. 96-501. That plan included WNP-3 in the regional resource portfolio, since the 70% public share of the project had already been acquired by the BPA.

After the adoption of the plan, the Administrator decided to delay construction of WNP-3. That decision is now the subject of litigation.

Because of the changing circumstances surrounding WNP-3, the Council directed its staff to analyze the cost-effectiveness of completing WNP-3. At its meeting November 2-3, 1983, the Council discussed a draft issue paper prepared by the staff, as well as public comments on this paper received before and during that meeting.

Resolution

Based upon the assumptions contained in the Northwest Conservation and Electric Power Plan and the draft issue paper presented at this meeting, the Council concludes that completion of WNP-3 is cost-effective to the region. Accordingly, WNP-3 should be preserved.

In order to preserve this cost-effective resource, the region must find a mechanism which allows financing at or near market rates for WNP-3, so that construction of the plant can be resumed.

The public utility participants and investor-owned utility owners of WNP-3 face different financing conditions. These differences pose a very significant threat to the preservation of the project.

Appendix 9 contains the executive summary of a Bonneville study of the cost effectiveness, and optimal scheduling, of WPPSS Unit 3. It also contains information supplied to us by the Washington Energy Facility Site Evaluation Council on the construction and licensing status of all five WPPSS nuclear units.

Possible Sales of Northwest Surplus

Firm Power in California

In addition to regional need for Units 1, 2, and 3, there may be regional benefits as a consequence of the large potential market for firm power in California. The utilities of California have estimated a need for new sources of firm power in the range of 3,000 to 6,000 MW

beginning in the 1990's, and in lesser but substantial amounts beginning in the latter 1980's. Their alternatives are limited and expensive, and they are already going to Utah and other places far outside their state for new base load power. According to the Intermountain Power Agency of Utah's most recent bond prospectus, its coal-fired project, begun in 1974, will cost Southern California purchasers an estimated levelized cost of 5.5¢ per kWh over its service life. According to Bonneville estimates, Unit 3 if finished by 1987 can deliver power in California at a fully allocated cost of approximately 4.8¢ per kWh. And it can displace expensive oil and gas which, in total, generates about 50% of all the electricity generated in California.

Capacity of Northwest-California
Transmission Should be Increased

Firm transmission capacity of 3000 MW already exists between the Northwest and California, and with completion of additional terminal facilities on The Dalles-Sylmar d.c. line this capacity will be increased by 400 MW in 1986. If a third leg of the existing 500 KV transmission ties to California already built to the Oregon-California line were completed to the San Francisco Bay area, the present firm interregional transmission capacity, counting

the d.c. expansion, would be enlarged by approximately 2,000 MW -- enough to market the output of both Units 1 and 3 in California if that became advantageous to both regions. If a second d.c. line were built to connect the Bonneville grid with load centers in California, the firm interregional transmission capacity could be increased by more than 2,000 MW. Other transmission alternatives are under study which provide comparable increases in transfer capability at comparable costs.

The Panel therefore recommends immediate action to complete either this third 500 KV a.c. transmission line from the Malin substation on the Oregon-California boundary into the San Francisco Bay area, or alternative transmission reinforcements that would similarly increase power transfer capability between the Pacific Northwest and California. There is some reason to believe that California has delayed the completion of the 500 KV a.c. line as a utility owned project either because of disputes within California over rights to the line's additional capacity, or as a means of putting pressure on the Northwest to sell its surplus power very cheaply. Whatever the reasons that the third 500 KV tie or an equivalent project has not been completed, we believe that it should be.

We recommend that construction of additional transfer capability be authorized as a federal line, to be constructed only if the California utilities persist in not building it. The line, we are convinced, would pay for itself over a short period, either from firm or non-firm power sales. And it would save large quantities of fuel oil and natural gas by displacing oil and gas-fired generation in California.

Along with considering the market for Northwest firm power in California, and the adequacy of transmission capacity between the two regions, the Panel has considered the legal restrictions that Congress has placed on the export of electricity from the Northwest to California. We have concluded, based in part upon advice from Bonneville and the non-federal generating utilities of the Northwest, that the Northwest utilities can offer long term firm power contracts to California utilities. Indeed, discussions among these parties looking toward a firm sale of 1500 MW are already in progress.

Federal Legislation will be Required to Assure
Financing for the Completion of Units 1 and 3

How, then, can the completion of Unit 3, and eventually of Unit 1, be financed? Almost everyone who ex-

pressed an opinion to our Panel on this question assumed that federal legislation will be required. WPPSS and Bonneville have been told both by the underwriters of WPPSS bond sales, and by a consortium of large commercial banks, that further financing of Unit 3 depends upon Bonneville's ability to assure investors or lenders that they will be repaid. Such assurances are required because of the possible claims of 4/5 bondholders and other 4/5 creditors upon all the assets of WPPSS, and the possible invalidity of the net billing contracts that secure the 1, 2, 3 bonds. To give such assurances, Bonneville needs Congressional approval.

Several forms of federal legislation that would give prospective investors or lenders the assurances they need to finance the completion of Unit 3, and eventually of Unit 1, have been proposed. The underwriters of financing for the net billed plants have one proposal. The investor-owned companies involved in Unit 3, and the commercial banks they have consulted, have another. Both such proposals would authorize or "clarify" the authority of Bonneville to guarantee directly the financing needed to complete these units. The main difference in the two proposals is that the underwriters would have Congress also put Bonneville's credit directly behind the already outstanding bonds issued to finance Units 1, 2, and 3.

This would remove any legal cloud over these bonds posed by the claims of the 4/5 bondholders and creditors against the assets of Units 1, 2, and 3, and by the possible invalidity of the net billing agreements for Units 1, 2, and 3. In doing so, it would increase their market value by 30 or more full percentage points -- perhaps as much as \$2 billion more than their present market value. Appendix 10 contains copies of both of these proposed federal enactments.

Neither the utilities' nor the underwriters' proposed federal legislation addresses the question of how to settle the claims of the 4/5 bondholders and other creditors.

To Obtain Passage of Federal Legislation Authorizing
Bonneville to Directly Finance Completion of Units 1
and 3, Our Region Must Address the Claims of the
4/5 Bondholders and Creditors.

Based upon our Panel's discussions both within the Pacific Northwest and outside the region, we doubt seriously that Congress will authorize completion of the financing of Units 1 and 3 unless, in the same legislation, it also provides a mechanism for settling the claims of the 4/5 bondholders and creditors.

Within the Northwest, representatives of many public power agencies have taken the position that federal legislation must address the problems of all five WPPSS units; and that, while they favor completion of Units 1, 2, and 3, they also want concurrent assurance of provision for a settlement of the multi-billion dollar claims against them arising from the Units 4 and 5 bond default. Outside the Northwest, public power agencies take a similar position, though for a somewhat different reason: they fear that their cost of financing new projects will be increased unless and until the claims of the 4/5 bondholders are settled.

The Chemical Bank, as trustee for the 4/5 bondholders, has announced a program to alert bondholders to ask Congress for relief. When the Northwest requests Congressional help to finance the completion of Units 1 and 3, it can be expected that the Congressional response will include consideration of the rights of the constituents of possibly every congressman and senator in the Congress, namely, the thousands of 4/5 bondholders.

When our Panel talked with members of Congress, both those from within and without the Pacific Northwest, we were told repeatedly that Congress is ready to consider the Northwest's regional problems, and is well aware that

Bonneville as a federal agency has a \$6 billion stake in resolution of those problems (\$7.5 billion including interest paid to date through net billing), but that our region must take to Congress solutions on which there is a regional consensus. If we simply lay our intra-regional disputes before the Congress, we will probably be told to go home and settle them before returning to seek help -- and we run the danger of leaving the legislative field open to initiatives by interests not representing the interests of the Pacific Northwest.

For this reason, and because of the attitude of certain Congressional members from other parts of the United States, we believe that any federal legislation we propose to make it possible to complete the financing of Units 1 and 3 must also address the claims of 4/5 bondholders and, as well, the concerns of present holders of 1, 2, 3 bonds arising from those claims and from the legal challenges to the net billing contracts.

State Legislation as an Alternative
to Federal Legislation

One way to deal with the claims of the 4/5 bondholders might be by an Act of the Washington State Legislature to ratify and validate the authority of the Washington

municipal and PUD participants to have entered into the hell or high water contracts securing the 4/5 bonds.

Apart from the political impracticability of this course, it would present other serious problems. It would not, for example, deal with the validity of such contracts signed by participants in Oregon, Idaho, Montana, Wyoming, California, and Nevada, totalling about 25% of all the 4/5 participant shares. It would do nothing toward settlement of the claims of 4/5 bondholders who have previously sold their bonds and taken a loss, nor claims against WPPSS for the repayment of bridge and termination loans, and unpaid claims of contractors and suppliers. It would ignore the reality that, although sponsored only by WPPSS and 88 public and cooperative utilities, Units 4 and 5 if completed would have been regional assets from which all consumers would have benefited directly or indirectly. And the pendency of such ratifying legislation would surely trigger wild speculative trading in 4/5 bonds.

Nor, we believe, would it be politically practicable to deal with the claims of 4/5 bondholders by interstate compact. Possibly the seven states in which the 88 participating utilities in Units 4 and 5 do business could authorize a special tax to raise the money to pay the bondholders. But inevitably there would be disagreements

as to what share each state should pay, what kind of tax should be employed, what settlement offer should be made to the 4/5 bondholders and by whom, etc. If Units 1 and 3 are to be completed, and the federal investment of more than \$4 billion recovered, there simply isn't time to undertake such a complicated process of bringing as many as seven state legislatures, and the Congress, and the bondholders together.

The 4/5 Bondholders and Northwest Power System Consumers
Should Share the Losses Associated with Units 4 and 5.

The Panel's approach to a proposed settlement with the 4/5 bondholders is that everyone -- bondholders and Northwest power system consumers -- should share in the losses occasioned by the WPPSS dry holes. Bondholders, who until the Washington Supreme Court's decision on June 15, 1983, had every reason to think they were buying a legally valid security, should not be required to suffer the loss of their entire investment. On the other hand, the revenue bonds they purchased were primarily secured by expected revenues from two nuclear plants that will never be finished; and their contractual security in the form of the 88 participants' "hell or high water contracts" has been held invalid by the Washington Supreme Court.

A Compromise Settlement Keyed to the Market Value of 4/5 Bonds Prior to Washington Supreme Court Decision on June 15, 1983, and Eliminating Speculative Profits, Could be Financed with Annual Region-wide Charge of 0.6 Mill Per kWh or Less.

A logical way to allocate the loss occasioned by the termination of Units 4 and 5 between bondholders and rate-payers, the Panel believes, would be to offer each bondholder a new bond in face amount equal to the approximate market value of his or her old bond on the day prior to the Washington Supreme Court decision, and bearing the same interest rate and maturity date as the old bond. In considerable part, the drop in the market value of the 4/5 bonds prior to that decision can be related to changes in the overall municipal bond market, and to investor concerns that Units 4 and 5 might never produce any revenue. Both of these factors are risks that investors in revenue bonds normally are expected to take.

To prevent speculative profiteering, bondholders who acquired their bonds after the date of the Supreme Court decision would be offered a new bond in face amount the lower of what he or she had actually paid, or the price that represents the market value of 4/5 bonds on July 8, 1983, the day our Panel was appointed.

We recommend that a trust fund be established to finance a settlement with present and former 4/5 bondholders who have suffered losses. The amount of such a fund, we believe, should be sufficient, with reasonable reserves, to support a settlement in the range above proposed; to settle the class actions brought on behalf of former 4/5 bondholders who sold their bonds at a loss; and to settle the contractor claims of some \$100-\$150 million. To receive the new security, bondholders would be required to relinquish all claims arising from their purchase of 4/5 bonds.

We estimate that a trust fund with annual income of approximately \$100 million, less a credit of \$18.5 million hereinafter proposed to account for a portion of the cost of nuclear "dry holes" payable by customers of investor-owned companies, or a net of \$81.5 million, would be sufficient for this purpose. See Appendix 11. So-called bridge and termination loans made by participants, investor-owned utilities, and direct service industries in principal amount of \$68 million are subordinate to the 4/5 bonds, and we believe must be written off.

The source of this trust fund, we believe, should be a charge for access to the Bonneville transmission grid, imposed by federal law, and collected from each generating

utility within the Pacific Northwest which is interconnected with the Bonneville grid and whose customers are eligible for benefits under the Northwest Regional Power Act of 1980, or under the Public Utility Regulatory Policies Act of 1978 ("P.U.R.P.A."). The charge would be collected by a new entity hereinafter proposed, and placed in a trust fund.

We propose a basic charge of 0.6 mill (6/100's of a cent) per kWh to be paid for each kWh generated by Northwest utilities for consumption within the Pacific Northwest or for export to the Pacific Southwest. To the extent that other power suppliers, British Columbia for example, use the Bonneville transmission grid for sales in the United States within or without the Pacific Northwest, the same charge per kWh should apply. As proposed later in our report, credits against this access charge should be allowed customers of the investor-owned utilities to the extent they have to pay for the Skagit, Pebble Springs and 10% of WPPSS Unit 5 nuclear dry holes.

The Panel's recommendation is that the transmission grid access charge be so designed that it is imposed only once on each kWh generated by the interconnected utilities for consumption in the Northwest or for transport through the Bonneville grid to other regions; and that it be

shared equally by all consumers, preference and non-preference alike, and therefore not affect the Section 7-b-2 rate calculation specified in the Northwest Regional Power Act.

The proposed transmission access charge would produce gross annual revenue of approximately \$81.5 million, net of the credit allowed for part of the cost of the Skagit and Pebble Springs projects and Pacific's share of WPPSS Unit 5. If power consumption increases in the Pacific Northwest, and more power is transported through the Bonneville grid to regions outside the Northwest, the 0.6 mill charge would be reduced. Similarly it would be reduced if high interest bearing bonds tendered to 4/5 bondholders later were refinanced at lower interest, and if substantial recoveries or settlements were obtained from the underwriters, contractors, engineers, lawyers, and other defendants in the WPPSS litigation or their insurers. In the event, unlikely as we see it, that most of the 4/5 bondholders reject the tender offer, and prevail in litigation to the extent that a trust fund of this size would not be sufficient to cover the cost of extinguishing all of the 4/5 bondholder claims, it might be necessary for the trustee of the fund to seek Congressional approval to increase the Bonneville transmission charge.

Appendix 12 explains the methods by which the yield of the proposed transmission access charges are calculated. It also contains calculations to illustrate other methods of regionalizing the cost of the proposed settlement with 4/5 bondholders and other creditors, for example, regionalizing through a surcharge to Bonneville customers only.

The Alternative of Regionalizing 4/5
Bondholders Settlements Exclusively
Through Bonneville Sales

For several reasons, the concept of a region-wide charge to distribute or "regionalize" the cost of a settlement with 4/5 bondholders and creditors seems to the Panel to be preferable to regionalizing the cost exclusively through a surcharge on Bonneville's sales. Although Bonneville's transmission grid is the network that integrates all electric systems in the Northwest, Bonneville markets less than 50% of the power consumed in the region and transmitted through the Bonneville transmission lines to California. The remainder is generated and (in large part through use of the Bonneville grid) delivered by a number of publicly and privately owned utilities, and by British Columbia. Thus to raise a trust fund of \$81.5 million per year to settle with the 4/5 bondholders by a

surcharge on only Bonneville sales the per kilowatt hour charge would have to be 1.30 mills -- more than twice as high as a region-wide charge.

Further, a charge that is limited to Bonneville only would fall most heavily on utilities that buy all or nearly all their power from Bonneville, typically small cooperative or publicly owned utilities, and on the direct service industries, some of whose production facilities already are economically marginal. Such a charge would place Bonneville at a disadvantage in marketing surplus power to California, since other Northwest suppliers of surplus power to the California market, including British Columbia, would be exempt from the charge.

Credits for Customers of Pacific
Northwest Investor-owned Utilities
That Have "Nuclear Dry Holes"

If, as the Panel recommends, the customers of the Pacific Northwest investor-owned utilities should share through the above-recommended charges in settlements for the cost of the 4/5 dry holes, the Panel believes they should be allowed an appropriate credit for the cost of the Skagit and Pebble Springs, and Pacific's 10% interest in WPPSS Unit 5, dry holes for which they must share in paying.

Because of the different rulings that the several state utility regulatory bodies have made as to the allocation of the cost of Skagit and Pebble Springs, and Pacific's 10% interest in WPPSS Unit 5, between ratepayers and investors, and pending court challenges to their rulings, it is difficult to arrive at what would be an "appropriate credit." In the calculation of the transmission access charge payable on kWh's by the four investor-owned utilities with their own nuclear dry holes we have assumed that, as a group, they would be credited for the same percentage of the after-tax cost of their dry holes as will be offered to the WPPSS 4/5 bondholders for the cost of the WPPSS dry holes (35%). However, the appropriate credit for each company should be determined on a company-by-company analysis, and may be more or less than what we have assumed in our calculation.

Appendix 13 includes charts showing estimates of (1) the annual sums necessary to pay 25%, 35%, and 100% of the outstanding 4/5 bonds, and to settle other claims against Units 4 and 5; (2) an estimate of the annual sums recommended to pay the same proportions of the after-tax cost of the Pebble Springs and Skagit projects, as well as Pacific's 10% share of WPPSS Unit 5, over the same period at the same interest rate as the WPPSS bonds would be paid; and (3) the per kWh charge that would be necessary

(a) to fund the WPPSS payments from Bonneville sales only, and (b) to fund the WPPSS, Pebble Springs, and Skagit payments from a region-wide charge.

Legal authority for the establishment of a trust fund through the imposition of a Bonneville transmission grid access charge of the sort herein recommended can be found in the United States Constitution's grant of taxing power. Such a tax would not be arbitrary, but would bear a reasonable if not exact relationship to the benefits received by the utilities and their customers from the federal involvement in generation and distribution of electric power. Those required to pay the tax receive benefits under the Northwest Regional Power Act of 1980 and P.U.R.P.A. and depend upon the grid for the efficient operation of their electric systems. Appendix 14 is a legal memorandum supporting the constitutionality of the Bonneville transmission grid access charge herein proposed.

A New Entity Should Replace WPPSS

To be the financing vehicle for the completion of Units 1 and 3, and to administer the trust fund herein recommended to permit settlement with the 4/5 bondholders and creditors, we recommend the creation of a new entity.

Although WPPSS has done a remarkable job of straightening out its construction problems during the past two years, it has lost the confidence of the investment community and, we believe, the general public of our region insofar as its nuclear program is concerned.

We further recommend that this new entity acquire all the assets and liabilities of WPPSS except the Packwood hydroelectric project and that it also acquire the present staff of WPPSS. We recommend that automatic transfer of all licenses and permits be expressly authorized in the federal legislation that creates the new entity and the state legislation that authorizes WPPSS to transfer its assets and liabilities to the new entity.

As a condition of acquiring the assets of WPPSS, the new entity should be required to indemnify and hold harmless WPPSS, all members of WPPSS, all participants in Units 4 and 5, and Pacific as co-owner of Unit 5, together with the past and present directors and officers of each, from the claims filed against them arising from the 4/5 bond default, excepting claims covered by insurance or other third party liability. This indemnification should be so structured that 4/5 bondholders and creditors have the same, but no greater, rights because of the indemnification agreement. Thus it should preserve whatever legal

separation is provided by the several bond indentures as between Units 1, 2, 3 and Units 4 and 5; as well as any other defenses that the indemnitees could assert on their own behalf. The new entity should, of course, be subrogated to all rights of the parties protected by its indemnification covenants, including their insurance coverage.

WPPSS Should be Replaced by a Federal Corporation with Regional Directors

What sort of new entity should replace WPPSS? Ideally it should recognize the predominant federal and regional interest in Units 1, 2, and 3; be non-political in character; be governed by individuals with integrity, skill, and experience in overseeing the financing, construction, and operation of large projects; and possess legal ability to finance the completion of Units 1, 2, and 3, and a settlement with the bondholders and creditors of Units 4 and 5 with tax-exempt municipal bonds on the same basis as WPPSS.

Such a financing vehicle should be designed so that it can serve also to finance conservation programs included from time to time in the Council's twenty year plans. It is probable, however, that such financing of new resources would have to be done without the benefit of tax-exemption.

We do not recommend that the new entity have authority to construct or operate projects other than those it acquires from WPPSS. It need not immediately replace WPPSS, but could contract with WPPSS for the completion of construction or operation of such projects for a period as long as one year pending the transfer of WPPSS assets and liabilities to the new entity.

We believe that a new federal corporation could best fulfill the criteria for the entity to replace WPPSS. Surely it is Bonneville, an agency of the federal government, that has the largest financial stake in WPPSS. Through net billing contracts Bonneville has invested \$6 billion in Units 1, 2, and 3 (plus \$1.5 billion of interest already paid through net billing); and only through Bonneville credit can the additional approximately \$4.5 billion be raised to complete the three units. The entire Pacific Northwest also has a vital interest in WPPSS Units 1, 2, and 3 because the output of the three units will be available to consumers throughout the region, and ultimately the units (whether or not completed) will be paid for by ratepayers throughout the region.

Although such a corporation might be created under the laws of the State of Washington, serious questions would arise as to how the directors should be selected,

what financial controls should be placed on the corporation and by whom, etc. We believe it preferable that a new entity to replace WPPSS be created by an Act of Congress. Its board of directors should be appointed by the President from non-partisan nominations submitted by the Governors of Washington, Oregon, Idaho, and Montana, and should include ex officio the Administrator of Bonneville and the Chairman of the Council. We recommend that the board consist of seven directors, and that the Chairman be designated by the President.

Powers of the New Entity

The federal corporation's function would not be to make energy policy, but primarily to provide a financing vehicle for approved WPPSS Units 1, 2, and 3, and the acquisition of conservation resources. Its credit would be based entirely on the credit of Bonneville backed by the revenues of the federal Columbia River Power system. Its debt therefore would be, in fact, a regional obligation, not involving the full faith credit of the United States.

The new entity would not supplant, nor assume any of the authorities of, the Bonneville Power Administration or the Northwest Power Planning Council. Its credit would be defined by, and limited to, that which Bonneville agreed

to extend. The project or programs it financed would be only those approved under the provisions of the Pacific Northwest Power Planning and Conservation Act. It would construct and operate no projects except those acquired from WPPSS. Its staff, initially, would be the personnel transferred from WPPSS.

This new entity, which might be called the Northwest Energy and Conservation Financing Corporation, should be allowed exceptions from the U.S. Civil Service laws, the General Service Administration laws, and possibly other federal statutes not appropriate to its purposes. Because Congress and the U.S. Treasury Department have approved WPPSS tax-exempt financing for Units 1, 2, and 3 through approval of the net billing process, the outstanding obligations should remain tax-exempt; and Congress should permit the new entity that replaces WPPSS to complete the financing and refinancing of those projects with tax-exempt financing. Indeed it is essential to carrying out the plan we recommend that it have the legal ability to offer new tax-exempt bonds in exchange for outstanding 4/5 bonds; to offer to exchange new tax-exempt bonds to holders of presently outstanding 1, 2, 3 tax exempt bonds; and to refinance with tax-exempt bonds outstanding high interest bearing bonds for all units. For examples of savings available to Bonneville and its customers through

the refinancing of Units 1, 2, and 3 high interest bearing bonds, see Appendix 15.

As regards its power to borrow money through the sale of securities or promissory notes, the new entity should be given immediate authority, with Bonneville's prior approval, to finance the completion of Units 1, 2, and 3; and, if Bonneville finds it desirable, to finance more than Bonneville's present 70% interest in Unit 3. This authority could permit construction of Unit 3 to go forward, thus possibly saving hundreds of millions of dollars in the cost of that project. We recommend that the financing of the completion of Units 1 and 3 be so arranged that all or a portion of the interest on the new borrowings be capitalized, thus deferring the need to recover this interest cost through Bonneville rates until the project for which the borrowing was made is completed and producing revenue.

The new federal corporation should also be given authority to receive the proceeds of the transmission grid access charge above described; and to set them aside in a trust fund for settlement of the claims of the 4/5 bondholders and other creditors; as well as for the settlement of claims against WPPSS members, and participants and their officers to the extent they are not covered by

insurance or other third party liability. The corporation would seek to augment the trust fund by pursuing vigorously its subrogation to the rights of WPPSS and the 88 participants against third parties such as contractors alleged to have rigged bids or overcharged for the work they performed, engineering consultants, underwriters, lawyers, etc. .

Based upon an unsolicited suggestion received by our Panel from a group of large institutional holders of 1, 2, 3 bonds, we recommend that the legislation creating the new entity should also authorize it, with Bonneville's approval, to offer the holders of WPPSS 1, 2, and 3 bonds a new security directly guaranteed by Bonneville. Presently, the 1, 2, and 3 bonds have had their credit rating suspended by the rating agencies, and therefore are selling at 30 or more full percentage points below the market price of a AAA rated municipal bond. If Bonneville would approve an offer of the new entity to exchange a bond directly guaranteed by it, the new security should receive a AAA rating or at least a AA. Thus, it might well be possible to arrange such an exchange at very substantial savings to Bonneville and the ratepayers of the region.

For example, a tender offer of the new Bonneville guaranteed security at 85 could be seen by present holders

of 1, 2, 3 bonds as increasing the market value of their holdings by 15 full percentage points. If as many as 80% of the holders of the approximately \$6 billion of 1, 2, 3 bonds were to accept such a tender offer, the savings to Bonneville and ratepayers would be more than \$700 million. From discussions initiated by them with several of the large institutional holders of WPPSS 1, 2, 3 bonds we believe that an exchange of this sort, at substantial savings to Northwest ratepayers, is a strong possibility. We have suggested to representatives of such institutions that at the proper time they communicate their interest in such an exchange directly to Bonneville and to the appropriate committees of the Congress.

A Mechanism for Negotiating Settlements
With Unit 4/5 Bondholders and Creditors

How would the federal corporation attempt to settle with the holders of 4/5 bonds? We recommend that it begin by entering the consolidated bondholder litigation pending before Judge Richard M. Bilby sitting in the United States District Court for the Western District of Washington. All of the necessary parties to a settlement are in that Court: present bondholders, former bondholders, WPPSS, the utility members of WPPSS, the 88 participants in Units

4 and 5, the four investor-owned companies with ownership of shares in Units 3 and 5, Bonneville, the project engineers, the underwriters, the lawyers, etc. Judge Bilby, after hearing some evidence to be offered in the case, might be in a position to bring the parties together for a settlement that would bind all the parties. The upper limit of the federal corporation's authority to settle would be the estimated net proceeds of the 0.6 mill Bonneville transmission access charge.

If the parties before Judge Bilby cannot be brought together, the new federal corporation could make a tender offer of a new security backed by the trust fund, on some basis above their present market value but less than their original cost, but, again, limited to an offer which could be paid through the 0.6 mill Bonneville transmission access charge. The new bonds could bear the same interest as the old bonds being tendered in exchange, and the maturities could be the same, though the call provisions might be shortened to permit sooner refunding if market conditions should warrant, and the put provisions eliminated.

In the event of a tender offer, a time limit would be placed on the offer, but no bondholder would be required to accept. The new entity would have authority to liti-

gate claims where settlement could not be achieved. Any bondholder who did not tender could share in a recovery, if any, that might ultimately be allowed his class of security in the consolidated action before Judge Bilby. Bonds tendered to the federal corporation and exchanged for new bonds would not be cancelled, but would be held by the corporation for proportionate sharing in any such class recovery.

It is essential that the new federal entity have authority to finance the completion of Units 1 and 3 without awaiting the outcome of settlement negotiation or litigation.

Reasons Why Such a Compromise Settlement
May be Acceptable to the Parties in Interest

The Panel believes that a settlement of WPPSS related problems of the type suggested above meets the three principal objectives it was told to achieve. It would utilize the Bonneville investment of \$4.4 billion in Units 1 and 3, and the investor-owned utilities' investment of \$737 million in Unit 3, thus saving ratepayers from having to pay huge sums for more "dry holes." These two units would be made available for future power supply to support economic growth in our region, thus achieving the second

objective required by our instructions. Through the trust fund created with the proceeds of a regional transmission grid access charge, the 4/5 bondholders would be given an opportunity without further litigation to recoup a substantial part of their after-tax investment in the bonds. Together with recommendations we make in a later part of this report for expedited bond validation proceedings, and for insurance of new revenue bond issues, we believe this provision of a trust fund for settling with 4/5 bondholders will go far toward restoring municipal credit in our region and the nation.

Let us, however, examine more closely the advantages and disadvantages of the recommended settlement to ratepayers and bondholders.

Residential and Rural Ratepayers

A trust fund sufficient to fund a settlement with the 4/5 bondholders such as herein proposed would require a transmission access charge of only 0.6 mill or less per kWh. For the average residential ratepayer in the Northwest who uses 1200 kWh per month, this would equate to a monthly charge of approximately 72 cents over the next 35 years.

It might well cost the many residential ratepayers much more than 72 cents per month over that period if a plan such as we propose for settling with the 4/5 bondholders and creditors is rejected, and the courts are required to settle everything. The bondholders and other plaintiffs might win their lawsuits, in which event the monthly cost could far more than exceed the suggested settlement, and would fall especially hard on the customers of the members of WPPSS and the participants in Units 4 and 5. Because of the long-drawn out litigation, during which Units 1 and 3 could not be financed to completion, those units too might have to be scrapped. In that event, Bonneville would have the burden of amortizing \$3.75 billion in outstanding debt for Units 1 and 3 dry holes (which alone would cost residential customers approximately \$5.60 per month for which they would receive nothing); paying for more expensive coal projects to replace Units 1 and 3; and paying higher interest rates because of the interest penalty investors demanded from a region that experienced the largest municipal bond default in history. Certainly, also, the ratepayers on top of all this will have tens of millions of dollars to pay in attorney fees and court costs.

There could be further advantage to ratepayers in the settlement package herein proposed, namely, that derived

from an exchange of outstanding 1, 2, 3 bonds for new bonds directly guaranteed by Bonneville.

Direct Service Customers

The case of Bonneville's direct service customers, principally aluminum companies, deserves special discussion. In total these customers provide about 30% of Bonneville revenues. Since 1974, their rates have risen faster -- from 2 mills to 26.8 mills -- than any other class of Bonneville customers. They assert that if they must pay their share of a transmission grid access charge, they may have to shut some production down, and possibly leave our region.

This Panel has no desire to see the aluminum industry leave our region. It provides jobs, taxes, and a large part of Bonneville revenues. But, just as with the case of the residential ratepayer, we believe that it will cost the aluminum companies more in higher rates if nothing is done to settle with the 4/5 bondholders and everything is left to be settled in the courts.

The presently unsettled outlook for energy in the Pacific Northwest -- both from the standpoint of rates and supply -- has to make planning difficult for the direct

service industries, especially those companies facing the need for large capital investment to modernize old facilities. The completion of Units 1, 2, and 3, and settlement of the 4/5 bondholder claims, will make more predictable and favorable the region's energy future. In fact, there is every reason to believe that, if this can be accomplished, the Northwest's competitive position as regards electric price and supply should steadily improve over the coming twenty years.

Customers of Pacific, PGE, Water Power and Puget

On balance, we believe that customers of the four "West Group" investor-owned utilities would benefit from the type of settlement we have proposed. We have discussed, above, the direct stake that their residential and rural customers have in accomplishing such a settlement.

As regards the commercial and industrial customers of these utilities, the benefits of settlement are less direct. Surely, however, they have an interest in restoring the credit of the public agencies of the region, since higher state and municipal interest rates mean higher taxes. If failure to settle with the WPPSS 4/5 bondholders results in the scrapping of WPPSS Unit 3, they may be required to share in the \$700 million or more dry hole

costs of the investor-owned companies. Further, they have an interest in ending the lawsuits that threaten to plague utility managers for the next decade, and distract their attention from planning adequate and economical power supplies to planning for the next trial. Too, they have an interest in the financial integrity of the Bonneville Power Administration: if it were not for the Bonneville transmission system, their electric rates would be higher than they are today.

Part of our recommendation, as above indicated, is that all customers of these four investor-owned companies -- residential and rural, commercial, and industrial -- receive an appropriate credit against the Bonneville transmission access charge for the cost of the Skagit, Pebble Springs, and WPPSS Unit 5 nuclear dry holes they may have had to pay for.

Customers of Idaho Power, Montana

Power and Utah Power & Light

Also deserving special discussion is the case of Idaho Power Company, Montana Power Company, and Utah Power and Light Company customers located in the Pacific Northwest, specifically, in parts of Oregon, Idaho, Montana, and Wyoming. None of these utilities has any nuclear "dry

holes" for which its customers must pay. Only one of them, Montana Power, has an interest in a WPPSS unit.

But the customers of such utilities do receive substantial benefits from the Bonneville transmission grid. To the extent that these utilities take advantage of the Northwest Regional Power Act, which offers Bonneville's preference rate to the residential and rural customers of all regional utilities, their customers would also share the benefits of completing Units 1 and 3, or, as the case may be, the cost of repaying the \$3.75 billion in outstanding debt if Units 1 and 3 turn out to be dry holes. Possibly they might even be required to share in the \$2.25 billion cost of Units 4 and 5 if the courts should rule that 4/5 bondholders have claims on Bonneville or on Units 1, 2, and 3.

Further, the municipal corporations in all parts of the Northwest have a strong interest in settlement of the 4/5 indebtedness and removing the shadow it casts over all new municipal financing in the region.

There is simply no perfect way of allocating the costs of the failed nuclear projects. Every utility, and every state, can make a plausible case why it should not have to pay, or should pay less. But if this difficult

period in the Northwest's energy history can be put behind the region, and the costs distributed on the widest possible basis the region as a whole surely will benefit. And, in the decades ahead, the Pacific Northwest -- with its great Columbia River, and fuel efficient steam electric plants, and large potential low cost conservation -- can continue to have the most economical supply of electric energy in the Nation.

4/5 Bondholders

For bondholders, the recommended compromise presents an opportunity to negotiate for a substantial settlement of their claims with a fiscally responsible entity. It does not require them to accept the settlement, but leaves them free to pursue whatever legal remedies they presently have. If they do not accept the federal corporation's settlement offer, however, they face many years of litigation, perhaps five to ten years, at the end of which they may lose everything.

Units 1, 2, and 3 Bondholders

As previously indicated, there could be considerable advantage both to Bonneville and to the holders of outstanding 1, 2, and 3 bonds if a trade of securities

could be negotiated whereby bonds of the new federal corporation, backed by Bonneville, were offered in exchange for the outstanding 1, 2, 3 bonds. The new security should merit a AAA or at least AA rating, and therefore command a substantially higher price than the outstanding 1, 2, 3 bonds where credit ratings have been suspended.

By exchanging for the new security, present holders of 1, 2, 3 bonds would remove the uncertainties that have driven down the value of their investments by approximately 30 percentage points -- uncertainties such as the claims of the 4/5 bondholders to all WPPSS assets, and the legal challenges that have been mounted to the validity of the net billing contracts that are the ultimate security for the 1, 2, 3 bonds. Further, by accepting a security that, in effect, would reduce the capital required to complete Unit 3, they would make its completion more likely, and to that extent reduce the danger of a total collapse of Units 1 and 3 with its potential financial consequences to all WPPSS bondholders.

Recommended State Legislation

Thus far, the Panel's recommendations have centered on proposed federal legislation to create a successor to

WPPSS, to provide a means to finance the completion of Units 1 and 3, and to establish a fund and a mechanism to settle the claims of the 4/5 bondholders and to offer a new security to 1, 2, 3 bondholders.

If these recommendations are to be carried out, it will be necessary that the Washington State Legislature authorize transfer of the assets and liabilities of WPPSS to the new federal corporation, and the transfer of state licenses and permits as well. The legislation should also authorize favorable tax treatment for the new entity; and affirm the authority of WPPSS to perform services for the new entity pending the transfer of WPPSS assets and liabilities.

There is additional state legislation that the Panel believes would make new issues of Northwest municipal securities more attractive, and therefore less expensive. Most importantly, the legislatures of each state should review their laws with respect to the pre-validation of the legality of new bond issues by a declaratory judgment proceeding. We believe that such proceedings should be given docket priority in the highest courts of each state, so that validation can be obtained quickly and new issues timed to take advantage of changing bond market conditions.

Further, we recommend that the several state legislatures authorize public power agencies to form a mutual revenue bond insurance company. An insured new bond issue will command a better price (i.e., lower interest and terms more favorable to the issuer) than an uninsured issue. Such insurance is already available from private companies in limited amounts, and also through bank letters of credit. However, it could be useful to public power agencies to obtain lower premium costs if they had their own mutual company, especially if they used an assessment feature which provided that within specified limits related to the revenues of each member utility, they would contribute to the mutual company to cover a loss whenever its reserves were not sufficient to do so.

Finally, we believe that legislatures should review the state statutes to make certain that each public power agency not only publishes a summary of its budget or contract for jointly financing a new project before acting upon it, but also sets forth the estimated rate impact of the construction programs included in the budget or contract, and gives adequate opportunity for the public to examine the budget or contract and express its views thereon. The legislature might also require that a specified percentage of the interest payable on bonds issued to finance new construction must be paid from the

public agency's current revenues. Such a requirement would bring home to all ratepayers very quickly the fact that at least in the short run new construction may mean higher electric rates.

No Practicable Way to Shift the Cost of
4/5 Bonds to the U.S. Treasury

The Panel has considered a suggestion that the many WPPSS related lawsuits should not be settled by compromise, but should be litigated to completion in the hope that the courts ultimately will enter a judgment requiring Bonneville to pay the 4/5 bondholders.

The argument runs this way: Such a judgment, if entered, would be based upon the theory that Bonneville, a federal agency, had committed a "tort" in persuading the 88 participants to sponsor Units 4 and 5. A tort judgment against a federal agency is a general obligation of the United States. Therefore if such a judgment were entered, the Treasury of the United States and not Bonneville would be required to pay it. Thus, it is argued, the taxpayers of the United States would pay the 4/5 bondholders, and, indirectly, "bail out" WPPSS and all of the other parties who might be liable to pay those bondholders.

The suggestion is ingenious, but not practicable. It would require five to ten years of expensive litigation to decide whether Bonneville is liable. The Department of Justice and Bonneville vigorously deny liability. In the meantime, it is unlikely that financing could be found to complete Unit 3 or Unit 1. Thus even if Bonneville were found to have committed a "tort," (itself a doubtful assumption) and the measure of damages were found to be the face value of all \$2.25 billion of 4/5 bonds, the price of victory could be two more "dry holes" costing ratepayers about \$5 billion.

Finally, it seems wishful thinking that Congress would appropriate funds to pay such a \$2.25 billion judgment against Bonneville without, at the same time, amending the Northwest Power Act to require that Bonneville collect that amount through rate surcharges over a period of years.

Summary of Recommendations

In summary the Panel recommends as follows:

First. Federal legislation that would create a federal corporation with legal power to assume the assets and liabilities of WPPSS, to automatically succeed to its

federal licenses and permits without further administrative or judicial proceedings, and to accept transfer of the staff of the Washington Public Power Supply System; to finance, with the approval of Bonneville, the completion of Units 1, 2, and 3, and the acquisition of conservation resources that from time to time are included in the Council's Twenty Year Plan; to complete the construction of Units 1, 2, and 3, and to operate those units and the Hanford Generating Project; to establish a trust fund for settlement with the bondholders and other creditors of the 4/5 projects; to seek to negotiate settlements with such bondholders and creditors; if settlements with all or some of the creditors cannot be concluded, to defend the suits commenced by them, and to indemnify and hold harmless WPPSS, the member utilities of WPPSS, and the 88 participant utilities in Units 4 and 5 and Pacific, including their past and present officers and directors, for claims arising out of 4/5 bond default and not covered by insurance or other third party payments; and to pursue vigorously all claims of WPPSS and other indemnitees against contractors and others by right of subrogation.

Second: Federal legislation that would impose a basic Bonneville transmission grid access charge of up to 0.6 mill upon each kilowatt hour generated by Northwest utilities for consumption within the Pacific Northwest or

for export to the Pacific Southwest including power generated outside the Northwest but wheeled through the Bonneville grid to the Northwest or other regions. Proceeds of this charge would be placed in a trust fund to be administered by the newly created federal corporation for settlement of the claims of the 4/5 bondholders and other 4/5 creditors. Appropriate credits against the transmission charge would be allowed to customers of investor-owned companies who are required to pay for the cancelled Skagit and Pebble and 10% of WPPSS Unit 5 nuclear units.

Third: Federal legislation that would make possible construction of a federal 500 KV a.c. line from Malin substation on the Oregon-California boundary to the San Francisco Bay area, or, alternatively, other transmission reinforcements that would increase the transfer capability between the Pacific Northwest and California load centers by 2,000 megawatts or more.

Fourth: Federal legislation that would authorize the federal corporation, with Bonneville's approval, to offer a new tax-exempt security to holders of outstanding 1, 2, 3 bonds on terms to be negotiated.

Fifth: Washington State legislation that would provide for the transfer of WPPSS assets and liabilities except the Packwood hydroelectric projects, and, automatically, the related licenses and permits, to the new federal corporation.

Sixth: State legislation in the several Northwest states to establish judicial procedures for rapid validation of proposed new bond issues; authorize public power agencies to form mutual insurance companies to insure future issues of revenue bonds; and require that proposed budgets and contracts of public agencies that contemplate capital construction be widely publicized, state the estimated impact of the new construction on ratepayers, and be subject to public scrutiny and hearings. To give an even stronger signal to ratepayers of the rate impact of new capital construction, the legislature further might require that a specified percentage of the interest payable on the bonds issued to finance such construction must be paid from the public agencies' current revenues.