

BERGER & STEINGUT
ATTORNEYS AT LAW
800 MADISON AVENUE
NEW YORK, NEW YORK 10022
(212) 980-1400

STANLEY STEINGUT
JEROME TARNOFF
ROBERT A. WEINER
LAWRENCE J. FOX †
PETER R. STERN
MICHAEL F. SOBIN
CHARLES S. WEBB III
LAWRENCE A. MANDELER
PAULA L. CHESTER
JOAN A. KING
PETER J. KIERWAN †
THEODORE S. STEINGUT
STEVEN A. BERGER

NANCY ADELSON
JONATHAN BARZILAY
JONATHAN BIREMAN
STEPHEN B. FRANCE †
LELAND L. GREENE
BRENDA D. BARNES
ANTHONY J. HATAS
STEVEN P. POLIVY
MICHAEL L. STEINDAN
AMY L. TALBERT
HOWARD WINTNER

† ALSO ADMITTED IN D.C.
‡ ONLY ADMITTED IN D.C.

COUNSEL
HENRY F. DRESSEL
ALLAN ALTMAN
MARC JACOBSON

SPECIAL TAX COUNSEL
NEIL E. MILLMAN

TELECOPIER
(212) 980-1175

TELEX
661385 BSWFS

CABLE ADDRESS
CONSILIOR

WASHINGTON OFFICE
1050 THOMAS JEFFERSON ST. N.W.
WASHINGTON DC 20007
(202) 337-0826

TELECOPIER
(202) 338-2381

April 6, 1987

VIA FEDERAL EXPRESS

Consuela M. Washington, Esq.
Counsel
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Ms. Washington:

This letter summarizes the complete involvement of representatives of the State of Washington in the WPPSS fiasco. Although we have requested the Enforcement Division of the SEC to examine the Washington State involvement in the issuance of the securities and the decision to terminate plus default, we are not aware at this point that such will be pursued.

This firm has experience in this issue because of our governmental background. Members of this firm were involved in solving the New York City fiscal crisis as well as the New York State Urban Development Corporation potential default. Although those were not state obligations, decisions as to termination of projects and possible default unquestionably involved State government at all levels.

When this firm was retained by the National 4 & 5 Bondholders Committee, we immediately looked toward what role the State of Washington played in the entire project. We examined documents through the Washington State Freedom of Information Law and discovered that the State was deeply immeshed in the creation, issuance, marketing and control of the entire WPPSS projects as well as the issuance of the securities to construct those projects.

Page Two
Consuela M. Washington, Esq.
April 6, 1987

Pursuant to Washington statute, RCW 43.52.360, et seq., WPPSS was created to serve as a construction and financing vehicle for electric power projects beyond the capability of a single utility.

In the early 1970's, WPPSS embarked upon the construction of three nuclear power plants 1, 2 and 3. These three plants were financed by "net billing" through the Bonneville Power Administration. This provided security for repayment of the bonds.

By 1973 and 1974 it appeared that additional thermal power plants would be necessary. Accordingly, WPPSS began planning for 4 and 5. Construction was to be financed through the sale of WPPSS revenue bonds. By this time, however, a change in federal law precluded the continued use of net billing as a security device. Some other form of security had to be found.

Bond Purchasers are acutely aware of the security for repayment of bonds. Since the construction and operation of nuclear plants were relatively new technologies in the 1970's, WPPSS would not be able to sell bonds based solely on the projected revenues of the nuclear plants. Accordingly, finding other financial resources to serve as security for repayment of the Bonds was crucial.

By 1976, eighty-eight (88) municipal and public utilities and rural electric cooperatives agreed to participate in the financing of 4 and 5. The security for repayment of the Bonds was to be the unconditional promise of each utility to repay the Bonds pursuant to an Agreement. Each utility absolutely and unconditionally promised to purchase defined electrical needs from 4 and 5, and pay the annual costs of the project, regardless of whether the plants were ever built or electricity was ever generated.

WPPSS's bond counsel only opined that seventy-two (72) of the eighty-eight (88) agreements were legal and binding. Bond counsel rendered the same opinion on fourteen (14) separate occasions between 1977 and 1981. The State Auditor was aware that bond counsel's opinion was so limited.

From 1977 through March, 1981, WPPSS issued fourteen (14) series of Bonds pursuant to Bond Resolution No. 890 in the principal sum of \$2.25 billion. The State Auditor had certain responsibilities in connection with the issuance of the Bonds and the operation of WPPSS. He discharged those responsibilities in a manner which was designed to, and did induce, the public to purchase and thereafter hold Bonds,

Page Four
Consuela M. Washington, Esq.
April 6, 1987

s/Robert Graham
Auditor of the State of
Washington

SEAL OF THE STATE OF WASHINGTON By _____
OF WASHINGTON s/
Deputy State Auditor

By statute, the Auditor's certification made the Bond a prima facie valid and enforceable obligation in accordance with its terms. Bond Purchasers were entitled to, and did rely on the certification as proof of prima facie validity. Accordingly, they accepted as valid the term contained on the face of each Bond that:

All acts, conditions and things required by the Constitution and statutes of the State of Washington to exist, to have happened and to have been performed precedent to and in the issuance of the Bond do exist, have happened and have been performed in due time, form and manner as prescribed by law. . .

Consequently, Bond Purchasers, relying on the language of RCW 54.24.070, reasonably believed that the Bonds were "prima facie valid and binding obligations in accordance with their terms." Since Bond Purchasers reasonably believed that the agreement was an integral part of the terms of the Bonds, they also believed that it, too, was valid and binding in accordance with its terms.

Among the purchasers of these bonds were over 70 thousand individuals. Many of these were senior citizens who used their retirement money. Although WPPSS has been identified by the Attorney General of the State of Washington to be a municipal corporation of the State of Washington, the bond itself in bold letters states that the bond is from the State of Washington and that WPPSS is a joint operating agency of the State of Washington. There is an inherent difference between a municipal corporation of a State, such as in local government and an agency of the State itself. Before certification, the State Auditor had a complete checklist which he was required to review in order to determine whether the bonds were in proper order for issuance.

Pursuant to RCW 43.09,260, the Auditor was required to audit WPPSS at least once every three years.

On every such examination, inquiry shall be made as to the financial condition and resources of the taxing district; whether the Constitution

Page Five
Consuela M. Washington, Esq.
April 6, 1987

and laws of the state, the ordinances and orders of the taxing district, and the requirements of the division of municipal corporations have been properly complied with; and into the methods and accuracy of the accounts and reports.

In fact, an assistant state auditor was assigned to WPPSS in the mid-1970's and continuously audited its financial and legal operations.

During the period in which all the Bonds were marketed, the Auditor, himself, authorized the inclusion of a letter in each of WPPSS' annual reports. The letter, obviously intended to be read by Bond Purchasers, represented that the Auditor had continuously audited WPPSS and had issued annual reports covering each year of operation. In contrast, RCW 43.09.260 only requires an audit every three years. The letter reads as follows:

To Whom It May concern:

The Washington State Auditor's Division of Municipal Corporations conducts a continuous examination of all of the operations of the Washington Public Power Supply System, including each and every project. Reports are issued covering each fiscal year, and are public documents.

On every such examination, state law requires that inquiry shall be made as to the financial condition and resources of the Supply System, whether the Constitution and laws of the state, the resolutions and orders of the supply system, and the requirements of the Division of Municipal Corporations have been properly complied with; and into the methods and accuracy of the accounts and reports.

Very truly yours,

ROBERT V. GRAHAM, State Auditor

As the financial condition of WPPSS deteriorated after 1978 -- and as late as 1981 -- the Auditor continued to permit The Letter to be included in WPPSS' annual reports despite the fact that the examinations and inquiries represented therein had either not been made or had not been made with due care. These annual reports were sent to Bond Purchasers and brokerage firms.

In February, 1979, the Washington State House and Senate Energy and Utilities Committees began investigating

Page Six
Consuela M. Washington, Esq.
April 6, 1987

WPPSS' management problems and cost overruns. It was disclosed that for ten (10) of the months between January, 1979, and October, 1980, WPPSS used cost estimates in its budgets which it knew, and the Auditor either knew or should have known, were almost certainly incorrect. In at least one instance, the actual interest cost of the Bonds substantially exceeded the assumed interest cost underlying construction cost estimates. In at least one Official Statement accompanying a Bond sale, WPPSS used cost projections that its own staff estimated had only a one in five thousand chance of being accurate. Nevertheless, the Auditor failed to disclose these departures by WPPSS from methods of accurate accounting and reporting.

In the fall of 1980, two field examiners for the State Auditor's office questioned the way in which WPPSS had changed contracts to increase their original amounts. After concluding that such changes violated Washington State law, they reported their findings to their superiors. As of this date, neither the State Auditor nor the Attorney General can explain why the report was buried.

When the 4 and 5 projects began to have serious financial problems, the legislature and governor immediately began to examine not only the feasibility of continuing the projects but also the exposure that the State of Washington might have if these projects were terminated and default occurred. Recognizing the possibility of state liability, the legislature adopted disclaimer statutes in 1981 and again in 1982 specifically denying any liability on the part of the State as a result of termination and default.

"Nothing in this chapter shall be construed to mean that an operating agency is in any manner an agency of the state."

Laws of 1981, 1st Ex. Sess. Chapter 3, §2.

"Nothing in this chapter alters or destroys the status of an operation agency as a separate municipal corporation or makes the state liable in any way or to any extent for any preexisting of future debt of the operating agency or any present or future claim against the agency."

Laws of 1982, 1st Ex. Sess. Chapter 43, §3.

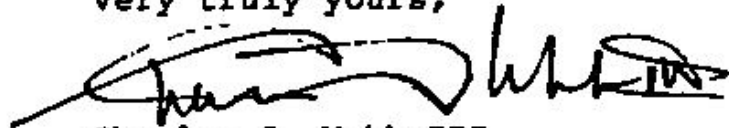
Page Seven
Consuela M. Washington, Esq.
April 6, 1987

If the State was in fact not involved and had no exposure of liability, what would be the purpose of these two Amendments?

Since formal discovery has not been permitted to date, the foregoing merely scratches the surface of state involvement. As we obtain further evidence of such participation, we will immediately forward the same to your office.

Thank you for the opportunity of meeting with you on this most important matter.

Very truly yours,

A handwritten signature in black ink, appearing to read "Charles S. Webb III", written over a horizontal line.

Charles S. Webb III

Attachments

1. Opinion of the Attorney General dated August 10, 1981
2. A sample copy of the Bond.
3. The State Auditors checklist.
4. Copy of Seattle Times article dated August 7, 1983.