

**STAFF REPORT ON THE INVESTIGATION
IN THE MATTER OF TRANSACTIONS IN
WASHINGTON PUBLIC POWER SUPPLY SYSTEM SECURITIES**



**The Division of Enforcement
United States Securities and Exchange Commission**

September 1988



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20540

September 22, 1988

The Honorable John D. Dingell
Chairman
Subcommittee on Oversight and Investigations
House Committee on Energy and Commerce
2323 Rayburn House Office Building
Washington, D.C. 20515

The Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: In the Matter of Transactions in Washington
Public Power Supply System Securities

Dear Chairmen Dingell and Proxmire:

I am pleased to transmit a report by the Commission's staff In the Matter of Transactions in Washington Public Power Supply System (WPPSS) Securities. The Staff Report contains a comprehensive discussion of the facts and circumstances that led to the largest default of publicly issued securities in the history of our capital markets.

With the release of the Staff Report, the Commission has determined to close its investigation into transactions in WPPSS securities without initiating any enforcement actions. ^{1/} This decision was made after considering the facts set forth in the Staff Report in the context of applicable legal standards and industry practices, the potential costs and benefits that would be associated with Commission enforcement

^{1/} The decision to terminate the investigation without enforcement action was approved by Commissioner Cox, acting as duty officer, with my concurrence. The other members of the Commission recused themselves from participation in this decision.

action, and the extent to which the WPPSS matter reflects systematic characteristics of the regulatory framework for municipal securities that might be addressed more appropriately by regulatory or legislative initiatives.

The Staff Report discusses several areas in which the disclosures made to investors in WPPSS securities were deficient. As the Staff Report indicates, the parties involved in the WPPSS project and its financing included the Washington Public Power Supply System, financial advisers, engineers, bond counsel, system participants (various participating utilities), the Bonneville Power Administration, underwriters, various unit investment trusts, and rating agencies. In reaching its conclusion to close its investigation, the Commission considered, among other factors, the difficulty of assigning responsibility for disclosure deficiencies in a highly complicated factual situation under the federal securities law antifraud provisions applicable to exempt offerings. In addition, many of the disclosure deficiencies do not relate directly to the precipitating factor in the default, the Washington Supreme Court's decision invalidating contractual agreements between WPPSS and certain public utilities.

The Commission also notes that the WPPSS matter has been the subject of extensive private class action litigation attempting to establish responsibility in this matter. Private class actions and a bond trustee action, which are consolidated in federal multi-district litigation (MDS-551), have been brought against all the major participants in the sale of WPPSS securities. Tentative settlements have been reached with several defendants in this case, and a trial involving the remaining defendants has commenced this month. The pendency of the private litigation means that the issues and claims will be exposed in a judicial forum even without institution of a Commission action.

The private litigation also provides an indication of the extensive resources that might be consumed by a Commission enforcement action in the WPPSS matter. The factual record in the MDL litigation may well be the largest ever compiled in a case brought under the federal securities laws. It has been reported that the attorneys for the bondholders' trustee alone have been paid \$76 million, with the trial having commenced just this month. Without suggesting that the Commission

The Honorable John D. Dingell
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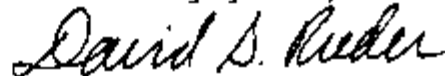
would be required to expend anything approaching that amount, I believe that the Commission's enforcement resources would be more effectively devoted to other matters.

Finally, Commissioner Cox and I determined that the responsibilities of participants in offerings of municipal securities might more effectively be addressed by regulatory measures that would apply to all participants in the municipal securities markets, and not just to the participants in offerings of WPPSS securities. Therefore, I have directed the Commission staff to review the regulatory framework applicable to municipal securities transactions and prepare appropriate recommendations for consideration by the full Commission.

Certain staff recommendations, including rule proposals, will be considered by the full Commission at an open meeting today. Following consideration by the full Commission, I will forward to you the text of any Commission action taken at that meeting, together with a Commission Report that will place these matters in a more complete context.

I believe it extremely important that steps be taken to enhance investor protection in the municipal securities markets, and I believe the Commission is pursuing the course appropriate to accomplishing that goal.

Sincerely yours,



David S. Ruder
Chairman

Enclosure

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PART I

INTRODUCTION AND EXECUTIVE SUMMARY

A. INTRODUCTION

This Staff Report discusses the circumstances of the default on \$2.25 billion of bonds issued by the Washington Public Power Supply System ("Supply System"). The default was the largest non-payment default in municipal bond history. The Supply System, a joint operating agency that is a municipal corporation under Washington State law, issued the bonds to finance the construction of two of five nuclear power generating plants, Washington Public Power Supply System Nuclear Projects Nos. 4 and 5, that the Supply System had undertaken to build on behalf of the publicly-owned utilities in the Pacific Northwest. 1/

Construction of Projects Nos. 4 and 5 began in 1976 and 1977, respectively, and the first long-term bonds to finance the projects were sold in February 1977. Fourteen bond sales averaging \$160 million each were completed over four years from the beginning of 1977 to early 1981. At the time of the last bond sale, in March 1981, Project No. 4 was 16% complete and Project No. 5 was 11% complete. The face value of bonds issued

1/ Approximately \$6.2 billion of bonds were sold to finance the other three projects, Project Nos. 1, 2, and 3. Those bonds were backed by "net-billing" agreements under which the Bonneville Power Administration ("BPA" or "Bonneville") essentially accepted the obligation to pay the bonds out of its revenues. Although only one of these projects was completed and the other two were mothballed, the BPA has continued to meet its commitments under the agreements for all three projects.

to that time, \$2.25 billion, equalled the original estimate of the total cost of both projects.

Increases in the estimates of construction costs announced in late May 1981 led to a moratorium on construction of the two projects. Efforts to provide regional funding to preserve the projects in a suspended state were unsuccessful, and they were terminated in January 1982. Eighty-eight publicly-owned utilities in the Pacific Northwest ("Participants") had entered into agreements ("Participants' Agreements") under which they were obligated to pay the costs of the Supply System's share of the projects ^{2/} regardless of whether the projects were completed. On June 15, 1983, the Washington Supreme Court ruled that certain Washington publicly-owned utilities, whose agreements provided for the payment of more than 68% of the Supply System's share of the projects' cost, lacked the authority to enter into those agreements because they were not to own the projects but were obligated to pay for the projects even if they were never completed (a "take or pay" obligation). Subsequent judicial decisions released the remaining utilities from their obligations.

^{2/} An investor-owned utility owned a 10% share of Project No. 5.

The Commission commenced an investigation into the circumstances of the offers and sales of the bonds. This Staff Report discusses the results of the investigation. ^{3/} Its purpose is to advise Congress of events surrounding the issuance by the Supply System of bonds to finance the construction of Projects Nos. 4 and 5 and the default by the Supply System on those bonds. The Staff Report was prepared based on information gathered in the non-public investigation into this matter. The investigation was not an adjudicatory proceeding of the Commission and it is not intended that the findings or conclusions contained in this Report be used in any adjudicatory proceeding.

^{3/} Private actions related to the default are pending. Class actions and an action by the bond trustee were consolidated as In re Washington Public Power Supply System Securities Litigation, MDL No. 551 (W.D. Wash.). Some settlements were reached in the Federal MDL No. 551 actions. Trial against the non-settling defendants, who include most of the Participants that were Supply System members, the financial advisor to the Supply System and two construction engineer firms, commenced on September 7, 1988.

State actions have also been brought. In Haberman v. WPPSS, No. 84-2-06452-8 (Super. Ct. of St. of Wash. for King County), bondholders sued for fraud and misrepresentation. In Arthur Hoffer v. The State of Washington, No. 84-2-16459-0 (Super. Ct. of St. of Wash. for King County), bondholders sued to recover from the State of Washington principally in connection with the role of the State Auditor and his certification on the bonds and his statements in a letter contained in the Supply System's annual reports. The Washington State Supreme Court reversed lower court dismissals of those actions. Haberman v. WPPSS, 109 Wash. 107, 744 P.2d 1032 (Wash. 1988); Hoffer v. The State of Washington, 110 Wash. 2d 415, 755 P.2d 781 (Wash. 1988).

B. EXECUTIVE SUMMARY

The judicial decisions that invalidated the agreements of the 88 publicly-owned utilities to pay for Projects Nos. 4 and 5 caused the ultimate default on payment of the bonds. This Report takes no position on the merit of those decisions. Rather, the Report examines disclosure issues arising from this matter. The Report first examines developments during the sale of bonds relating to costs, financing, power demand, and Participant support (Part II). The Report next examines the marketing of the bonds during the same period, including the roles of the underwriters, the rating agencies and unit investment trusts (Part III). Finally, the Report examines the extent to which Supply System counsel recognized and disclosed legal problems relating to the validity of those agreements. (Part IV). A summary of the Parts of the Report follows.

1. The Projects (Part II)

a. Cost Estimates (Budgets) for the Projects

The original estimate of the total cost of both Projects Nos. 4 and 5 was \$2.25 billion. The estimate after the last bond sale was almost \$12 billion. The largest increases in cost estimates occurred toward the end of construction. The last increase, announced in May 1981, caused a moratorium on construction. The staff's investigation sought to determine whether the cost estimates made public during the bond sales had understated the anticipated costs.

The Supply System produced annual budgets, reflecting estimates of the costs to complete each of Projects Nos. 1 through 5. The budgets consisted principally of estimates of direct construction costs, the cost of interest on bonds that financed the five projects, and a contingency amount that the Supply System determined. The estimates were included in the official statements, issued in connection with the bond offerings, as establishing the amount of the financing needed for the projects.

The Supply System maintains that it produced detailed, comprehensive, and realistic budgets. The budgets were produced under a "tight but attainable" philosophy to avoid having budget increases become self-fulfilling prophecies. The budgets that resulted from this practice tended to understate the likely costs of the five projects. The practice also sometimes conflicted with the views of the Bonneville Power Administration ("BPA"), a government agency that distributed power from dams in the Pacific Northwest and planned to obtain additional power from Projects Nos. 1, 2, and 3. The BPA desired more inclusive budgets in order to plan rate increases and resource availability. One of the results of the BPA's interest in Projects Nos. 1, 2 and 3 was that the Supply System began performing risk analyses, i.e., analyses of the probability of meeting the budgets. The initial risk analyses, performed in late 1977 and early 1978, indicated that there was little probability that the budgets would be met.

In 1979, when the Supply System adopted a fiscal year that ran from July to June, the budgets were increased, under the influence of the BPA, to a level reflecting a 50% probability, based on the risk analysis, that the projects could be completed within the budgets. These budgets, however, quickly became obsolete because of cost overruns.

The budgets rose again in the summer of 1980 when the fiscal year 1981 budgets were adopted. The budgets as adopted, however, had only a 20% probability of success based on the risk analysis. Management concluded that further increases were not warranted. The budgets also were determined under the "tight but attainable" budget practice. The budgets for the five projects would have had to have been increased by an additional \$1.5 billion in total to reach the 50% probability level. The BPA used budgets at a 50% probability for rate making purposes and requested a mid-year update estimate. No disclosure of the 20% probability was made in the official statement for the next Projects Nos. 4 and 5 bond offering in July 1980, but the BPA obtained disclosure of a low probability level in the fiscal year 1981 budget process in the official statement for the next bond sale, in August 1980, for Project No. 1.

In November 1980, after the conclusion of strikes that had halted construction at three of the five projects from late Spring 1980, a possible increase of \$3 billion in the budgets, including \$1.5 billion to reach the 50% probability level in

the fiscal year 1981 budgets, was discussed as a revised estimate. Senior management discussed acknowledging a portion of the increase then and another portion later. After management was advised that disclosure obligations required that any increase be disclosed at the time that it was determined, management instructed the staff to conduct an overall assessment of the budgets. A rapid one-week reestimate of the budgets was conducted using a modified form of the risk analysis with input about cost increases from the project personnel. This estimate showed a \$4.4 billion increase over the fiscal year 1981 budget for the five projects combined. The Supply System's Managing Director rejected this estimate and its methodology and, instead, adopted cost increases related only to the strike and certain other specific developments, totalling \$1.38 billion. Most of these categories of costs had been expressly excluded from the fiscal year 1981 budget at the time it was adopted, and they did not reflect overall escalation in the budget. The \$4.4 billion increase estimate, in contrast, was a reassessment of the entire budget and reflected overall increases in the budget. The \$4.4 billion increase estimate was never disclosed, even to some of the consultants who helped draft the official statements.

New budgets for fiscal year 1982 were available in early May 1981. These budgets, showing an increase of \$7.8 billion over the fiscal year 1981 budgets for all five projects,

including an increase of \$4.16 billion for Projects Nos. 4 and 5, caused the Supply System management to recommend a temporary moratorium on the construction of the Projects Nos. 4 and 5 when the budgets were disclosed in late May. Construction never resumed.

b. The Financing Program

All costs of the Supply System's share of Projects Nos. 4 and 5, including interest on outstanding bonds, were financed by the sale of bonds to investors. The Supply System financing requirements increased from \$3.4 billion at the start of the bond sales in February 1977 to \$11.1 billion at the time of the construction moratorium. Because the budgets continued to increase, the amount of additional bonds to be sold increased, averaging \$160 million dollars each over four years. The increase in the financing requirements made it less likely that the projects could be successfully financed to completion. Moreover, increasing rates of current actual expenditures decreased the availability of cash to pay for current construction expenses.

In the first two years after the initial bond sale in February 1977, the budgets did not increase significantly and the financing program did not experience serious difficulties. Although the Supply System was not always able to maintain its goal of one to two years cash flow coverage, i.e. the projected time that current expenditures could be paid from funds available, it was near the lower range of the goal.

In 1979, as the budgets began to increase significantly and the general bond market began experiencing the effects of inflation and rapidly rising interest rates, the financing program began to encounter difficulties. The interest rate on the bonds rose and went to a premium even over similar high yielding bonds. Also, the type of investor purchasing the bonds changed. Insurance companies, which had been large investors in the bonds, played a smaller role, and unit investment trusts, which were sold principally to individuals, played an increasingly large role.

In late 1979, the Supply System's financial advisor recommended that the Supply System gain the ability to issue short and intermediate-term debt, in addition to the long-term debt that had been the method of financing. The Participants' Agreements for the projects, however, did not require the Participants to make any payments until the projects were completed or until a date certain in 1988, unless the projects were terminated. In order to issue short or intermediate-term debt that might come due sooner, the Participants were asked to agree to a change in their Agreements. Such a change became increasingly necessary in 1980. Budgets increased significantly, and financing Projects Nos. 4 and 5 to completion became less likely. Also, increased rates of expenditure put the Supply System in the position where it had barely enough cash to meet expenditures from one offering to the next. During this time, the Supply System advised the

Participants that project termination was possible because of the financial problems unless they approved the changes needed for short and intermediate-term debt. Many Participants, however, did not make the needed changes to their Agreements. As a result, in late 1980 and early 1981, the Supply System used financing devices, such as put bonds -- i.e., bonds that the investor could require the Supply System to repurchase after a fixed period of time -- to try to maintain sufficient cash to avoid having to halt construction.

In early May 1981, a planned offering of Projects Nos. 4 and 5 bonds was suspended when the fiscal year 1982 budget figures became available within the Supply System, although that reason was not given in the announcement of the suspension. In late May, the Supply System management announced the budget figures and recommended a moratorium on construction because of the difficulties in continuing the financing program and because of the shortage of cash. The underwriters advised the Supply System that continued financing would be feasible only if the Participants agreed to pay 50% of the interest on the bonds. The Participants did not give the required approval for this change, and the financing program ended.

c. Need for the Projects - Power Supply and Resources

The projects were undertaken based on the projected need for the power that was to be produced by the projects. The need for the power from the projects was depicted prominently

in the official statements in tables and charts of forecasts of future power demand and projected power deficits for both the Pacific Northwest region and the Participants.

During the period of the sales of the Projects Nos. 4 and 5 bonds, each successive forecast showed a smaller increase in power demand. Moreover, the actual demand for power in the years during the sale of bonds was less than even the reduced forecasts. Although the official statements substituted the new forecasts for the old, and deficits were still indicated, they did not show the decline in the forecasts or that the reduced forecasts exceeded actual use. This information would have indicated that the forecasts might be overstated and could continue to decline.

d. Participants' Committee's Reevaluation of Participants' Position

The Participants' interests in the projects were represented by a Participants' Committee. Although the Participants' Committee had certain formal functions and gave certain required approvals, the Supply System effectively controlled the projects, and the Participants' Committee was not actively involved in substantive issues in the early years of the projects.

The Supply System's request that the Participants change their agreements and obligate themselves to pay short and intermediate-term debt if it could not be refinanced caused the Participants' Committee to become more involved. Some Participants formally approved the change. The proposal,

however, ultimately caused a negative reaction in the Participants' Committee. At a Participants' Committee meeting on October 16, 1980, the Committee members reviewed the original aim that Projects Nos. 4 and 5 would be a regional resource and the burdens would be shared by others. Rising project costs and falling power demand forecasts, however, meant that the Participants alone might be left to bear the burden of high cost power from the projects. The Participants discussed possible options, including a slowdown or termination of the projects, if others did not agree to take steps to share some of the burden.

The Committee asked the Supply System to conduct a study of a slowdown or termination of Projects Nos. 4 and 5. They also decided to confront the BPA and its industrial customers to get them to agree to share some of the burdens of the projects, including a BPA commitment to acquire the capacity of the projects and an extension of an industrial customers' agreement to buy power from the projects. They met with the BPA a few days later and stated their position.

The possible adverse consequences to the financing program if these considerations reached the investment community and the need to keep them secret were recognized in the Participants' Committee meeting and in the meeting with the BPA. Although the Supply System knew about these developments, and was represented in these meetings, nothing about the meetings or the considerations was disclosed in the Projects

Nos. 4 and 5 official statements, which continued to describe the Participant's involvement only in positive terms.

The negotiations with the BPA and its industrial customers continued until the moratorium on construction was declared, but the BPA was unable, and the industrial customers were unwilling, to accept more of the burden of the projects. The Supply System conducted a delay and termination study. The study became known to, and was reported in, the news media, but the fact that the study had been requested by the Participants' Committee was not disclosed.

When, after the moratorium, the Participants were requested to agree to pay 50% of the interest on the bonds to permit financing to continue, Participants having a substantial interest in Projects Nos. 4 and 5 stated that they would not agree unless the burdens of the projects were shared regionally. Subsequently, when regional agreement to pay the costs of mothballing Projects Nos. 4 and 5 could not be reached, the projects were terminated.

2. Marketing of Projects Nos. 4 and 5 Bonds (Part III)

a. Role of the Underwriters

Underwriters purchased the bonds from the Supply System and sold them into the market. With the exception of one sale, the underwriters purchased the bonds from the Supply System through a competitive bid procedure, as provided under Washington State law. In a competitive bid sale, the issuer distributes a preliminary official statement and then offers

the bonds for sale to underwriting syndicates, with the best bid, i.e., the bid offering the lowest interest cost, winning the bonds. The other method of public distribution of bonds is a negotiated sale, in which the issuer selects an underwriter in advance of the sale. In a negotiated sale, the underwriter assists the issuer in preparing the official statement and then negotiates the price it will pay and sells the bonds through a syndicate it has formed.

Initially, the Projects Nos. 4 and 5 bonds were sold to two syndicates, each led by two managing underwriters. In early 1980, the managing underwriters of one of the syndicates were unable to form a syndicate capable of bidding on the bonds, and that syndicate joined with the other syndicate in a single bid. Only one bid was received by the Supply System on all the subsequent sales of Projects Nos. 4 and 5 bonds.

In sales of corporate securities, underwriters can be liable to investors under provisions of the federal securities laws for misstatements and omissions in registration statements or prospectuses unless they establish that they made reasonable efforts to determine that there were no misstatements or omissions. Underwriters of corporate securities usually hire underwriters' counsel to conduct an investigation of disclosure items, or a "due diligence" investigation, and to issue an opinion, limited by the scope of the investigation, that proper disclosure has been made. Municipal bonds are expressly excluded from these liability provisions. Underwriters of

municipal bonds are legally liable to investors, however, under the general antifraud provisions of the federal securities laws. They are also subject to market risks in holding the bonds during the time it takes to sell them. Underwriters often retain their own counsel, known as underwriters' counsel, to issue opinion letters on the adequacy of disclosure under the antifraud provisions in negotiated sales of bonds, where the underwriters participate in drafting the official statement.

The underwriters did not conduct due diligence-type investigations to verify the adequacy of disclosure by the Supply System in connection with the sales of Projects Nos. 4 and 5 bonds. During the staff's investigation, the underwriters contended that they had no legal obligation to conduct an investigation and that it was not industry practice to do so in competitive sales of municipal bonds. Although the underwriters met with the Supply System from time to time during the sales of the Projects Nos. 4 and 5 bonds, the discussions were confined largely to the issue of the market for the bonds.

The underwriters were aware, as were many in the investing community, of some problems with the projects from press coverage and other sources. In reports that were circulated internally and to institutional investors, analysts for some of the underwriters noted problems. Also, in bidding on the bonds, the underwriters had to be knowledgeable about the

market for the bonds. One managing underwriter held an internal meeting in 1979 to consider whether to continue bidding on the Supply System's bonds, at which time possible problems with the projects were discussed.

The underwriters became involved in one negotiated offering when, in April 1980, the Supply System rejected the single bid it received and negotiated some of the terms of the underwriting with the lead underwriter it selected. Although in a negotiated bond sale the underwriter typically conducts an inquiry, the Supply System wanted to limit the underwriters' role and proceed quickly with the underwriting. As a result, no significant inquiry was done, and a letter on the adequacy of disclosure was obtained only from the Supply System's bond counsel. After that offering, the underwriters continued the practice of not conducting investigations on the adequacy of disclosure and of not obtaining any underwriters' counsel opinion letters. As a result, there was limited opportunity for the underwriters to discover the November 1980 estimate of a \$4 billion budget increase or the October 1980 Participants' Committee's request for a delay and termination study.

In late 1980 and early 1981, some of the underwriters were consulted on the financing program. The underwriters then supported the Supply System on matters before the Washington state legislature and became involved in matters relating to the short and intermediate-term debt proposal.

In May 1981, the Supply System, through a change in the Washington law, obtained general authority to negotiate underwritings of the bonds of its projects. After the announcement of the fiscal year 1982 budget figures, the underwriters, which were then negotiating the underwritings, advised the Supply System that the Participants needed to agree to begin paying interest on the bonds in order to make further sales of bonds. The Participants did not make the needed change, and no further underwriting was done.

b. The Role of the Rating Agencies

Each offering of the Projects Nos. 4 and 5 bonds was rated by Moody's Investors Service, Inc. and Standard and Poor's Corporation. The initial Moody's rating of A1 and the Standard and Poor's rating of A+ were maintained throughout the four years of bond sales, despite growing problems with the projects. The ratings reassured investors and permitted unit investment trusts, or UITs, to continue purchasing the Projects Nos. 4 and 5 bonds.

The ratings were based in large part on the Participants' obligation to pay and the need for the projects. Some problems with the projects, however, were noted over time, and, after the moratorium recommendation, the ratings were reduced even before the Washington State Supreme Court ruled that the obligations of many of the Participants were invalid.

The rating agencies' publications include disclaimers noting limitations on the use of their ratings. Here, the

rating agencies relied to a large extent on representations by the Supply System and were not told of some significant developments, such as the November 1980 update estimate of a \$4.4 billion budget increase and the request of the Participants' Committee for a slowdown or termination study. Also, although the agencies had analysts with experience in certain areas who could be consulted, they did not have experts to examine and evaluate critical information. The agencies also were not knowledgeable about the market for the bonds. Developments in the market might have suggested some grounds for caution. Finally, it appears the services tended to wait for a major development or decisive confirmation of a trend before changing a rating. Investors who relied only on the ratings were not fully apprised that there were developing problems.

c. The Role of Unit Investment Trusts

UITs are investment companies that issue redeemable securities representing an interest in a portion of a fixed portfolio of securities, which, in the case of tax-exempt trusts, are municipal bonds. The portfolio holdings are diversified as to type of issuer and as to individual bonds. Sponsors, which usually are broker-dealers, purchase bonds and deposit them in the trusts. Units of interests in the trusts are then sold by underwriters, including the sponsors, largely to individual investors.

Sponsors purchased increasingly large amounts of Projects Nos. 4 and 5 bonds for UITs. Ultimately, approximately 25% of all Projects Nos. 4 and 5 bonds were held by UITs, though, because of internal diversification limits, the bonds seldom composed more than 7 1/2% of any individual trust's portfolio. These purchases provided important support to the financing program.

Purchases of Projects Nos. 4 and 5 bonds for the trusts increased even as the problems with the projects were increasing. The sponsors, which usually were also members of the underwriting syndicates, denied that they purchased the bonds at the request of their bond underwriting departments. The purchases, however, helped the market for the bonds and indirectly resulted in a distribution of the bonds to individuals as part of the diversified trust portfolios. The principal immediate cause of the increasingly large purchases appears to have been that the trusts competed intensely on the basis of investment yield. As the yield of the Projects Nos. 4 and 5 bonds went to a premium even over similar high-yielding bonds, the sponsors purchased the bonds for the high yield.

The representations of quality standards in the prospectuses used to sell the trusts generally were not specific. Most stated that the trusts would include only bonds rated A or better by one of the rating services. The sponsors' own quality evaluation procedures varied. One sponsor did not have any direct internal credit approval process, but relied

only on the rating and the fact that the sponsor was also an underwriter of the bonds. Other sponsors had some direct internal approval process. Even where there was a quality approval process, however, it appears that it did not add much to the reliance on ratings in meeting the representation in almost all of the trust prospectuses that one of the factors considered in selection of the bonds was their price in relation to other bonds of comparable quality and maturity. Generally, the sponsors' bond buyer was told only whether the bonds were approved and did not have information, other than the rating service ratings, to compare the quality of bonds and determine relative value.

The problems with the projects did not deter the purchase of the bonds. In the case of one trust, a question was raised within the sponsor in late 1979 about whether to continue purchasing the Projects Nos. 4 and 5 bonds for the trust. Negative developments with the projects were discussed. In the course of deliberations, the person responsible for assembling the portfolios observed that if these premium yield bonds were not purchased, the trusts' own yield might not stay competitive. The person observed further, that if these trusts, which were the largest purchasers of Projects Nos. 4 and 5 bonds, stopped buying, this might be noticed by the market and possibly cause a "slam-out," or collapse, of the Projects Nos. 4 and 5 financing program. The sponsor decided

to continue purchasing relying upon the security of the Participants' obligation to pay.

3. The Opinions and Conduct of the Bond Counsel and Special Counsel Regarding the Validity and Enforceability of the Agreements that Were To Provide Security for the Projects Nos. 4 and 5 Bonds (Part IV)

Prior to the first sale of the Projects Nos. 4 and 5 bonds, the Supply System's bond counsel and special counsel had evaluated the validity and enforceability of the Participants' Agreements, which were to provide security for the bonds. At the closing for each bond sale, bond counsel and special counsel delivered identical opinion letters in which each firm stated that it had examined 72 of the 88 Participants' Agreements and opined that those Agreements were valid and enforceable. A form of these letters was included in the official statement for that bond sale. The investigation considered two issues in connection with conduct of counsel: first, whether it was appropriate to issue, for inclusion in the official statements, unqualified opinions as to the authority of certain participants, i.e., the Washington municipal corporations, to enter into the Agreement; and, second, whether the disclosure about the 16 Participants on whose Agreements the firms did not give a favorable opinion, was adequate.

a. Legal Uncertainties As to the Participation of the Washington State Municipal Corporation Participants

The most significant Participants' Agreements that counsel included in their opinion letters were the Agreements of the Washington State municipal corporation Participants. The Agreements of these 28 Participants, which consisted of municipalities and public utility districts, accounted for the payment of approximately 68% of the Supply System's share of the cost of Projects Nos. 4 and 5. The Washington State Supreme Court's holding that these Agreements were invalid effectively eliminated the security for the projects' bonds.

The court reached its decision as a result of the provision of the Participants' Agreement under which the Participants agreed to pay the Supply System's share of the cost of the projects regardless of the completion of either project or of any performance by the Supply System (the "take-or-pay" provision). The court held that the Washington municipal corporation Participants "simply are not authorized to guarantee another party's ownership of a generating facility in exchange for a possible share of any electricity generated." 4/ The dissenting opinion contended that the Participants' Agreements were valid under Washington State case

4/ Chemical Bank v. Washington Pub. Power Supply Sys., 99 Wash. 2d 772, 799, 666 P.2d 329, 343 (1983), aff'd on rehearing, 102 Wash.2d 874, 691 P.2d 524 (1984), cert. denied, 471 U.S. 1075 (1985).

precedent, and this Report does not take a position on whether the court's decision was to be expected.

The Participants' Agreements represented an untried means of financing in the Pacific Northwest. For the first time, publicly-owned utilities that were not all members of a project's sponsor, and that were not to own the project themselves, agreed to pay the costs of the project regardless of whether it was completed or the sponsor performed. Unlike some other states, Washington had no statute that expressly authorized a municipal corporation to enter into a take-or-pay contract. The Washington statutes authorized municipal corporations to purchase power and to construct, own, and operate electric facilities. The court previously had held that municipal corporations had those powers expressly granted by statute and those necessarily implied from the express powers, but that, in case of doubt about whether a power was granted, the doubt would be resolved by denying the power. The court had never before addressed the validity of take-or-pay arrangements.

The bond counsel and special counsel attorneys contended in testimony that Washington municipal corporations had broad authority to enter into power purchase contracts and to fix the terms of those contracts. They viewed the take-or-pay provision of the Participants' Agreement as merely one term of a power purchase contract that did not change its nature as a power purchase contract. However, at about the time the

Participants' Agreements were signed; representatives of the BPA's industrial customers asserted to the special counsel and others that the inclusion of a take-or-pay provision in an agreement under which those customers were to acquire some of the anticipated output of Projects Nos. 4 and 5 made that agreement a loan guarantee rather than a power purchase agreement. As such, the customers said that their corporate bond indentures prohibited them from participating in Projects Nos. 4 and 5 in that way. Moreover, in connection with preliminary financing proposals for the projects, the special counsel, based on discussions with the bond counsel and others, had prepared a memorandum noting possible legal impediments to the Supply System's issuing notes backed by guarantees of municipal corporations that were not Supply System members.

Despite these indications of legal difficulties with the take-or-pay provisions and the lack of legal precedent on the issue, counsel issued an unqualified opinion without taking action to have the legality of the Participants' Agreement determined. In prior Pacific Northwest power projects in which counsel had issued unqualified opinions, test cases had been brought or legislative changes were sought to resolve legal uncertainties. Counsel testified that they did not even consider bringing a test case to determine the authority of Washington municipal corporations to enter into the Participants' Agreement.

b. Legal Uncertainties as to Other Participants' Authority

In their opinion letters, the bond counsel and special counsel each stated that it had "examined into the validity of" 72 of the utilities' agreements to participate in the Projects. Counsel did not disclose that they had looked into all 88 agreements and were unwilling to opine on 16 of the utilities, accounting for the purchase of 4.06% of the anticipated output of the Projects. Ten of the 16 were excluded because of issues as to their authority to enter into the agreements. Counsel took the position that they believed these Participants had the legal authority to participate but that counsel had not attained the high degree of certainty as to the Participants' authority that was necessary to include the Agreements in their opinion letters.

The ten Participants had been participants in earlier Supply System projects. In connection with earlier projects, where one or both firms identified a question as to a participant's authority to enter into the agreement, the firms made efforts, including seeking amendments to statutes, municipal charters, or by-laws, to have the authority of that participant established expressly. When the efforts were unsuccessful, the firms then excluded the agreements of these participants from the opinions that they had rendered. Some of the participants whose earlier agreements were excluded because of authority issues became Participants in Projects Nos. 4 and 5. The authority issues that had led the firms to exclude

these Participants' earlier agreements were essentially the same as the issues that led the firms to exclude the Participants' Agreements of these Participants from the firms' opinions for Projects Nos. 4 and 5.

It appears that, while the agreements for Projects Nos. 4 and 5 were being drafted, consideration was given to excluding from any involvement in the projects those Participants whose Participants' Agreements the firms later excluded from their opinion letters because of authority issues. These utilities were allowed to participate, however, in part because they were located outside of Washington State and project backers sought broad regional participation in the projects. Regional participation was important because the Participants hoped to obtain legislation in Congress to allow BPA to acquire the anticipated output from the projects. Regional participation, it was believed, would lead to more support in Congress.

Counsel did not disclose the legal uncertainties as to the authority of these Participants. Counsel did not inform the investing public, nor even the utilities themselves, that they were unwilling to opine favorably on the validity and enforceability of these Agreements. Counsel indicated in testimony to the staff that, because of a "step-up" provision in the Participants' Agreement that required non-defaulting Participants to assume the financial responsibilities of a defaulting Participant, any uncertainty about the enforceability of these Participant's Agreements, which covered

approximately 4% of one project's anticipated output, did not have to be disclosed.

Not only did counsel fail to disclose these authority questions, but each official statement included a statement in the section on the security for the bonds, which bond counsel and special counsel prepared, that "[e]ach Participant is obligated to pay the Supply System its share of the total annual cost of the projects" By including that statement, and by stating that they had examined, and could opine favorably upon, 72 of the Participants' Agreements, while stating nothing about the remaining 16 utilities, including the ten whose legal authority was uncertain, counsel provided the investing public with incomplete information.

C. IDENTIFICATION OF PRINCIPAL PARTIES

1. The Washington Public Power Supply System

The Supply System is a municipal corporation and a joint operating agency of the State of Washington. It was organized in 1957 and has the authority to construct and operate electric power generating facilities. At the time of the first offering of Projects Nos. 4 and 5 bonds, its membership consisted of 22 publicly-owned utilities in the State of Washington. ^{5/} Management and control of the Supply System was vested in a Board of Directors composed of representatives of the membership. In addition, the Supply System had an Executive

^{5/} With three exceptions, the Supply System's members also were among the utilities that participated in the Project Nos. 4 and 5.

Committee, composed of seven members of the Board, that handled matters arising between meetings of the Board of Directors.

Unlike the utilities that were Participants in Projects Nos. 4 and 5, the Supply System had no ratepayers and did not make retail sales of power. Rather, the Supply System functioned primarily as an entity for the construction of generating facilities that would provide additional resources to meet the power needs of the region. The first Supply System project, a small hydroelectric facility, was undertaken in 1961. Later, the Supply System built a steam turbine facility that operated from power generated by a United States Government nuclear plant. These were the only facilities constructed by the Supply System before it began a program of building five nuclear power plants in the early 1970's. Only one of the five projects has been completed.

2. Blyth Eastman Dillon & Co.

The investment firm of Blyth Eastman Dillon & Co. ("Blyth") was the Financial Advisor to the Supply System. ^{6/} As Financial Advisor, Blyth advised the Supply System on the marketing of its bonds, acted as liaison with the financial community, and helped draft the official statements. The principal individual from Blyth who advised the Supply System

^{6/} In January 1980, Blyth merged with Paine, Webber, Jackson and Curtis, Inc. The organization within the merged company that performed the financial advisory work was Blyth Eastman Paine Webber. The name of the parent after the merger was Paine Webber Jackson & Curtis Inc., and then PaineWebber, Inc.

during the period of the Projects Nos. 4 and 5 bond sales was Donald E. Patterson. The firm and Mr. Patterson are referred to herein as the Financial Advisor as the context indicates.

3. R.W. Beck and Associates

R.W. Beck and Associates ("R.W. Beck") was the Consulting Engineer on all of the projects. R.W. Beck provided consulting services to the Supply System, helped draft the Supply System's official statements, and provided the Supply System with a letter for inclusion in each official statement in which it opined on the feasibility of the projects and set forth information on the forecasted need for power and projected revenues of the participating utilities. The principal R.W. Beck official responsible for Projects Nos. 4 and 5 bond sales was Winston Peterson.

4. Wood Dawson Love & Sabatine

Wood Dawson Love & Sabatine ("Wood Dawson") ^{1/} is a small New York law firm that acted as the Supply System's bond counsel. Wood Dawson has served as bond counsel for municipal corporations throughout the United States. Wood Dawson helped draft the official statements. Brendan O'Brien was the attorney at Wood Dawson principally responsible for the firm's work in connection with Projects Nos. 4 and 5.

^{1/} The firm now operates under the name of Wood Dawson Smith & Hellman, and, at times relevant to the Staff Report, operated under other names.

5. Houghton Cluck Coughlin & Riley

Houghton Cluck Coughlin & Riley ("Houghton Cluck") 8/ is a Seattle, Washington law firm that acted as special counsel to the Supply System. The firm had been involved in the formation of the Supply System and on a continuing basis thereafter performed a variety of work for it. It helped draft the official statements. Bert L. Metzger, Jr. and Jack R. Cluck were the attorneys at Houghton Cluck principally responsible for the firm's work in connection with the sale of Projects Nos. 4 and 5 bonds.

6. The Participants

Eighty-eight utilities entered into agreements to purchase a share in the Supply System's share 9/ of Projects Nos. 4 and 5. The aggregate amount that the Participants were to pay for that power was to equal the Supply System's share of the cost of the projects. Of the 88 utilities, only 19 were members of the Supply System. 10/ These utilities were to pay for 56% of the Supply System's shares of the projects power.

The Participants consisted of municipal corporations and cooperatives in Washington, Oregon, Idaho, Nevada, Montana, Wyoming and Utah. Some Participants were very small and

8/ The firm now operates under the name of Skellinger Ginsberg & Bender, and, like Wood Dawson, at times relevant to the report, operated under other names.

9/ An investor-owned utility purchased a 10% interest in Project No. 5.

10/ During the period of the sale of bonds one other Participant became a member of the Supply System.

others, such as the City of Tacoma, Washington, were relatively large. All of the Participants were part of a group of publicly-owned utilities that was entitled to preference in access to power by the BPA.

7. The Bonneville Power Administration

The BPA is a federal agency within the Department of Energy. ^{11/} The BPA marketed to the Participants and others inexpensive power from federal dams located on major river systems in the Pacific Northwest. In addition, the BPA agreed to purchase, through differing methods, the anticipated electricity output of projects undertaken by the Supply System, other than Projects Nos. 4 and 5, and by other utilities in the Pacific Northwest. It then incorporated that output into its resource base for sale to its customers. Although the BPA did not have the same involvement in Projects Nos. 4 and 5 as it had in the other Supply System projects, it helped initiate the projects and was knowledgeable about them largely because they were to be built in conjunction with two of the Supply System projects in which the BPA was involved.

8. The Underwriters

The Projects Nos. 4 and 5 bonds were underwritten by two syndicates that bid on the bonds. Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch") and Salomon Brothers Inc. ("Salomon") led one syndicate. Prudential-Bache Securities,

^{11/} Prior to 1977, the BPA was an agency within the Department of Interior.

Inc. ("Bache") and Smith Barney, Harris Upham & Co., Inc. ("Smith Barney") led the other. In early 1980, the Bache/Smith Barney syndicate ceased bidding on the bonds and joined in the bid of the Merrill Lynch/Salomon syndicate.

9. The Unit Investment Trusts

Unit investment trusts, a type of investment company, consist of unmanaged portfolios of securities assembled by sponsoring brokerage firms. Fractional individual interests in the portfolios are sold to investors as units. Sponsors of the trusts increased their purchases of Projects Nos. 4 and 5 bonds dramatically over time to the point where UITs ultimately held approximately 25% of all Projects Nos. 4 and 5 bonds issued.

10. The Rating Services

Moody's Investors Services, Inc. and Standard and Poor's Corporation are rating services that rated the Projects Nos. 4 and 5 bonds.

D. CHRONOLOGY OF SIGNIFICANT EVENTS

Listed below are the dates of some of the events referred to in the Report and of the sales of Projects Nos. 4 and 5 bonds.

<u>Date</u>	<u>Event</u>
	<u>1957</u>
January 19	Supply System organized.

1968

October 23 Program under which the Supply System's Projects Nos. 1, 2, and 3 were undertaken is approved. That Program, known as Phase 1 of the Hydro-Thermal Power Program, provided for the BPA to acquire power from non-federal thermal projects by net billing, which was designed so that, under the project agreements, the BPA would assume the risk of a project's non-completion and of non-performance by a project's sponsor. The power from the Phase 1 projects was to be integrated into the other power the BPA had available to market, and the costs were to be integrated into the rates the BPA charged its customers.

1970

October 7 Legislation enacted authorizing the BPA to acquire by net billing the anticipated output of Projects 1, 2 and 3.

1973

May 30 An organization of customers entitled to preference in obtaining BPA power, the Public Power Council, requests that the Supply System build Project No. 4, which later became Projects Nos. 4 and 5.

June 22 Supply System adopts a Resolution accepting the proposal for it to undertake Project No. 4.

November 15 Houghton Cluck considers preliminary financing alternatives for Project No. 4 and, after discussion of alternatives with Wood Dawson and others, notes possible legal impediments to the Supply System's issuing notes based on guarantees of municipal corporations that are not Supply System members.

December 19 Completion of memorandum describing program, of which Projects Nos. 4 and 5 were considered a part, for the construction of projects in addition to the Phase 1 projects. The program, known as Phase 2 of the Hydro-Thermal Power Program, contemplated that the BPA would acquire power for publicly-owned utilities as their agent and that the entire Pacific Northwest region or interested utilities would share costs caused by any project that was not completed.

1974

- March 20 The Supply System goes forward with the first financing for what became Projects Nos. 4 and 5 by issuing \$2,500,000 of member-backed notes for preliminary work on Project No. 4.
- May Work begins on agreement that later became the Participants' Agreement, and a decision is made to build Projects Nos. 4 and 5.
- August 22 Supply System issues \$15,000,000 of member-backed notes for preliminary work on Projects Nos. 4 and 5.
- November 1974- Wood Dawson and Houghton Cluck conduct majority
February 1975 of their research into authority of BPA preference customers to enter into Participants' Agreement and Option Agreement.
- December 1974- In order to provide time for power allocation
January 1975 issues to be resolved and thereby remove an obstacle to execution of the Participants' Agreements, decision is made for prospective participants in Projects Nos. 4 and 5 each to enter into an Option Agreement, which was developed to provide security for an interim financing for Projects Nos. 4 and 5.

1975

- January 20 Houghton Cluck advises Wood Dawson with regard to Projects Nos. 4 and 5 that Idaho cities "should not be allowed in."
- The BPA advises Wood Dawson that each preference customer should enter into the Option Agreement.
- January 22 Houghton Cluck finalizes summary of Option Agreement, which includes statement that Idaho cities and others would not be parties.
- March 31 Representatives of Idaho cities meet in Portland, Oregon with Houghton Cluck, BPA, Public Power Council attorneys and others to discuss Projects Nos. 4 and 5 agreements. A tentative decision is reached to bring a test case to determine the authority of Idaho cities to participate in Projects Nos. 4 and 5.

April 1-7 Decision made by Houghton Cluck, and possibly Wood Dawson and others, not to go forward with a test case on Idaho cities. Houghton Cluck informs Idaho city attorneys that there is no time for a test case, that Idaho cities have authority, and that, if a court decides otherwise, the Idaho cities simply will not have to pay.

July 22 The signed Option Agreements are given this date.

July 24 The Supply System issues \$100 million of development bonds backed by Option Agreements, for Projects Nos. 4 and 5; 7.04% interest cost; Merrill Lynch lead underwriter.

December Concern that Participants' Agreements will not be executed in time to provide basis for needed financing leads to consideration of a second option agreement to avoid running out of funds and/or spending authority. After it seems that some utilities will not sign, the proposal is abandoned.

1976

April 15 The Participants' Agreement is mailed for signature to Option Participants.

April 16 Certain utilities refuse to sign Participants' Agreement unless they first know what their future allocations of power from the BPA will be. In response, the BPA sends a letter to its preference customers, including utilities that signed Option Agreements, advising that it would be inequitable to use participation in Projects Nos. 4 and 5 as a basis for reducing future allocation of BPA power.

June 24 The BPA issues Notice of Insufficiency to preference customers to the effect that, as of July 1, 1983, the BPA will not guarantee to meet the requirements of its preference customers. The notice thus encourages preference customers to participate in Project No. 4 and 5.

July 14 Previously signed Participants' Agreements are dated as of this date.

1977

- February 23 The Supply System issues first bonds for Projects Nos. 4 and 5 that are backed by Participants' Agreements (Series 1977A); \$145 million; 5.93% interest cost; Smith Barney lead underwriter.
- May 24 Projects Nos. 4 and 5 bond sale (Series 1977B); \$90 million; 6.32% interest cost; Bache lead underwriter.
- July-September BPA questions Supply System about adequacy of cost and schedule projections. Despite reassurances, BPA requests risk analysis on probability of projections.
- September 13 Projects Nos. 4 and 5 bond sale (Series 1979C); \$130 million; 5.96% interest cost; Bache lead underwriter.

1978

- January Risk analysis shows only very low probability on Projects Nos. 1, 2, and 3 budgets and schedules.
- January 31 Projects Nos. 4 and 5 bond sale (Series 1978A); \$150 million; Salomon Brothers lead underwriter.
- May 23 Projects Nos. 4 and 5 bond sale (Series 1978B); \$150 million; 6.86% interest cost; Smith Barney lead underwriter.
- August- Supply System reluctant to acknowledge a schedule September slippage in a net-billed project official statement.
- August 1 Supply System Treasurer complains that 12-24 month cash flow goal is not being met.
- October 12 Projects Nos. 4 and 5 bond sale (Series 1978C); \$170 million; 6.81% interest cost; Bache lead underwriter.

1979

February 12 Merrill Lynch analyst report noting problems with Projects Nos. 4 and 5 issued.

February 14 Projects Nos. 4 and 5 bond sale (Series 1979A); \$175 million; 7.16% interest costs; Merrill Lynch lead underwriter.

June Merrill Lynch meeting on whether to continue underwriting Supply System bonds.

June 20 Financial Advisor warns Supply System of bad market for Projects Nos. 4 and 5 bonds.

July Fiscal year budgets adopted at 50% probability under BPA prodding. First and only budget at that probability.

August 28 Projects Nos. 4 and 5 bond sale (Series 1979B); \$150 million; 7.69% interest costs; Smith Barney lead underwriter.

October 29-
November 2 Supply System Investor Tour at Richland, Washington. After tour, Merrill Lynch UIT analyst recommends reevaluating further purchases of Projects Nos. 4 and 5 bonds; T. Rowe Price analyst rates Projects Nos. 4 and 5 bonds below investment grade and sells holdings.

November Meeting in Merrill Lynch UIT department following analyst's recommendation of reevaluation of Projects Nos. 4 and 5 bonds purchases. Portfolio buyer speculates on possible "slam-out" or collapse of Projects Nos. 4 and 5 market if Merrill Lynch UITs stopped purchasing.

December 11 Projects Nos. 4 and 5 bond sale (Series 1979C); \$200 million; 8.30% interest costs; Smith Barney lead underwriter.

1980

April 24 Board authorizes Supply System to proceed with Balanced Financing Program.

April 29 Only one bid entered on Projects Nos. 4 and 5 bonds. First time only one bid received. Bid rejected and Merrill Lynch subsequently selected as lead underwriter.

May 9 Projects Nos. 4 and 5 bond sale (Series 1980A); \$130 million; 9.23% interest cost; Merrill Lynch lead underwriter.

June Risk analysis on fiscal year 1981 budget. Projects personnel questioned an probability. Budget set by management at 20% probability.

July BPA notifies Supply System that use of low probability means budgets likely understate costs and it will use 50% budget for rate calculations; believe mid-year update will be needed.

July 15 Projects Nos. 4 and 5 bond sale (Series 1980B); \$180 million; 9.5% interest cost; Salomon lead underwriter. Official statement uses fiscal year 1981 budget but does not disclose low probability as indicated by risk analysis.

August A new Managing Director, Robert Ferguson, arrives at Supply System.

August Disclosure first made of low probability of budgets in Project No. 1 official statement at BPA request.

August 26 Ferguson briefed on budgets, including 20% probability of 1981 budget and mid-year review promised to BPA.

September 17 Meeting between large institutional investors and Supply System at Richland. Problems discussed. Utility representatives tell investors that projects will not be cancelled.

September - Smith Barney considers Balanced Financing Program; Smith Barney analyst prepares analysis critiquing program and pointing out some institutional investor resistance to Supply System bonds.

September 23 Projects Nos. 4 and 5 bond sale (Series 1980C); \$180 million; 10.69% interest cost; Merrill Lynch lead underwriter.

- October 13 Additional budget briefing for Ferguson.
- October 16 Participants' Committee meeting. Proposal to issue short and intermediate-term debt creates discussion about Participants' position. Changes in circumstances from original premise of sharing burden of Projects discussed. Discussion of considering slow-down or termination as possible options. Supply System asked to do study on slow-down or termination for Participants' Committee.
- October 21 Participants' Committee representatives meet with BPA Administrator to seek to have BPA and industries share risk. They tell BPA they are looking at possibility of slow-down, sale or termination.
- November 5 Supply System meeting on possible budget update immediately after end of strike. Discussion of possible splitting of recognition of possible budget increase is discussed. Managing Director told that full amount of any increase must be disclosed. He instructs the staff to prepare intensive, quick budget update.
- November 16-17 Meetings to review interim budget estimate. New estimate of \$20.4 billion presented, \$4.4 billion over 1981 budget recently adopted. Basis of estimate discussed. Managing Director orders all figures be kept confidential and rejects estimate and methodology. Only estimated costs of certain specific developments disclosed.
- November 20 Financial Advisor warns Participants' Committee of critical financial condition and possibility of termination if cash shortage. Participants' Committee not told that a budget estimate made four days before indicated a \$4.4 billion budget increase.
- December 9 Projects Nos. 4 and 5 bond sale (Series 1980D, E); \$200 million; 12.44% and 11.83% interest cost; Salomon lead underwriter. Put bonds used for first time.

1981

- February 5 The PNUCC Executive Committee meets and discusses its upcoming 1981 forecast. The BPA indicates that its revised estimate for 1981 will reflect a 500 megawatt reduction for the forecast year 1981 as a result of a study of deviation between forecast and actual usage.
- February 27 The BPA formally transmits its revised load estimate for inclusion in the 1981 PNUCC regional forecast.
- March 17 Projects Nos. 4 and 5 bond sale (Series 1981 A, B); \$200 million; 11.77% and 11.06% interest cost; Merrill Lynch lead underwriter.
- March 18 The PNUCC System Planning Committee meets and discusses its 1981 regional forecast summary, dated March 16, 1981, which projected a drop in forecasted demand for the West Group area of 2,676 average megawatts for the 1981-82 forecast year.
- May 3 Initial fiscal year 1982 budget figures become available at Supply System.
- May 5 May 1981 Projects Nos. 4 and 5 bond offering postponed because fiscal year 1982 budget figures available. Supply System press release of May 5, 1981 does not disclose availability of budget figures.
- May 29 Managing Director announces fiscal year 1982 budget estimate of \$23 billion for all Projects, recommends a moratorium on construction.
- August 27 Participants with 8.2% of shares vote against resolution to require Participants to pay a portion of interest during construction, a condition required by underwriters for any further sales of Projects Nos. 4 and 5 bonds. Participants with 30% of shares indicate they are unlikely to agree to pay interest during construction unless Projects are regionalized.
- December 22 Suit challenging validity of Participant's Agreement of Oregon city filed by residents (Defazio action).

1982

- January 22 Projects Nos. 4 and 5 formally terminated.
- May 18 Trustee for Projects Nos. 4 and 5 bonds files declaratory judgment action in Washington state court to establish validity of Participants' Agreements.
- November 5 Oregon trial court holds Oregon Participants lacked authority to enter into take or pay agreements (Defazio action).
- November 16 Washington State trial court enters order on summary judgment motion that Washington Participants had authority to enter into Participants' Agreements.

1983

- May 13 Supply System fails to pay monthly debt service to Projects Nos. 4 and 5 bond trustee.
- June 15 Washington State Supreme Court rules that Washington municipalities and public utility districts were not authorized to enter into take-or-pay agreements on Projects Nos. 4 and 5.
- September Idaho Supreme Court rules that Idaho cities did not have authority to enter into participants' agreements.

1984

- March 20 Oregon Supreme Court reverses trial court decision and holds that Oregon Participants had authority to enter into take or pay agreements, but does not preclude other defenses to obligation to pay.
- November 6 On rehearing, Washington State Supreme Court affirms its June 15, 1983 decision and relieves all Participants of their obligations.

1985

- April 29 U.S. Supreme Court declines to review Washington State Supreme Court decision.

PART II

THE PROJECTS

A. COST ESTIMATES (BUDGETS) FOR THE PROJECTS

1. Introduction

The official statement for each issue of Projects Nos. 4 and 5 bonds included an estimate of the costs to complete the projects. 12/ The estimates of the costs to complete were produced as part of the Supply System's annual budget process for all five of its projects. The Supply System was obligated to develop a budget for each project each year by agreements that governed the projects. The budgets included updated estimates of the costs to be incurred for each project through completion. 13/ These annually prepared budgets, which were occasionally revised in mid-year, were subject to disapproval by various entities associated with the projects. Therefore, they served as both estimates of, and authorizations for, expenditures by the Supply System.

12/ The estimates were included in a table that established the financing needed for the projects.

13/ The total of the budgets was often referred to as the "budget" for a given year, and such reference is sometimes used here.

a. How The Estimates Were Done

The Supply System's fiscal year began on July 1. ^{14/} The budget process began the preceding December or January, when the Supply System issued instructions to those working on the budgets on how to make and present calculations of costs. One of the important initial steps in the preparation of the budgets was setting the schedules for the projects because the schedules affected the construction cost analysis and the interest cost analysis. The schedules were set by consultation between the Supply System and the companies that were managing the building of the projects.

The costs for building the projects were calculated from the elements of the building process. The direct cost of construction was determined from estimates of construction quantities to be installed, such as yards of concrete in the project, and estimated costs of accomplishing those quantities. The cost of engineering design work was determined by amounts expended and the estimates of design work remaining. Finally, the cost of equipment purchased from outside vendors was estimated based on contract prices or on market prices. Each element of these estimates provided for "escalation" to account for the effect of inflation over the duration of the projects.

^{14/} The Supply System completed a conversion to this fiscal year from a calendar year in 1979.

The assumptions about the rate of inflation for labor and materials were determined by the Supply System.

The Supply System determined and added various "owner's costs," which included administrative overhead. The Supply System also determined and added the cost of the nuclear fuel that was to be acquired before the start of commercial operation of the projects. It also determined and added an overall contingency amount in a Potential Exposure item to encompass anticipated overruns that were not reflected in the contractors' contingency amounts. Finally, the Supply System calculated and added to the budgets the cost of interest to be paid on the bonds issued to finance the construction of the projects before the projects were complete. Interest was a very large item for Projects Nos. 4 and 5 because all the interest payable during the construction of Projects Nos. 4 and 5 was financed by the sale of additional bonds and was part of the budget. ^{15/} Because of this, any schedule delay meant that interest had to be paid on more money over a longer period. This interest factor made any delay very expensive.

The Supply System would generally complete the estimates in May or June and then submit the resulting budgets for each of the

^{15/} Interest was less significant in the Projects Nos. 1, 2 and 3 budgets because after a fixed date the BPA paid the interest on the bonds issued to finance the construction of those Projects.

projects to its Board of Directors and to each of the entities having a contractual right to review and pass on the budgets. In the case of Projects Nos. 1, 2, and 3, the BPA and the Participants' Review Board, composed of representatives of the Participants in those projects, had such a right. In the case of Projects Nos. 4 and 5, the Participants' Committee, composed of representatives of the Participants in those projects, had a similar right. In the case of Projects Nos. 3 and 5, investor-owned utilities that owned a minority portion of the capability of those projects also had such a right. 16/

2. Practices Tending to Cause Understatement of the Budgets

a. Introduction

The Supply System consistently failed to meet construction goals on Projects Nos. 4 and 5. As a result, there were enormous cost increases. The estimated cost to complete Projects Nos. 4 and 5 rose from a combined total of approximately \$2.25 billion at the time of the preliminary estimate to a combined total of approximately \$12 billion when the projects were suspended in 1981. Almost every annual budget showed increases in the estimated cost to complete the projects, but the greatest increases were recognized in the last two

16/ An investor-owned utility purchased a 10% interest in Project No. 5. Other investor-owned utilities purchased 30% of Project No. 3.

budgets. (SEE CHART, NEXT PAGE) 17/

17/ The budget estimates of the cost for Projects Nos. 4 and 5, reflected in the chart on the next page, were:

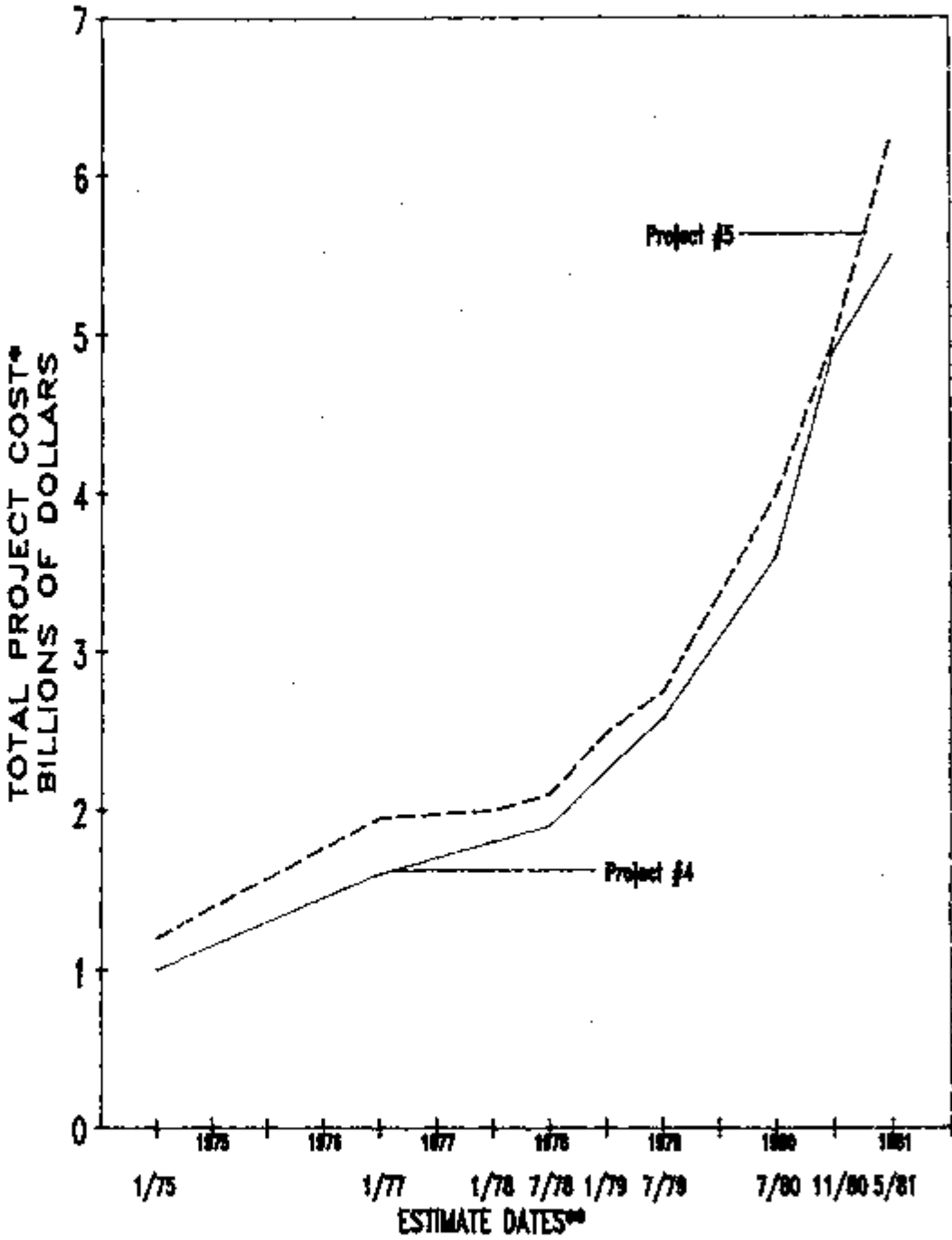
<u>Estimate</u> <u>Date</u>	<u>Cost (millions)</u>	
	<u>Project</u> <u>No. 4</u>	<u>Project</u> <u>No. 5</u>
1/75	\$1,009	\$1,210
1/77	1,610	1,951
1/78	1,870	2,018
7/78	1,915	2,129
1/79	2,251	2,492
7/79	2,580	2,753
7/80	3,614	4,002
11/80*	4,932	4,975
5/81	5,510	6,261

* undisclosed estimate (See SEC Exh. 520 and discussion in text below).

Presentation to R.L. Ferguson (October 13, 1980) (1/75 through 7/80 estimates) (SEC Exh. 493); Project Cost Summary (November 1980 estimate of cost to complete, information presented at November 16, 1980 meeting (SEC Exh. 520); Construction Budgets, 1982 Estimate at Completion, Presentation to Board of Directors (July 24, 1981) (May 1981 estimate of cost to complete) (SEC Exh. 434).

The following abbreviations are used in this Report: Testimony taken by the Commission in its investigation is cited as "SEC tr. at ___ (date)," and exhibits from the Commission's investigation are cited as "SEC Exh. ___". Some information from the private actions was considered by the staff in the investigation. Deposition testimony from the federal court proceeding is cited as "MDL tr. at ___ (date)," and exhibits from those proceedings are cited as "MDL Exh. ___". Deposition testimony from a state court action is cited as "Chemical Bank tr. at ___ (date)," and exhibits are cited as "Chemical Bank Exh. ___".

PROJECT NOS. 4 AND 5
BUDGET HISTORY



*See preceding footnote for figures.

**Estimate for 11/80 is estimate that was not disclosed, see discussion below.

The Supply System believes that the budgets it produced were the result of diligent efforts, were consistent with industry practices, and were realistic. 18/ The budgets were intended to be constrained, however, and were referred to by Supply System personnel as "tight but attainable" or "tight but achievable" budgets. 19/ The Supply System chose to have tight budgets and tight schedules because management believed that larger budget figures or longer schedules would become self-fulfilling prophecies. 20/

Although continuing construction problems caused increases in each new budget, the budgets that were produced tended to understate likely costs because of this desire to keep budgets tight. This often prevented investors from having an accurate perception of the likely costs and put the Supply System in conflict with the BPA, which had its own needs for cost and schedule information on Projects Nos. 1, 2, and 3. The budget increases in the early stages of construction were relatively

18/ See Memorandum of Washington Public Power Supply System in Response to the Staff's Proposed Recommendation That Civil Injunctive Proceedings be Instituted Against the Supply System 85-121 (Apr. 9, 1987) [hereinafter Supply System Memorandum to SEC].

19/ Id.; Frank D. McElwee SEC tr. at 50, 70-71, 86 (Apr. 2, 1985) (Supply System Manager of all the Projects).

20/ Frank D. McElwee SEC tr. at 70 (Apr. 2, 1985) ("[L]oose budgets, loose schedules were self-fulfilling. I believe in tight budgets, and tight schedules. I think the record [bears] that out"); Jerome Read SEC tr. at 59-60 (Feb. 7, 1985).

modest. Understatement in the budgets appears to have become more pronounced in the year before the Supply System management recommended a moratorium on construction of Projects Nos. 4 and 5 in May 1981, as the budgets reached a magnitude that threatened continued financing on the existing basis. The underestimate during this period is reflected particularly in the undisclosed results of a November 1980 update estimate 21/ that indicated that the budgets had grown enormously.

b. Early Practices

Even as bond sales for Projects Nos. 4 and 5 began in early 1977, the Supply System was following practices that tended to cause understatement of cost estimates for the Supply System Projects. By the middle of 1977 the Supply System was having problems maintaining the schedules and cost projections for Projects Nos. 1, 2, and 3, and the BPA held meetings with the Managing Director of the Supply System in July and September to discuss these problems. 22/ The budget and schedule procedures

21/ See discussion, infra.

22/ Letter from S. Munro to N. Strand (Jan. 31, 1978) (letter from BPA Administrator to Supply System Managing Director referring to 1977 meetings). (SEC Exh. 232.)

The BPA had a particular interest in the budgets and schedules for Projects Nos. 1, 2, and 3, because power from those projects was to become part of the BPA's electrical supply. The BPA needed accurate schedule information to make accurate forecasts of when the power from the projects would be available. The BPA also had a keen interest in the budgets because it had to plan rate increases to pay for Projects Nos. 1, 2, and 3, including interest it had to pay during construction. The BPA also had some knowledge about the projects because it had several employees at the sites
(continued...)

for those projects were the same as those for Projects Nos. 4 and 5 as the Projects Nos. 1 and 3 plants were duplicates of the Projects Nos. 4 and 5 plants, respectively. 23/

In those meetings, the Supply System advised the BPA about the Supply System's problems in meeting costs and schedules but told the BPA that there was a 50% probability of meeting the projected September 1980 completion date on Project No. 2, contingent upon an acceleration in construction progress from 1.5% of project completion per month to 2%. 24/ The BPA nonetheless requested in September 1977 that a study of the budgets and schedules be conducted to analyze the probability of meeting the projected budgets and schedules ("risk analysis") for each of Projects Nos. 1, 2, and 3. 25/

By January 1978, the increase in the construction rate projected by the Supply System had not occurred. Further, a risk analysis on Project No. 2 that had been completed in

22/ (...continued)

to help in monitoring Projects Nos. 1, 2, and 3. The Supply System maintains that policy differences and tensions between the Supply System and the BPA affected BPA's position on budget matters. Supply System Memorandum to SEC, supra, at 129-33.

23/ The projects were being constructed at the same sites, with the construction activity on Projects Nos. 4 and 5 following Projects Nos. 1 and 3 by approximately 18 months.

24/ Letter from S. Munro to N. Strand 1 (Jan. 31, 1978) (letter from BPA Administrator to Supply System Managing Director referring to 1977 meetings). (SEC Exh. 232.)

25/ Id. at 2.

December 1977 by a consulting firm hired by the Supply System at the request of the BPA showed that the probability of achieving the existing budget on Project No. 2 was only between 3% and 7% and that the most likely outcome was a budget increase of \$200 to \$300 million and a 12 to 15 month schedule slippage. 26/ The analysis was based on project performance to date, a comparison with other nuclear plants, and an analysis of the critical points in the construction program. BPA officials expressed their concern about the impact of these developments on its resource and rate planning. 27/

A second risk analysis, covering Projects Nos. 1, 2, and 3, was completed in January 1978. This analysis did not use prior experience on the projects or critical construction point analysis because Projects Nos. 1 and 3 were less advanced than

26/ Holmes & Narver, Inc. Risk Analysis (Dec. 1977). (SEC Exh. 213.)

27/ Letter from S. Munro to N. Strand 2 (Jan. 31, 1978) (letter from BPA Administrator to Supply System Managing Director):

As mentioned in our meeting we are very much concerned with the lack of progress over the past 6 months and with your consultant's risk analysis report. It is apparent to us that the current commercial operation date of September 1980 has a very low probability of being achieved.

The current costs of the three net-billed projects have a very substantial impact on our projected rate increase in 1979. Delays in the presently scheduled commercial operation dates and increased project costs will have a significant impact to BPA's resource planning and future rate studies.

(SEC Exh. 232.)

Project No. 2 and sufficient data were not available. A larger industry comparison base, however, was used for the industry comparison. That risk analysis showed a 20% chance of meeting the schedule on Project No. 1, a 0% chance on Project No. 2, and a 6% chance on Project No. 3. 28/

The person who performed the risk analyses for the consulting firm was subsequently hired as an employee by the Supply System to perform additional analyses and to develop additional industry statistics to be used in risk analyses. 29/ Since the risk analysis process was newly developed for the Supply System budgets and schedules, however, it was not initially made a formal part of the budget process. The Supply System continued its "tight but attainable" philosophy even though, as recognized by the Supply System official in charge of the projects, that approach produced budgets and schedules that had less than a 50% chance, in risk analysis terms, of being achieved. 30/

28/ Holmes & Narver, Inc., Risk Analysis of the Schedules of Hanford #1, #2, and #3 Nuclear Projects, and the Development of a Basic Industry Model (Jan. 1978). (SEC Exh. 214.)

29/ In addition to the risk analyses in December 1977 on Project No. 2 and in January 1978 on Projects Nos. 1, 2, and 3, risk analyses on Projects Nos. 1, 2 and 3 were done in January 1979 and in June 1979, and a risk analysis on Projects Nos. 1, 2, 3, 4, and 5 was done in June 1980.

30/ Frank D. McElwee SEC tr. at 71 (Apr. 2, 1985). The conflict between the appropriate probability level for management target goals in contrast to the appropriate probability level for planning financing needs was reflected in the first risk analysis, which expressly
(continued...)

Management practices with respect to the budgets occasionally resulted in conflicts between the Supply System management and the group of consultants that participated in drafting the official statements. The drafting group consisted of the Supply System's Financial Advisor, Special Counsel, Bond Counsel, Consulting Engineer, and, on Projects Nos. 1, 2, and 3 bond sales, the BPA. 31/ On one occasion, involving a Project No. 3 offering in September 1978, information about an event that would likely cause an addition to costs became known to a member of the drafting group. At a drafting session in August 1978 on the official statement for the pending bond offering, the Supply System official in charge of the projects stated that the next budget would "hold the line" on the current budget and would probably show only small increases. 32/ The Financial Advisor, however, questioned the official about the effect on the budget of the fact that the pouring of concrete for the project was to start three months later than the date in the existing schedule:

30/ (...continued)

stated that a 20% probability would be appropriate for a target budget while an 80% probability would be appropriate for a financing budget. Holmes & Narver, Inc. Risk Analysis of the Estimate and Schedule of Hanford #2 Nuclear Project 39 (Dec. 1977). (SEC Exh. 213.)

31/ For identification of the portions involved, see Part I C, supra.

32/ Memorandum from H. Spigal to H. Durocher 1 (Sept. 7, 1978) (memorandum from BPA employee assigned to represent the BPA in the official statement preparation to his supervisor). (SEC Exh. 233.)

Don Patterson [the Financial Advisor] asked why the slippage of 3 months for the WNP No. 3 concrete pour would not affect the new year's budget. McElwee [the Supply System official in charge of all the projects] said that the slippage must be analyzed in connection with the overall schedule. In addition, a 3-month slippage was not a question of disclosure, but a matter of management philosophy. McElwee stated that he did not want to slip the overall WNP No. 3 schedule and create a "self fulfilling prophecy." In response to Patterson's further questions regarding slippage of No. 3 and the impact on budgets for both WNP Nos. 3 and 5, McElwee stated that he was not saying there would be no schedule slippage, but that he did not want to take the slippage at this time. 33/

As the drafting of the official statement proceeded to its final stages in early September, the disagreement over the issue of whether the slippage on Project No. 3 should be disclosed continued. The Supply System was of the opinion that the slippage could be made up, although that would require a rate of progress greatly above the rate achieved to that time. 34/ The debate revolved around the conflict between management's desire for tight budgets and schedules to maintain control over contractors and BPA's interest in having more inclusive budgets and schedules for planning purposes. As noted by the BPA employee who supervised BPA's budget oversight and negotiated with the Supply System on this point:

33/ Id. at 1 (emphasis in original). See also Winston Peterson SEC tr. at 87-91 (Sept. 17, 1985) (testimony of consulting engineer).

34/ In his testimony McElwee did not recall the events of this incident but expressed the view that the estimates could not be made more accurately than three months in any event. Frank McElwee SEC tr. at 57-62 (Apr. 2, 1985).

On August 30 I met with Neil Strand [Supply System Managing Director], Frank McElwee [Head of all the projects] and Jim Perko [chief financial officer] to try to resolve our differences.

It is apparent that WPPSS and BPA have conflicting management philosophies with respect to the need and type of information that should be disclosed. Their [i.e., the Supply System's] view is to put off or postpone as long as possible acknowledgment of delays, because in their view it would have a counter productive impact on their management of the projects. They feel time constraints on the architect/engineer, the construction contractors, and their own staff is necessary throughout the duration of the project. That ultimately, even though there may be schedule extensions, the benefit of the time pressure will produce a lower bottom line cost.

I mentioned to Strand that that philosophy conflicts with our needs from a resource and financial planning standpoint as well as full disclosure to the investors. They acknowledge this difference in views but did not have any suggestion as to how we might resolve it. 35/

Ultimately the BPA prevailed and the official statement was changed to disclose the slippage problem and its possible impact on the schedules and cost estimates in months and dollars.

The difficulties in getting adequate disclosure in the official statements caused the principal BPA representative in the drafting group to comment to his supervisor on the deteriorating participation of certain members of the drafting group

35/ Memorandum from Thomas Wagenhoffer to Files 1 (Sept. 7, 1978) (memorandum from BPA Assistant to the Administrator, Thermal Projects, with copies to the Administrator and other BPA staff members) (SEC Exh. 586). See also Thomas Wagenhoffer SEC tr. at 27-31 (Nov. 8, 1985); Memorandum from H. Spigal to H. Durocher (Sept. 8, 1978) (SEC Exh. 585).

in seeing to disclosure. 36/ A BPA representative was not

36/ Memorandum from H. Spigal to H. Durocher 4-5 (Sept. 8, 1978) (memorandum from BPA representative on the Projects Nos. 1, 2, and 3 drafting group to supervisor):

I believe that the process for drafting official statements has changed significantly during the 2 years I have been involved.

Previously, all members of the financing group took an active role in ferreting out the information necessary to make full disclosure. WPPSS personnel who reported to the financing group regarding project construction, although not eager to pass on information unfavorable to WPPSS, did not systematically avoid revealing such facts. Through the financing group's question and answer process, the facts regarding project construction, completion dates, and costs were determined and disclosed in the official statements.

Recent experience at financing meetings is that WPPSS's bond counsel [Brendan O'Brien of Wood Dawson] is present, but says very little. Retained counsel [Bert Metzger, Jr. of Houghton Cluck] principally limits his participation to discussions of legal issues, disclosure regarding litigation, and similar matters, and avoids participating in discussions of the disclosure to be made about project construction schedules, budgets or related problems. Bert Metzger has advised me that he views his role as that of a lawyer whose obligation to provide legal advice does not extend to recommending what should be disclosed regarding project construction, schedules, or completion dates.

WPPSS's consulting engineer [Winston Peterson of R.W. Beck] has a clearer obligation to dig out the facts which should be disclosed and assure that they are appropriately disclosed. Winn Peterson is obviously uncomfortable with the level of disclosure which WPPSS's management seeks to make, and is clearly concerned about his liability for failure to make full disclosure. However, he seems reluctant to

(continued...)

present in the drafting sessions for the official statements for the Projects Nos. 4 and 5 bond sales; only the other representatives of the drafting group participated with the Supply System in drafting those official statements.

A public event that indicated that budget information in the official statement was inaccurate subsequently caused members of the drafting group to express to the Supply System concern about access to budget information. In early 1979, shortly after a preliminary official statement had been published, a news report described an adverse budget development that the drafting group had not been informed of during the official statement drafting process. Although the incident apparently involved a misinterpretation by the media, it prompted a conference call from some of the members of the drafting group to the managing director of the Supply System to express concern about the flow of information on budget matters:

36/ (...continued)

press WPPSS regarding disclosure matters. In addition, he has advised me that his only real access to information regarding project construction, budgets, and schedules is through Jim Perko, the Assistant Director for Finance. I believe that Jim Perko's access to information is limited, at best.

Only the Supply System's financial advisor [Donald Patterson of Blyth, Eastman Dillon] now takes an active and aggressive role in seeking disclosure of relevant information. Don Patterson has stated that he is concerned about WPPSS' long-term credibility in the financing marketplace.

(SEC Exh. 585.)

He [Donald Patterson, the Financial Advisor] stated that the matter [of access to cost and schedule information] had recently come to head [sic] with respect to financing for the No. 2 Project when information concerning serious problems with certain of the construction contracts for Projects 1 and 4 was not disclosed to the financial consultants but was made public after the sale and prior to the closing, where the information was of a nature which indicated that it had been known to project staff at the time the official statements were prepared. Mr. Patterson, Peterson, O'Brien and Metzger all stated they had serious concerns with the completeness and adequateness of the information flow from project staff to the financing group and indicated that serious action was called for on the part of management to correct the situation or major damage could be done to the credibility of the Supply System in its financing program with consequent serious damage to the financing program itself. 37/

Subsequently, the Supply System's budget review group was moved from the staff of the project manager to the staff of the chief financial officer, who was involved in the preparation of the official statement. 38/

37/ Memorandum from BLM to WPPSS Finance Correspondence File (Apr. 2, 1979) (memorandum of Bert L. Metzger, Jr. on March 30, 1979 conference call from drafting group to Neil Strand and James Perko) (SEC Exh. 6036); see also Winston Peterson SEC Tr. at 452-56 (Sept. 19, 1985). The author of the memorandum, Bert L. Metzger, Jr., testified that, prior to placing the telephone call, it was learned that the news report apparently misinterpreted statements by Supply System personnel. The call was nonetheless made to address increasing problems in getting the project personnel to provide information in light of their preoccupation with project demands. Bert L. Metzger, Jr. SEC tr. at 1964-69 (Nov. 6, 1986).

38/ James Perko MDL tr. at 298-301 (June 4, 1985); Bert L. Metzger, Jr. SEC tr. at 1968-69 (Nov. 6, 1986). Also, Winston Peterson of R.W. Beck, the consulting engineer,
(continued...)

In the beginning of 1979, the Supply System publicly announced schedule extensions for all five projects. 39/ It appears that Supply System management had initially sought to minimize disclosure of the extensions by recognizing only a portion of the extensions at that time and disclosing the rest at a later date. 40/ Ultimately the schedule extensions that were announced were within the general range of a 50% probability

38/ (...continued)

became more involved in the Supply System budget matters: Winston Peterson MDL tr. at 1722 (Oct. 17, 1985); Bert L. Metzger Jr. SEC tr. at 1969 (Nov. 6, 1986).

39/ The completion dates were extended 12 months for Project No. 1; 9 months for Project No. 2; 11 months for Project No. 3; 12 months for Project No. 4; and 11 months for Project No. 5. Washington Public Power Supply System 1980 Project Construction Budgets.

40/ Memorandum from T.V. Wagenhoffer to R. Foleen 2 (Dec. 22, 1978) (memorandum from BPA Assistant to the Administrator and head of the BPA's oversight team to BPA Deputy Administrator):

McElwee [The Supply System official in charge of all the projects] plans to present the Holmes & Narver analysis to the Executive Committee on December 29. He hopes to receive some direction from the Executive Committee on how to address the disclosure of the delays. He mentioned that the staff will be preparing a bond statement for WNP-4&5 during the week of January 2, and that the disclosure of the delays will have to be addressed at that time. He suggested that the Holmes & Narver 10 to 20 percent probability schedule delays be used. This would acknowledge about 50 percent of the delays estimated by both Holmes & Narver and the WPPSS staff. He then proposed that the remaining delay and cost be included in the Fiscal 1980 budget which is due in June 1979.

(SEC Exh. 218.)

of achievement, as reflected in the risk analysis performed at that time. Some budget increases were also recognized as a direct consequence of the schedule extensions. 41/ The fiscal year 1980 budget, prepared in the Spring of 1979 and effective July 1, 1979, was based on the schedule revisions of January 1979. The new cost calculations, however, resulted in higher budget figures than those recognized in January. 42/ It appears that, again, Supply System management initially intended to use budget figures that, under a risk analysis, had less than a 50% probability of achievement, but was induced by the BPA to increase the budgets to a 50% probability. 43/

The fiscal year 1980 budgets were quickly shown to be inadequate. During the balance of 1979 through early 1980,

41/ The total financing cost increased from approximately \$8.7 billion to \$10.2 billion for all five projects and from \$4 billion to \$4.6 billion for Projects Nos. 4 and 5.

42/ The total financing costs for all five projects increased to approximately \$11.5 billion and to \$5.2 billion for Projects Nos. 4 and 5.

43/ Letter from S. Munro to N. Strand 2 (June 12, 1979) (letter from BPA Administrator to Supply System Managing Director):

During a budget review meeting on May 23, my staff was informed that the budget estimates were based upon a 30 percent or less probability level and the project schedules were based upon a 50 percent probability. At the time, we questioned the appropriateness of having both the budget and schedule based upon different probability levels. It is my understanding that all costs and schedules now have been revised and are based on a 50 percent probability.

(SEC Exh. 600); see also Thomas Waggenhoffer SEC tr. at 30-33 (Nov. 8, 1985).

likely increases in costs and likely schedule extensions were identified within the Supply System. 44/ Continuing budget and schedule problems were taking on critical importance to Projects Nos. 4 and 5 because the increasing budgets were becoming a concern to the financial community. 45/

c. Fiscal Year 1981 Budget

The fiscal year 1981 budget, to become effective on July 1, 1980, was prepared in the first half of 1980. For this budget cycle, there was a change in the risk analysis. Up to this time the risk analyses had been based largely on analysis of statistical information. The risk analysis for the fiscal year 1981 budget also involved, for the first time, an intensive effort to obtain evaluations of the reliability of the cost estimates in meetings with the project personnel who created the

44/ See, e.g., Supply System Budget Review Meeting Minutes.

45/ For example, the Moody's rating service report on the August 1979 sale of Projects Nos. 4 and 5 bonds noted in the introductory opinion section of that report, for the first time:

Causes for concern, however, continue to be the higher construction estimates with the resultant impact on additional financing and ultimate higher costs to the participants. Supply System's ability to maintain construction schedules and to contain future cost increases become more significant factors for subsequent evaluations of this enterprise.

Moody's Investor Services, Inc., Municipal Credit Report - Washington Public Power Supply System-Nuclear Projects Nos. 4 and 5 at 1 (Aug. 22, 1979). (SEC Exh. 2323.)

estimates. 46/ The fiscal year 1981 risk analysis involved, in essence, having the persons who had produced the budgets revisit them to assess the likelihood of meeting the budgets. 47/ This risk analysis indicated only a low probability that the budgets would be met. 48/ The Supply System management reviewed the risk

46/ Jeremy Maidment SEC tr. at 105-08 (Aug. 21, 1984). Washington Public Supply System, Risk Analysis of WPPSS Nuclear Projects 1, 2, 3, 4, and 5, at 4 (June 1980):

Since it [the risk analysis on the previous budget] was the first time that this technique [risk analysis] had been used in the Supply System [formal budgets], it was only conducted with senior management at a very limited overview level. It helped to highlight the fact that the base 1980 budgets were significantly underestimated but not to the extent that has now become apparent with more detailed analysis.

This year the members of the Financial Management Controls Division who are responsible for this analysis were present at all project budget reviews so as to build up a background on which to base the final profiles. These profiles were ultimately developed at some 80 hours of open sessions. The participants involved were the estimators and engineers directly responsible for the base figures, senior project and staff management, A-E personnel, BPA representatives, and the staff members conducting the analysis. The profiles finally arrived at constitute a technical consensus of all participants involved.

(SEC Exh. 216(a).)

Also, the risk analysis covered all five projects for the first time.

47/ Jeremy Maidment SEC tr. at 105-08 (Aug. 21, 1984).

48/ Washington Public Power Supply System, Risk Analysis of WPPSS Nuclear Projects 1, 2, 3, 4, and 5, charts 7-12 (June 1980). (SEC Exh. 216(a).)

analysis results and decided to add a small additional amount to the budget contingency category so that the budgets would have an overall probability of approximately 20%. 49/ The total budget at this level of probability was \$15.9 billion for the five projects. 50/ To get the budget to the 50% probability level would have required the addition of a total of approximately \$1.5 billion to the budgets for the five projects. 51/

The Supply System management stated that the risk analysis was only a tool to help evaluate the budgets and, in light of the budget increases and the substantial contingency allowance already in the budget, it decided that further increases to the contingency allowance to bring the budgets to 50% on the risk

49/ James Perko SEC tr. at 345-47 (Oct. 18, 1985).

50/ Even at the relatively low probability level of 20%, the budgets showed sharp increases. The total financing requirements for all five projects increased from approximately \$11.7 billion to \$15.9 billion. The budget was accompanied by schedule extensions of 18 months for Project No. 1, 16 months for Project No. 2, 18 months for Projects No. 3, and 12 months for Projects Nos. 4 and 5. The completion date extensions for Projects Nos. 4 and 5 were less than for their twin plants, Projects 1 and 2, because the Supply System decided to reduce the projected separation time between the two projects from 18 months to 12 months. The completion date changes had been adopted in April 1980 in connection with the initial stages of the budget preparation process. Washington Public Power Supply System, 1981 Project Construction Budgets.

The budgets, moreover, expressly did not include amounts for several major developments, including an ongoing strike that had shut down construction at Projects Nos. 1, 2, and 4, the impact of a crane collapse that had interrupted work on Projects Nos. 3 and 5, and several other matters. Minutes of Board of Directors Meeting 5 (July 25, 1980).

51/ Risk Analysis (June 1980), supra, Chart 12 (SEC Ex. 216(a)); James Perko SEC tr. at 345-347 (Oct. 18, 1985).

analysis was not warranted. 52/ The budget decided upon by management at the 20% probability level was consistent with management's "tight but attainable" budget philosophy. 53/

Some were concerned by the use of a lower than 50% risk analysis probability for the fiscal year 1981 budget. The person representing the City of Seattle on the Board of Directors expressed this concern when the Board was voting on the budgets for all the projects, and he abstained from the vote on approving the budgets as estimates of costs to complete the projects. 54/ The BPA was also concerned about using a contingency allowance that was less than the 50% risk analysis amount. It informed the Supply System that it would use project costs on Projects Nos. 1, 2, and 3 corresponding to 50% probability for its rate calcula-

52/ James Perko SEC tr. at 345-347 (Oct. 18, 1985); Lindy Sandlin SEC tr. at 41-42 (Aug. 21, 1985).

53/ Frank McElwee SEC tr. at 86 (Apr. 2, 1985).

54/ Minutes of the Board of Directors Meeting 8-9 (July 25, 1980). See also memorandum from Dean Sunquist to Joe Recchi Re WPPSS Budget Review Meetings July 1 and 2, 1980 at 5 (July 8, 1980) (Seattle City Light internal memorandum regarding July 1 and 2, 1980 Supply System budget review meeting):

I personally have a problem with accepting a budget which has only a one in five probability of achievement. However the WPPSS staff presents various and asundry [sic] reasons for this approach. Jim Perko always cautions against negative impacts, on the bond market, which inflated budgets could produce.

tions. 55/ The BPA also noted that, because of the potential understatement of the budgets, uncertainties caused by the ongoing strikes, and other matters that had not been included in the budget, a mid-year review of the budget probably would be necessary. 56/

The official statement for the first bond offering after the fiscal year 1981 budget figures were available, a projects Nos. 4 and 5 offering, did not disclose that the risk analysis indicated a low probability that the budgets would be achieved

55/ Letter from S. Munro to N. Strand 2 (July 23, 1980) (SEC Exh. 575.) (letter from BPA Administrator to Supply System Managing Director):

An area of serious concern to us is the change of assumptions on the use of the risk analysis for this year's budget. You have chosen to include amounts in Potential Exposure which reduce the probability of achievement to a range of 10 to 25 percent rather than the midrange 50 percent probability used last year. Because of this, your 1981 budget representing costs to completion has a high probability of being understated. We believe it to be more realistic to use project costs for our rate studies which are based on the 50 percent probability and are higher by an aggregate of \$715 million than your budgeted project costs for WNP-1, 2, and 70 percent of WNP-3.

56/ Id. at 3:

To summarize our position on the 1981 Updated Construction Budgets, we have listed a number of concerns which we believe are significant It is also our belief that because of the many uncertainties and the potential understatement of project costs, it is likely a mid year review will be necessary.

for those projects. 57/ Disclosure of the low probability of the budgets was not made until the next offering, in August, 1980. That offering was a Project No. 1 offering, in which BPA was involved. The BPA wanted disclosure of the risk analysis probability and a brief text reference then was made to the low probability of the budgets. 58/

57/ Official Statement for \$180,000,000 Washington Public Power Supply System Generating Facilities Revenue Bonds, Series 1980B (Nuclear Projects Nos. 4 and 5) (July 15, 1980) (using the fiscal year 1981 budget figures, which were expected to be adopted formally by the Board of Directors shortly).

58/ James Perko SEC tr. at 363-64 (Oct. 18, 1985). The reference in the official statement was:

After estimates of the construction costs have been prepared by the construction engineer and Supply System staff responsible for estimating costs of a specific project, such costs are independently assessed by the Supply System's finance staff. As part of such independent assessment the Supply System applies risk analysis techniques to the construction engineers' and Supply System staff's estimates to determine the probability of constructing the projects within these estimates. To the extent deemed necessary, the Supply System established additional owners' contingencies to enhance this probability in preparing the 1981 project construction budgets. The Supply System increased the cost estimates so as to bring the probability to approximately 25%. In considering the methodology utilized in the risk analysis for the 1981 project construction budgets, the Supply System considers the use of a 25% probability factor to be appropriate.

Official Statement for \$210,000,000 Washington Public Power Supply System Generating Facilities Revenue Bonds Series 1980A (Nuclear Project No. 1) 13-14 (Aug. 5, 1980). This statement was then included in the next Projects Nos. 4 and 5 official statement for a September 1980 bond sale.

d. The November 1980 Estimates

In early August 1980, Robert L. Ferguson ("Ferguson"), the new Managing Director for the Supply System, arrived at the Supply System. 59/ At the time of Ferguson's arrival ongoing strikes had shut down work on three of the projects, and a crane accident had disrupted work on the two other projects.

An indication of possible budget and finance problems was provided to him even before he arrived. After he had been selected as the Managing Director in June, 1980, Ferguson requested that senior officials at the Supply System prepare short summaries of the major issues in the areas under their control for his review. The single sheet summary prepared for Ferguson by James Perko, the chief financial officer of the Supply System and the supervisor of the budget review officials, set forth a table of the Supply System's financing needs based on the fiscal year 1981 estimates that had just been made and noted:

This [financing] program [based on the fiscal year 1981 budget] represents the largest municipal financing program in the United States. The current status of project progress would conclude that additional slippages and cost increases will occur, increasing the above requirements perhaps as much as 25-40%. 60/

59/ Neil Strand, the preceding Managing Director, had resigned in February 1979, but remained until a new Managing Director had been selected.

60/ Memorandum entitled Major Issues and Concerns (SEC Exh. 566). See also James Perko SEC tr. at 336-44 (Oct. 18, 1985). Ferguson testified that he received summaries before he arrived pursuant to his request and probably read this summary but he could not specifically recall having read it. Ferguson SEC tr. at 206-53 (June 27, 1985).

After Ferguson arrived at the Supply System he received a briefing on the budget by James Perko and his staff on August 26, 1980. In the briefing, Perko informed Ferguson of the 20% probability of the fiscal year 1981 budget as reflected in the risk analysis. 61/ The concept of a mid-year review, requested by the BPA, was also presented. 62/ Ferguson had already been advised in an introductory meeting with the BPA that it desired a budget update. 63/

On October 13, 1980, Ferguson was more fully briefed on the 1981 budget. The briefing was conducted by Perko and two other top budget officials. Again the risk analysis and the use of a 20% probability factor for the 1981 budget were discussed. 64/

61/ Presentation to Robert L. Ferguson Managing Director (Aug. 26, 1980). (SEC Exh. 487.)

62/ Id.; James Perko SEC tr. at 386, 388-92 (Oct. 18, 1985). The written Presentation outlined a "Streamline Review Effort" concentrating on major variables from the 1981 budget and on conducting a risk analysis.

63/ Robert L. Ferguson SEC tr. at 19-26 (June 26, 1985).

64/ Presentation to: Robert L. Ferguson, Managing Director 1981 Budget Preparation (October 13, 1980) 31-36 (SEC Exh. 493); Lindy Sandlin SEC tr. at 60-63 (Aug. 21, 1985). The staff was under the impression that Ferguson understood and basically agreed with the use of risk analysis in general, but desired a more detailed briefing on its use at the Supply System. Notes by J. Read entitled Action Items, October 13, 1980 Meeting with R.L. Ferguson:

R.L. Ferguson understands methodology of risk analysis; has used the general approach and basically agrees. He believes our problem is in the manner of presentation. A more detailed briefing on risk analysis might be helpful.

(continued...)

Satisfying the BPA's concerns about the low probability factor of the 1981 budget without upsetting the financial community was also addressed. 65/

During the first few days of November 1980, the strike at Projects Nos. 1, 2, and 4 ended. 66/ The Supply System understood that the scheduled distribution of an official statement in late November for a Projects Nos. 4 and 5 offering required disclosure about the current status of the budget. On November 5, 1980, Ferguson met with senior staff personnel. The meeting focused on the budget and whether a new budget that Ferguson could endorse as his first budget could be produced at this time. 67/ The issue of a budget update as requested by the BPA also needed to be addressed, particularly in light of the

64/(...continued)

(SEC Exh. 502.)

Lindy Sandlin SEC tr. at 66-67 (Aug. 21, 1985). Ferguson testified that based on his prior negative experience with risk analysis he was never interested in risk analysis as it applied to the Supply System budgets. Robert Ferguson SEC tr. at 19, 63 (June 26, 1985).

65/ Action Items, supra, (SEC Exh. 502):

Develop the various scenarios [sic] that would satisfy BPA's concerns without upsetting the financial community until we get a handle on the budget. Get all the numbers down considering prior budget omissions, new items/impacts (labor problem) and additional contingency.

66/ Jerome Read SEC tr. at 365-88 (Feb. 8, 1985); Robert Ferguson SEC tr. at 50 (June 26, 1985).

67/ James Perko SEC tr. at 413-14 (Oct. 18, 1985).

BPA's use of 50% risk analysis probability in its rate calculations.

Budget personnel had compiled figures reflecting the budget impact of certain specific items, including the just-ended strike, recent contract trends, the amount needed to raise the risk analysis probability to 50% in the fiscal year 1981 budget, and certain other developments. These figures showed a "total projected increase" for the costs to complete all five projects of almost \$3 billion over the fiscal year 1981 budget. Roughly half the increase was to raise the 1981 budget to a 50% probability. 68/ The projection was discussed during the November 5, 1980 meeting between Ferguson and the senior staff. 69/ One issue considered in the meeting was whether to recognize the \$3 billion budget increase or to split the increase and publicly acknowledge part then and part later. 70/ Immediately after the meeting, a key aide to the chief finance officer in the bond offering process, who had attended the meeting, prepared an analysis of budget disclosure options for

68/ Chart entitled Update of June 1980 Risk Analysis (Nov. 5, 1980) (SEC Ex. 229(a)); Jerome Read SEC tr. at 379-88 (Feb. 8, 1985); Lindy Sandlin SEC tr. at 78-83 (Aug. 21, 1985).

69/ James Perko SEC tr. at 415-16, 420 (Oct. 18, 1985).

70/ James Perko SEC tr. at 415-16 (Oct. 18, 1985):

There were some things said in that meeting that, at the particular time, I did not -- that went against what I believed in terms of disclosure, especially people saying, "Hey, if it's a \$3 billion increase, we'll take a billion and a half now and a billion and a half in six months."

the chief finance officer's consideration. 71/ The analysis reviewed the options on disclosing the \$3 billion figure, including the advantages and disadvantages of splitting the disclosure and the harm to the financing program that disclosure of the full amount could cause. 72/ The chief financial officer

71/ Handwritten notes entitled 1982 Budget Strategy ["Notes"] (SEC Exh. 494); Stephen Buck SEC tr. 448-49 (Oct. 10, 1985); James Perko SEC tr. at 424-429 (Oct. 18, 1985).

72/ Notes, supra, (SEC Exh. 494). The notes read in part:

1982 BUDGET STRATEGY

3 BILLION COST INCREASE

"NOW MEANS NOVEMBER 19 or 20" [the date of the scheduled rating agency and financial community meetings on the upcoming Projects Nos. 4 and 5 bond sale]

WHY STEP FUNCTION THE COST INCREASES VERSUS ALL NOW?

* * * *

- ° PERCEPTION THAT FINANCIAL MARKETS WILL IMPROVE IN EARLY 1981 FROM THE CURRENT LEVELS - BREAK NEWS IN BETTER MARKETS
- ° POSTURE OF RATING AGENCIES, ESPECIALLY S&P RELATIVE TO COST INCREASES - THREAT OF DOWNGRADING # 4/5 BONDS

* * * *

- ° IF WE ARE DOWNGRADED - WILL WE LOSE MARKET ACCESS BECAUSE WE DON'T YET HAVE: (1) NEGOTIATION OR (2) BALANCED FINANCING PROGRAM? [two changes to financing methods awaiting approval]
- ° IF WE HAVE (1) AND (2) ABOVE, AND
(continued...)

was troubled about splitting disclosure. He felt that the senior management, many of whom were unfamiliar with investor financing, did not understand their disclosure obligations. After the November 5, 1980 meeting, he met with Ferguson and told him that if the budget increase was going to be \$3 billion, the full amount must be disclosed. 72/ Ferguson then instructed the

72/ (...continued)

WE ARE DOWNGRADED, PERHAPS WE
WOULD STILL HAVE MARKET ACCESS!

IF NO MARKET ACCESS (EVEN FOR A
SHORT PERIOD OF TIME) MAY BE
FORCED TO CURTAIL, SUSPEND OR
TERMINATE ONE OR MORE PROJECTS DUE
TO LACK OF CASH!

* * * *

HAZARD TO THIS WHOLE POSTURE:

TREASURY ARGUES FOR "TOTAL
DISCLOSURE", "CREDIBILITY IN
MARKETPLACE", "FREE FLOW OF
INFORMATION" AND YET THEN
CONSIDERS NOT TELLING THE WHOLE
STORY NOW FOR "MARKETING
CONSIDERATIONS".

COULD BE PERCEIVED AS THOUGH
TREASURY IS PROPOSING TO BREAK ITS
OWN "CARDINAL RULES"!

73/ James Perko SEC tr. 416 (Oct. 18, 1985):

I told Mr. Ferguson that what the -- you know, if he knew the budget was going to be \$3 billion, he had to announce that, now. That was the -- simply the disclosure rules that he had to follow, that the important thing was that it had to be right. . . and in conformance with the rules that we were operating under.

Supply System staff to make an all-out effort to quickly review the entire budget. 74/

The senior budget officials to whom the task was assigned understood that their charge was to develop the best current assessment of the budget that could be developed in the short period of time available. 75/ The head of budget reviews used a budget estimate method that utilized risk analysis. 76/ The headquarters budget personnel met with senior management at each project site during the week of November 9, 1980. Changes in major budget items were identified with project personnel at the sites and were evaluated by asking the project personnel to give

74/ Id. at 416-17:

After some discussion along those lines, he did commit to do it right, quote, right. And he, at that time -- I don't know whether it was at that meeting or in the next day or two, he got the staff together, again, said, "I'm going to cause to have happen in the next week an extensive review," and he really put a burden on Mr. Sandlin and his program directors to go out and conduct a most thorough analysis that they possibly could and work in 20 hours a day for six or seven days, straight.

75/ Lindy Sandlin SEC tr. at 83, 86 (Aug. 21, 1985). Jerome Read SEC tr. at 395, 398 (Feb. 8, 1985):

To the best of my recollection the overall purpose would have been for the senior people involved in the activities of the projects to review schedule and cost status, and provide to Mr. Ferguson all facts as they saw them, given the shortness of time, and to come back with, you know, appropriate supporting information regarding the schedules and the estimates. (at 395)

76/ Lindy Sandlin SEC tr. at 83, 86 (Aug. 21, 1985).

their assessments of the probabilities of the costs. 77/ The on-site personnel were told that the goal of the process was to produce the best estimates possible for public disclosure. 78/ Senior officials for each of the projects met that weekend to review the results. 79/

77/ Jerome Read SEC tr. at 389-91, 438-39 (Feb. 8, 1985); Project Schedules/Estimate Evaluation (Nov. 10, 1980) (Jerome Read outline of procedures to be used.) (SEC Exhs. 503, 504); Lindy Sandlin SEC tr. at 86-88 (Aug. 21, 1985); Jeremy Maidment SEC tr. at 17-24, 30-33 (Sept. 12, 1985).

78/ Memorandum by B. J. Casey 1 (Nov. 13, 1980) (memorandum by a senior official for Ebasco Services, Inc., the firm managing construction on Projects Nos. 3 and 5):

On November 11, 1980, a meeting was held to review the WNP-3/5 Project Budget. Ebasco was advised to participate in the meeting by the attached memorandum. The meeting was attended by F.D. McElwee, L.S. Sandlin, J.P. Maidment and W.A. Yatch from the Supply System's Richland Office. In addition, there were various attenders from the Supply System's and Ebasco's Site Office staffs.

Mr. McElwee [Supply System manager of Projects Nos. 3 and 5 at that time] set the tone for the meeting. He stated that Mr. Ferguson would be meeting with Moodys and Standard and Poors [rating agencies] next Tuesday in New York. The objective was, to start today and complete by Sunday evening a review of all five project estimates, to enable Mr. Ferguson to have the best possible estimates for his meetings with the bond rating people.

(SEC Exh. 91). Bernard Casey SEC tr. at 70-75 (July 18, 1984).

79/ Jerome Read SEC tr. at 441, 442-50 (Feb. 8, 1985); cost summary documents compiling the budget and schedule results (SEC Exhs. 514, 515 and 516); Lindy Sandlin SEC tr. at 93-95 (Aug. 21, 1985).

This process produced a budget estimate of \$20.440 billion for all five projects, an increase of \$4.491 billion over the \$15.949 billion fiscal year 1981 budget. 80/ Schedule slippages were estimated at 15 months for Project No. 4 and 6 months for Project No. 5. 81/

80/ Compilation of results, 1 (SEC EX. 520):

PROJECT COST SUMMARY
(\$ in Millions)

	<u>1981 Budget</u>	<u>11/80 Estimate</u>	<u>Variance</u>
WNP-1	2,736	3,589	853
WNP-2	2,467	3,062	595
WNP-3	3,130	3,882	752
WNP-4	3,614	4,932	1,318
WNP-5	<u>4,002</u>	<u>4,975</u>	<u>973</u>
Total	15,949	20,440	4,491

Jerome Read SEC tr. at 456-57 (Feb. 8, 1985).

81/ Compilation of results, 2 (SEC Exh. 520):

SCHEDULE:

	<u>C.O. [commercial operation] Date</u>	<u>Months Slippage</u>
WNP-1	6/86	12
WNP-2	3/84	14
WNP-3	9/86	3
WNP-4	9/87	15
WNP-5	12/87	6

Jerome Read SEC tr. at 456-57 (Feb. 8, 1985).

Bechtel Power Corporation, which Ferguson hired to assist him in evaluating the projects and which then became responsible for some of the projects, participated in the review sessions and prepared its own schedule evaluations
(continued...)

The results of the update were presented at a Sunday meeting at the Supply System headquarters on November 16, 1980. The meeting was attended by the senior Supply System officials and architect-engineers for each of the projects, Supply System budget and finance personnel, personnel from a recently retained construction management firm, a representative from R.W. Beck (the consulting engineer), and a representative from the BPA. 82/ The data from the update process were presented by the budget officials. 83/ An estimate similar to that discussed in the November 5, 1980 meeting, described above, was also presented. 84/

The project officials and others commented on the results of the \$20.4 billion update estimate done over the preceding week, and the person who formulated the risk analysis was called

81/(...continued)

based on their experiences on other nuclear power plant projects. Frank Waterhouse SEC tr. at 113-41; Jerome Read SEC tr. at 393, 394, 425-33 (Feb. 8, 1985); Jerome Read notes, page number stamped 114350 (SEC Exh. 512). Although Bechtel apparently did not produce comprehensive results, the compilation of the Supply System budget update results contains a reference to a Bechtel schedule slippage range. SEC Exh. 520 at 4 ("Bechtel Schedule Slippage Range for Unit #1 - 11 Months to 24 Months"); see also Jerome Read SEC tr. at 471-73 (Feb. 8, 1985).

82/ Lindy Sandlin SEC tr. at 99-102 (Aug. 21, 1985).

83/ Lindy Sandlin SEC tr. at 102-03 (Aug. 21, 1985); compilation of results, supra, (SEC Exh. 520).

84/ Lindy Sandlin SEC tr. at 111-14 (Aug. 21, 1985).

upon to describe the risk analysis process. 85/ Some of the project managers expressed reservations on the limited time for reviewing the results. 86/ Ferguson asked questions about the update process. 87/ The staff responsible for the estimate told Ferguson that this was their best effort and that if they had to adopt a new total budget figure they would focus on this number, although, in light of the limited time that had been available, they couldn't be confident of the figure. 88/ Ferguson stated

85/ Lindy Sandlin SEC tr. at 99-100 (Aug. 21, 1985); Jerome Read SEC tr. at 478 (Feb. 8, 1985).

86/ Sandlin SEC tr. at 99 (Aug. 21, 1985).

87/ James Perko SEC tr. at 461 (Oct. 18, 1985).

88/ James Perko SEC tr. at 457-58 (Oct. 18, 1985):

Q. Well, what did the [budget staff] presentors say that this 11-80 estimate [of \$20.4 billion], here, on the first page of 520 represented?

A. I think they represent -- I believe that they said in the week or so that they had or [-] this was Mr. Sandlin's and his staff working with the Project people, that if they had to buy into an '82 budget increase in November '80, that with the knowledge that they had, a week to do it, that that was a number that they probably would be keying in on
....

Lindy Sandlin SEC tr. at 110-111 (Aug. 21, 1985):

And to the best of my recollection, I had to tell him [Ferguson] that based on the complexity of it and based on the time frame, that I did not have a lot of confidence in that [\$20.4 billion] number; however, I had done my best. So he had -- he was trying to get his arms around these

(continued...)

that he did not find this to be a satisfactory basis for a new fiscal year 1982 budget and that he would use a different method for the fiscal year 1982 budget. 89/ He adjourned the meeting to take up the matter at a smaller meeting the next day. Ferguson instructed the persons present to keep information discussed at the meeting confidential. 90/

A meeting the next day was attended by a limited number of Supply System officials and others. 91/ Ferguson pressed the

88/ (...continued)

five units, and I tried -- as I pointed out to him -- tried to respond as best I could in the different ways that the estimate and schedule could be looked at until such time as his requirement of the bottoms-up [budget] be done by Bechtel and Ebasco.

89/ James Perko SEC tr. at 451-52 (Oct. 18, 1985); see also Lindy Sandlin SEC tr. at 116-17 (Aug. 21, 1985).

As discussed below, the Supply System management was aware of other adverse developments, including financing problems and Participants' Committee reactions to a new financial proposal, including a request from the Participants' Committee for a study of the consequences of slowing down or terminating the Projects, that might have been made worse by the disclosure of the November 1980 budget update estimate.

90/ Frank McElwee SEC Tr. at 129-130 (Apr. 2, 1985):

Bob Ferguson made a statement near the close of that meeting that he would summarily fire anyone who prematurely disclosed anything out of that meeting, and I took that to mean that if anything were taken out of context from that meeting, and I never heard the matter further discussed.

See Winston Peterson SEC tr. at 145-46, 153-55 (Sept. 17, 1985); Robert Ferguson SEC tr. at 531 (July 25, 1985).

91/ Lindy Sandlin SEC tr. at 118-19 (Aug. 21, 1985) (Sandlin recalls Ferguson, Squire, Perko, himself and Peterson of
(continued...))

head of budget reviews about his relative degree of confidence in the different estimates, including the estimates discussed earlier at the November 5, 1980 meeting. The head of budget reviews told Ferguson that he had the most confidence in the estimates of the costs limited to the direct impact of the strike, the crane collapse, and several smaller specific developments, which had constituted a portion of the \$3 billion estimate discussed at the November 5, 1980 meeting. 92/

Ferguson announced that he rejected the use of the risk analysis in the budget process. 93/ He then instructed the budget review staff to prepare cost figures limited to estimates of the direct impact of certain known events. 94/ The budget review staff estimated the costs of the specific developments to be \$1.379 billion. 95/ Most of these developments had been excluded from the fiscal year 1981 budget, and thus the cost

91/ (...continued)

R.W. Beck and Lewis of BPA as attendees). Project directors were called into the meeting as the different projects were discussed.

92/ Id. at 119.

93/ Id.

94/ Lindy Sandlin SEC tr. at 119, 136-37 (Aug. 21, 1985); Jerome Read SEC tr. at 478-84 (Feb. 8, 1985).

95/ The increase included amounts for the strike at Projects Nos. 1, 2 and 4 (\$707 million); accidents at Projects Nos. 3 and 5 (\$249 million); changes in interest rate assumptions (\$223 million); pay increases caused by new labor contracts (\$111 million); additional capitalization of nuclear fuel reload (\$91 million); and a reduction of \$2 million for training simulator. (SEC Ex. 229 at 2, 3); Lindy Sandlin SEC tr. at 123 (Aug. 21, 1985); Jerome Read SEC tr. at 469-91 (Feb. 8, 1985).

estimate was not an estimate of escalation of the 1981 budget. The increase of \$4.491 billion, in contrast, was not limited to specific events but estimated for changes in the entire budget.

On November 21, 1980, Ferguson reported the \$1.379 billion cost estimate for the specific developments to the Executive Committee of the Board. In a prepared statement delivered to the Executive Committee, Ferguson said:

With the resolution of the Hanford labor dispute, the Supply System has undertaken a study of factors which will additionally impact the 1981 budget. During the past two weeks, Supply System personnel have conducted a detailed review of the five projects now underway to identify these known additional costs. As you may recall, I previously committed to provide you with a midyear assessment of the 1981 budget. This evaluation completes that commitment. 96/

No mention was made of the \$4.4 billion overall budget estimate, the result of the only "detailed review" that had been done during the preceding two weeks. A November 24, 1980 Supply System press release also gave the \$1.379 billion as the costs increase without disclosing the \$4.4 billion increase estimate. 97/

96/ Robert Ferguson's Statement at Executive Committee Meeting, 1 (Nov. 21, 1980) (SEC Exh. 557); Robert Ferguson SEC tr. at 84-85 (June 26, 1985).

97/ News Release No. 80-68 (Nov. 24, 1980). (SEC Exh. 230.) The Washington State Senate Committee was conducting an investigation of the Supply System at this time (resulting in a published report in the Spring of 1981), including the costs of the projects. In response to a letter sent by the Committee staff the day after the press release, the Supply System referred to \$1.379 billion increase and to consideration that had been given to doing a review of
(continued...)

The official statement for the pending Projects Nos. 4 and 5 bond sale, which had triggered the need for an updated estimate, disclosed the \$1.379 billion costs for specific developments and stated that preparations for the fiscal year 1982 budget had begun. 98/ The official statement set forth the

97/(...continued)

schedules and budgets without revealing that an estimate actually had been completed or its amount:

Upon conclusion of the Hanford labor strike and in preparation for information meetings pertaining to an upcoming bond sale for WNP-4/5, Mr. Ferguson directed the staff to conduct an immediate review of the project schedules and estimates. Because of their recent involvement with WNP-1, 2 and 4, Bechtel Power Corporation was asked to assist the WPPSS staff in the evaluation of these projects.

After a brief review, it was concluded that substantially more time and effort would be required in order to provide meaningful results. In lieu of a more in-depth evaluation, which time would not allow, the WPPSS staff was then directed to identify any known additions to the 1981 budget. The staff's working papers for this study which resulted in the \$1.379 billion announced at the Executive Committee Meeting of November 21, 1980 are enclosed for your information.

Letter from Al Squire to Terry Husseman (Dec. 1, 1980) (letter from Supply System Deputy Managing Director to Chief Counsel, Washington State Senate Energy Utilities Committee Staff).

98/ Official Statement for \$200,000,000 Washington Public Power Supply System Generating facilities Revenue Bonds, Series 1980D&E (Nuclear Projects Nos. 4 and 5) 24 (Dec. 19, 1980):

A detailed analysis of the construction budgets has begun and will take several months to complete. This analysis will be used in the preparation of the 1982 project

(continued...)

fiscal year 1981 budget without disclosing that an overall budget estimate had been prepared that indicated a \$4.4 billion increase in that budget. Also, the reference in previous official statements to the low probability reflected in the June 1980 risk analysis was deleted.

Although the budget update estimate had been prepared in a short time, it was based on the latest information available from those responsible for the projects. The management of the projects was aware that the purpose of the new estimate was to produce information to be disclosed in connection with the next bond sale. Moreover, the fiscal year 1981 budget had been prepared in the Spring of 1980, and it was unlikely, particularly given the history of the projects, that cost increases over that budget beyond those attributable to the specific developments reflected in the \$1.3 billion increase had not occurred since the time that budget was prepared. ^{99/} Thus,

98/(...continued)

construction budgets. During the detailed analysis procedure, factors may be identified that would require adjustments to the schedules and costs in addition to those identified above.

99/ See, e.g., Dale Dobson SEC tr. at 37-38 (Aug. 27, 1984) (testimony of a Supply System official who had become Project manager at Projects Nos. 3 and 5 in August 1980):

I was serving in the role of the Project Manager. My major efforts were to attempt to perform against the budget and within the budget. It was a management tool. I am aware that in the fall of 1980 and early 1981 there was a great deal of concern with regard to Units 3 and 5, because we were not

(continued...)

even though the estimate might not have been appropriate for a new formal fiscal year 1982 budget, it was a reasonable indication that the fiscal year 1981 budgets set forth in the official statement were substantially understated. Moreover, the estimate was not revealed to some members of the official statement drafting group, which was responsible for evaluating the need for disclosure of information, including the lawyers and the Financial Advisor. 100/

99/ (...continued)

performing within the budget at all.

We were slipping the schedule and spending, I believe, over that budget. So most of the conversation had to do with the perception that barring a dramatic improvement in the performance, the budget -- or there was a low probability that we would achieve the budget and the schedule.

The fiscal year 1981 budgets had excluded the costs of the strikes and the crane collapse that constituted most of the \$1.379 billion additional costs announced in November. Thus those costs did not reflect increases that may have occurred in the underlying fiscal year 1981 budget.

100/ The Financial Advisor, who was closest to the financial community, testified that he was not told of the budget update estimate. Donald Patterson SEC tr. at 246-55 (July 23, 1985). James Perko, the Supply System's chief financial officer testified that he believed he talked with Patterson about the November 16, 1980 meeting and that, if he did speak with Patterson, he probably would have mentioned the figure. James Perko SEC tr. at 470-72 (Oct. 18, 1985). The two lawyers in the drafting group, the Special Counsel and Bond Counsel, testified that they were not told of the figure. Bert Metzger SEC tr. at 1639-43 (Feb. 25, 1986); Brendan O'Brien SEC tr. at 1031-32 (June 7, 1985).

Winston Peterson of R.W. Beck, the consulting engineer, who was also member of the official statement drafting group, attended the November 16th meeting and the meetings of the
(continued...)

e. The Fiscal Year 1982 Budget

The fiscal year 1982 budget, announced in late May 1981, showed a drastic increase in estimated costs. The budget estimated the cost of all five projects to be \$23.78 billion, an increase of \$7.8 billion over the fiscal year 1981 budget. 101/ These figures exceeded even the November 1980 \$20.4 billion update estimate. The increase in the budget presented cash flow and financing difficulties that compelled Ferguson to recommend on May 29, 1981 that the Board of Directors impose a moratorium on the construction of Projects Nos. 4 and 5. 102/

100/ (...continued)

following day. Peterson testified that he recalled the presentation on the budget update and that Ferguson instructed the attendees that information discussed at the meeting was not to be disclosed without his approval, but he did not remember the \$20 billion figure. Winston Peterson SEC tr. at 152-53 (Sept. 17, 1985).

The BPA was not involved in the drafting of the official statement, which was for a Project Nos. 4 and 5 bond offering. The BPA representative at the November 16, 1980 meeting, who was new to his position as the liaison official, did not recall the meeting. James Lewis SEC tr. at 56-77 (Jan. 10, 1985), at 15-22 (Nov. 5, 1985).

101/ Construction Budget 1982 Estimate at Completion, Presentation to Board of Directors at 4 (July 24, 1981). (SEC Ex. 434.)

The cost of Projects Nos. 4 and 5 was \$11.77 billion, an increase of approximately \$4.16 billion over the fiscal year 1981 budget. Id.

102/ Minutes of May 29, 1981 Special Board of Directors meeting. Robert Ferguson SEC tr. at 346-51 (July 24, 1985):

It [the normal process for the Fiscal Year 1982 budget] would have been to come to the Board on July 24th [for final formal approval of the budget], as we did, but the
(continued...)

The May 29, 1981 budget disclosure and moratorium recommendation marked the public recognition of cost and financing problems that had threatened the continued construction of Projects Nos. 4 and 5. Even in this instance, however, it appears that the Supply System delayed disclosure about the existence of the figures. The budgets were developed during the Spring of 1981. The budget estimate was initially available by the first weekend in May when the final step in totalling the budget, the calculation of interest costs, was

102/(...continued)

difference was that given the cash that we had on hand, I was very concerned that the Board deal with that issue to ramp down, to preserve the cash and to preserve the projects, while this dialogue was going on, and that's why I recommended a moratorium of up to a year for the region to address this issue. They wanted to ramp down very quickly to preserve the money that we had.

Because, you see, what was happening is that, with a demand of raising \$3 billion [in the next year for all projects] in order to conduct [the] projects on the schedule that we had come up with, and going into the marketplace to raise that money, and at the same time to continue to go forward with the projects and make commitments for which you didn't -- couldn't be assured that there would be money available, I felt, was a terribly irresponsible thing to do, and that's why I went to the Board as soon as I could get to them, and as quickly as I was able to verify the validity of the estimate. (at 349-50.)

The one-year moratorium recommendation, applied only to Projects Nos. 4 and 5 because, among other things, the financing problems were particularly great for these Projects. Minutes of May 29, 1981 Special Board of Directors meeting.

completed. The chief budget review official called the chief financial officer at home on Sunday, May 3, 1981, and told him of the budget results. 103/ The Managing Director was also notified of the results on that Sunday. 104/

At the time the estimates first became available in early May, the Supply System was about to distribute a preliminary official statement for a Projects Nos. 4 and 5 bond offering. The availability of the initial budget results showing enormous increases meant that some disclosure would have to be made if the offering went ahead. When the chief financial officer presented this requirement to the Managing Director, Ferguson decided not to go forward with the offering. 105/ The Supply System announced the postponement of the bond offering on May 5, 1981, citing adverse conditions in the marketplace as the

103/ James Perko SEC tr. at 480 (Oct. 18, 1985).

104/ Robert Ferguson SEC tr. at 351-53 (July 24, 1985).

The Managing Director was shocked by the magnitude of the estimate and asked the budget staff to conduct a sensitivity analysis on the interest portion of the budget to see if changes in assumptions about interest rates would have any effect on the budget. The calculations showed that the interest costs were influenced mostly by schedule extensions and were not significantly affected by changes in interest rate. Thus, even a drop in interest rates would not have a significant impact on the large budget increase. Robert Ferguson SEC tr. at 350, 352-53 (July 24, 1985).

105/ Robert Ferguson SEC. tr. at 378, 385 (July 24, 1985); James Perko SEC tr. at 483-84 (Oct. 18, 1985).

reason. 106/ They repeated this explanation to the Executive Committee of the Board on May 8, 1981. 107/ The budget figures were not disclosed until May 29, 1981, when the normal

106/ Supply System News Release No. 81-30 (May 5, 1981) (SEC Exh. 2783):

Richland--Adverse conditions in the financial marketplace have resulted in the postponement of a Washington Public Power Supply System bond sale, scheduled for the end of May, J.D. Perko, treasurer, said today

The chief financial officer apparently made reference to adverse market conditions when he spoke with the Managing Director about postponing the sale, but the problem about disclosing the preliminary budget figures was the prime cause of the postponement of the bond offering. Ferguson SEC tr. at 378, 385 (July 24, 1985).

107/ Transcript of Regular Executive Committee of the Board meeting 10 (May 8, 1981) (SEC Exh. 2419):

Now, also this last week, we had a situation where on the advice of Jim Perko, after intensive discussions, we decided to postpone the 4-5 bond sale.

Al Squire was in New York ready to meet with the rating agencies, and Jim [Perko] was about ready to go, and Don Claybo [Claybold, a Board member] was caught in at 5 o'clock in the morning before he caught a 6 o'clock airplane. So it was right up to the last minute. But, what happened is the prime rate was raised. The long-term bond market got very sloppy, and Jim can talk some more about this later on, but it just did not seem like a good time to go into the market.

At a Board of Directors meeting on May 15, 1981, the Deputy Managing Director expressly denied the existence of any budget figures. Minutes of Meeting of Board of Directors 9 (May 15, 1981).

schedules for the start of budget reviews with various parties and urgency of the financing situation compelled disclosure.

One study shows a significant, though not precipitous, market-adjusted drop of 5.51% in the value of Projects Nos. 4 and 5 bonds in the ten days surrounding announcement of the new budget figures and of the moratorium. 108/ This suggests the relative importance to the market of Participant commitment to the projects. The weakness of this commitment -- both moral and legal -- 109/ was still not fully known, and the bond prices continued to decline as this commitment publicly unravelled in the months intervening until the Washington Supreme Court's 1983 decision invalidating the take-or-pay requirements.

B. THE FINANCING OF THE PROJECTS

1. Introduction

The Projects Nos. 4 and 5 financing program was a major undertaking. From its inception it was subject to potential difficulties if the budgets increased. Ultimately the large increase in the fiscal year 1982 budget interrupted the financing program, leading finally to the termination of the projects.

108/ J. Peavy and G. Hempel, The Effect on the WPPSS Crisis on the Tax-Exempt Bond Market, 10 J. of Fin. Res. 239, 243 (1987).

109/ See discussion in Part II D and Part IV.

Two problems directly affected the Supply System's ability to finance the Projects Nos. The first was the enormous growth in the total amount of financing needed to complete the projects. The second was the Supply System's need to maintain sufficient cash flow to meet immediate cash needs for construction.

a. Growth of Total Financing Needs

Both the Supply System's construction costs and the bond interest costs on Projects Nos. 4 and 5 were financed solely by the sale of bonds to investors. The Participants were not required to make any payments for the projects until the projects were operating or until 1988, whichever came first, unless the projects were terminated. 110/ Increases in construction costs and extensions in the schedules thus directly increased the total financing needed. The extension of the schedules, in particular, had a great impact on financing needs because the extensions increased the period of time during which interest had to be paid. The combination of increased construction costs and extended schedules meant that more bonds had to be sold to raise more money for a longer time

110/ In the event of termination, the Participants were obligated to begin making payments one year after termination.

period. The amount of total required financing increased even as the proceeds from completed bond sales rose. 111/ (SEE CHART, NEXT PAGE.) Because the Supply System's financing needs increased more rapidly than bond sales financing could be completed, the amount of financing yet to be done, which should

111/ Financing figures for Projects Nos. 4 and 5 at date of each bond sale:

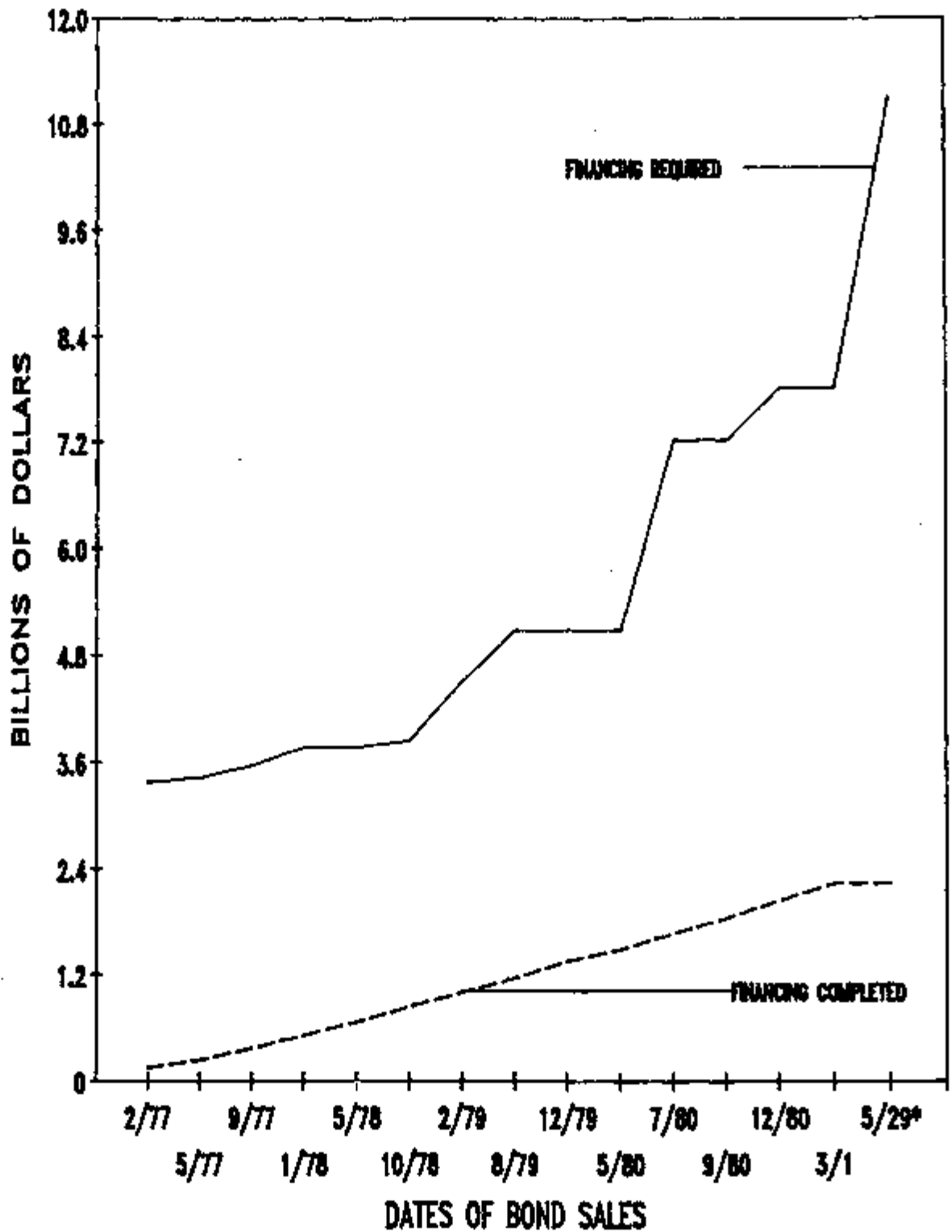
<u>Date of Bond Sales</u>	<u>Total Financing Required (\$ in Billions)*</u>	<u>Funds Obtained to date (including this sale) (\$ in Billions)</u>	<u>Difference (Financing to go) (\$ in Billions)</u>
2/77	3.38	.15	3.23
5/77	3.43	.24	3.19
9/77	3.57	.37	3.20
1/78	3.77	.52	3.25
5/78	3.77	.67	3.10
10/78	3.85	.84	3.01
2/79	4.51	1.01	3.50
8/79	5.08	1.16	3.92
12/79	5.08	1.36	3.72
5/80	5.08	1.49	3.59
7/80	7.23	1.67	5.56
9/80	7.23	1.85	5.38
12/80	7.82	2.05	5.77
3/81	7.82	2.25	5.57
5/29/81**	11.18	2.25	8.93

* Based on published budgets; excludes undisclosed November 1980 estimate, described above.

**Date of announcement of fiscal year 1982 budget.

Source: Official Statements (Estimated Financing Requirements section) and fiscal year 1982 budgets (for 5/29/81 figure).

**FINANCING COMPLETED
AND TOTAL FINANCING NEEDED
FOR PROJECT NOS. 4 AND 5**



*At announcement of moratorium.

See preceding footnote for financing figures.

have been decreasing, actually increased over time. 112/ (SEE CHART, NEXT PAGE.) The financing program, therefore, lost ground despite 14 bonds sales, averaging \$160 million each and totalling \$2.25 billion. 113/

b. Decline in Cash Flow Coverage

The second major financing problem was the risk that cash flow would be insufficient to cover current expenditures. Initially, cash flow was not a serious problem. However, over time, the rate of cash expenditures for construction increased while more rapidly than the rate of bond sales. The Supply System, therefore, was threatened with a cash shortage. By July 1980, the period of cash coverage, i.e., the projected number of months for which available cash could pay construction and interest costs, had decreased to the point where the Supply System consumed all its cash from one offering

112/ Additional financing needed (total financing needed minus amount of financing obtained to date) for Projects Nos. 4 and 5:

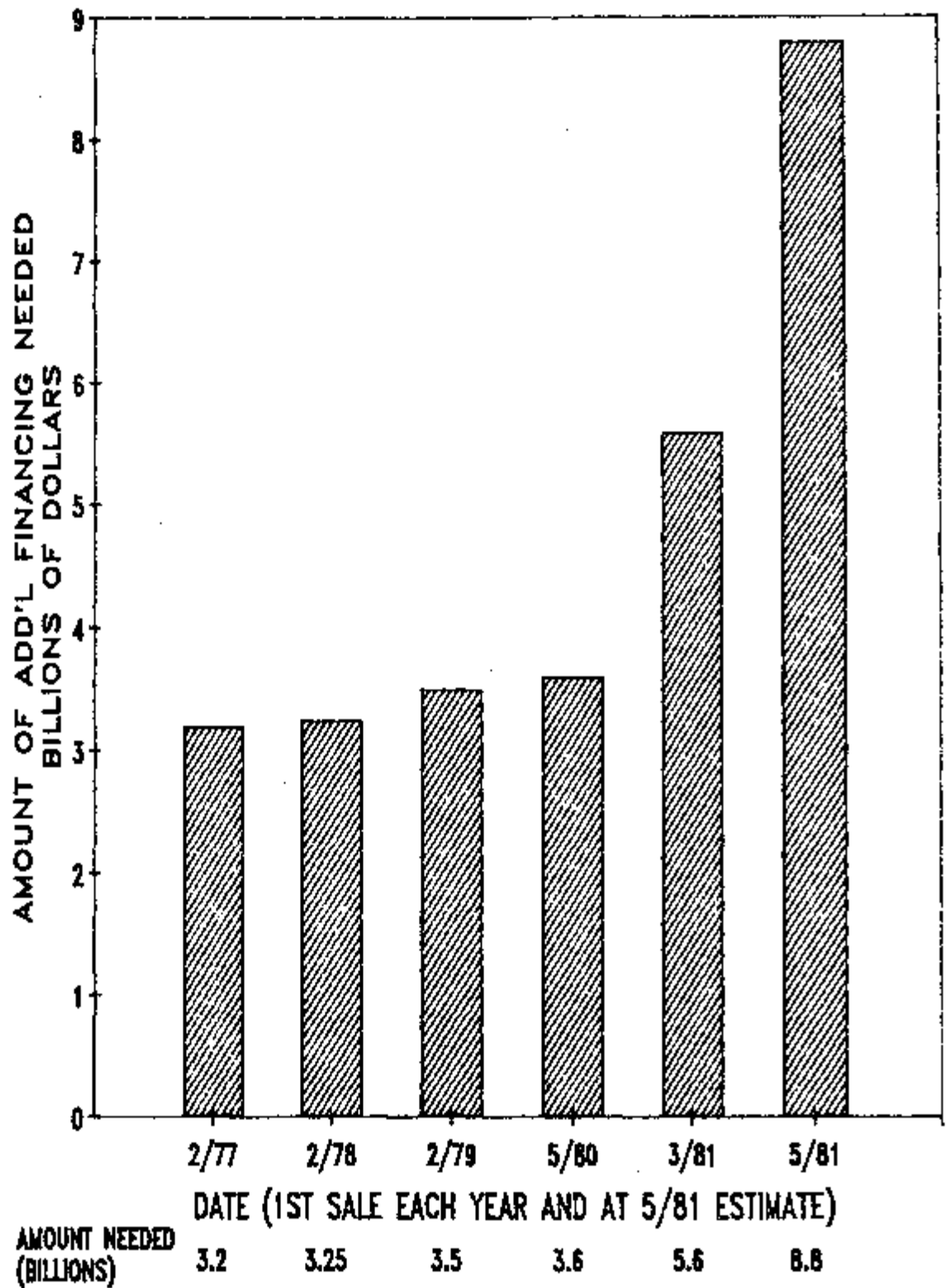
<u>Date (of first bond sale each year)</u>	<u>Amount of additional financing needed (in billions of dollars)</u>
2/77	3.2
1/78	3.25
2/79	3.5
5/80	3.6
3/81	5.6
5/81*	8.9

* At moratorium recommendation.

Source: Official Statements and fiscal year 1982 budget.

113/ The \$2.25 billion of financing that was completed equalled the initial estimate of the total cost of the projects.

ADDITIONAL FINANCING NEEDED FOR PROJECT NOS. 4 AND 5



SOURCE: OFFICIAL STATEMENTS AND 1982 BUDGET

to the next. 114/ (SEE CHART, NEXT PAGE) Any delay in a bond sale could cause suspension of construction.

2. Early Period of the Financing Program

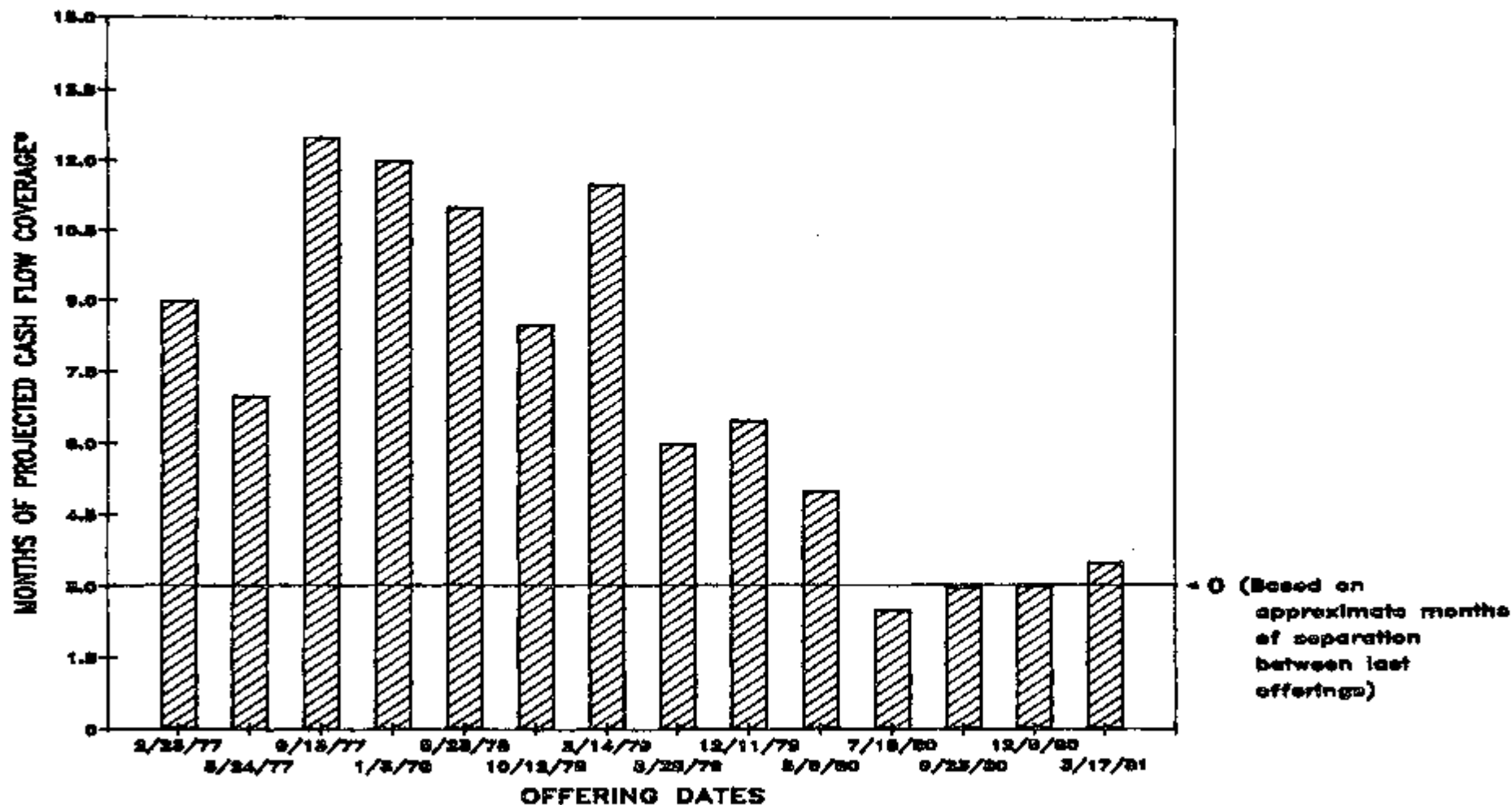
Within weeks after the Participants' Agreements were signed in July 1976, the Projects Nos. 4 and 5 budget increased from \$2.25 billion to more than \$3 billion. Financing problems at the time of the first bond sale in February 1977 were not critical, however, because the financing program was still of manageable size and the bond sales had just begun. Problems began to develop as the financing program proceeded.

114/ The Supply System's projected months of cash coverage for Projects Nos. 4 and 5 at each bond sale:

<u>Dates of Bond Sales</u>	<u>Months of Projected Cash Coverage</u>
2/23/77	9.0
5/24/77	7.0
9/13/77	12.5
1/03/78	12.0
5/23/78	11.0
10/12/78	8.5
2/14/79	11.5
8/28/79	6.0
12/11/79	6.5
5/09/80	5.0
7/15/80	2.5
9/23/80	3.0
12/09/80	3.0
3/17/81	3.5

Source: Official Statements, Estimated Financing Requirements section.

**SUPPLY SYSTEM PROJECTIONS OF MONTHS OF CASH COVERAGE ON
PROJECTS NOS. 4 AND 5 AT THE COMPLETION OF EACH OFFERING (BAR)
AND APPROXIMATE ZERO LEVEL OF CASH COVERAGE
AT TIME OF NEXT OFFERING (LINE)**



*See preceding footnote.

SOURCE: WPPSS Official Statements, Estimated Financing Requirements.