

2007 Contingency Planning

Financial Challenges...

Customer load growth

Benefit Cost Increases

Water Volatility

Relicensing Implementation Costs

Inverted Business Model

2007 Budget Shortfall

Debt coverage

Increasing cost of materials

Range of service offerings

Aging Facilities

Wholesale Revenue Volatility

Increasing O&M

Financial Challenges...

Near Term

Debt Coverage
Water Volatility

Long Term

Increasing cost of materials
Range of Service Offerings
Aging Facilities
Increasing O&M
Relicensing Implementation Costs
Inverted Business Model
Benefit Cost Increases
Customer load growth
Wholesale Revenue Volatility

Strategic
Planning
Process

Near Term

Debt coverage

Water Volatility

Debt Coverage Ratio

Operating Revenues - Operating Expenses

(Utility Revenue + Wholesale Revenue)

(Utility Expenses Non-Hydro)

Debt Service Costs

(Principal and Interest Payments on Utility Debt)

Cash Reserves are not a factor of debt coverage, thus fluctuations in the reserve balance do not affect coverage ratios.

Debt Coverage Needs

Hydro Debt Coverage Ratio

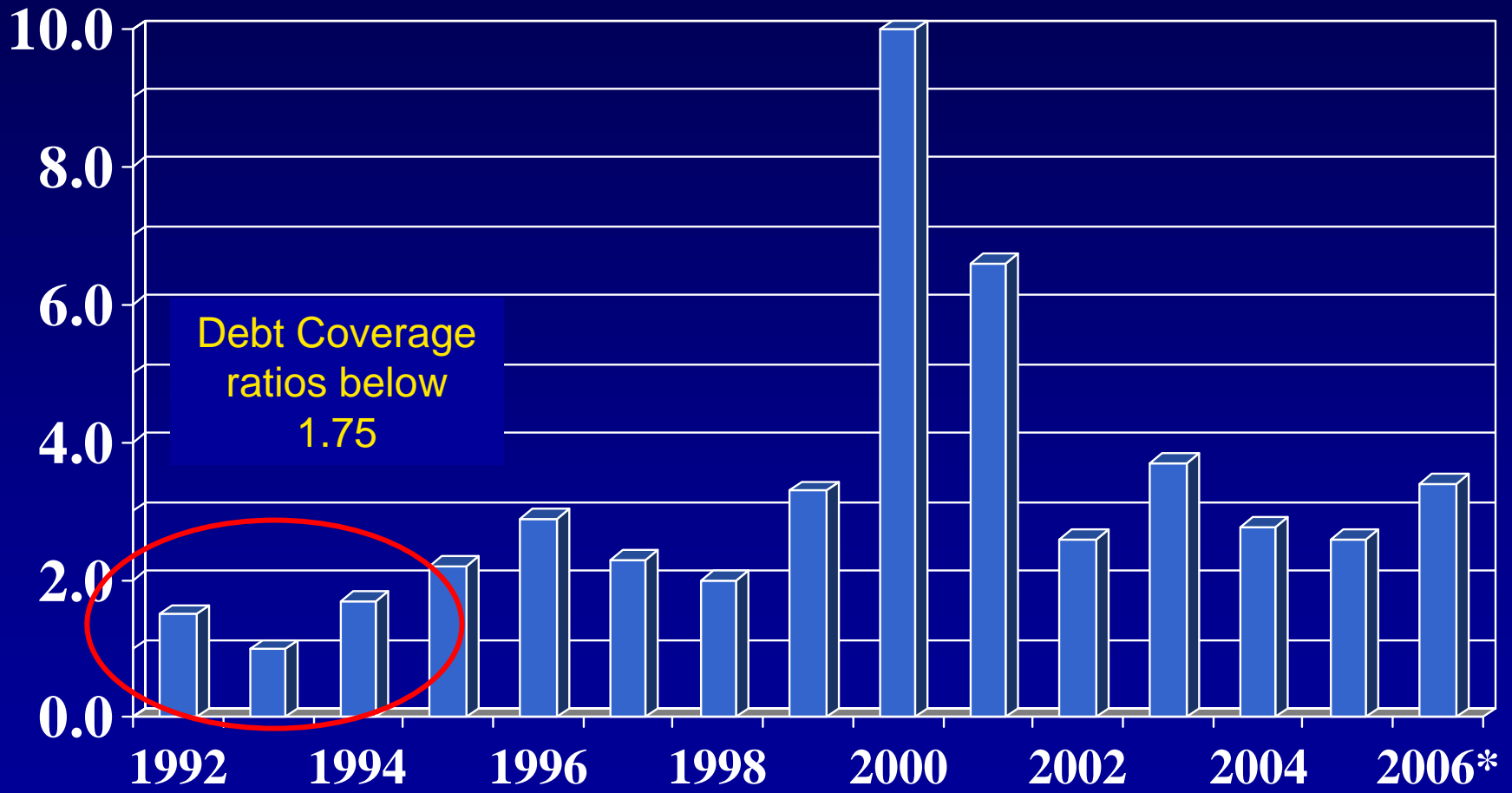
- Bond Covenant minimum 1.0 due to cost of service power contracts

Non-Hydro Debt Coverage Ratio

- 1.00 Bond covenant minimum
- 1.25 to issue new debt
- **1.75 minimum to support AA bond rating**

Debt Coverage Ratio

Historical View



*projected

2007 Debt Coverage Projection

Retail Revenue	Wholesale Revenue	Debt Coverage	\$ for 1.75 coverage
\$41.4M	\$40M (high)	1.77	(\$0M)
\$41.4M	\$35.9M (budget)	1.34	(\$3.8M)
\$41.4M	\$30M (low)	0.68	(\$9.7M)

In order to raise the debt coverage ratio we need to...

Decrease Operating Expenses

Decrease Debt Service Costs

Increase Operating Revenues

Decrease Operating Expenses

Operating Expenses Include:

- Electric Expenses
- Water Expenses
- Wastewater Expenses
- Fiber Expenses
- 15% Rocky Reach Dam Expenses
- 50% Rock Island Dam Expenses
- 100% Lake Chelan Dam Expenses

Budget First Draft	\$125.0M
Budget 10/23/06	\$119.6M
Reduction	\$5.4M

Significant budget cuts have been made; additional cuts in utility services would result in serious service impacts. Cutting Hydro expenses does not directly impact coverage since only a portion of those expenses are included in the ratio.

Decrease Debt Service Costs

Debt Service Costs include:

- Principal and Interest on Non-hydro debt

Using cash reserves to pay down debt reduces the debt service costs and indirectly improves the coverage ratio. Reducing cash reserves has serious long term implications that need to be considered.

Near Term

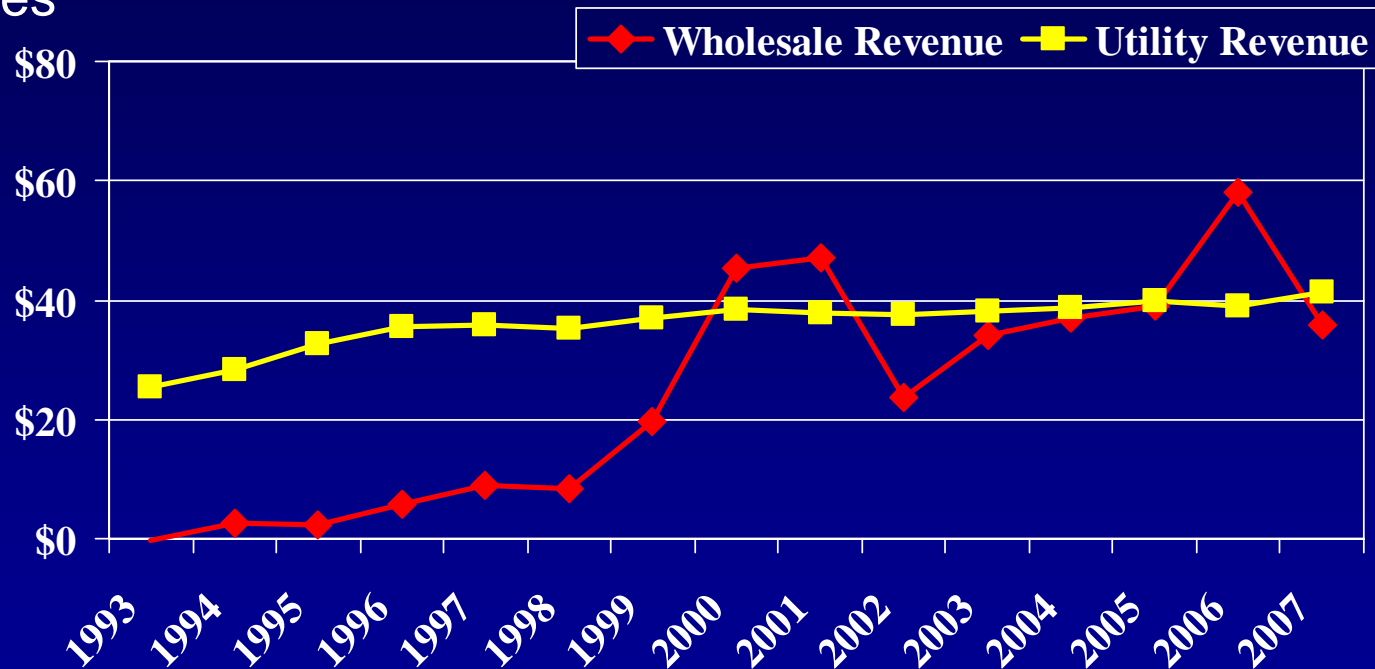
Water Volatility

Debt coverage issues

Increase Operating Revenue

Operating Revenues Include:

- Wholesale Sales
- Fiber
- Electric
- Water
- Wastewater



Wholesale revenues are subject to water and market fluctuations; they can vary dramatically year to year. Utility revenues are fairly consistent year to year, and have been approximately at the same level since 2000.

Water Volatility

Water supply is difficult to predict and manage. We have no control over how much water we will get or the timing of the run-off

Year	Water
2003	86%
2004	84%
2005	89%
2006	102%
2007	84%*

It is anticipated that 2007 will have less water and fewer expected market gains than 2006 which leads to lower wholesale revenues and thus lower debt coverage ratio

*expected case

Other Factors Impacting 2007

-Increased Materials Costs

(Fuel, Steel, Copper)

-Lake Chelan & Rocky Reach License Implementation

(Lake Chelan \$770K Rocky Reach \$1.4M)

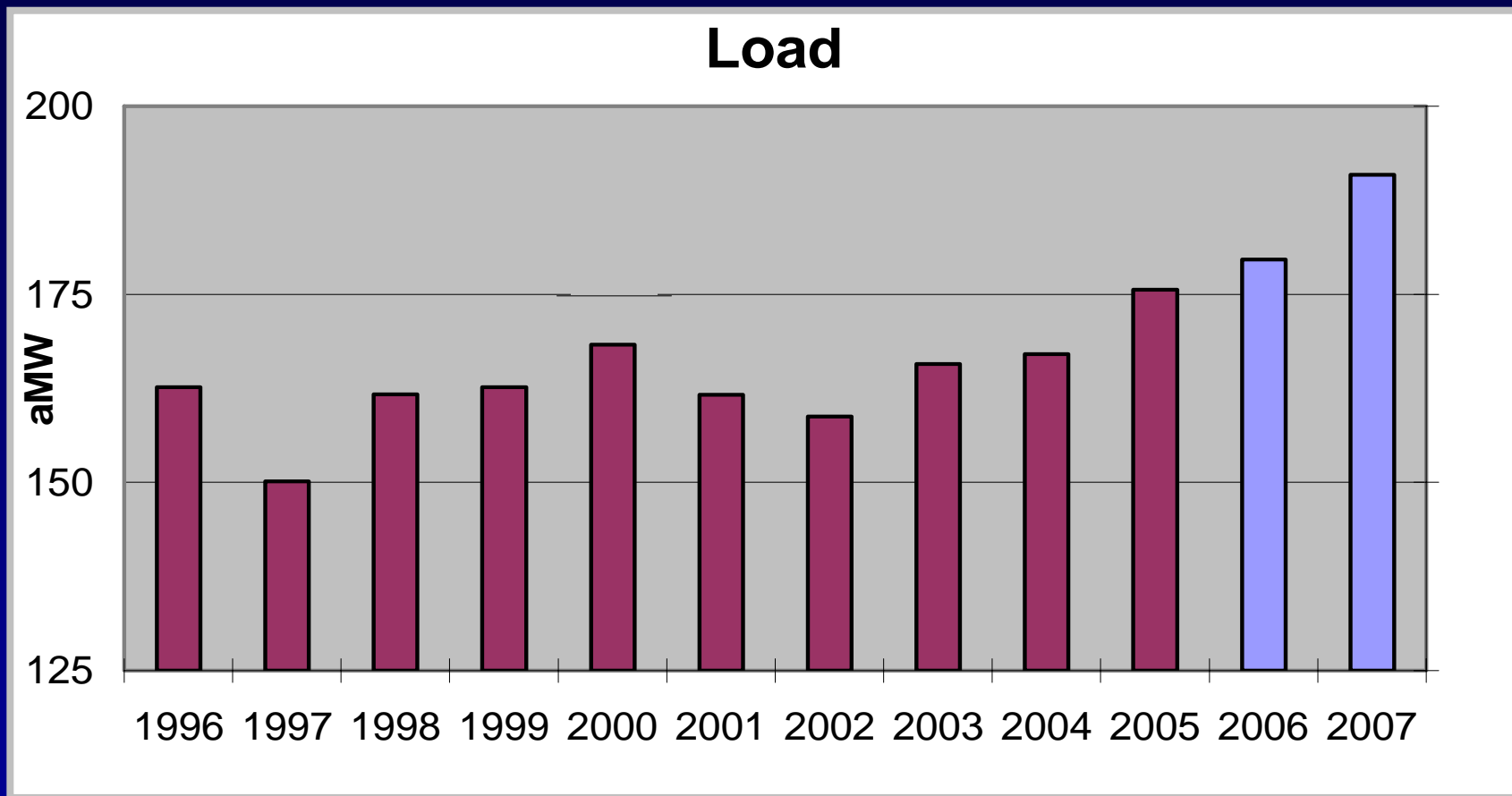
-Customer Load Growth

(4.9% growth = \$3.5M reduction in revenue)

-Employee Benefit Costs

(Medical up 18%, PERS 6.91%, OPEB \$2.4M)

Customer Load Growth



- Increasing retail loads mean less surplus to sell on wholesale market
- Current retail rate is \$30/mw versus a forward market price of \$58/mw
- A new 5mw industrial load @ \$19/mw reduces revenue by \$1.5M

Revenue Summary

Wholesale revenue is volatile.

There is too much variability to rely on wholesale sales for debt coverage.

Customer utility rates do not cover cost of service.

Utility revenue must be supplemented by wholesale revenue to cover expenses.

Water varies each year.

This variability has a substantial impact on wholesale revenue.

A revenue contingency plan is needed for 2007 in order ensure adequate coverage.

Retail Electric Surcharge

A revenue increase may be needed in 2007 to raise the debt coverage ratio to 1.75 and maintain our AA credit rating.

An electric rate surcharge is recommended as part of the contingency plan.

What is a surcharge?

A surcharge is a temporary increase put in place when low water causes a decrease in revenue.

How much would it be?

The surcharge would be a percentage of the total electric utility bill before taxes.

Have we ever had a surcharge before?

In 1977 there was a surcharge due to low water.

How long would it last?

If needed, this surcharge would end on December 31, 2007

Wholesale Revenue is a Factor in Surcharge Percentage

Example: Assumes 2007 surcharge starts March 1

Retail Revenue	Wholesale Revenue	\$ for 1.75 coverage	Surcharge
\$41.4M	\$40M	(\$0M)	0%
\$41.4M	\$35.9M	(\$3.8M)	15%
\$41.4M	\$30M	(\$9.7M)	29%

Monthly Impact on Residential Retail Customers

Surcharge	Monthly Increase
7%	\$3.46
17%	\$8.40
29%	\$14.33

Based on 2005 average monthly residential retail electric bill of \$49.41

Contingency Plan Recommendation

Increase Operating Revenue

- Consider surcharge options

Decrease Operating Expenses

- Consider additional reductions in expenses and services

Decrease Debt Service Payment

- Consider options for using cash reserves to lower debt

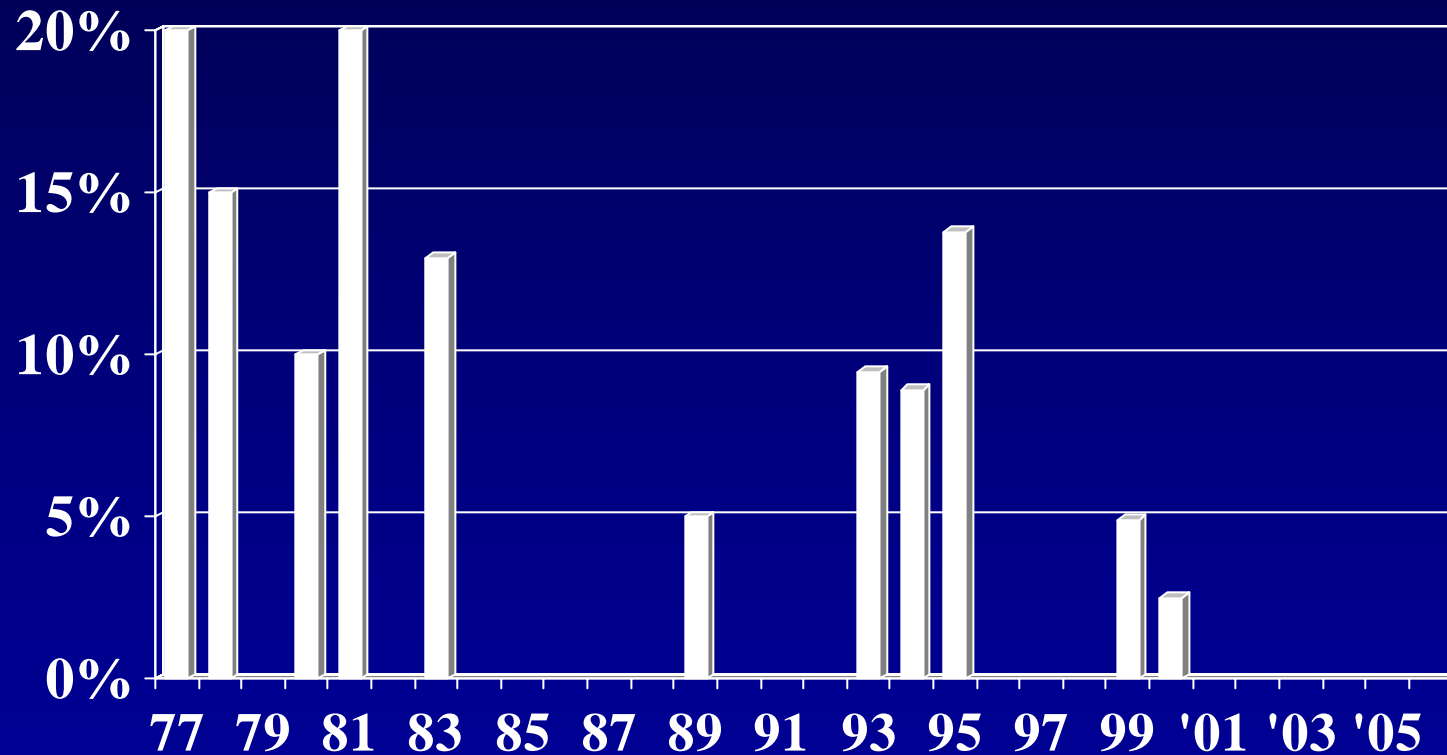
Contingency Plan Timeline

Nov. 13	Initial board presentation
Nov. 27	Discuss contingency plan and surcharge structure
Dec. 11	Finalize financial plan for 2007
Dec. 11	Establish surcharge structure
Dec. 11	Set meeting dates, give official notice of hearing
Jan. 3	Wenatchee informational meeting
Jan. 8	Chelan informational meeting and board meeting
Jan. 9	Leavenworth informational meeting
Jan. 9 –25	Process public comment
Jan. 25	Formal Rate Hearing
Feb. 12	Make final decision on surcharge
Mar. 1	Rate surcharge effective date

Questions?

Retail Electric Rate Increase

Historical View



In 1977 there was a 20% surcharge due to low water

Timing is a Factor in Surcharge Percentage

Example: Assumes wholesale revenues are between \$30M-\$40M

Start Date	Surcharge needed
January 1	0-23%
February 1	0-25%
March 1	0-29%
April 1	0-32%
May 1	0-36%
June 1	0-41%

Utility revenues fluctuate throughout the year. Twice as much revenue comes in December as June.

Surcharge Timing Considerations

- Surcharge increases over time
- Water forecast becomes more accurate each month
- Time needed for Billing System configuration
- Length of Rate Hearing Process