

Long Term Marketing Strategy Update: Cost Plus

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No action is required



Why We Are Here

- Follow up on Long Term Marketing Strategy (LTMS) efforts from 3/15/21 meeting re: Cost Plus Contract Template Development



3/15/21 Presentation on LTMS

- Shift of 50/30/20 to 40-50/20-30/20-30 – cost plus/market/retail load
- Still significant emphasis on longer term Cost Plus Contract's
- Consistent with LTMS presentation – begin to implement Cost Plus work
- End of cost plus in sight –
 - Post 2028 for Alcoa
 - Post 2031 for Puget Sound Energy (PSE)
- Actions – Define principles and Explore Market for Post Alcoa/Puget
- Identified “cost plus working group” – broad cross section of District
 - Objectives:
 1. Review/Define principles – portfolio/cost plus
 2. Update cost plus contract template in preparation for negotiations
 3. Look at market opportunities for cost plus and begin discussions with interested counterparties

Portfolio Guiding Principles

1. Retain sufficient power for Chelan County's current and long-term needs for retail load growth for under 5 MW loads.
2. Provide power products to support larger than 5 MW loads within strategic plan guidance to support economic development without raising retail rates by more than 5% cumulative related/resulting to/from economic development
3. Seek to provide adequate revenue to support stable and predictable retail rates that reasonably assures increases do not exceed inflation through 2035, while achieving strategic goals for hydro system capability, distribution reliability and safety
4. Create take or pay contract "templates" that will be used for all fixed market price and cost of production plus contracts for ease and consistency of administration and understanding
5. Have high assurance of not being short to meet District obligations during wholesale price spikes
6. Provide a strategic mix of fixed market price and cost of production based contracts that reduces streamflow and outage risk
7. Concentration of wholesale sales should be diversified by counterparty and geography

Cost Plus Contract Guiding Principles

1. Maintain District flexibility and control of all operations and maintenance decision making for hydro systems and network transmission systems
2. Maintain District flexibility and control of all asset investment and financing decision making related to the District's hydro systems and network transmission systems
3. Ensure the costs of power reflect all costs of the District's production and delivery of energy, capacity and other ancillary services products
4. Include the ability to pay for capital improvements as we go as determined by the District
5. Ensure that all contractual commitments align with independent operations and potential future coordination
6. Cost of production contracts should include all costs associated with hydropower generation and transmission including contributions towards "pay as you go" capital investment and debt related costs
7. Ensure counter-party support on legislative and regulatory issues of mutual interest to protect and enhance the value of hydro and network transmission systems
8. "Future proof" the template to the extent possible regarding legislative and/or regulatory changes that could negatively impact, or enhance, the value of the District's finances and operations
9. Seek to capture a portion, but not all, of the difference between cost-based and market-based pricing creating value for the District's customer-owners and power purchasers to promote long-term collaborative partnerships and revenue stability

Cost Plus Contract Template Update

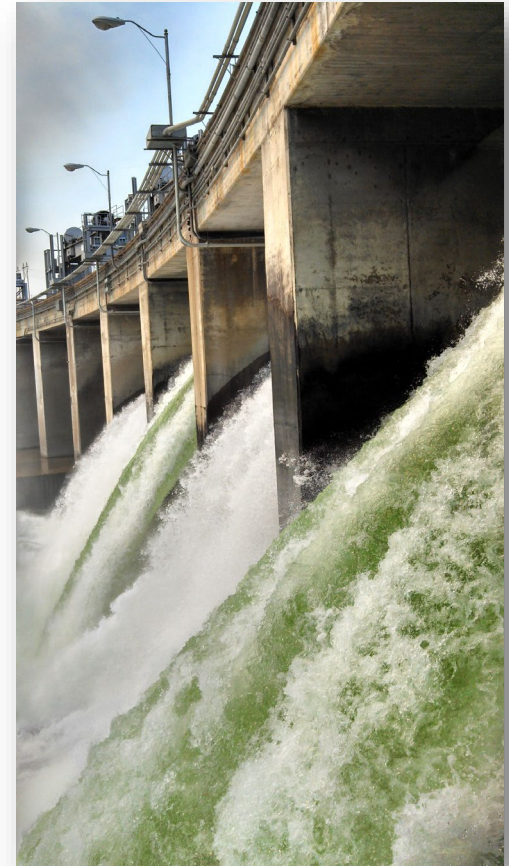
- Want to keep you updated on our progress along the way
- Started with the PSE cost plus contract and continued template approach from Board Resolution 06-12830
- Task to update the template terms with guiding principles in mind
- Developed “working team” comprised of Energy Resources, Finance, Risk and Middle Office, Legal, Generation, Transmission
 - Completed bulk of work end of May
 - Some work left to do:
 1. “Punch list” items for cleanup and references
 2. Consult with internal subject matter experts (SMEs) – Treasury, Strategic Financial Planning, Accounting/Taxes
 3. Consult with outside resources – including legal and marketing
- Have begun to share drafts with interested potential counterparties

Benefits of Cost Plus

Benefit	District	Purchaser
1. Hedge against market	X	X
2. Keeps interests aligned between District & Purchaser		
a. Ensures cost recovery	X	X
b. Columbia River Treaty	X	X
c. Relicensing	X	X
d. Hydro value – provides and preserves economic and environmental value of hydro for region (dam removal, renewables/carbon free, climate, environmental)	X	X
3. Lock in value of hydro for parties (environmental attributes, capacity and carbon)	X	X
4. Protects District against purchasers walking away from or selling contract	X	
5. Provides for significant market structure changes, RTO, EIM	X	X
6. Provide Resource Adequacy value to purchaser		X
7. Provides capacity, pond, and storage value	X	X
8. Provides a below market price product		X
9. District is covered against steamflow, outage and cost risk	X	

Major Template Concepts

1. Contemplates Slice of System – like we have now
 - a. “System” includes RR and RI
 - b. Flexibility as to percentage share
 - c. Targeting 20 years duration
 - d. Thinking about concentration issues – volumetric/geographic



Major Template Concepts

2. Take or Pay Obligation

- a. Counterparty to pay share of costs equal to the slice percentage regardless of actual amount of Output produced or received
- b. No guarantee of amount of Output produced (but much higher capacity value than other carbon free resources)
- c. District retains right and discretion to interrupt service or curtail output for operational and reliability reasons
- d. Clear that the amount of Output produced is subject to limiting conditions, including, but not limited to:
 - i. Availability of water
 - ii. Operability of units
 - iii. Reliability requirements
 - iv. Compliance requirements and commitments
 - v. Jurisdictional laws, regulations, rules and/or orders
- e. Output delivered to “points of delivery” on the edge of District system

Major Template Concepts

3. Output –

- a. Includes deliverable slice percentage of energy produced, net of adjustments for:
 - i. Encroachment obligations
 - ii. Transmission losses
 - iii. Columbia River Treaty obligations/Canadian Entitlement
 - iv. Other agreements and obligations – FERC Licenses, coordinating agreements, habitat conservation plans, etc.
- b. Capacity
- c. Pond/Storage
- d. Environmental Attributes

Major Template Concepts

4. Cost Plus Pricing

- a. Costs - Purchaser to pay share of costs equal to percentage of all costs and expenses of any kind, direct and indirect, paid or accrued by the District with respect to its ownership, operation, maintenance, repair and improvement of and the production, sale and delivery of output, including:
 - i. Operation and Maintenance
 - ii. Working capital
 - iii. Coverage Fund
 - iv. Capital recovery
 - v. Debt reduction
 - vi. Transmission charges
- b. “Plus” – The additional amount to be paid not tied to District costs representing the additional hydro values
 - i. Fixed annual charge

Major Template Concepts

5. Operational Control

- a. District retains right to make all operational decisions in its sole discretion using prudent utility practices

6. Payments –

a. Fixed Annual Charge –

- i. Payable monthly in 12 equal installments
- ii. Working on calculations with consultant assistance
- iii. represents value of environmental attributes, capacity, carbon and other non-energy elements of Output

b. Working Capital Charge –

- i. Due on project availability date
- ii. Roughly 3 months of operating and maintenance (O&M) costs
- iii. Used to pay for O&M prior to purchaser payments
- iv. Annual charge to increase with inflation

Major Template Concepts

6. Payments – cont.

c. Net Costs

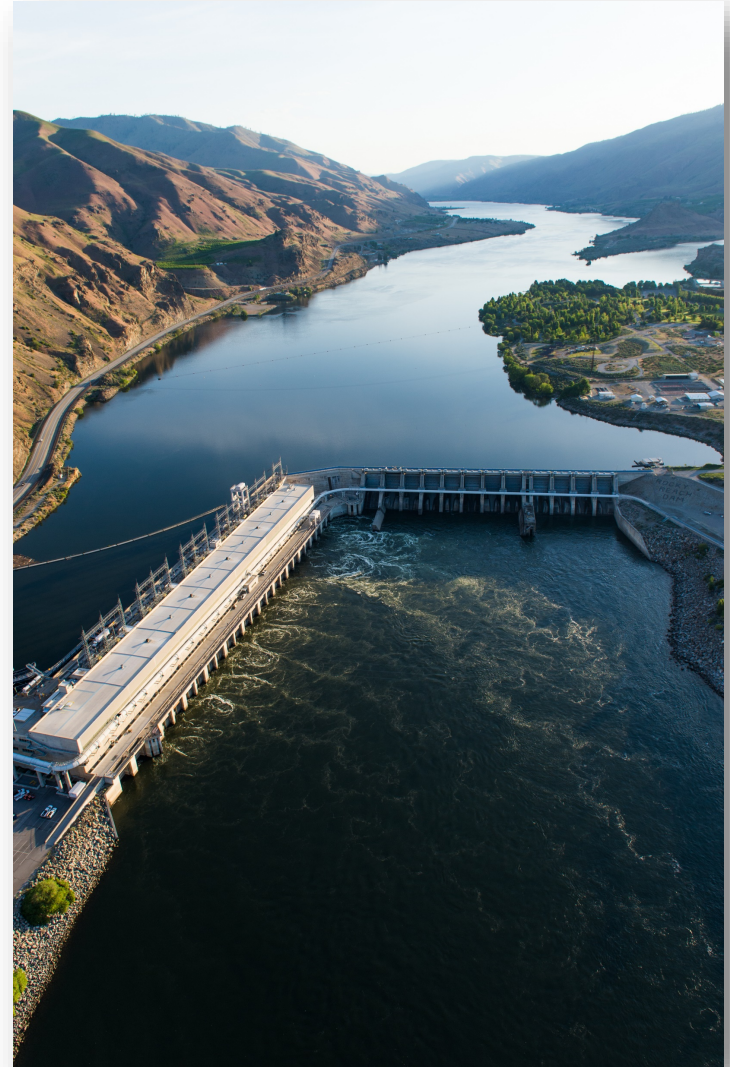
- i. Paid monthly
- ii. Calculated by district based on actual O&M and taxes and defined debt service

d. Coverage fund charge

- i. Due on availability date
- ii. To provide coverage for debt obligations
- iii. Calculated based on 15% of highest annual principal and interest and reset if needed when new debt issued

e. Transmission charges

- i. Monthly
- ii. Per transmission tariff



Major Template Concepts

6. Payments – cont.

f. Debt reduction charge (DRC)

- i. Paid monthly
- ii. Calculated annually
- iii. 3% of total debt obligations at beginning of year
- iv. Used for fund capital improvements or pay down hydro debt
- v. Charge may be limited in last 5 years of contract based on unspent DRC fund balance

g. Capital recovery charge (CRC)

- i. Paid monthly
- ii. Calculated annually
- iii. 50% of capital base (30-yr average annual capital improvements) increased annually for inflation
- iv. Used to fund capital improvements or pay down hydro debt
- v. Charge may be limited in last 5 years of contract based on unspent CRC fund balance

h. Debt admin charge

- i. Paid monthly
- ii. Calculated annually
- iii. Percentage charge based on purchaser's credit rating
- iv. Recognize District's high credit rating and administration of debt portfolio



Major Template Concepts

6. Payments – cont.

- i. District may use funds for any lawful purpose when not specified
- j. District retains funds at termination
- k. Purchaser pays own taxes associated with purchase



Major Template Concepts

7. Miscellaneous Provisions

- a. EIM/RTO – District has discretion to join. Costs shared with purchaser proportionate to share. Purchaser's Output subject to terms of EIM/RTO agreement.
- b. Columbia River Treaty and Canadian Entitlement – purchaser allocated their contribution proportionate to share
- c. No interest in system – purchaser has no ownership rights in District system or assets
- d. Assignment – no assignment without consent
- e. Collateral – added collateral annex similar to market-based slice contracts

Major Template Concepts

7. Miscellaneous Provisions, cont.

- f. Support and Cooperation – purchaser must support
 - i. Relicensing
 - ii. Columbia River Treaty
 - iii. Regulations
 - iv. Hydro value
- g. Insurance
 - i. Required
 - ii. Self insurance suffices
- h. Default and Termination
 - i. Well defined reasons
 - ii. District discretion to declare
 - iii. Remedies at District election
 - iv. While in default we can sell – keep surplus – purchaser makes up deficiency
 - v. One way termination – District's discretion



Next Steps

- Share template concepts in draft with interested potential Counterparties
- Complete remaining work
- Develop final costs estimates and calculations for specific charges
- Finalize concentration limits
- If successful – back with agreement in principle and seek Board feedback