MEMORANDUM

TO: Board of Commissioners

FROM: ***POWER CONTRACT NEGOTIATING TEAM***

RE: **PROPOSED NEW POWER SALES AGREEMENT AND TRANSMISSION AGREEMENT WITH ALCOA**

REFERENCE IS MADE TO MAJOR POINTS MEMO REGARDING PROPOSED TERM SHEET DATED OCTOBER 15, 2007

DATE: June 16, 2008

We have utilized the points as described in the "Major Points of the Proposed Term Sheet" memo dated October 15, 2007 as a starting place to describe the provisions of the final negotiated Power Sales Agreement with Alcoa. The red text reflects the provisions of the proposed definitive Power Sales Agreement and Transmission Agreement.

MAJOR POINTS OF TERM SHEET AND THE PROVISIONS OF THE DEFINITIVE NEW POWER SALES AGREEMENT AND TRANSMISSION AGREEMENT

Terms that are capitalized are specifically defined in the proposed Power Sales Agreement and the definitions appear in Section 1.01 and in the Appendices.

1. **25% or 26% of Output** of Rocky Reach and Rock Island. A 26% share is the maximum agreed upon in this proposed term sheet. We are hopeful that the parties will be able to negotiate a capacity-energy exchange with a third party to decrease that percentage share to 25% or less. The parties have agreed to allow three years after the final agreement is signed to negotiate and execute a capacity/energy exchange. If that is not possible and a 26% share is sold to Alcoa, the District will keep for its own use and benefit the capacity not needed to provide energy to Alcoa. Note that there is a provision for a different percentage to be sold from October 2011 (when the Rocky Reach contract expires) until July 2012 (when Rock Island power is available).

   A 25%/26% share of Output in an average water year will provide energy to operate three pot lines compared to the current two. We had originally discussed a post-2011 agreement for a 20% share in the 2001 and 2004 Agreements. However, based upon plant economics, a 25%/26% share was negotiated. (See the CRU report, Item No. 13 in notebook.)

The proposed definitive new Power Sales Agreement provides for the sale of **26%** of Output. Output is defined to be an amount of Energy determined in relation to the energy production of the Chelan Power System (Rock Island and Rocky Reach projects). The term Energy is defined as production, expressed in megawatt hours, as determined in relation to the Output of the Chelan Power System. Energy may be supplied by the District from any source and the District is not obligated to supply Energy from any particular source. The term Equivalent Energy is defined in Appendix B, Section 1 and defines the methodology by which the District will determine the megawatt hours associated with the 26% of Output being sold.

In addition, between the November 1, 2011 and June 30, 2012 (the period after the Rocky Reach contract expires and when the Rock Island contract expires), the District agrees to sell Alcoa 27.5% of the Output based on Rocky Reach production only. This is roughly equivalent (in an average water year) to what Alcoa currently receives under the current contract from the District. The costs to be paid for this interim period of time will be dictated by the new Power Sales Agreement, not the current contract.

The first paragraph above describes three differences between the Term Sheet as approved and the definitive agreement. The reasons why District staff believes those changes are beneficial to the District are described below. The differences are summarized as: (1) rather than waiting until 3 years from now (June 2011) to determine if Alcoa would exercise its option to obtain 26%, we agreed that 26% share of Output should be included in the definitive agreement now; (2) the District retains the capacity and pond associated with that 26% share of Output (except as needed to follow the power requirements at the Wenatchee Works and reserve requirements); and (3) the management of the 26% is within the District's control and will be managed along with the District's resources. This final point can be described best as a "synthetic slice" and is comparable to how the current wholesale agreement with Alcoa is managed. In the 1950's, the District sold a 23% slice of Rocky Reach to Alcoa. In 1992, Alcoa assigned that slice back to the District and the District provides Alcoa with "Rocky Reach Replacement Power." Alcoa remains liable for payment of all costs and terms of the underlying slice contract. This assignment and resulting management of the resource as a whole has provided value to the District in terms of flexibility and efficiencies.

So, why does this change bring value to the District and why is staff recommending it? The parties were unable to negotiate a capacity/exchange agreement with another party and other northwest parties did not appear interested in a potential capacity/energy exchange. The District staff took another look at the situation and concluded that the capacity has value to the District. In exchange for agreeing to a contract for 26% share, the District retains for its sole use and benefit the capacity and pond at Rock Island and Rocky Reach (except

what is necessary to follow the power requirements at the Wenatchee Works and reserve requirements associated with the 26% of Output). This will be valuable to the District for a number of reasons, including, but not limited to (a) additional flexibility in capacity and its use in the future; and (b) it adds value to the environmental attributes associated with the 26% share which are retained by the District pursuant to Section 5.15 and makes them more useable in the future for the District.

No amount of Energy or Output is guaranteed to Alcoa. Alcoa is responsible for its own forecasting for its operational purposes.

See definitions of: Chelan Power System; Energy; and Output in Section 1.01 and the definition of Equivalent Energy in Appendix B, Section 1.
See Sections 5.01; 5.02; 5.03; 5.05; Appendix B.

2. **17 years – expires October 31, 2028**. Definitive agreement if approved by both parties would become effective if Alcoa is not in default of the current 2004 Agreement and has continuously operated the plant for the 12 months prior to October 2011. If a shutdown has been caused by an Uncontrollable Circumstance as defined later in the term sheet in Section 5.8, there would be an "assumed operational level" as described in section 5.8 for those 12 months and agreement would be effective.

   Same but more detail added.
   See Article 3 for the provisions defining the term and conditions precedent to the effectiveness of the new Power Sales Agreement.
   Section 5.10 describes the adjustment to operating criteria due to Uncontrollable Circumstances.

3. **Take and pay obligation**. Alcoa will pay the percentage of costs related to Output share (25%/26%) regardless of the actual amount of Output produced by the Projects or received by Alcoa at Wenatchee Works. The District has the right to interrupt service or curtail output for operational and reliability reasons. Same as Puget.

   Alcoa will pay its 26% share of all costs regardless of the actual amount of energy delivered. This concept is stated several places in the proposed new Power Sales Agreement, including Sections 7.02; 5.03(B); 5.11; and Appendix A.

   The District's right to interrupt or curtail Output/deliveries is described in Sections 5.01 and 5.03; and Article 6.

4. **Operational Control**. The District will make operational decisions in its sole discretion using prudent utility practices. The District has the obligation to use commercially reasonable efforts to operate and maintain the Projects in an efficient and workmanlike manner. Semi-annual meetings with Alcoa are required

to provide information and consider any recommendations. There is no obligation by the District to follow or implement such recommendations. Same as Puget.

Same with more detail. Article 10 and Sections 8.04 and 17.01 describe these concepts.

5. **No ownership**. This is a proposed contract for the sale of Output only. Alcoa is granted no rights to or interest in the Projects. Same as Puget.

   Same except with respect to definition of Output as described above. See Sections 8.04 and 17.01 of the Power Sales Agreement.

6. **Cost-based contract**. This is "cost-based." Costs are defined to include concepts not included in current contracts (i.e. transmission; relicensing). There are additional amounts to be paid that are not tied to District costs. Same as Puget.

   Same except with respect to definition of Output as described above. Article 7; Appendix A; and the Transmission Agreement describe the payments to be made with regard to the costs of production and delivery of the Output.

7. **Financial Control**. The District will make financial funding decisions without obtaining approval from Alcoa. Same as Puget.

   Same except with respect to definition of Output as described above. See Article 10; Section 13.01(a); and Appendix A of the Power Sales Agreement.

8. **Upfront payment payable when definitive agreement is approved by FERC**

   This is a payment for the right to reserve system capacity for 17 years starting in 2011. This payment is not tied to the District's costs of operation.

   Capacity Reservation Charge (CRC)
   $21,000,000 if 26% (2006 Dollars)
   $17,500,000 if 25% (2006 Dollars)

   This provision differs from the Puget PSA due to the jobs and economic value of the Alcoa plant to the local economy. The difference between this dollar figure and $89,000,000 paid by Puget is deferred. If Alcoa remains in operation, there is no further payment of the deferred CRC. However, if Alcoa does shut down, Alcoa will pay the deferred CRC as described below.

   The deferred amount increases between signing of the definitive agreement and 2012 based upon an assumed interest rate of 6% to recognize foregone interest.

Then, the balance declines over the 17 years. See table below taken from Appendix C to the proposed term sheet.[1]

If Alcoa shuts down for 90 days (initial shutdown), Alcoa would pay an "Initial Shutdown Amount" defined as a fraction (numerator is the months from the start of the shutdown to when a startup has occurred and the denominator is twelve) of $8,615,526. If that initial shutdown continues for 18 months or there is a second shutdown of 90 days' duration, whichever occurs first, Alcoa would owe the entire balance of the deferred CRC. The amounts to be paid and the decreasing balance of the deferred capacity reservation charge are set forth on Appendix C and the table below. There is an exception for the payment if a "shutdown" is the result of an Uncontrollable Circumstance and for this situation only, an Uncontrollable Circumstance could include a strike and lockout situation as defined in Section 11(a)(v). This clause is only effective if certain criteria are met.

Proposed Term Sheet
Exhibit C

Column	A Initial Shutdown Amount	B Shutdown Settlement Amount
2012	8,615,526	87,067,603
2013	8,615,526	83,676,133
2014	8,615,526	80,081,175
2015	8,615,526	76,270,520
2016	8,615,526	72,231,225
2017	8,615,526	67,949,573
2018	8,615,526	63,411,021
2019	8,615,526	58,600,156
2020	8,615,526	53,500,640
2021	8,615,526	48,095,152
2022	8,615,526	42,365,335
2023	8,615,526	36,291,729
2024	8,615,526	29,853,707
2025	8,615,526	23,029,404
2026	8,615,526	15,795,642
2027	8,615,526	8,127,855
2028	8,615,526	8,127,855

See Section 12 of this memorandum (and Section 5 of the proposed term sheet) for other economic consequences of less-than-full operation by Alcoa.

[1] The deferred CRC does not become payable until after effective date of the approved definitive agreement. If Alcoa shuts down between now and 2012, the current 2004 Agreement controls and the new agreement may not go into effect (See Section 2 above).

The amount to be paid 30 days after the Signing Date is $21,000,000 in 2006 dollars which reflects the 26% share. In 2008 dollars if paid in July/August of this year, the amount will be $22,900,000 due to the escalation factor. See Section 7.01(A). Please note that the payment date is 30 days after the agreement is signed, not after approval by FERC.

The amount of the Shutdown Settlement Amount has not changed, except with respect to a potential for revision in the future as reflected in the proposed Amendment No. 2 to the existing Amended and Restated Industrial Power Sales Contract (2004).

See the following sections of the Power Sales Agreement regarding shutdown and the impacts of that shutdown on the payment of the Shutdown Settlement Amount and Initial Shutdown Amounts: Sections 7.01(A); 15.02; 15.03(J) and Appendix E.

Also see Article 5 with regard to operating levels of the Wenatchee Works and impacts/consequences of various operational levels.

9. **Payments – lump sum payments – payable 2011/2012**

a. Prepayment to be used as collateral/Collateralization of obligations. A prepayment is not included in the proposed Alcoa term sheet as it was in the Puget PSA. Rather, a requirement to fully collateralize payment obligations is included (Section 28 of term sheet). This provision was discussed as an option in January 3, 2006, memo. Puget chose to "prepay" in lieu of posting collateral if their credit rating dropped. Alcoa chose not to prepay and will post collateral if their credit rating drops to below investment grade. See Section 12f of this memo.

Alcoa will not prepay the collateralization amount as Puget chose to do. Rather, Alcoa has agreed to post collateral satisfactory to the District if certain events occur. See Section 20 and the definitions contained in the Power Sales Agreement regarding Alcoa's collateralization requirements. In particular, note the definition of "Performance Assurance" that requires that if a collateral call is made by the District, Alcoa must post collateral (cash, letter of credit or Qualified Investments) satisfactory to the District that is equivalent to (1) an estimated highest three months of Periodic Payments (payments required in Section 7 and Article 5) and (2) an amount equal to the Shutdown Settlement Amount that would be due in the fiscal year if required to be paid.

b. Working capital. Upon the respective effective dates of the contract for each Project, Alcoa will pay $2,500,000 (if 25% and $2,600,000 if 26%) per Project as working capital. The funds may be used for operating costs while waiting for monthly payments or otherwise. This is an upfront

payment but will be adjusted annually per the Consumer Price Index (inflation). The District may increase the working capital fund as necessary to meet prudent utility practices. The initial amount is roughly equivalent to Alcoa's share of an estimated three (3) months of the District's anticipated operating expenses for the Projects. At the end of the contract, the District retains the funds. The funds retained can be used for any purpose by the District. Same as Puget.

Same except the payment will be $2,600,000 (2004 dollars) to reflect the 26% share of Output as described above. See Sections 7.01(B) and 7.06.

c. Coverage fund. In 2011/2012 respectively for each Project, Alcoa will pay into a fund its 25%/26% share of the Coverage Amount. The Coverage Amount is equal to 15% of the highest annual payment necessary to cover the debt service (principal and interest) on outstanding debt obligations of the Projects. As new debt obligations are issued that increase the overall debt service, Alcoa will pay an additional 15% on the incremental portion. The District retains the interest in this fund. At the end of the term, the District retains the money in the fund. The funds retained can be used for any purpose by the District. Same as Puget

Same except the payment will reflect the 26% share of Output as described above. See Section 7.01(D).

10. **Payments - monthly – payable after 2011/2012**

a. Monthly operating and maintenance costs. Alcoa will pay 25%/26% of all costs and expenses of every kind, direct and indirect, incurred by the District regarding the operation and maintenance of both Projects. Specifically, certain relicensing costs (Rock Island license expires in 2028 and the relicensing process will probably begin by 2020) are included as ongoing operating costs. Same as Puget.

Same except the payment will reflect the 26% share of Output as described above. See Sections 7.01(C) and Appendix A.

b. Financing costs. Alcoa will pay 25%/26% of financing costs on outstanding and future debt obligations. Alcoa will pay a set amount as defined. If debt is refinanced or remarketed, the District will retain all benefit or costs of such activity which would not change Alcoa's payment obligations. Other details beneficial to the District include changing the definition of average service life for new capital improvements to provide that service life of assets will not exceed 25 years. Further, Alcoa will pay an "assumed index rate" on debt obligations which is 110% of a taxable rate based on an amortization of 25 years or less. Same as Puget.

Same except the payment will reflect the 26% share of Output as described above. See Sections 7.01(D) and 7.01(F).

c. Capital Recovery Charge. Alcoa will pay a "Capital Recovery Charge" on a monthly basis. This will be a percentage, designated annually (notice given one year in advance) by the District, which falls between 0% and 50% of the "Charge Base." The Charge Base is $25,000,000 (2004 dollars – will escalate per the Consumer Price Index). This Charge Base is computed upon an estimate of the District's annual capital improvements for the next 30 years. The Charge Base may be modified by the District if necessary. Example: A 30% charge would result in a total capital recovery amount of $7,500,000. Alcoa's pro rata share would be $1,875,000 per year (based on an assumed 25% share). Interest accumulates in this fund. Money may be used to fund capital improvements when needed (pay for some capital as we go) or may be used to defease or redeem debt obligations associated with the Projects. Same as Puget.

Same except the payment will reflect the 26% share of Output as described above. See Section 7.01(G).

d. Debt Reduction Charge. Alcoa will pay a "Debt Reduction Charge" on a monthly basis. This will be a percentage, designated annually by the District (notice given one year in advance) which falls between 0% and 3% of the total debt obligations outstanding at the beginning of each year associated with the Projects. Example: A 2% charge on $800,000,000 would be $16,000,000. Alcoa's pro rata share would be $4,000,000 per year (based on an assumed 25% share). Interest accumulates in the fund. Money can be used to redeem or defease debt obligations or fund capital improvements for the Projects. Same as Puget.

Same except the payment will reflect the 26% share of Output as described above. See Sections 7.01(F); 7.01(H); and Appendix A of the Power Sales Agreement.

e. Limit on Capital Recovery and Debt Reduction Charges. There will be a limit on the total amount that can be accumulated in the combined Capital Recovery and Debt Reduction funds by an amount equal to five times the escalated charge base of $25,000,000 (2004 dollars). The limit on the District's ability to raise the amounts of these charges only applies in the last two years of the contract. In the Puget contract, the limit applied in the last five years. Reason for difference is due to shorter length of the Alcoa proposed term sheet.

Same. See Section 7.01(H) of the Power Sales Agreement.

f. Credit Rating Premium. Puget chose to pay a fixed Debt Administration Fee of 1% over the life of the contract plus some cash upfront. Alcoa chose the other option discussed in the January 3, 2006, memo which is a charge that "floats" with the difference between Alcoa's credit rating and the District's. A situation where Alcoa's credit rating is low and our rating is high will result in a larger premium being paid to the District. In no event will Alcoa receive a credit if its rating is higher than the District's. This charge may be used for any purpose by the District.

Same. See Section 7.01(E) of the Power Sales Agreement.

g. Transmission Charges. The District currently has substations, switchyards, and high voltage lines that serve to integrate the Projects and deliver energy to our purchasers. These facilities (which have been previously hydro assets) will be moved to Distribution System. The District will then charge transmission fees for the delivery of the output from the point of generation to Alcoa's point of interconnection to our system. This income will go directly to the Distribution System and may be used for any purpose. This is a change from our current contract to reflect the true costs of delivering the output to Alcoa. There will be a separate Transmission Agreement. Same as Puget.

Same. See Transmission Agreement.

h. Interconnection Agreement. The parties will also need to negotiate an interconnection agreement. One currently exists that was signed in 1967. This agreement will address the interconnection points and costs of improving the McKenzie Substation, the Rocky Reach Columbia No. 2 tap line and working with BPA regarding the Valhalla Substation. The interconnection agreement will be different than the one executed with Puget.

The parties have agreed to negotiate an Interconnection Agreement no later than January 1, 2010 (unless we mutually agree to a later date). This later negotiation and approval of an Interconnection Agreement was contemplated when the Term Sheet was approved given the issues that required resolution and the study to be performed (which has now been completed).

i. Taxes. Alcoa will pay its own state and federal taxes associated with the purchase of output.

Same. See Section 14.01.

11. **Miscellaneous Provisions**.

a. Step up. If another purchaser with a similar contract defaults, Alcoa agrees to "step up" and take its pro rata share of the defaulting party's share of output upon the same terms and conditions as described herein. (Note: energy taken as a result of the step up can be sold by Alcoa on the market). Same as Puget.

Same. See Section 5.14 of Power Sales Agreement.

b. Insurance. Insurance is required of Alcoa and the District. The District's self-insurance program is approved as being adequate and prudent. Same as Puget.

Same. See Section 14.02 of Power Sales Agreement

c. Assignment. Alcoa has no right or ability to assign the proposed contract to any other entity without written consent of the District. This provision is different than the Puget PSA. The Puget PSA allowed assignment under limited situations (i.e. merger).

We included several additional provisions in the new Power Sales Agreement to further protect the District. The District's consent to assignment is within the District's control and subject only to the District's sole discretion (no reasonableness standard). This applies to assignment regardless of how accomplished. For example, Alcoa cannot assign the Power Sales Agreement to anyone without the District's express written consent. Further, if there is a Change of Control of Alcoa, the District must specifically consent to this Power Sales Agreement being included in the transfer of assets/Change of Control, or there will be a default by Alcoa which then can lead to the District's termination of the Power Sales Agreement. See definitions of Change of Control; Article 13; and Section 15.01(G).

d. Audit. Alcoa has the right to annually audit expenses charged to it. However, the District's determination of charges is final. Same as Puget.

Same. See Section 8.03.

e. Events of default. The events of default are well defined. The District reserves a variety of remedies in the event of Alcoa's default. Same as Puget. However, the remedies for default by Alcoa include payment of the deferred capacity reservation charge as appropriate in the year of any default.

The events of default and remedies for default are included in Article 15.

The District has the right to suspend the District's performance (delivery of Output) if there is a default by Alcoa. The District also has the right upon an Event of Default (a default that has not been cured in the agreed upon time frame) to terminate the contract and sue for damages. Section 15.02. The calculation of damages is described in Section 15.03. The District would not be able to sue for damages if the default is due to a Change of Control to which we have chosen not to consent. Section 15.03(K). The District's termination of the Power Sales Agreement due to the operational criteria set out in Section 5.13 would not be considered a default and also would not result in an action for damages by the District against Alcoa.

Alcoa's only remedies in the event of a default by the District are: (1) a lawsuit (writ of mandamus) to make the District perform; and (2) seek limited damages if there is an Intentional Breach of the District of its obligations. See Section 15.02 and the definition of Intentional Breach.

f. Limitation of liability. Neither party is liable for damages caused to the other party's system or lost revenues. There is no personal liability of Board members or employees of either party. Same as Puget.

We negotiated additional protections in this Power Sales Agreement to ensure that the District would not be liable for any damages suffered by Alcoa, except for the District's Intentional Breach. These provisions are different than the Puget contract for a number of reasons. Most importantly, the provisions in this Power Sales Agreement protects the District from potential claims of loss of profits/revenues in the event of a non-delivery of power. This was important to include due to the fact that Alcoa produces a product. See Article 21.

g. Lawsuit. If there is a lawsuit, it will take place (venue) in Chelan County Superior Court. Same as Puget.

We agreed to federal court in the Eastern District of Washington as a forum for any lawsuit. See Section 23.02 of the Power Sales Agreement.

h. Pondage and ancillary services. The District has maintained flexibility in the pondage by committing that Alcoa (and other purchasers) will only have access to their pro rata share of 90% of the total pondage. Some ancillary services are included in the definition of output (i.e. load following) and others (i.e. black start) are not (and may be sold under separate agreements). Same as Puget.

As part of the negotiation for Alcoa receiving a 26% share of Output, the District maintains for its own benefit and use 100% of the capacity and

pond (except that which is necessary to follow the power requirements at the Wenatchee Works and reserve requirements associated with the 26% share of Output).

i. Environmental Attributes. See Section 12g of this memo regarding environmental attributes associated with the Output sold to Alcoa. Different than Puget.

Same. See Section 5.15 of the Power Sales Agreement. As noted above, the ability of the District to retain the capacity and pond associated with the Output sold to Alcoa is anticipated to make these Environmental Attributes more valuable and more useable (i.e., I-937 compliance) to the District.

j. RTO. The Agreement contemplates the potential of a Regional Transmission Organization (RTO) but does not (and cannot) resolve all possible issues associated with a potential RTO. Same as Puget.

Same. See Appendix B, Section 4 of the Power Sales Agreement.

12. **Use of energy in Wenatchee and protection of District's interests distinct to Alcoa**. Provisions unique to the proposed Alcoa term sheet.

a. Energy can only be used by Alcoa at Wenatchee Works (Section 5.2).

b. Alcoa will do its own forecasting of water and weather to determine an operating level it can maintain with energy from RR/RI and market purchases (Section 5.3).

c. Different operating levels have different economic consequences based upon the power available (Section 5). The concept is to incent Alcoa to run at a high level (more jobs) when the energy is available.

A three potline operation would employ about 460 to 490 employees. A two potline operation employs about 390 employees.

The level of operation set forth as megawatts translates as follows into number of pot lines:

Level 1 – 250 aMW plus - approximately 3 or more pot lines
Level 2 – 215 to less than 250 aMW - approximately 2½ -3 pot lines
Level 3 – 175 to less than 215 aMW - approximately 2 – 2½ pot lines
Level 4 – less than 175 aMW but not shutdown - approximately less than 2 pot lines
Shutdown – 60 aMW or less (ingot production only)

The aMW numbers allow for some flexibility in having a few pots out of service.

The negotiating team determined that measuring aMW used was an objective criterion that the District could independently verify and measure. Unlike the 2001 Agreement with Alcoa, a guarantee of a particular number of jobs was not included. District staff have good knowledge of the Alcoa plant operation and will know what energy is available and what is being used. The negotiating team thought this was a more practical and verifiable measurement but also provided Alcoa with some means to be efficient and continue operations.

Also see how Uncontrollable Circumstances impact this calculation as allowing for an assumed level of operation under certain circumstances.

If Alcoa receives sufficient energy to operate at a higher level but chooses to operate at a lower level, the excess energy will be sold on the market. Depending on operating levels and energy available, the District will share in proceeds from excess energy sales if Alcoa is operating at less than Level 1. For example, if Alcoa operates at Level 2 but has available to it from its share more energy than used, then the excess energy will be sold. Alcoa will pay all operating costs associated with the entire share. No proceeds will be used to pay operating costs. The District will be paid an administrative fee of 1.5%[2]. Then, of the surplus monies generated from the sales, Alcoa will be credited 50% of the proceeds and the District will retain for its own uses 50%. The pro rata split of proceeds varies based on the operation levels. See 5.6 of proposed term sheet.

Any and all proceeds credited to Alcoa will be retained by the District to be used for market purchases necessary for Alcoa's plant operations. If the credits are not fully utilized, the District will retain the balance at the end of the contract. The District is not obligated to separately manage the proceeds and no interest shall accrue or be deemed to accrue on the credit that is accumulated. See Section 5.7 of the proposed term sheet.

All of these provisions are contained in Article 5 of the Power Sales Agreement.

d. Protection for the District from a sustained shutdown is defined in Sections 5.10 and 11(a) of the proposed term sheet. One of these protections (payment of the deferred CRC) is discussed in Section 8 of this memorandum. In addition to payment of the deferred CRC, if the plant is shut down as defined, energy will be sold. The proceeds will first be applied to the costs, and then the District will retain for its own purposes

[2] The 1.5% fee applies to all sales by the District.

100% of the excess proceeds. These net proceeds can be used by the District in any manner and for any purpose.

These provisions are included in Article 5 of the Power Sales Agreement.

e. District has the option to terminate the final definitive agreement if Alcoa operates at less than 175 aMW for 18 months or longer or announces a shutdown (See Section 25). This provision will allow the District to sell the power to another purchaser as it sees fit. It is an option by the District only. If the District decides not to terminate the Agreement, Alcoa remains liable to pay all continued payments. The optionality of this right is important to the District given the uncertainties of costs and operations until 2028.

These provisions are included in Section 5.13 of the Power Sales Agreement. We added that the District has the right to terminate if Alcoa announces that the Wenatchee Works operation is sold to a third party operator (and the District does not consent to that assignment).

f. There are also collateralization requirements. Alcoa will be required to post a letter of credit or other collateral satisfactory to the District if Alcoa's credit rating drops to below investment grade (Section 28). The collateral to be posted must cover three months of operating expenses plus the amount of the shutdown payment that would be due if the plant were to shut down. The posting of collateral is due to the credit rating, not based upon whether a shutdown occurs or not. If collateral satisfactory to the District is not posted, that would be a default under the contract and result in the District having remedies under the default provisions (including termination of the contract). If collateral is not posted, the District may declare the contract in default and, if the default is not cured, the District may exercise its remedies, including termination of the contract and collect damages.

Collateralization requirements are discussed above. See Article 20 of the Power Sales Agreement and definition of Performance Assurance.

g. There are provisions similar to those in the 2004 Agreement protecting the District from counterparty risks (delivery and payment).

See Appendix D and Section 5.01(E).

h. RPS and environmental attributes issues are addressed in Section 30 of the proposed term sheet. Alcoa is a wholesale purchaser and should not be considered part of the District's retail load for purposes of the state's RPS requirements (Initiative 937). Protection has been built in so that if our

interpretation is challenged, Alcoa will be responsible for all additional resources or costs associated with compliance with the RPS.

Same. We added provisions for other Changes in Law, not just interpretation of I-937 that could require the acquisition of renewable resources related to Alcoa's power usage at Wenatchee Works. In all of those events, Alcoa would be responsible to provide and keep the District whole in terms of costs of such resources. See Section 5.16 of the Power Sales Agreement

j. The current Industrial Power Contract (first entered into in 1992 and restated in 1996 and 2004) provides Alcoa the ability to use up to 42 aMW at the average industrial rate (Section 31). Alcoa uses approximately 17 aMW in an average year to operate two pot lines. The District currently sells for its benefit the remaining 25 aMW. If Alcoa increases its usage for more than two pot lines between now and 2011, Alcoa will pay the average industrial rate plus $7.00 per MWH for that extra energy. This is a modification to a current agreement. This current agreement expires October 2011, and there is no extension of that industrial power contract.

We negotiated further on this and Alcoa agreed to pay market rate for any energy used beyond the two pot line operation, a potential increase beyond the $7.00 adder as originally negotiated. In consideration of this change, the Shutdown Settlement Amount in Appendix E of the Power Sales Agreement will be reduced by up to $4,000,000 if Alcoa accesses any of the incremental power for a third potline and pays the market price for that power. Alcoa also specifically agreed that any surcharges imposed on industrial customers would apply to the entire share of the 1995/2000 power (the 42 aMW) referenced above. These changes are reflected in the Amendment Two to Restated and Amended Industrial Power Sales Contract.

OTHER PROVISIONS IN THE POWER SALES AGREEMENT TO CONSIDER – DETAILS THAT WERE NOT INCLUDED IN THE TERM SHEET

The Power Sales Agreement does not become effective unless Alcoa has met certain criteria, including that their credit not be downgraded to BBB- and been placed on negative watch; that they have operated Wenatchee works at a two potline operation for the 12 months prior to the Project Availability Dates (Rocky Reach, Nov. 2011 and Rock Island, July, 2012). Section 3.02.

The representations being made by both parties are important to consider. Article 4.

Load shedding is addressed in Section 6.04.

The District may use funds received (except for certain funds such as Coverage, Capital Recovery and Debt Reduction) as the District determines in its sole discretion for any purpose. Section 7.05.

At the end of the contract, "all amounts deposited or credited to any debt service, reserve, capital coverage, working capital credit pool or other fund or account" shall be retained by the District. Alcoa has no right to claim the funds or any interest earnings on those funds. Section 7.06.

Billing will be monthly. Billing by the District will be done by the 10th of the month and payment due on the 20th day. Late charges and interest will accrue on unpaid billings at a rate of 2% of the unpaid amount of the invoice (late charge) and interest at 1.5% per month. Section 8.01(A) and (B).

The District will make material corrections in billings but corrections will only be made on the basis of looking back for three (3) years. This allows for more timely reviews and corrections than the normal "statute of limitations" which would be six (6) years. Section 8.01(E).

Relicensing support and costs are covered in Article 11 and Appendix A. Alcoa agrees to pay on-going costs for relicensing as a cost of on-going operations (Rock Island license expires December 31, 2028 so we anticipate costs will be incurred in the years prior to the termination of the Power Sales Agreement which also terminates in 2028) and to support the District in efforts to obtain new licenses.

The District has disclaimed all warranties with respect to the Output and Energy to be delivered in Article 12. This is an important aspect with regard to limitation of liability.

There is specific disclaimer of any and all personal liability of any board member or employee for failure to perform the agreement. Section 21.03.

The agreement cannot be "severed." That is, if any one part is deemed to be invalid, the whole agreement is then invalid. The parties have also specifically agreed that neither party will directly or indirectly challenge provisions of the Power Sales Agreement (or Transmission Agreement) nor assist a third party in doing so. Section 23.09.

There are provisions in Appendix A with regard to the determination of Net Costs that are also worthy of specific note. The definition of Net Costs is all inclusive of costs that will be incurred by the District. The District retains flexibility on financing decisions and determination of the appropriate financing mechanisms, including refunding and refinancing decisions.

Appendix B relates to the management of the Output and other issues regarding what aspects of the energy, ancillary services and other products which are included and not included in the percentage share of Output sold to Alcoa.

Appendix D describes how the District will buy and sell additional market purchases on Alcoa's behalf. Of particular note is the exclusion of any liability by the District for any transaction. See subsection (c), (d) and (e) in particular.