

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2009

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition period from _____ to _____

Commission File Number	Exact name of registrant as specified in its charter, state of incorporation, address of principal executive offices, telephone number	I.R.S. Employer Identification Number
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1-4393

PUGET SOUND ENERGY, INC.

91-0374630

A Washington Corporation
10885 NE 4th Street, Suite 1200
Bellevue, Washington 98004-5591
(425) 454-6363

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes /X/ No //

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes // No //

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer, accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	//	Accelerated filer	//	Non-accelerated filer	/X/	Smaller reporting company	//
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes // No /X/

All of the outstanding shares of voting stock of Puget Sound Energy, Inc. are held by its parent company, Puget Energy, Inc.

Table of Contents

	<u>Page</u>
Definitions	3
Forward Looking Statements	4
Part I. Financial Information	6
Item 1. Financial Statements	6
Puget Sound Energy, Inc.	
Consolidated Statements of Income – Three Months Ended March 31, 2009 and 2008	6
Consolidated Statements of Comprehensive Income – Three Months Ended March 31, 2009 and 2008	7
Consolidated Balance Sheets – March 31, 2009 and December 31, 2008	8
Consolidated Statement of Common Shareholder’s Equity – March 31, 2009 and December 31, 2008	10
Consolidated Statements of Cash Flows – Three Months Ended March 31, 2009 and 2008	11
Notes	
Notes to Consolidated Financial Statements	12
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 3. Quantitative and Qualitative Disclosure About Market Risk	37
Item 4. Controls and Procedures	40
Part II. Other Information	40
Item 1. Legal Proceedings	40
Item 1A. Risk Factors	40
Item 6. Exhibits	40
Signatures	41
Exhibit Index	41

DEFINITIONS

AFUDC	Allowance for Funds Used During Construction
ASC	Average System Cost
BPA	Bonneville Power Administration
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FIN	Financial Accounting Standards Board Interpretation
FSP	FASB Staff Position
GAAP	Generally Accepted Accounting Principles
ISDA	International Swaps and Derivatives Association
kW	Kilowatt
kWh	Kilowatt Hour
LIBOR	London Interbank Offered Rate
MMBtus	One Million British Thermal Units
MW	Megawatt (one MW equals one thousand kW)
MWh	Megawatt Hour (one MWh equals one thousand kWh)
NAESB	North American Energy Standards Board
NERC	North American Electric Reliability Corporation
Ninth Circuit	United States Court of Appeals for the Ninth Circuit
NPNS	Normal Purchase Normal Sale
PCA	Power Cost Adjustment
PCORC	Power Cost Only Rate Case
PF	BPA Priority Firm Exchange Rate
PGA	Purchased Gas Adjustment
PSE	Puget Sound Energy, Inc.
Puget Energy	Puget Energy, Inc.
Puget Holdings	Puget Holdings LLC
PURPA	Public Utility Regulatory Policy Act
REP	Residential Exchange Program
RPSA	Residential Purchase and Sale Agreement
SFAS	Statement of Financial Accounting Standards
VIE	Variable Interest Entity
Washington Commission	Washington Utilities and Transportation Commission
WSPP	Western Systems Power Pool

FORWARD-LOOKING STATEMENTS

Puget Sound Energy, Inc. (PSE) is including the following cautionary statements in this Form 10-Q to make applicable and to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by or on behalf of PSE. This report includes forward-looking statements, which are statements of expectations, beliefs, plans, objectives and assumptions of future events or performance. Words or phrases such as “anticipates,” “believes,” “estimates,” “expects,” “future,” “intends,” “plans,” “predicts,” “projects,” “will likely result,” “will continue” or similar expressions identify forward-looking statements.

Forward-looking statements involve risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed. PSE’s expectations, beliefs and projections are expressed in good faith and are believed by PSE, as applicable, to have a reasonable basis, including without limitation management’s examination of historical operating trends, data contained in records and other data available from third parties. However, there can be no assurance that PSE’s expectations, beliefs or projections will be achieved or accomplished.

In addition to other factors and matters discussed elsewhere in this report, some important factors that could cause actual results or outcomes for PSE to differ materially from those discussed in forward-looking statements include:

- Governmental policies and regulatory actions, including those of the Federal Energy Regulatory Commission (FERC) and the Washington Utilities and Transportation Commission (Washington Commission), with respect to allowed rates of return, cost recovery, financing, industry and rate structures, transmission and generation business structures within PSE, acquisition and disposal of assets and facilities, operation, maintenance and construction of electric generating facilities, maintenance, construction and operation of natural gas and electric distribution and transmission facilities (natural gas and electric), licensing of hydroelectric operations and natural gas storage facilities, recovery of other capital investments, recovery of power and natural gas costs, recovery of regulatory assets and present or prospective wholesale and retail competition;
- Failure to comply with FERC or Washington Commission standards and/or rules, which could result in penalties based on the discretion of either commission;
- Failure to comply with electric reliability standards developed by the North American Electric Reliability Corporation (NERC) for users, owners and operators of the power system, which could result in penalties of up to \$1.0 million per day per violation;
- Changes in, adoption of, and compliance with laws and regulations, including decisions and policies concerning the environment, climate change, emissions, natural resources and fish and wildlife (including the Endangered Species Act);
- The ability to recover costs arising from changes in enacted federal, state or local tax laws through revenue in a timely manner;
- Changes in tax law, related regulations, or differing interpretation or enforcement of applicable law by the Internal Revenue Service or other taxing jurisdiction;
- Natural disasters, such as hurricanes, windstorms, earthquakes, floods, fires and landslides, which can interrupt service and/or cause temporary supply disruptions and/or price spikes in the cost of fuel and raw materials and impose extraordinary costs;
- Commodity price risks associated with procuring natural gas and power in wholesale markets;
- Wholesale market disruption, which may result in a deterioration of market liquidity, increase the risk of counterparty default, affect the regulatory and legislative process in unpredictable ways, negatively affect wholesale energy prices and/or impede PSE’s ability to manage its energy portfolio risks and procure energy supply, affect the availability and access to capital and credit markets and/or impact delivery of energy to PSE from its suppliers;
- Financial difficulties of other energy companies and related events, which may affect the regulatory and legislative process in unpredictable ways and also adversely affect the availability of and access to capital and credit markets and/or impact delivery of energy to PSE from its suppliers;
- The effect of wholesale market structures (including, but not limited to, regional market designs or transmission organizations) or other related federal initiatives;
- PSE electric or natural gas distribution system failure, which may impact PSE’s ability to deliver energy supply to its customers;
- Changes in weather conditions in the Pacific Northwest, which could have effects on customer usage and PSE’s revenues;
- Weather, which can have a potentially serious impact on PSE’s ability to procure adequate supplies of natural gas, fuel or purchased power to serve its customers and on the cost of procuring such supplies;
- Variable hydro conditions, which can impact streamflow and PSE’s ability to generate electricity from hydroelectric facilities;

- Plant outages, which can have an adverse impact on PSE's expenses with respect to repair costs, added costs to replace energy or higher costs associated with dispatching a more expensive resource;
- The ability of natural gas or electric plant to operate as intended;
- The ability to renew contracts for electric and natural gas supply and the price of renewal;
- Blackouts or large curtailments of transmission systems, whether PSE's or others', which can affect PSE's ability to deliver power or natural gas to its customers and generating facilities;
- The ability to restart generation following a regional transmission disruption;
- The failure of the interstate natural gas pipeline delivering to PSE's system, which may impact PSE's ability to adequately deliver natural gas supply or electric power to its customers;
- The amount of collection, if any, of PSE's receivables from the California Independent System Operator (CAISO) and other parties and the amount of refunds found to be due from PSE to the CAISO or other parties;
- Industrial, commercial and residential growth and demographic patterns in the service territories of PSE;
- General economic conditions in the Pacific Northwest, which might impact customer consumption or affect PSE's accounts receivable;
- The loss of significant customers or changes in the business of significant customers or the condemnation of PSE's facilities, which may result in changes in demand for PSE's services;
- The failure of information systems or the failure to secure information system data which may impact the operations and cost of PSE's customer service, generation, distribution and transmission;
- The impact of acts of God, terrorism, flu pandemic or similar significant events;
- Capital market conditions, including changes in the availability of capital and interest rate fluctuations;
- Employee workforce factors, including strikes, work stoppages, availability of qualified employees or the loss of a key executive;
- The ability to obtain insurance coverage and the cost of such insurance;
- The ability to maintain effective internal controls over financial reporting and operational processes;
- Changes in PSE's credit ratings, which may have an adverse impact on the availability and cost of capital for PSE; and
- Deteriorating values of the equity, fixed income and other markets which could significantly impact the value of investments of PSE's retirement plan and post-retirement medical trusts and the funding of obligations thereunder.

Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, PSE undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of any such factor on the business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. You are also advised to consult Item 1A-"Risk Factors" in the Company's most recent annual report on Form 10-K.

PART I FINANCIAL INFORMATIONItem 1. **Financial Statements**

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands)
(Unaudited)

	THREE MONTHS ENDED	
	MARCH 31,	
	2009	2008
Operating revenues:		
Electric	\$ 600,230	\$ 606,134
Gas	506,436	443,236
Other	889	1,562
<u>Total operating revenues</u>	<u>1,107,555</u>	<u>1,050,932</u>
Operating expenses:		
Energy costs:		
Purchased electricity	260,249	272,832
Electric generation fuel	48,127	47,014
Residential exchange	(32,404)	(7)
Purchased gas	320,063	276,195
Net unrealized gain on derivative instruments	2,330	88
Utility operations and maintenance	114,893	112,163
Non-utility expense and other	1,307	55
Merger and related costs	27,563	--
Depreciation and amortization	81,361	75,367
Conservation amortization	20,829	13,366
Taxes other than income taxes	101,343	94,273
<u>Total operating expenses</u>	<u>945,661</u>	<u>891,346</u>
Operating income	161,894	159,586
Other income (deductions):		
Other income	9,932	6,814
Other expense	(2,443)	(975)
Interest charges:		
AFUDC	1,681	2,429
Interest expense	(52,576)	(51,048)
Interest expense on Puget Energy note	(73)	(237)
Income before income taxes	118,415	116,569
Income tax expense	33,438	35,665
<u>Net income</u>	<u>\$ 84,977</u>	<u>\$ 80,904</u>

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

	THREE MONTHS ENDED	
	MARCH 31,	
	2009	2008
Net income	\$ 84,977	\$ 80,904
Other comprehensive income:		
Unrealized gain from pension and postretirement plans, net of tax of \$509 and \$95, respectively	945	176
Net unrealized gain (loss) on energy derivative instruments during the period, net of tax of \$(36,911) and \$25,457, respectively	(68,549)	47,277
Reclassification of net unrealized gain on energy derivative instruments settled during the period, net of tax of \$7,521 and \$957, respectively	13,967	1,778
Amortization of financing cash flow hedge contracts to earnings, net of tax of \$43 and \$43, respectively	80	80
Other comprehensive income (loss)	(53,557)	49,311
Comprehensive income	\$ 31,420	\$ 130,215

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

ASSETS

	MARCH 31, 2009 (Unaudited)	DECEMBER 31, 2008
Utility plant: (at original cost, including construction work in progress of \$282,785 and \$255,214, respectively)		
Electric plant	\$ 6,702,507	\$ 6,596,359
Gas plant	2,546,179	2,500,236
Common plant	572,155	550,368
Less: Accumulated depreciation and amortization	(3,445,778)	(3,358,816)
Net utility plant	6,375,063	6,288,147
Other property and investments:		
Investment in Bonneville Exchange Power contract	29,095	29,976
Other property and investments	117,946	118,039
Total other property and investments	147,041	148,015
Current assets:		
Cash	101,028	38,470
Restricted cash	15,988	18,889
Accounts receivable, net of allowance for doubtful accounts	395,871	207,776
Secured pledged accounts receivable	--	158,000
Unbilled revenues	171,604	248,649
Materials and supplies, at average cost	66,718	62,024
Fuel and gas inventory, at average cost	73,266	120,205
Unrealized gain on derivative instruments	22,186	15,618
Prepaid income taxes	10,272	17,317
Prepaid expenses and other	24,285	14,420
Deferred income taxes	34,508	9,439
Total current assets	915,726	910,807
Other long-term and regulatory assets:		
Regulatory asset for deferred income taxes	92,202	95,417
Regulatory asset for PURPA buyout costs	102,669	110,838
Power cost adjustment mechanism	3,147	3,126
Other regulatory assets	765,715	766,732
Unrealized gain on derivative instruments	10,203	6,712
Other	73,071	40,365
Total other long-term and regulatory assets	1,047,007	1,023,190
Total assets	\$ 8,484,837	\$ 8,370,159

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

CAPITALIZATION AND LIABILITIES

	MARCH 31, 2009 (Unaudited)	DECEMBER 31, 2008
Capitalization:		
Common shareholder's investment:		
Common stock (\$10 stated value) - 150,000,000 shares authorized, 85,903,791 shares outstanding	\$ --	\$ 859,038
Common stock (\$0.01 par value) - 150,000,000 shares authorized, 85,903,791 shares outstanding	859	--
Additional paid-in capital	2,962,864	1,296,005
Earnings reinvested in the business	351,501	356,947
Accumulated other comprehensive loss, net of tax	(316,361)	(262,804)
Total shareholder's equity	2,998,863	2,249,186
Redeemable securities and long-term debt:		
Preferred stock subject to mandatory redemption	--	1,889
Junior subordinated notes	250,000	250,000
Long-term debt	2,295,860	2,270,860
Total redeemable securities and long-term debt	2,545,860	2,522,749
Total capitalization	5,544,723	4,771,935
Current liabilities:		
Accounts payable	225,142	341,255
Short-term debt	175,000	964,700
Short-term note owed to parent	19,443	26,053
Current maturities of long-term debt	233,000	158,000
Accrued expenses:		
Purchased gas liability	29,725	8,892
Taxes	96,172	85,068
Salaries and wages	19,374	35,280
Interest	46,084	36,112
Unrealized loss on derivative instruments	324,331	236,866
Other	141,999	117,223
Total current liabilities	1,310,270	2,009,449
Long-term liabilities and regulatory liabilities:		
Deferred income taxes	769,863	750,440
Unrealized loss on derivative instruments	176,665	158,423
Regulatory liabilities	222,181	219,221
Other deferred credits	461,135	460,691
Total long-term liabilities and regulatory liabilities	1,629,844	1,588,775
Total capitalization and liabilities	\$ 8,484,837	\$ 8,370,159

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDER'S EQUITY
(Dollars in thousands)
(Unaudited)

FOR QUARTER ENDED MARCH 31, 2009	COMMON STOCK		ADDITIONAL	RETAINED	ACCUMULATED OTHER	TOTAL
	SHARES	AMOUNT	PAID-IN CAPITAL	EARNINGS	COMPREHENSIVE LOSS	AMOUNT
Balance at December 31, 2008	85,903,791	\$ 859,038	\$ 1,296,005	\$ 356,947	\$ (262,804)	\$ 2,249,186
Net income	--	--	--	84,977	--	84,977
Common stock dividend declared	--	--	--	(90,423)	--	(90,420)
Change in par value	--	(858,179)	858,179	--	--	--
Investment from Puget Energy	--	--	808,680	--	--	808,677
Other comprehensive loss	--	--	--	--	(53,557)	(53,557)
Balance at March 31, 2009	85,903,791	\$ 859	\$ 2,962,864	\$ 351,501	\$ (316,361)	\$ 2,998,863

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	THREE MONTHS ENDED	
	MARCH 31,	
	2009	2008
Operating activities:		
Net income	\$ 84,977	\$ 80,904
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	81,361	75,367
Conservation amortization	20,829	13,366
Deferred income taxes and tax credits, net	26,408	22,327
Amortization of gas pipeline capacity assignment	(2,308)	(2,614)
Non cash return on regulatory assets	(2,397)	(3,363)
Net unrealized loss on derivative instruments	2,330	88
Mint Farm deferred costs	(5,449)	--
Non cash Colstrip settlement	--	10,487
Change in residential exchange program	6,330	(921)
Other	(16,630)	(251)
Counterparty collateral deposit	(5,268)	--
Change in certain current assets and liabilities:		
Accounts receivable and unbilled revenue	46,949	25,456
Materials and supplies	(4,693)	930
Fuel and gas inventory	46,938	59,482
Prepaid income taxes	7,046	41,271
Prepayments and other	(9,865)	3,146
Purchased gas receivable/payable	20,833	(9,436)
Accounts payable	(101,670)	(17,884)
Taxes payable	11,530	22,900
Accrued expenses and other	6,654	11,397
Net cash provided by operating activities	213,905	332,652
Investing activities:		
Construction expenditures - excluding equity AFUDC	(179,308)	(126,646)
Energy efficiency expenditures	(16,570)	(14,010)
Restricted cash	2,901	(1)
Other	4,960	1,884
Net cash used by investing activities	(188,017)	(138,773)
Financing activities:		
Change in short-term debt, net	(10,376)	(158,882)
Dividends paid	(67,871)	(48,581)
Loan from (payment to) parent	(6,610)	14,234
Long term bond issued	250,000	--
Redemption of trust preferred stock	(1,889)	--
Redemption of bonds and notes	(150,000)	--
Investment from parent	29,616	--
Issuance cost of bonds and other	(6,199)	3,979
Net cash provided (used) by financing activities	36,671	(189,250)
Net increase in cash	62,559	4,629
Cash at beginning of year	38,470	40,773
Cash at end of period	\$ 101,029	\$ 45,402
Supplemental cash flow information:		
Cash payments for interest (net of capitalized interest)	\$ 39,709	\$ 38,642
Cash refunds from income taxes	(271)	(39,730)

The accompanying notes are an integral part of the financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Consolidation Policy

BASIS OF PRESENTATION

Puget Sound Energy, Inc. (PSE) is a subsidiary of Puget Energy, Inc. (Puget Energy), an energy services holding company incorporated in the state of Washington in 1999. On February 6, 2009, Puget Holdings LLC (Puget Holdings) completed its merger with Puget Energy. PSE's basis of accounting will continue to be on a historical basis and PSE's financial statements will not include any Statement of Financial Accounting Standards (SFAS) No. 141R, "Business Combinations" purchase accounting adjustments.

PSE's consolidated financial statements include the accounts of PSE and its subsidiaries. PSE is referred to herein as "the Company." The consolidated financial statements are presented after elimination of all significant intercompany items and transactions. The consolidated financial statements contained in this Form 10-Q are unaudited. In the opinion of PSE's management, all adjustments necessary for a fair statement of the results for the interim periods have been reflected and were of a normal recurring nature. These financial statements should be read in conjunction with the audited financial statements (and the Combined Notes thereto) included in the combined Puget Energy and PSE Report on Form 10-K for the year ended December 31, 2008.

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

PSE collected Washington State excise taxes (which are a component of general retail rates) and municipal taxes of \$85.9 million for the three months ended March 31, 2009 and \$76.6 million for the three months ended March 31, 2008. The Company's policy is to report such taxes on a gross basis in operating revenues and taxes other than income taxes in the accompanying consolidated statements of income.

(2) Merger

In conjunction with the merger on February 6, 2009, Puget Energy contributed \$808.9 million in capital to PSE, of which \$779.3 million was used to pay off short-term debt owed by PSE, including \$188.0 million in short-term debt outstanding through the PSE Funding accounts receivable securitization program that was terminated upon closing of the merger. The \$779.3 million is excluded as cash provided by financing activities in the statement of cash flows. An additional \$29.6 million of the capital contribution was used to pay for change in control costs associated with the merger and is included as cash provided by financing activities in the statement of cash flows. The stated value of the outstanding common stock was changed from \$10.00 to a par value of \$0.01 per share. The remaining \$9.99 of the original stated value was transferred to additional paid in capital.

During the first quarter 2009, PSE incurred \$27.6 million pre-tax in merger costs. These costs include compensation costs as a result of the change in control, write-off of deferred debt costs associated with the termination of the pre-merger credit facilities, expenses associated with new credit facilities and the impact of deferred compensation liabilities as a result of the merger. Pursuant to the Washington Commission merger order commitments, PSE will not seek recovery of these costs. In addition, a requirement of the merger was that Puget Energy be the sole shareholder of PSE. Accordingly, on February 5, 2009, prior to the close of the merger, PSE defeased and called for the redemption of its two outstanding series of preferred stock. The redemption was completed on March 13, 2009.

The merger order issued by the Washington Utilities and Transportation Commission (Washington Commission) was subject to a Settlement Stipulation which included 78 conditions. The conditions provided for, among other matters, minimum equity to capitalization ratio, dividend restrictions, financial reporting and rate credits of \$10.0 million per year for ten years.

(3) Accounting for Derivative Instruments and Hedging Activities

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as amended, requires that all contracts considered to be derivative instruments be recorded on the balance sheet at their fair value. The Company enters into contracts to manage its energy resource portfolio and interest rate exposure including forward physical and financial contracts, option contracts and swaps. The majority of the Company's physical contracts qualify for the Normal Purchase Normal Sale (NPNS) exception to derivative accounting rules, provided they meet certain criteria. Generally, NPNS applies to contracts with creditworthy counterparties, for which physical delivery is probable and in quantities that will be used in the normal course of business. Power purchases designated as NPNS must meet additional criteria if the counterparty owns or controls energy resources within the western region to allow for physical delivery of the energy and if the transaction is within the Company's forecasted load requirements. The Company may enter into financial fixed contracts to hedge the variability of certain NPNS contracts. Those contracts that do not meet NPNS exception or cash flow hedge criteria are marked-to-market to current earnings in the income statement, subject to deferral under SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), for energy related derivatives due to the Power Cost Adjustment (PCA) mechanism and Purchased Gas Adjustment (PGA) mechanism.

The Company pursues various portfolio optimization strategies, but is not in the business of assuming risk for the purpose of realizing speculative trading revenues. The nature of serving regulated electric customers with its wholesale portfolio of owned and contracted electric generation resources exposes the Company and its customers to some volumetric and commodity price risks within the sharing mechanism of the PCA. Therefore, wholesale market transactions are focused on balancing the Company's energy portfolio, reducing costs and risks where feasible and reducing volatility in wholesale costs and margin in the portfolio. The Company's energy risk portfolio management function monitors and manages these risks using analytical models and tools. In order to manage risks effectively, the Company enters into physical and financial transactions which are appropriate for the service territory of the Company and are relevant to its regulated electric and gas portfolios.

The following table presents electric derivatives that do not meet the NPNS exception at March 31, 2009 and December 31, 2008, including contracts designated as cash flow hedges:

(DOLLARS IN MILLIONS)	ELECTRIC DERIVATIVES	
	MARCH 31, 2009	DECEMBER 31, 2008
Current asset	\$ 1.3	\$ 0.4
Long-term asset	0.9	0.5
Total assets	\$ 2.2	\$ 0.9
Current liability	\$ 151.9	\$ 90.6
Long-term liability	122.3	96.1
Total liabilities	\$ 274.2	\$ 186.7

If it is determined that it is uneconomical to operate the Company's controlled electric generating facilities in the future period, the fuel supply cash flow hedge relationship is terminated and the hedge is de-designated which results in recognition of future changes in value in the income statements. As these contracts are settled, amounts previously deferred in other comprehensive income (OCI) are recognized as energy costs and are included as part of the PCA mechanism.

The following table presents the impact of changes in the market value of derivative instruments not meeting NPNS or cash flow hedge criteria to the Company's earnings during the three months ended March 31, 2009 and March 31, 2008:

(DOLLARS IN MILLIONS)	MARCH 31, 2009	MARCH 31, 2008	CHANGE
Decrease in earnings	\$ (2.3)	\$ (0.1)	\$ (2.2)

The decrease in earnings in 2009 primarily relates to a \$3.2 million unrealized loss associated with the ineffective portion of cash flow hedges for two long-term power supply agreements.

The amount of unrealized loss, net of tax, related to the Company's energy-related cash flow hedges under SFAS No. 133 deferred in accumulated other comprehensive income consisted of the following at March 31, 2009 and December 31, 2008:

(DOLLARS IN MILLIONS, NET OF TAX)	MARCH 31, 2009	DECEMBER 31, 2008
Other comprehensive income – unrealized loss	\$ (166.3)	\$ (111.7)

The following table presents natural gas derivative contracts at March 31, 2009 and December 31, 2008:

(DOLLARS IN MILLIONS)	GAS DERIVATIVES	
	MARCH 31, 2009	DECEMBER 31, 2008
Current asset	\$ 20.9	\$ 15.2
Long-term asset	9.3	6.2
Total assets	\$ 30.2	\$ 21.4
Current liability	\$ 172.4	\$ 146.3
Long-term liability	54.4	62.3
Total liabilities	\$ 226.8	\$ 208.6

At March 31, 2009, the Company had total assets of \$30.2 million and total liabilities of \$226.8 million related to financial contracts used to economically hedge the cost of physical gas purchased to serve natural gas customers. All fair value adjustments on derivatives relating to natural gas have been reclassified to a deferred account in accordance with SFAS No. 71 due to the PGA mechanism. All increases and decreases in the cost of natural gas supply are passed on to customers with the PGA mechanism. As the gains and losses on the hedges are realized in future periods, they will be recorded as gas costs under the PGA mechanism.

The ending balance in OCI related to the forward starting swaps and previously settled treasury lock contracts at March 31, 2009 is a net loss of \$7.8 million after tax and accumulated amortization. This compares to a loss of \$7.9 million in OCI after tax and accumulated amortization at December 31, 2008.

SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – An Amendment of Financial Accounting Standards Board (FASB) Statement No. 133" (SFAS No. 161), requires enhanced disclosures about a company's derivative activities and how the related hedged items affect a company's financial position, financial performance and cash flows. To meet the objectives, SFAS No. 161 requires qualitative disclosures about the Company's fair value amounts of gains and losses associated with derivative instruments, as well as disclosures about credit-risk-related contingent features in derivative agreements.

The following table presents the fair values and locations of derivative instruments recorded in the balance sheet at March 31, 2009:

(DOLLARS IN MILLIONS) AT MARCH 31, 2009	DERIVATIVES DESIGNATED AS HEDGING INSTRUMENTS			
	ASSET DERIVATIVES		LIABILITY DERIVATIVES	
	BALANCE SHEET LOCATION	FAIR VALUE	BALANCE SHEET LOCATION	FAIR VALUE
Commodity contracts:				
Electric derivatives:				
Current	Unrealized gain on derivative instruments	\$ --	Unrealized loss on derivative instruments	\$ 145.6
Long term	Unrealized gain on derivative instruments	0.3	Unrealized loss on derivative instruments	120.0
Gas derivatives:				
Current	Unrealized gain on derivative instruments	--	Unrealized loss on derivative instruments	--
Long term	Unrealized gain on derivative instruments	--	Unrealized loss on derivative instruments	--
Total derivatives designated as hedging instruments		\$ 0.3		\$ 265.6

(DOLLARS IN MILLIONS) AT MARCH 31, 2009	DERIVATIVES NOT DESIGNATED AS HEDGING INSTRUMENTS			
	ASSET DERIVATIVES		LIABILITY DERIVATIVES	
	BALANCE SHEET LOCATION	FAIR VALUE	BALANCE SHEET LOCATION	FAIR VALUE
Commodity contracts:				
Electric derivatives:				
Current	Unrealized gain on derivative instruments	\$ 1.2	Unrealized loss on derivative instruments	\$ 6.3
Long term	Unrealized gain on derivative instruments	0.6	Unrealized loss on derivative instruments	2.2
Gas derivatives:				
Current	Unrealized gain on derivative instruments	20.9	Unrealized loss on derivative instruments	172.4
Long term	Unrealized gain on derivative instruments	9.3	Unrealized loss on derivative instruments	54.4
Total derivatives not designated as hedging instruments		\$ 32.0		\$ 235.3
Combined total		\$ 32.3		\$ 500.9

The following table presents the effect of energy related derivatives on the PGA mechanism in the balance sheet as of March 31, 2009:

(DOLLARS IN MILLIONS) AT MARCH 31, 2009	BALANCE SHEET		BALANCE SHEET	
	LOCATION ¹	FAIR VALUE	LOCATION ¹	FAIR VALUE
Commodity contracts:				
Gas derivatives:				
Current	Other regulatory assets	\$ 196.6	Regulatory liabilities	\$ --
Total		\$ 196.6		\$ --

¹ Natural gas derivatives are deferred, in accordance with SFAS No. 71 and all increases and decreases in the cost of natural gas supply are passed on to customers with the PGA mechanism. As gains and losses are realized in future periods, they will be recorded as purchased gas costs in the income statement.

The following table presents the effect of hedging instruments on OCI and income for the three months ended March 31, 2009:

(DOLLARS IN MILLIONS)	AMOUNT OF LOSS RECOGNIZED IN OCI ON DERIVATIVES	LOCATION OF LOSS RECLASSIFIED FROM ACCUMULATED OCI INTO INCOME	AMOUNT OF LOSS RECLASSIFIED FROM ACCUMULATED OCI INTO INCOME	LOCATION OF LOSS RECOGNIZED IN INCOME ON DERIVATIVES	AMOUNT OF LOSS RECOGNIZED IN INCOME ON DERIVATIVES
DERIVATIVES IN SFAS No. 133 CASH FLOW HEDGING RELATIONSHIPS	EFFECTIVE PORTION ¹	EFFECTIVE PORTION ²		INEFFECTIVE PORTION AND AMOUNT EXCLUDED FROM EFFECTIVENESS TESTING ^{2,3}	
Interest rate contracts:	\$ --	Interest expense	\$ (0.1)		\$ --
Commodity contracts:				Net unrealized loss on derivative instruments	
Electric derivatives	(48.5)	Electric generation fuel	(21.5)		--
Electric derivatives	(19.4)	Purchased electricity	--	Net unrealized loss on derivative instruments	(3.2)
Gas derivatives	--	Purchased gas	--	Net unrealized loss on derivative instruments	--
Total	\$ (67.9)		\$ (21.6)		\$ (3.2)

¹ Changes in OCI are reported in after tax dollars.

² Losses are reported in pre-tax dollars.

³ Ineffective portion of long-term power supply contracts that are designated as cash flow hedges.

For derivative instruments that meet cash flow hedge criteria, the effective portion of the gain or loss on the derivative is reported as a component of OCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivatives representing hedge ineffectiveness are recognized in current earnings. The Company expects that in the future it may be extremely difficult to qualify for cash flow hedge treatment due to market conditions. The Company expects that \$88.6 million of losses in OCI will be reclassified into earnings within the next 12 months. The maximum length of time over which the Company is hedging its exposure to the variability in future cash flows extends to February 2015 for the physical electric contracts and to January 2012 for electric generation fuel financial contracts.

The following table presents the effect of derivatives not designated as hedging instruments on income for the three months ended March 31, 2009:

(DOLLARS IN MILLIONS) THREE MONTHS ENDED MARCH 31, 2009	LOCATION OF GAIN IN INCOME ON DERIVATIVES	AMOUNT OF GAIN RECOGNIZED IN INCOME ON DERIVATIVES
Interest rate contracts:		\$ --
Commodity contracts:	Net unrealized gain on derivative instruments	0.9
Electric derivatives		
Gas derivatives	Net unrealized gain on derivative instruments	--
Total		\$ 0.9

For the quarter ended March 31, 2009, the Company reported \$4.8 million in losses that were reclassified into earnings as a result of the discontinuance of cash flow hedges because the original forecasted transactions have a remote chance of occurring. The Company also reported year-to-date gains of \$5.7 million related to transactions that did not meet NPNS or cash flow hedge criteria.

The Company had the following outstanding commodity contracts that were entered into as of March 31, 2009:

THREE MONTHS ENDED MARCH 31, 2009	NUMBER OF UNITS
Derivatives designated as hedging instruments:	
Electric generation fuel	61,660,000 MMBtus
Purchased electricity	4,812,300 MWh
Derivatives not designated as hedging instruments:	
Gas derivatives ¹	86,021,684 MMBtus
Electric generation fuel	5,228,960 MMBtus
Purchased electricity	2,635,400 MWh

¹ Gas derivatives are deferred in accordance with SFAS No. 71.

The Company is exposed to credit risk primarily through buying and selling electricity and natural gas to serve customers. Credit risk is the potential loss resulting from a counterparty's non-performance under an agreement. The Company manages credit risk with policies and procedures for, among other things, counterparty analysis, exposure measurement, exposure monitoring and exposure mitigation.

Where deemed appropriate, the Company may request collateral or other security from its counterparties to mitigate the potential credit default losses. Criteria employed in this decision includes, among other things, the perceived creditworthiness of the counterparty and the expected credit exposure.

The Company monitors counterparties' credit standing, including those that are experiencing financial problems, have significant swings in credit default swap rates, have credit rating changes by external rating agencies or have changes in ownership.

It is possible that volatility in energy commodity prices could cause the Company to have material credit risk exposures with one or more counterparties. If such counterparties fail to perform their obligations under one or more agreements, the Company could suffer a material financial loss. However, as of March 31, 2009, approximately 99.6% of the counterparties with transaction amounts outstanding in the Company's energy portfolio, including NPNS transactions, are rated at least investment grade by the major rating agencies and 0.4% are either rated below investment grade or are not rated by rating agencies. The Company assesses credit risk internally for counterparties that are not rated.

The Company has entered into commodity master arrangements with its counterparties to mitigate credit exposure to those counterparties. The Company generally enters into the following master arrangements: (1) Western Systems Power Pool agreements (WSPP) - standardized power sales contract in the electric industry; (2) International Swaps and Derivatives Association agreements (ISDA) - standardized financial gas and electric contracts; and (3) North American Energy Standards Board agreements (NAESB) - standardized physical gas contracts. The Company believes that entering into such agreements reduces the risk of default by allowing a counterparty the ability to make only one net payment.

The Company computes credit reserves at a master agreement level (i.e. WSPP, ISDA or NAESB) by counterparty. The Company considers external credit ratings and market factors, such as credit default swaps and bond spreads, in determination of reserves. The Company recognizes that external ratings may not always reflect how a market participant perceives counterparty's risk of default. The Company uses both default factors published by Standard & Poor's (S&P) and factors derived through analysis of market risk, which reflect the application of an industry standard recovery rate. The Company selects a default factor by counterparty at an aggregate master agreement level based on a weighted average default tenor for that counterparty's deals. The default tenor is used by weighting fair values and contract tenors for all deals for each counterparty and coming up with an average value. The default factor used is dependent upon whether the counterparty is in a net asset or a net liability position after applying the master agreement levels.

The Company applies the counterparty's default factor to compute credit reserves for counterparties that are in a net asset position. Moreover, the Company applies its own default factor to compute credit reserves for counterparties in a net liability position. The Company's S&P rating at March 31, 2009 was BBB. Credit reserves are booked as contra accounts to unrealized gain (loss) positions. As of March 31, 2009, the Company was in a net liability position with the majority of counterparties, so the default factors of counterparties did not have a significant impact on reserves for the year. The majority of the Company's derivative contracts are with financial institutions and other utilities operating within the Western Electric Coordinating Council.

The Company enters into energy contracts with various credit-risk-related contingent features, which could result in a counterparty requesting immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in a net liability position.

The table below presents the fair value of the overall contractual contingent liability positions for the Company's derivative activity at March 31, 2009:

(DOLLARS IN MILLIONS) AT MARCH 31, 2009	FAIR VALUE ⁴	POSTED	CONTINGENT
CONTINGENT FEATURE	LIABILITY	COLLATERAL	COLLATERAL
Credit rating ¹	\$ (4.0)	\$ --	\$ 4.0
Reasonable grounds for adequate assurance ²	(143.4)	--	--
Forward value of contract ³	(60.2)	35.0	N/A
Total	\$ (207.6)	\$ 35.0	\$ 4.0

¹ The Company is required to maintain an investment grade credit rating from each of the major credit rating agencies.

² A counterparty with reasonable grounds for insecurity regarding performance of an obligation may request adequate assurance of performance.

³ Collateral requirements may vary, based on changes in forward value of underlying transactions.

⁴ Represents derivative fair values of contracts with contingent features for counterparties in net derivative liability positions at March 31, 2009. Excludes NPNS and accounts payable and accounts receivable activity.

(4) Fair Value Measurements

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157), establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by SFAS No. 157 are as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives and listed equities. Equity securities that are also classified as cash equivalents are considered Level 1 if there are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange-traded derivatives such as over the counter forwards and options.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs. At each balance sheet date, the Company performs an analysis of all

instruments subject to SFAS No. 157 and includes in Level 3 all of those whose fair value is based on significant unobservable inputs.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. If a fair value measurement relies on inputs from different levels of the hierarchy, the entire measurement must be placed into the same level based on the lowest level input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values incorporates various factors that not only include the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits, letters of credit and priority interests), but also the impact of the Company's nonperformance risk on its liabilities.

As of March 31, 2009, the Company considers the markets for its electric and natural gas Level 2 derivative instruments to be actively traded. Management's assessment is based on the trading activity volume in real-time and forward electric and natural gas markets. The Company regularly confirms the validity of pricing service quoted prices (e.g. Level 2 in the fair value hierarchy) used to value commodity contracts to the actual prices of commodity contracts entered into during the most recent quarter.

The following table sets forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2009:

RECURRING FAIR VALUE MEASURES (DOLLARS IN MILLIONS)	AT FAIR VALUE AS OF MARCH 31, 2009				AT FAIR VALUE AS OF MARCH 31, 2008			
	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Assets:								
Energy derivative instruments	\$ --	\$ 31.5	\$ 0.9	\$ 32.4	\$ --	\$ 107.8	\$ 34.6	\$ 142.4
Money market accounts	63.9	--	1.4	65.3	13.8	--	1.4	15.2
Total assets	\$ 63.9	\$ 31.5	\$ 2.3	\$ 97.7	\$ 13.8	\$ 107.8	\$ 36.0	\$ 157.6
Liabilities:								
Energy derivative instruments	\$ --	\$ 322.5	\$ 178.5	\$ 501.0	\$ --	\$ 1.4	\$ 10.2	\$ 11.6
Other financial items	--	--	--	--	--	--	7.2	7.2
Total liabilities	\$ --	\$ 322.5	\$ 178.5	\$ 501.0	\$ --	\$ 1.4	\$ 17.4	\$ 18.8

The following table sets forth a reconciliation of changes in the fair value of derivatives classified as Level 3 in the fair value hierarchy:

(DOLLARS IN MILLIONS)	2009	2008
Balance at beginning of period (net credit reserve on energy derivatives)	\$ (132.2)	\$ (7.3)
Changes during period :		
Realized and unrealized energy derivatives		
- included in earnings	(2.4)	(0.1)
- included in other comprehensive income	(53.1)	28.7
- included in regulatory assets/liabilities	(7.4)	0.3
Purchases, issuances, and settlements	8.1	(1.9)
Energy derivatives transferred in/out of Level 3	10.8	(1.1)
Balance as of March 31, 2009 (net credit reserve on energy derivatives)	\$ (176.2)	\$ 18.6

Realized gains and losses on energy derivatives for Level 3 recurring items are included in energy costs in the Company's income statement under purchased electricity, electric generation fuel or purchased gas when settled.

Unrealized gains and losses for Level 3 inputs on energy derivatives recurring items are included in the net unrealized (gain) loss on derivative instruments section in the Company's income statement and as net unrealized (gain) loss on derivative instruments in OCI. The Company does not believe that the fair values diverge materially from the amounts the Company currently anticipates realizing on settlement or maturity.

Energy derivative instruments are classified as Level 3 in the fair value hierarchy because Level 3 inputs are significant to their fair value measurement. Energy derivatives transferred out of Level 3 represent existing assets or liabilities that were classified as Level 3 at end of the prior reporting period for which the lowest significant input became observable during the

current reporting period. The net unrealized loss recognized during the reporting period is primarily due to a significant decrease in market prices.

(5) Retirement Benefits

The Company has a defined benefit pension plan covering substantially all PSE employees, with a cash balance feature for all but International Brotherhood of Electrical Workers employees. Benefits are a function of age, salary and service. The Company also maintains a non-qualified supplemental retirement plan for officers and certain director-level employees.

The following table summarizes the estimate of net periodic benefit cost for the three months ended March 31:

(DOLLARS IN THOUSANDS)	QUALIFIED PENSION BENEFITS		SERP PENSION BENEFITS		OTHER BENEFITS	
	2009	2008	2009	2008	2009	2008
Components of net periodic benefit cost:						
Service cost	\$ 3,271	\$ 3,054	\$ 267	\$ 234	\$ 32	\$ 43
Interest cost	6,905	6,498	579	553	266	283
Expected return on plan assets	(10,755)	(10,455)	--	--	(111)	(197)
Amortization of prior service cost	283	161	154	154	21	21
Amortization of net loss (gain)	808	--	221	183	(46)	(199)
Amortization of transition obligation	--	--	--	--	13	13
Net periodic benefit cost (income)	\$ 512	\$ (742)	\$ 1,221	\$ 1,124	\$ 175	\$ (36)

The Company previously disclosed in its financial statements for the year ended December 31, 2008 that it expected contributions by the Company to fund the Supplemental Executive Retirement Plan (SERP) and the other postretirement plans for the year ending December 31, 2009 to be \$4.0 million and \$0.1 million, respectively. The full amount of the pension funding for 2009 is for the Company's non-qualified supplemental retirement plan.

During the three months ended March 31, 2009, payments of benefits related to the Company's non-qualified pension plans were \$0.4 million. Based on this activity, the Company anticipates paying additional benefits of \$3.6 million for the Company's non-qualified pension plan during 2009. During the three months ended March 31, 2009, actual other post-retirement medical benefit plan contributions were \$0.2 million. The Company expects to make additional contributions of approximately \$18.0 million during the remaining periods of 2009.

(6) Regulation and Rates

On April 17, 2009, the Washington Commission issued a final order approving and adopting a settlement agreement that authorized PSE to defer certain ownership and operating costs related to its purchase of the Mint Farm Generation Station (Mint Farm) that will be incurred prior to PSE recovering such costs in electric customer rates. Under Washington State law, a company may defer the costs associated with purchasing and operating a gas plant that complies with the greenhouse gases (GHG) emissions performance standard until the plant is included in rates or for two years from the date of purchase, whichever is sooner. As of March 31, 2009, PSE had established a regulatory asset of \$7.7 million. The prudence of the Mint Farm acquisition, recovery of costs of Mint Farm and compliance with the GHG emissions performance standard will be addressed in the Company's next rate proceeding.

On October 8, 2008, the Washington Commission issued its order in PSE's consolidated electric and natural gas general rate case filed in December 2007, approving a general rate increase for electric customers of \$130.2 million or 7.1% annually, and an increase in natural gas rates of \$49.2 million or 4.6% annually. The rate increases for electric and natural gas customers were effective November 1, 2008. In its order, the Washington Commission approved a weighted cost of capital of 8.25% and a capital structure that included 46.0% common equity with a return on equity of 10.15%. The Washington Commission issued a separate order on January 15, 2009, that authorized the continuation of the Power Cost Only Rate Case (PCORC) with certain modifications to which the Washington Commission staff and the Company had agreed. The five procedural modifications to the PCORC include extending the expected procedural schedule from five to six months, limiting the power cost updates to one per PCORC unless an additional update is allowed by the Washington Commission as part of the compliance filing, prohibiting the overlap of PCORC and general rate cases (except for requests for interim rate relief),

shortening data request time from ten to five business days and requiring the Company to provide its future energy resource model projections at the outset of a case.

On September 25, 2008, the Washington Commission approved PSE's requested revisions to its PGA tariff schedules resulting in an increase of \$108.8 million or 11.1% on an annual basis in gas sales revenues effective October 1, 2008. The rate increase was the result of higher costs of natural gas in the forward market and a reduction of the credit for the accumulated PGA payable balance. The PGA rate change will increase PSE's revenue but will not impact the Company's net income as the increased revenue will be offset by increased purchased gas costs.

(7) Litigation

Residential Exchange. Petitioners in several actions in the U. S. Court of Appeals for the Ninth Circuit (Ninth Circuit) against the Bonneville Power Administration (BPA) asserted that BPA acted contrary to law in entering into or performing or implementing a number of agreements, including the amended settlement agreement (and the May 2004 agreement) between BPA and PSE regarding the Residential Exchange Program (REP). Petitioners in several actions in the Ninth Circuit against BPA also asserted that BPA acted contrary to law in adopting or implementing the rates upon which the benefits received or to be received from BPA during the October 1, 2001 through September 30, 2006 period were based. A number of parties claimed that BPA rates proposed or adopted in the BPA rate proceeding to develop BPA rates to be used in the agreements for determining the amounts of money to be paid to PSE by BPA during the period October 1, 2006 through September 30, 2009 are contrary to law and that BPA acted contrary to law or without authority in deciding to enter into, or in entering into or performing or implementing such agreements.

On May 3, 2007, the Ninth Circuit issued an opinion in *Portland Gen. Elec. v. BPA*, Case No. 01-70003, in which proceeding the actions of BPA in entering into settlement agreements regarding the REP with PSE and with other investor-owned utilities were challenged. In this opinion, the Ninth Circuit granted petitions for review and held the settlement agreements entered into between BPA and the investor-owned utilities being challenged in that proceeding to be inconsistent with statute. On May 3, 2007, the Ninth Circuit also issued an opinion in *Golden Northwest Aluminum v. BPA*, Case No. 03-73426, in which proceeding the petitioners sought review of BPA's 2002-2006 power rates. In this opinion, the Ninth Circuit granted petitions for review and held that BPA unlawfully shifted onto its preference customers the costs of its settlements with the investor-owned utilities. On October 5, 2007, petitions for rehearing of these two opinions were denied. On February 1, 2008, PSE and other utilities filed in the Supreme Court of the United States a petition for a writ of certiorari to review the decisions of the Ninth Circuit, which petition was denied in June 2008.

In May 2007, following the Ninth Circuit's issuance of these two opinions, BPA suspended payments to PSE under the amended settlement agreement (and the May 2004 agreement). On October 11, 2007, the Ninth Circuit remanded the May 2004 agreement to BPA in light of the *Portland Gen. Elec. v. BPA* opinion and dismissed the remaining three pending cases regarding settlement agreements.

In March 2008, BPA and PSE signed an agreement pursuant to which BPA made a payment to PSE related to the REP benefits for the fiscal year ended September 30, 2008, which payment is subject to true-up depending upon the amount of any REP benefits ultimately determined to be payable to PSE. In March and April 2008, Clatskanie People's Utility District filed petitions in the Ninth Circuit for review of BPA actions in connection with offering or entering into such agreement with PSE and similar agreements with other investor-owned utilities. Clatskanie People's Utility District asserts that BPA's actions in entering into and executing the 2008 REP agreements were contrary to law or without authority and that such agreements are null and void and result in overpayments of REP benefits to PSE and other regional investor-owned utilities.

In September 2008, BPA issued its record of decision in its reopened WP-07 rate proceeding to respond to the various Ninth Circuit opinions. In this record of decision, BPA adjusted its fiscal year 2009 rates, determined the amounts of REP benefits it considered to have been improperly paid after fiscal year 2001 to PSE and the other regional investor-owned utilities, and determined that such amounts are to be recovered through reductions in REP benefit payments to be made over a number of years. The amount determined by BPA to be recovered through reductions commencing October 2007 in REP payments for PSE's residential and small farm customers was approximately \$207.2 million plus interest on unrecovered amounts. However, these BPA determinations are subject to subsequent administrative and judicial review, which may alter or reverse such determinations. PSE and others, including a number of preference agency and investor-owned utility

customers of BPA, in December 2008 filed petitions for review in the Ninth Circuit of various of these BPA determinations. PSE is reviewing its options in determining if it will contest the amounts withheld as improper payments made since 2001.

In September 2008, BPA and PSE signed a short-term Residential Purchase and Sale Agreement (RPSA) under which BPA is to pay REP benefits to PSE for fiscal years ending September 30, 2009–2011. In December 2008, BPA and PSE signed another long-term RPSA under which BPA is to pay REP benefits to PSE for the period October 2011 through September 2028. PSE and other customers of BPA in December 2008 filed petitions for review in the Ninth Circuit of the short-term and long-term RPSAs signed by PSE (and similar RPSAs signed by other investor-owned utility customers of BPA) and BPA's record of decision regarding such RPSAs. Generally, REP benefit payments under a RPSA are based on the amount, if any, by which a utility's average system cost (ASC) exceeds BPA's Priority Firm (PF) Exchange rate for such utility. The ASC for a utility is determined using an ASC methodology adopted by BPA. The ASC methodology adopted by BPA and the ASC determinations, REP overpayment determinations, and the PF Exchange rate determinations by BPA are all subject to Federal Energy Regulatory Commission (FERC) review or judicial review or both and are subject to adjustment, which may affect the amount of REP benefits paid or to be paid by BPA to PSE. As discussed above, BPA has determined to reduce such payments based on its determination of REP benefit overpayments after fiscal year 2001.

It is not clear what impact, if any, such development or review of such BPA rates, review of such ASC, ASC methodology, and BPA determination of REP overpayments, review of such agreements, and the above described Ninth Circuit litigation may ultimately have on PSE. Any changes to the REP payments passes through to customers with no impact to PSE's net income.

Proceedings Related to the Western Power Market. Puget Energy's and PSE's Annual Report on Form 10-K for the year ended December 31, 2008 includes a summary relating to the western power market proceedings. PSE is vigorously defending each of these cases. Litigation is subject to numerous uncertainties and PSE is unable to predict the ultimate outcome of these matters. Accordingly, there can be no guarantee that these proceedings, either individually or in the aggregate, will not materially and/or adversely affect PSE's financial condition, results of operations or liquidity.

CPUC v. FERC. On August 2, 2006, the Ninth Circuit decided that FERC erred in excluding potential relief for tariff violations for periods that pre-dated October 2, 2000 and additionally ruled that FERC should consider remedies for transactions previously considered outside the scope of the proceedings. The August 2, 2006 decision may adversely impact PSE's ability to recover the full amount of its California Independent System Operator (CAISO) receivable. The decision may also expose PSE to claims or liabilities for transactions outside the previously defined "refund period." At this time the ultimate financial outcome for PSE is unclear. Rehearing by the Ninth Circuit was denied on April 6, 2009. Parties have been engaged in court-sponsored settlement discussions, and those discussions may result in some settlements. PSE is unable to predict either the outcome of the proceedings or the ultimate financial effect on PSE.

(8) Related Party Transactions

On June 1, 2006, PSE entered into a revolving credit facility with its parent, Puget Energy, in the form of a Demand Promissory Note (Note). Through the Note, PSE may borrow up to \$30.0 million from Puget Energy, subject to approval by Puget Energy. Under the terms of the Note, PSE pays interest on the outstanding borrowings based on the lowest of the weighted-average interest rate of (a) PSE's outstanding commercial paper interest rate or (b) PSE's senior unsecured revolving credit facility. At March 31, 2009 and December 31, 2008, the outstanding balance of the Note was \$19.4 million and \$26.1 million, respectively and the interest rate was 1.4% and 1.7% respectively. This Note is unaffected by the February 6, 2009 merger.

The Company has a general liability claim from AEGIS Insurance Services Inc. (AEGIS) for \$3.3 million as of March 31, 2009 which was recovered by the Company in April 2009. A PSE management employee serves on one of AEGIS' risk management advisory committees for which no compensation is received.

PSE has property insurance with various companies and approximately 35.0% of the property insurance coverage is with American International Group, Inc (AIG). On October 23, 2008, AIG named the wife of PSE's President and Chief Executive as its Vice Chairman and Chief Restructuring Officer.

(9) Other

In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46), as further revised in December 2003 with FIN 46R, which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have a controlling interest or sufficient equity at risk for the entity to finance its activities without additional financial support.

A variable interest entity (VIE) is an entity in which the equity of the investors as a group do not have: (1) the characteristics of a controlling financial interest; (2) sufficient equity at risk for the entity to finance its activities without additional subordinated financial support; or (3) symmetry between voting rights and economic interests and where substantially all of the entity's activities either involve or are conducted on behalf of an investor with disproportionately few voting rights. Variable interests in a VIE are contractual, ownership or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interest.

FIN 46R requires that if a business entity has a controlling financial interest in a VIE, the financial statements must be included in the consolidated financial statements of the business entity. The adoption of FIN 46R for all interests in VIEs created after January 31, 2003 was effective immediately. For VIEs created before February 1, 2003, it was effective July 1, 2003. The adoption of FIN 46R was effective March 31, 2004 for the Company.

The Company evaluated its power purchase agreements and determined that two power purchase agreements may be considered significant VIEs under FIN 46R. The Company is required to buy all the generation from the two plants, subject to displacement by the Company, at rates set forth in the relevant power purchase agreements. As a result, the Company submitted requests for information to those parties; however, the parties have refused to submit to the Company the necessary information for the Company to determine whether they meet the requirements of a VIE that requires consolidation. The Company will continue to submit requests for information to the counterparties annually to determine if FIN 46R is applicable. PSE's purchased electricity expense for the three months ended March 31, 2009 and 2008 for these entities was \$47.4 million and \$54.9 million, respectively.

In December 2008, FASB issued FIN 46R-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" (FIN 46R-8), which requires new expanded disclosures in the quarterly financial statements for periods ending after December 15, 2008 for VIEs. The disclosures required by FIN 46R-8 are intended to provide users of the financial statements with greater transparency about a transferor's continuing involvement with transferred financial assets and an enterprise's involvement with VIEs.

A primary beneficiary of a VIE is the variable interest holder (e.g. a contractual counterparty or capital provider) deemed to have the controlling financial interest(s) and is considered to be exposed to the majority of the risks and rewards associated with the VIE and therefore must consolidate it. The Company enters into a variety of contracts for energy with other counterparties and evaluates all contracts for variable interests. The Company's variable interests primarily arise through power purchase agreements where the Company obtains control other than through voting rights and is required to buy all or a majority of generation from a plant at rates set forth in a power purchase agreement, subject to displacement. If a counterparty does not deliver energy to the Company, the Company may have to replace the energy at prices which could be higher or lower than agreed to prices. Therefore, the Company may be exposed to risk associated with replacement costs of a contract.

The Company evaluates variable interest relationships based on significance. If the Company did not participate significantly in the design or redesign of an entity and the variable interest is not considered significant to the Company's financial statements, the variable interest is not considered significant. Purchase power contracts with governmental organizations do not require disclosure. When the Company determines a significant variable interest may exist with another party, the Company requests for information to determine if it is required to be consolidated.

The following table presents the Company's VIE relationships, irrespective of significance, related to power purchase agreements as of March 31, 2009:

VARIABLE INTERESTS IN POWER PURCHASE AGREEMENTS FOR THE MONTH ENDED MARCH 31, 2009				
(DOLLARS IN MILLIONS)				
NATURE OF VARIABLE INTEREST	LONGEST CONTRACT TENOR	NUMBER OF COUNTERPARTIES	AGGREGATE CARRYING VALUE LIABILITY ²	LEVEL OF ACTIVITY - 2009 EXPENSES ²
Electric-combustion turbine co-generation plant ¹	2011	2	\$ (12.4)	\$ 47.4
Electric-hydro	2037	8	(0.6)	2.2
Other	2011	3	--	0.1
Total		13	\$ (13.0)	\$ 49.7

¹ Variable interests may be significant.

² Carrying values are classified in the balance sheet in accounts payable and expenses are classified on the income statement in purchased electricity.

(10) New Accounting Pronouncements

On April 9, 2009, FASB issued FASB Staff Position (FSP) No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FSP No. 157-4). FSP No. 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, when the volume and level of activity for the asset or liability have significantly decreased. FSP No. 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. 157-4 will be effective for the Company as of June 30, 2009. The Company is currently assessing the impact of the FSP on its SFAS No. 157 calculations and disclosures.

On April 9, 2009, FASB issued FSP No. 107-1, "Interim Disclosures about Fair Value of Financial Instruments" (FSP No. 107-1). This FSP amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP No. 107-1 also amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in summarized financial information at interim reporting periods. FSP No. 107-1 will be effective for the Company as of June 30, 2009.

Item 2. **Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of the Company's financial condition and results of operations contains forward-looking statements that involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations and intentions. Words or phrases such as "anticipates," "believes," "estimates," "expects," "future," "intends," "plans," "projects," "predicts," "will likely result," and "will continue" and similar expressions are used to identify forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. The Company's actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the factors described below and under the caption "Forward-Looking Statements" at the beginning of this report. Readers should not place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-Q.

Overview

Puget Sound Energy, Inc. (PSE) is a subsidiary of Puget Energy, Inc. (Puget Energy), an energy services holding company incorporated in the state of Washington in 1999. On February 6, 2009, Puget Holdings LLC (Puget Holdings) completed its merger with Puget Energy. PSE's basis of accounting will continue to be on a historical basis and PSE's financial statements will not include any Statement of Financial Accounting Standards (SFAS) No. 141R, "Business Combinations" purchase accounting adjustments.

PSE is the largest electric and natural gas utility in the state of Washington, primarily engaged in the business of electric transmission, distribution, generation and natural gas distribution. PSE generates revenues primarily from the sale of electric and natural gas services to residential and commercial customers within Washington State. PSE's operating revenues and associated expenses are not generated evenly throughout the year. Variations in energy usage by consumers occur from season to season and from month to month within a season, primarily as a result of weather conditions. PSE normally experiences its highest retail energy sales and subsequently higher power costs during the winter heating season in the first and fourth quarters of the year and its lowest sales in the third quarter of the year. Varying wholesale electric prices and the amount of hydroelectric energy supplies available to PSE also make quarter-to-quarter comparisons difficult.

As a regulated utility company, PSE is subject to Federal Energy Regulatory Commission (FERC) regulations, North American Electric Reliability Corporation (NERC) standards and Washington Utilities and Transportation Commission (Washington Commission) regulations which affects a wide array of business activities, including regulating future rate increases; directed accounting requirements that may negatively impact earnings; licensing of PSE-owned generation facilities; and other FERC and Washington Commission directives that may impact attainment of PSE's business objectives. In addition, PSE is subject to risks inherent to the utility industry as a whole, including weather changes affecting purchases and sales of energy; outages at owned and non-owned generation plants where energy is obtained; storms or other events which can damage natural gas and electric distribution and transmission lines; increasing regulatory standards for system reliability and wholesale market stability over time; and significant evolving environmental legislation.

PSE is investing heavily in its utility infrastructure and customer service functions in order to meet increasing regulatory requirements, customer growth and aging infrastructure needs. Such investments and operating requirements give rise to significant growth in depreciation expense and operating expense which costs are not timely recovered via the ratemaking process which relies predominately on a historic test year to fix rates and revenue requirements. Such "regulatory lag" is expected to continue for the foreseeable future.

PSE's main business objective is to provide reliable, safe and cost-effective energy to its customers. To help accomplish this objective, PSE seeks to become more energy efficient and environmentally responsible in its energy supply portfolio. PSE filed its most recent Integrated Resource Plan (IRP) on May 31, 2007 with the Washington Commission. The 2007 IRP demonstrated PSE's need to acquire significant amounts of new generating resources, driven primarily by expiration of existing purchase power contracts. The plan supports a strategy of significantly increasing energy efficiency programs, pursuing additional renewable resources (primarily wind) and additional base load natural gas-fired generation to meet the growing needs of its customers. The next IRP will be filed in July 2009.

On January 16, 2009, Standard & Poor's (S&P) Rating Services raised its corporate credit rating on PSE and removed PSE from its watch list for negative implications citing a stable outlook. The rating actions reflected the completion of the

acquisition of Puget Energy and PSE by Puget Holdings. On February 2, 2009, Moody's Investors Service (Moody's) affirmed the long-term ratings of PSE. The ratings outlook for PSE is stable. PSE's equity ratio increased from 38.0% at December 31, 2008 to 50.2% at March 31, 2009.

NON-GAAP FINANCIAL MEASURES – ENERGY MARGINS

The following discussion includes financial information prepared in accordance with generally accepted accounting principles (GAAP), as well as two other financial measures, electric margin and gas margin, that are considered “non-GAAP financial measures.” Generally, a non-GAAP financial measure is a numerical measure of a company's financial performance, financial position or cash flows that exclude (or include) amounts that are included in (or excluded from) the most directly comparable measure calculated and presented in accordance with GAAP. The presentation of electric margin and gas margin is intended to supplement investors' understanding of the Company's operating performance. Electric margin and gas margin are used by the Company to determine whether the Company is collecting the appropriate amount of energy costs from its customers to allow recovery of operating costs. The Company's electric margin and gas margin measures may not be comparable to other companies' electric margin and gas margin measures. Furthermore, these measures are not intended to replace operating income as determined in accordance with GAAP as an indicator of operating performance.

Results of Operations

PSE's operating revenues and expenses are not generated evenly throughout the year. Variations in energy usage by customers occur from season to season and from month to month within a season, primarily as a result of weather conditions. PSE normally experiences its highest retail energy sales and subsequently higher power costs during the winter heating season in the first and fourth quarters of the year and its lowest sales in the third quarter of the year. Power cost recovery is seasonal, with underrecovery normally in the first and fourth quarters when electric sales volumes and power costs are higher and overrecovery in the second and third quarters. Varying wholesale electric prices and the amount of hydroelectric energy supplies available to PSE also make quarter to quarter comparisons difficult.

Net income for the three months ended March 31, 2009 was \$85.0 million on operating revenues of \$1.1 billion as compared to net income of \$80.9 million on operating revenues of \$1.0 billion for the same period in 2008.

Net income for the three months ended March 31, 2009 as compared to the same period in 2008 was positively impacted by a \$26.3 million pre-tax increase in electric margin and a \$12.1 million pre-tax increase in gas margin. Electric and natural gas margins were favorably impacted by general tariff rate increases of 7.1% and 4.6%, respectively, that were approved by the Washington Commission and were effective November 1, 2008. The favorable impact of lower natural gas prices and wholesale power costs was offset by below normal hydroelectric energy production during the first quarter of 2009. Net income was negatively impacted by one-time merger costs of \$27.6 million related to the merger of Puget Energy with Puget Holdings. These costs were primarily related to PSE employee compensation triggered by the Puget Energy's change of control, credit agreement related expenses and the income statement impact of deferred compensation related liability increases triggered by the merger. In addition, net income was negatively impacted due to an increase in depreciation and amortization of \$6.0 million.

ENERGY MARGINS

The following table displays the details of electric margin changes for the three months ended March 31, 2009 as compared to the same period in 2008. Electric margin is electric sales to retail and transportation customers less pass-through tariff items, revenue-sensitive taxes, and the cost of generating and purchasing electric energy sold to customers, including transmission costs to bring electric energy to PSE's service territory.

(DOLLARS IN MILLIONS) THREE MONTHS ENDED MARCH 31,	ELECTRIC MARGIN			PERCENT
	2009	2008	CHANGE	CHANGE
Electric operating revenue ¹	\$ 600.2	\$ 606.1	\$ (5.9)	(1.0) %
Less: Other electric operating revenue	(0.8)	(12.2)	11.4	93.4
Add: Other electric operating revenue-gas supply resale	(8.9)	2.6	(11.5)	*
Total electric revenue for margin	590.5	596.5	(6.0)	(1.0)
Adjustments for amounts included in revenue:				
Pass-through tariff items	(21.7)	(12.9)	(8.8)	(68.2)
Pass-through revenue-sensitive taxes	(44.4)	(41.6)	(2.8)	(6.7)
Net electric revenue for margin	524.4	542.0	(17.6)	(3.2)
Minus power costs:				
Purchased electricity ¹	(260.2)	(272.8)	12.6	4.6
Electric generation fuel ¹	(48.1)	(47.0)	(1.1)	(2.3)
Residential exchange ¹	32.4	--	32.4	*
Total electric power costs	(275.9)	(319.8)	43.9	13.7
Electric margin ²	\$ 248.5	\$ 222.2	\$ 26.3	11.8 %

¹ As reported on PSE's Consolidated Statement of Income.

² Electric margin does not include any allocation for amortization/depreciation expense or electric generation operation and maintenance expense.

* Percent change not applicable or meaningful.

Electric margin increased \$26.3 million for the three months ended March 31, 2009 as compared to the same period in 2008. The increase in electric margin was primarily due to a general rate case increase of 7.1% effective November 1, 2008 and favorable impact of lower natural gas and wholesale power prices offset by below normal hydroelectric energy production during the first quarter 2009 which increased margin by \$28.3 million. With lower natural gas prices, PSE increased its generation from its gas-fired generating facilities. This increase was partially offset by a 0.5% decrease in retail kilowatt hour (kWH) sales and other items which decreased margin by \$1.9 million.

The following table displays the details of gas margin changes for the three months ended March 31, 2009 as compared to the same period in 2008. Gas margin is natural gas sales to retail and transportation customers less pass-through tariff items and revenue-sensitive taxes, and the cost of natural gas purchased, including transportation costs to bring natural gas to PSE's service territory.

(DOLLARS IN MILLIONS) THREE MONTHS ENDED MARCH 31,	GAS MARGIN			PERCENT
	2009	2008	CHANGE	CHANGE
Gas operating revenue ¹	\$ 506.4	\$ 443.2	\$ 63.2	14.3 %
Less: Other gas operating revenue	(4.9)	(4.6)	(0.3)	(6.5)
Total gas revenue for margin	501.5	438.6	62.9	14.3
Adjustments for amounts included in revenue:				
Pass-through tariff items	(4.7)	(4.4)	(0.3)	(6.8)
Pass-through revenue-sensitive taxes	(41.6)	(35.0)	(6.6)	(18.9)
Net gas revenue for margin	455.2	399.2	56.0	14.0
Minus purchased gas costs ¹	(320.1)	(276.2)	(43.9)	(15.9)
Gas margin ²	\$ 135.1	\$ 123.0	\$ 12.1	9.8 %

¹ As reported on PSE's Consolidated Statement of Income.

² Gas margin does not include any allocation for amortization/depreciation expense or electric generation operations and maintenance expense.

Gas margin increased \$12.1 million for the three months ended March 31, 2009 as compared to the same period in 2008 primarily due to the general rate case increase of 4.6% effective November 1, 2008 which increased margin by \$20.4 million. This increase was partially offset by a decrease in margin of \$6.4 million due to customer mix and other pricing variances and a decrease of \$1.9 million due to a 1.6% decrease in gas therm volume.

ELECTRIC OPERATING REVENUES

The table below sets forth changes in electric operating revenues for PSE for the three months ended March 31, 2009 as compared to the same period in 2008.

(DOLLARS IN MILLIONS) THREE MONTHS ENDED MARCH 31,	2009	2008	CHANGE	PERCENT CHANGE
Electric operating revenues:				
Residential sales	\$ 358.8	\$ 346.6	\$ 12.2	3.5 %
Commercial sales	231.6	212.0	19.6	9.2
Industrial sales	26.5	27.5	(1.0)	(3.6)
Other retail sales, including unbilled revenue	(29.4)	(11.6)	(17.8)	*
Total retail sales	587.5	574.5	13.0	2.3
Transportation sales	2.5	1.5	1.0	66.7
Sales to other utilities and marketers	9.3	18.0	(8.7)	(48.3)
Other	0.9	12.1	(11.2)	(92.6)
Total electric operating revenues	\$ 600.2	\$ 606.1	\$ (5.9)	(1.0) %

* Percent change not applicable or meaningful.

Electric retail sales increased \$13.0 million for the three months ended March 31, 2009 as compared to the same period in 2008. The increase was due in part to the electric general rate increase of November 1, 2008 partially offset by a merger rate credit effective February 13, 2009, which combined, contributed to an increase in electric retail sales of \$41.4 million for 2009 as compared to 2008. Electric retail sales also increased by \$7.5 million as a result of an increase in the conservation rider charged to customers due to an increase in the Company's energy efficiency programs, which has no impact on net income as the amount is offset in conservation amortization. These increases were partially offset by a decrease in retail electricity usage of 30,346 megawatt hours (MWh) or 0.5% for 2009 as compared to the same period in 2008, which resulted in a decrease of approximately \$2.9 million to electric operating revenue. The benefits of the Residential and Farm Energy Exchange Benefit credited to customers reduced electric operating revenues by \$33.9 million in 2009. This credit also reduced power costs and revenue sensitive taxes by a corresponding amount with no impact on earnings.

Sales to other utilities and marketers decreased \$8.7 million for the three months ended March 31, 2009 as compared to the same period in 2008 primarily due to a decrease in wholesale electric energy prices which decreased revenue by of \$9.1 million. This decrease was partially offset by an increase in other items.

Other electric operating revenues decreased \$11.2 million for the three months ended March 31, 2009 as compared to the same period in 2007 primarily due to a decrease of \$11.5 million in noncore gas sales and related losses from hedging contracts entered into to manage those noncore gas sales.

The following electric rate changes were approved by the Washington Commission in 2008 and 2009:

TYPE OF RATE ADJUSTMENT	EFFECTIVE DATE	AVERAGE PERCENTAGE INCREASE (DECREASE) IN RATES	ANNUAL INCREASE (DECREASE) IN REVENUES (DOLLARS IN MILLIONS)
Electric General Rate Case	November 1, 2008	7.1 %	\$130.2
Merger Rate Credit	February 13, 2009	(0.4)%	\$ (6.7)

GAS OPERATING REVENUES

The table below sets forth changes in gas operating revenues for PSE for the three months ended March 31, 2009 as compared to the same period in 2008.

(DOLLARS IN MILLIONS) THREE MONTHS ENDED MARCH 31,	2009	2008	CHANGE	PERCENT CHANGE
Gas operating revenues:				
Residential sales	\$ 344.2	\$ 294.2	\$ 50.0	17.0 %
Commercial sales	139.4	127.8	11.6	9.1
Industrial sales	14.8	12.8	2.0	15.6
Total retail sales	498.4	434.8	63.6	14.6
Transportation sales	3.1	3.8	(0.7)	(18.4)
Other	4.9	4.6	0.3	6.5
Total gas operating revenues	\$ 506.4	\$ 443.2	\$ 63.2	14.3 %

Gas retail sales increased \$63.6 million for the three months ended March 31, 2009 as compared to the same period in 2008 due to a \$64.8 million increase in gas operating revenues as a result of a 11.1% Purchased Gas Adjustment (PGA) mechanism rate increase for retail customers effective October 1, 2008 and a general rate increase effective November 1, 2008. The PGA mechanism passes through to customers increases or decreases in the natural gas supply portion of the natural gas service rates based upon changes in the price of natural gas purchased from producers and wholesale marketers or changes in natural gas pipeline transportation costs. PSE's gas margin and net income are not affected by changes under the PGA mechanism. Partially offsetting the increase was a 1.0 million decrease in gas therm sales which decreased margin \$1.3 million.

The following natural gas rate adjustments were approved by the Washington Commission in 2008 and 2009:

TYPE OF RATE ADJUSTMENT	EFFECTIVE DATE	AVERAGE PERCENTAGE INCREASE (DECREASE) IN RATES	ANNUAL INCREASE (DECREASE) IN REVENUES (DOLLARS IN MILLIONS)
Purchased Gas Adjustment	October 1, 2008	11.1 %	\$ 108.8
General Rate Case	November 1, 2008	4.3 %	\$ 49.2
Merger Rate Credit	February 13, 2009	(0.4)%	\$ (3.6)

OPERATING EXPENSES

The table below sets forth significant changes in operating expenses for PSE and its subsidiaries for the three months ended March 31, 2009 as compared to the same period in 2008.

(DOLLARS IN MILLIONS) THREE MONTHS ENDED MARCH 31,	2009	2008	CHANGE	PERCENT CHANGE
Purchased electricity	\$ 260.3	\$ 272.8	\$ (12.5)	(4.6) %
Residential exchange	(32.4)	--	(32.4)	*
Purchased gas	320.1	276.2	43.9	15.9
Utility operations and maintenance	114.9	112.2	2.7	2.4
Merger and related costs	27.6	--	27.6	*
Depreciation and amortization	81.4	75.4	6.0	8.0
Conservation amortization	20.8	13.4	7.4	55.2
Taxes other than income taxes	101.3	94.3	7.0	7.4

* Percent change not applicable or meaningful.

Purchased electricity expenses decreased \$12.5 million for the three months ended March 31, 2009 as compared to the same period in 2008. The decrease is related to lower wholesale power prices and increased generation at PSE's gas-fired generating facilities due to lower cost of natural gas in the three months ended March 31, 2009 as compared to the same period in 2008, which resulted in a decrease of \$13.1 million. PSE utilizes less purchased power when the cost of natural gas

is lower than the cost of wholesale purchased power due to its recent acquisitions of the Goldendale and Mint Farm gas-fired generating facilities, which have low heat rates. This decrease was partially offset by an increase of \$0.6 million in transmission and other expenses.

To meet customer demand, PSE economically dispatches resources in its power supply portfolio such as fossil-fuel generation, owned and contracted hydroelectric capacity and energy and long-term contracted power. However, depending principally upon availability of hydroelectric energy, plant availability, fuel prices and/or changing load as a result of weather, PSE may sell surplus power or purchase deficit power in the wholesale market. PSE manages its regulated power portfolio through short-term and intermediate-term off-system physical purchases and sales and through other risk management techniques.

Residential exchange credits associated with the Bonneville Power Administration (BPA) Residential Exchange Program (REP) increased to \$32.4 million for the three months ended March 31, 2009 as a result of an agreement with BPA to continue to pass on REP benefits to PSE's customers. REP does not have an impact on net income.

Purchased gas expenses increased \$43.9 million for the three months ended March 31, 2009 as compared to the same period in 2008 primarily due to an increase of 11.1% in PGA rates which provides the rates used to determine gas costs based on customer usage. The rate increase was the result of higher costs of natural gas in the forward market and a reduction of the credit for accumulated PGA payable balance. The PGA mechanism allows PSE to recover expected natural gas supply and transportation costs, and defer, as a receivable or liability, any natural gas supply and transportation costs that exceed or fall short of this expected gas cost amount in PGA mechanism rates, including accrued interest. The PGA mechanism payable balance at March 31, 2009 was \$29.7 million as compared to \$8.9 million at December 31, 2008. PSE is authorized by the Washington Commission to accrue carrying costs on PGA receivable and payable balances. A receivable balance in the PGA mechanism reflects an under recovery of market natural gas cost through rates. A payable balance reflects over recovery of market natural gas cost through rates.

Utility operations and maintenance expense increased \$2.7 million for the three months ended March 31, 2009 as compared to the same period in 2008. The increase for the three months ended March 31, 2009 was primarily due to an increase in administrative and general expenses of \$3.1 million which included increases in salary and employee benefits expense, an increase in rent expense and an increase in property insurance costs, customer service costs of \$3.0 million, electric transmission and distribution costs of \$1.9 million and a \$1.6 million increase in gas operations and distribution expenses. These increases were partially offset by a \$7.8 million decrease in production operations and maintenance costs related to settlement of a lawsuit at the Colstrip generating facilities.

Merger and related costs associated with the merger with Puget Holdings incurred for the three months ended March 31, 2009 were \$27.6 million. These costs include compensation costs as a result of the change in control, write-off of deferred debt costs associated with the termination of the pre-merger credit facilities, expenses associated with new credit facilities and the impact of deferred compensation liabilities as a result of the merger. Pursuant to the Washington Commission merger order commitments, PSE will not seek recovery of these costs.

Depreciation and amortization expense increased \$6.0 million for the three months ended March 31, 2009 as compared to the same period in 2008. Excluding the regulatory credit for the deferral of Mint Farm Generation Station (Mint Farm) fixed costs of \$3.8 million, depreciation and amortization expense increased \$9.8 million for the three months ended March 31, 2009 as compared to the same period in 2008. This increase is due to additional depreciable property placed into service and an increase in storm amortization costs as approved in PSE's general rate case effective November 1, 2008.

Conservation amortization increased \$7.4 million for the three months ended March 31, 2009 as compared to the same period in 2008 due to higher authorized recovery of electric conservation expenditures. Conservation amortization is a pass-through tariff item with no impact on earnings.

Taxes other than income taxes increased \$7.0 million for the three months ended March 31, 2009 as compared to the same period in 2008. Revenue sensitive taxes increased \$9.3 million due to an increase in revenue offset by a decrease of \$2.7 million in property taxes from a true-up of accrued property taxes recorded for 2008.

CAPITAL REQUIREMENTS

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following are PSE's aggregate consolidated commercial commitments as of March 31, 2009:

COMMERCIAL COMMITMENTS (DOLLARS IN MILLIONS)	TOTAL	AMOUNT OF COMMITMENT EXPIRATION PER PERIOD			
		2009	2010- 2011	2012- 2013	2014 & THEREAFTER
Working capital facility	\$ 225.0	\$ --	\$ --	\$ --	\$ 225.0
Capital expenditure facility	400.0	--	--	--	400.0
Energy hedging facility	315.0	--	--	--	315.0
Energy operations letter of credit	6.6	6.6	--	--	--
Energy hedging letter of credit	35.0	35.0	--	--	--
Total commercial commitments	\$ 981.6	\$ 41.6	\$ --	\$ --	\$ 940.0

The following are PSE's aggregate contractual obligations and commercial commitments as of March 31, 2009:

CONTRACTUAL OBLIGATIONS (DOLLARS IN MILLIONS)	TOTAL	PAYMENTS DUE PER PERIOD			
		2009	2010- 2011	2012- 2013	2014 & THEREAFTER
Long-term debt including interest	\$ 6,243.9	\$ 146.3	\$ 809.6	\$ 305.7	\$ 4,982.3
Short-term debt including interest	194.5	194.5	--	--	--
Service contract obligations	398.3	51.9	129.2	82.3	134.9
Non-cancelable operating leases	193.6	47.4	28.9	27.7	89.6
Fredonia gas-fired generating facility lease ¹	46.3	46.3	--	--	--
Energy purchase obligations	4,796.2	645.5	1,635.2	772.0	1,743.5
Contract initiation payment/collateral requirement	18.5	--	18.5	--	--
Financial hedge obligations	112.6	59.7	52.9	--	--
Purchase obligations	130.1	73.1	6.6	6.8	43.6
Non-qualified pension and other benefits funding and payments	67.8	21.5	8.8	9.9	27.6
Total contractual cash obligations	\$ 12,201.8	\$ 1,286.2	\$ 2,689.7	\$ 1,204.4	\$ 7,021.5

¹ See "Fredonia 3 and 4 Operating Lease" under "Off-Balance Sheet Arrangements" below.

OFF-BALANCE SHEET ARRANGEMENTS

Fredonia 3 and 4 Operating Lease. PSE leases two gas-fired turbines for its Fredonia 3 and 4 generating facility pursuant to a master operating lease that was amended for this purpose in April 2001. On November 14, 2008, GE Capital Commercial Inc. notified PSE of its intentions to cancel the lease effective January 14, 2009. PSE intends to purchase the gas-fired turbines by January 2010. Payments under the lease vary with changes in the London Interbank Offered Rate (LIBOR). At March 31, 2009, PSE's outstanding balance under the lease was \$44.7 million. The expected residual value under the lease is the lesser of \$42.3 million or 60.0% of the cost of the equipment.

UTILITY CONSTRUCTION PROGRAM

PSE's construction programs for generating facilities, the electric transmission system and the natural gas and electric distribution systems are designed to meet continuing customer growth and to support reliable energy delivery. The cash flow construction expenditures, excluding equity Allowance for Funds Used During Construction (AFUDC) and customer refundable contributions, was \$177.7 million for the three months ended March 31, 2009. The anticipated utility construction expenditures, excluding AFUDC, for 2009, 2010 and 2011 are:

CAPITAL EXPENDITURE ESTIMATES			
(DOLLARS IN MILLIONS)	2009	2010	2011
Energy delivery, technology and facilities	\$ 687	\$ 840	\$ 786
New supply resources	234	621	346
Total expenditures	\$ 921	\$ 1,461	\$ 1,132

The proposed utility construction expenditures and any new generation resource expenditures that may be incurred are anticipated to be funded with a combination of cash from operations, short-term debt, long-term debt and equity. Construction expenditure estimates, including any new generation resources, are subject to periodic review and adjustment in light of changing economic, regulatory, environmental and efficiency factors.

CAPITAL RESOURCES

CASH FROM OPERATIONS

Cash generated from operations for the three months ended March 31, 2009 was \$213.9 million, a decrease of \$118.8 million from the \$332.7 million generated during the first quarter of 2008. The decrease was primarily the result of an increase of \$118.7 million in natural gas payments and payment of gas financial hedge contracts, power cost and other payable balances as compared to the same period in 2008. Further, PSE received a refund of \$39.7 million in income taxes in the first quarter 2008 compared to a refund of \$0.2 million in 2009 which resulted in a decrease of \$39.5 million in the current quarter. Also contributing to the decrease in operating activities was a Colstrip legal settlement accrual of \$10.5 million in the first quarter 2008 and an increase in fuel and gas inventories and materials and supplies of \$18.2 million over the same period in 2008. PSE increased first quarter 2009 prepayments by \$13.0 million compared to the same period in 2008.

The decrease in cash generated from operating activities for the first quarter 2009 as compared to 2008 was partially offset by overrecovery of natural gas costs through the PGA mechanism during the first quarter 2009 of \$20.8 million compared to an underrecovery of \$9.4 million during the same period in 2008 which increased operating activities by \$30.2 million. Further, PSE collected \$21.5 million in accounts receivable in 2009 over 2008.

FINANCING PROGRAM

Financing utility construction requirements and operational needs are dependent upon the amount of cash available and the cost and availability of external funds through capital markets. PSE anticipates refinancing the redemption of bonds with its liquidity facilities and/or the issuance of new bonds. Access to funds depends upon factors such as general economic conditions, regulatory climate and policies and PSE's credit ratings.

On January 23, 2009, PSE issued \$250.0 million of first mortgage bonds. The bonds were placed with approximately 35 institutional investors, have a term of seven years and carry a 6.75% coupon.

LIQUIDITY FACILITIES AND COMMERCIAL PAPER

PSE's short-term borrowings and sales of commercial paper are used to provide working capital and funding of utility construction programs. PSE has not been significantly impacted by the recent disruption in the credit environment.

PSE CREDIT FACILITIES

Credit Agreements. Effective immediately after the merger on February 6, 2009, PSE has three committed unsecured revolving credit facilities that provide, in aggregate, \$1.15 billion in short-term borrowing capability. These new facilities

include a \$400.0 million credit agreement for working capital needs, a \$400.0 million credit facility for funding capital expenditures and a \$350.0 million facility to support other working capital and energy hedging activities.

These facilities mature in February 2014 and each contain similar terms and conditions and are syndicated among numerous banks. The agreements provide PSE with the ability to borrow at either a base rate (which is based on the Prime Rate) or the Eurodollar rate (which is based on the LIBOR), plus a spread. The Company must also pay a commitment fee on the unused portion of the facilities. The spread and the commitment fee depend on PSE's credit ratings as determined by S&P and Moody's. At the Company's current credit ratings, the spread is 85 basis points and the commitment fee is 26 basis points. The \$400.0 million working capital facility and \$350.0 million credit agreement to support energy hedging permit the issuance of standby letters of credit up to the entire amount of the credit agreements. The \$400.0 million working capital facility also serves as a backstop for PSE's commercial paper program.

As of March 31, 2009, PSE had borrowed \$175.0 million on the \$400.0 million working capital facility and had a \$35.0 million letter of credit outstanding under the \$350.0 million facility. There were no borrowings under the \$400.0 million capital expenditure facility as of March 31, 2009. In addition to the credit agreements, PSE had a \$6.6 million letter of credit through a bank in support of a long-term transmission contract.

Demand Promissory Note. On June 1, 2006, PSE entered into an uncommitted revolving credit facility with its parent, Puget Energy, pursuant to a Demand Promissory Note (Note) under which PSE may borrow up to \$30.0 million from Puget Energy. Under the terms of the Note, PSE pays interest on the outstanding borrowings based on the lowest of the weighted-average interest rate of (a) PSE's outstanding commercial paper interest rate or (b) PSE's senior unsecured revolving credit facility. At March 31, 2009, the outstanding balance of the Note was \$19.4 million. This Note is unaffected by the February 6, 2009 merger.

LONG-TERM FUNDING AND RESTRICTIVE COVENANTS

In determining the type and amount of future financing, PSE may be limited by restrictions contained in its electric and natural gas mortgage indentures, restated articles of incorporation and certain loan agreements. Under the most restrictive tests, at March 31, 2009, PSE could issue:

- approximately \$1.0 billion of additional first mortgage bonds under PSE's electric mortgage indenture based on approximately \$1.7 billion of electric bondable property available for issuance, subject to an interest coverage ratio limitation of 2.0 times net earnings available for interest (as defined in the electric utility mortgage), which PSE exceeded at March 31, 2009;
- approximately \$560.0 million of additional first mortgage bonds under PSE's natural gas mortgage indenture based on approximately \$930.0 million of gas bondable property available for issuance, subject to interest coverage ratio limitations of 1.75 times and 2.0 times net earnings available for interest (as defined in the natural gas utility mortgage), which PSE exceeded at March 31, 2009;

At March 31, 2009, PSE had approximately \$5.1 billion in electric and natural gas ratebase to support the interest coverage ratio limitation test for net earnings available for interest.

CREDIT RATINGS

PSE has no debt outstanding that would accelerate debt maturity upon a credit rating downgrade. A ratings downgrade could adversely affect the ability to renew existing, or obtain access to new credit facilities and could increase the cost of such facilities. For example, under PSE's revolving credit facility, the borrowing costs and commitment fee increase as PSE's corporate/issuer credit ratings decline. A downgrade in commercial paper ratings could preclude PSE's ability to issue commercial paper under its current programs. The marketability of PSE commercial paper is currently limited by the A-2/P-3 ratings by S&P's and Moody's. In addition, downgrades in PSE's debt ratings may prompt counterparties to require PSE to post a letter of credit or other collateral, make cash prepayments, obtain a guarantee or provide other security.

On January 16, 2009, S&P's Rating Services raised its corporate credit rating on PSE and removed it from its watch list for negative implications citing a stable outlook. The rating actions reflected the anticipated completion of the acquisition of Puget Energy and PSE by Puget Holdings, which occurred on February 6, 2009.

On February 2, 2009, Moody's affirmed the long-term ratings of PSE. The ratings outlook for PSE is stable.

The ratings of PSE, as of April 27, 2009, were as follows:

	Ratings	
	<u>S&P¹</u>	<u>Moody's²</u>
Puget Sound Energy		
Corporate credit/issuer rating	BBB	Baa3
Senior secured debt	A-	Baa2
Junior subordinated notes	BB+	Ba1
Preferred stock	BB+	Ba2
Commercial paper	A-2	P-3
Bank facilities	BBB	Baa3
Ratings outlook	Stable	Stable

¹ On January 16, 2009, S&P's upgraded PSE's corporate and other credit ratings. It also removed all the ratings from negative watch, citing a stable outlook.

² On February 2, 2009, Moody's affirmed the long-term ratings of PSE.

Other

REGULATION AND RATES

On April 17, 2009, the Washington Commission issued a final order approving and adopting a settlement agreement that authorized PSE to defer certain ownership and operating costs related to its purchase of the Mint Farm that will be incurred prior to PSE recovering such costs in electric customer rates. Under Washington state law, a company may defer the costs associated with purchasing and operating a gas plant that complies with the greenhouse gases (GHG) emissions performance standard until the plant is included in rates or for two years from the date of purchase, whichever is sooner. As of March 31, 2009, PSE had established a regulatory asset of \$7.7 million. The prudence of the Mint Farm acquisition, recovery of costs of Mint Farm and compliance with the GHG emissions performance standard will be addressed in the Company's next rate proceeding.

On October 8, 2008, the Washington Commission issued its order in PSE's consolidated electric and natural gas general rate case filed in December 2007, approving a general rate increase for electric customers of \$130.2 million or 7.1% annually, and an increase in natural gas rates of \$49.2 million or 4.6% annually. The rate increases for electric and natural gas customers were effective November 1, 2008. In its order, the Washington Commission approved a weighted cost of capital of 8.25% and a capital structure that included 46.0% common equity with a return on equity of 10.15%. The Washington Commission issued a separate order on January 15, 2009, that authorized the continuation of the Power Cost Only Rate Case (PCORC) with certain modifications to which the Washington Commission staff and the Company had agreed. The five procedural modifications to the PCORC include extending the expected procedural schedule from five to six months, limiting the power cost updates to one per PCORC unless an additional update is allowed by the Washington Commission as part of the compliance filing, prohibiting the overlap of PCORC and general rate cases (except for requests for interim rate relief), shortening data request time from ten to five business days and requiring the Company to provide its future energy resource model projections at the outset of a case.

On September 25, 2008, the Washington Commission approved PSE's requested revisions to its PGA tariff schedules resulting in an increase of \$108.8 million or 11.1% on an annual basis in gas sales revenues effective October 1, 2008. The rate increase was the result of higher costs of natural gas in the forward market and a reduction of the credit for the accumulated PGA payable balance. The PGA rate change will increase PSE's revenue but will not impact the Company's net income as the increased revenue will be offset by increased purchased gas costs.

PROCEEDINGS RELATING TO THE WESTERN POWER MARKET

Puget Energy's and PSE's Annual Report on Form 10-K for the year ended December 31, 2008 includes a summary relating to the western power market proceedings. PSE is vigorously defending each of these cases. Litigation is subject to numerous uncertainties and PSE is unable to predict the ultimate outcome of these matters. Accordingly, there can be no

guarantee that these proceedings, either individually or in the aggregate, will not materially and/or adversely affect PSE's financial condition, results of operations or liquidity.

CPUC v. FERC. On August 2, 2006, the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit) decided that FERC erred in excluding potential relief for tariff violations for periods that pre-dated October 2, 2000 and additionally ruled that FERC should consider remedies for transactions previously considered outside the scope of the proceedings. The August 2, 2006 decision may adversely impact PSE's ability to recover the full amount of its California Independent System Operator (CAISO) receivable. The decision may also expose PSE to claims or liabilities for transactions outside the previously defined "refund period." At this time, the ultimate financial outcome for PSE is unclear. Rehearing by the Ninth Circuit was denied on April 6, 2009. Parties have been engaged in court-sponsored settlement discussions, and those discussions may result in some settlements. PSE is unable to predict either the outcome of the proceedings or the ultimate financial effect on PSE.

PROCEEDINGS RELATING TO THE BONNEVILLE POWER ADMINISTRATION

Petitioners in several actions in the Ninth Circuit against BPA asserted that BPA acted contrary to law in entering into or performing or implementing a number of agreements, including the amended settlement agreement (and the May 2004 agreement) between BPA and PSE regarding the REP. Petitioners in several actions in the Ninth Circuit against BPA also asserted that BPA acted contrary to law in adopting or implementing the rates upon which the benefits received or to be received from BPA during the October 1, 2001 through September 30, 2006 period were based. A number of parties claimed that the BPA rates proposed or adopted in the BPA rate proceeding to develop BPA rates to be used in the agreements for determining the amounts of money to be paid to PSE by BPA during the period October 1, 2006 through September 30, 2009 are contrary to law and that BPA acted contrary to law or without authority in deciding to enter into, or in entering into or performing or implementing such agreements.

On May 3, 2007, the Ninth Circuit issued an opinion in *Portland Gen. Elec. v. BPA*, Case No. 01-70003, in which proceeding the actions of BPA in entering into settlement agreements regarding the REP with PSE and with other investor-owned utilities were challenged. In this opinion, the Ninth Circuit granted petitions for review and held the settlement agreements entered into between BPA and the investor-owned utilities being challenged in that proceeding to be inconsistent with statute. On May 3, 2007, the Ninth Circuit also issued an opinion in *Golden Northwest Aluminum v. BPA*, Case No. 03-73426, in which proceeding the petitioners sought review of BPA's 2002-2006 power rates. In this opinion, the Ninth Circuit granted petitions for review and held that BPA unlawfully shifted onto its preference customers the costs of its settlements with the investor-owned utilities. On October 5, 2007, petitions for rehearing of these two opinions were denied. On February 1, 2008, PSE and other utilities filed in the Supreme Court of the United States a petition for a writ of certiorari to review the decisions of the Ninth Circuit, which petition was denied in June 2008.

In May 2007, following the Ninth Circuit's issuance of these two opinions, BPA suspended payments to PSE under the amended settlement agreement (and the May 2004 agreement). On October 11, 2007, the Ninth Circuit remanded the May 2004 agreement to BPA in light of the *Portland Gen. Elec. v. BPA* opinion and dismissed the remaining three pending cases regarding settlement agreements.

In March 2008, BPA and PSE signed an agreement pursuant to which BPA made a payment to PSE related to the REP benefits for the fiscal year ended September 30, 2008, which payment is subject to true-up depending upon the amount of any REP benefits ultimately determined to be payable to PSE. In March and April 2008, Clatskanie People's Utility District filed petitions in the Ninth Circuit for review of BPA actions in connection with offering or entering into such agreement with PSE and similar agreements with other investor-owned utilities. Clatskanie People's Utility District asserts that BPA's actions in entering into and executing the 2008 REP agreements were contrary to law or without authority and that such agreements are null and void and result in overpayments of REP benefits to PSE and other regional investor-owned utilities.

In September 2008, BPA issued its record of decision in its reopened WP-07 rate proceeding to respond to the various Ninth Circuit opinions. In this record of decision, BPA adjusted its fiscal year 2009 rates, determined the amounts of REP benefits it considered to have been improperly paid after fiscal year 2001 to PSE and the other regional investor-owned utilities, and determined that such amounts are to be recovered through reductions in REP benefit payments to be made over a number of years. The amount determined by BPA to be recovered through reductions commencing October 2007 in REP payments for PSE's residential and small farm customers was approximately \$207.2 million plus interest on unrecovered amounts. However, these BPA determinations are subject to subsequent administrative and judicial review, which may alter

or reverse such determinations. PSE and others, including a number of preference agency and investor-owned utility customers of BPA, in December 2008 filed petitions for review in the Ninth Circuit of various of these BPA determinations. PSE is reviewing its options in determining if it will contest the amounts withheld as improper payments made since 2001.

In September 2008, BPA and PSE signed a short-term Residential Purchase and Sale Agreement (RPSA) under which BPA is to pay REP benefits to PSE for fiscal years ending September 30, 2009–2011. In December 2008, BPA and PSE signed another long-term RPSA under which BPA is to pay REP benefits to PSE for the period October 2011 through September 2028. PSE and other customers of BPA in December 2008 filed petitions for review in the Ninth Circuit of the short-term and long-term RPSAs signed by PSE (and similar RPSAs signed by other investor-owned utility customers of BPA) and BPA's record of decision regarding such RPSAs. Generally, REP benefit payments under a RPSA are based on the amount, if any, by which a utility's average system cost (ASC) exceeds BPA's Priority Firm (PF) Exchange rate for such utility. The ASC for a utility is determined using an ASC methodology adopted by BPA. The ASC methodology adopted by BPA and the ASC determinations, REP overpayment determinations, and the PF Exchange rate determinations by BPA are all subject to FERC review or judicial review or both and are subject to adjustment, which may affect the amount of REP benefits paid or to be paid by BPA to PSE. As discussed above, BPA has determined to reduce such payments based on its determination of REP benefit overpayments after fiscal year 2001.

It is not clear what impact, if any, such development or review of such BPA rates, review of such ASC, ASC methodology, and BPA determination of REP overpayments, review of such agreements, and the above described Ninth Circuit litigation may ultimately have on PSE.

NEW ACCOUNTING PRONOUNCEMENTS

On April 9, 2009, the Financial Standards Accounting Board (FASB) issued Staff Position (FSP) No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FSP No. 157-4). FSP No. 157-4 provides additional guidance for estimating fair value in accordance with Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157), when the volume and level of activity for the asset or liability have significantly decreased. FSP No. 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. 157-4 will be effective for the Company as of June 30, 2009. The Company is currently assessing the impact of the FSP on its SFAS No. 157 calculations and disclosures.

On April 9, 2009, FASB issued FSP No. 107-1, "Interim Disclosures about Fair Value of Financial Instruments" (FSP No. 107-1). FSP No. 107-1 amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP No. 107-1 also amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in summarized financial information at interim reporting periods. FSP No. 107-1 will be effective for the Company as of June 30, 2009.

Item 3. **Quantitative and Qualitative Disclosure About Market Risk**

ENERGY PORTFOLIO MANAGEMENT

The Company maintains energy risk policies and procedures to manage commodity and volatility risks and the related effects on credit, tax, accounting, financing and liquidity. The Company's Energy Management Committee establishes the Company's risk management policies and procedures, and monitors compliance. The Energy Management Committee is comprised of certain Company officers and is overseen by the Board of Directors.

The Company is focused on commodity price exposure and risks associated with volumetric variability in the gas and electric portfolios and the related effects noted above. It is not engaged in the business of assuming risk for the purpose of speculative trading. The Company hedges open gas and electric positions to reduce both the portfolio risk and the volatility risk in prices. The exposure position is determined by using a probabilistic risk system that models 250 simulations of how the Company's gas and power portfolios will perform under various weather, hydro and unit performance conditions. The objectives of the hedging strategy are to:

- ensure physical energy supplies are available to reliably and cost-effectively serve retail load;
- manage the energy portfolio prudently to serve retail load at overall least cost and limit undesired impacts on PSE's customers and shareholders;
- reduce power costs by extracting the value of the Company's assets; and
- meet the credit, liquidity, financing, tax and accounting requirements of the Company.

The following table presents electric derivatives that do not meet the Normal Purchase Normal Sale (NPNS) exception at March 31, 2009 and December 31, 2008 including contracts designated as cash flow hedges:

(DOLLARS IN MILLIONS)	ELECTRIC DERIVATIVES	
	MARCH 31, 2009	DECEMBER 31, 2008
Current asset	\$ 1.3	\$ 0.4
Long-term asset	0.9	0.5
Total assets	\$ 2.2	\$ 0.9
Current liability	\$ 151.9	\$ 90.6
Long-term liability	122.3	96.1
Total liabilities	\$ 274.2	\$ 186.7

If it is determined that it is uneconomical to operate the Company's controlled electric generating facilities in the future period, the fuel supply cash flow hedge relationship is terminated and the hedge is de-designated which results in recognition of future changes in value in the income statements. As these contracts are settled, amounts previously deferred in other comprehensive income (OCI) are recognized as energy costs and are included as part of the Power Cost Adjustment (PCA) mechanism.

The following table presents the impact of changes in the market value of derivative instruments not meeting NPNS or cash flow hedge criteria to the Company's earnings for the three months ended March 31, 2009 and March 31, 2008:

(DOLLARS IN MILLIONS)	MARCH 31, 2009	MARCH 31, 2008	CHANGE
Decrease in earnings	\$ (2.3)	\$ (0.1)	\$ (2.2)

The decrease in earnings in 2009 primarily relates to a \$3.2 million unrealized loss associated with the ineffective portion of cash flow hedges for two long-term power supply agreements.

The amount of unrealized gain (loss), net of tax, related to the Company's energy-related cash flow hedges under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), deferred in accumulated OCI consisted of the following at March 31, 2009 and December 31, 2008:

(DOLLARS IN MILLIONS, NET OF TAX)	MARCH 31, 2009	DECEMBER 31, 2008
Other comprehensive income – unrealized loss	\$ (166.3)	\$ (111.7)

The following table presents natural gas derivative contracts at March 31, 2009 and December 31, 2008:

(DOLLARS IN MILLIONS)	GAS DERIVATIVES	
	MARCH 31, 2009	DECEMBER 31, 2008
Current asset	\$ 20.9	\$ 15.2
Long-term asset	9.3	6.2
Total assets	\$ 30.2	\$ 21.4
Current liability	\$ 172.4	\$ 146.3
Long-term liability	54.4	62.3
Total liabilities	\$ 226.8	\$ 208.6

At March 31, 2009, the Company had total assets of \$30.2 million and total liabilities of \$226.8 million related to financial contracts used to economically hedge the cost of physical gas purchased to serve natural gas customers. All fair value adjustments on derivatives relating to the natural gas business have been reclassified to a deferred account in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), due to the PGA mechanism. All increases and decreases in the cost of natural gas supply are passed on to customers with the PGA mechanism. As the gains and losses on the hedges are realized in future periods, they will be recorded as gas costs under the PGA mechanism.

A hypothetical 10.0% decrease in market prices of natural gas and electricity would decrease the fair value of derivative contracts by \$93.6 million, with a corresponding after-tax decrease in OCI and earnings of \$33.3 million and \$2.3 million, respectively, after-tax, and would decrease the fair value of those contracts marked-to-market in earnings by \$1.6 million after-tax. A discussion of the Level 3 valuation is included in Note 4, "Fair Value Measurements."

CONTINGENT FEATURES AND COUNTERPARTY CREDIT RISK

The Company is exposed to credit risk primarily through buying and selling electricity and natural gas to serve customers. Credit risk is the potential loss resulting from a counterparty's non-performance under an agreement. The Company manages credit risk with policies and procedures for, among other things, counterparty analysis, exposure measurement and exposure monitoring and exposure mitigation.

Where deemed appropriate, the Company may request collateral or other security from its counterparties to mitigate the potential credit default losses. Criteria employed in this decision includes, among other things, the perceived creditworthiness of the counterparty and the expected credit exposure. As of March 31, 2009, the Company held approximately \$1.1 million worth of standby letters of credit in support of various electricity and renewable energy credit transactions.

It is possible that volatility in energy commodity prices could cause the Company to have material credit risk exposures with one or more counterparties. If such counterparties fail to perform their obligations under one or more agreements, the Company could suffer a material financial loss. However, as of March 31, 2009, approximately 99.6% of the counterparties with transaction amounts outstanding in the Company's energy portfolio, including NPNS transactions, are rated at least investment grade by the major rating agencies and 0.4% are either rated below investment grade or are not rated by rating agencies. The Company assesses credit risk internally for counterparties that are not rated.

The Company has entered into commodity master arrangements with its counterparties to mitigate credit exposure to those counterparties. The Company generally enters into the following master arrangements: (1) Western Systems Power Pool agreements (WSPP) - standardized power sales contract in the electric industry; (2) International Swaps and Derivatives Association agreements (ISDA) - standardized financial gas and electric contracts; and (3) North American Energy Standards Board agreements (NAESB) - standardized physical gas contracts. The Company believes that entering into such agreements reduces the risk of default by allowing a counterparty the ability to make only one net payment.

The Company monitors counterparties that are experiencing financial problems, have significant swings in credit default swap rates, have credit rating changes by external rating agencies, or have changes in ownership. Counterparty credit risk impacts the Company's decisions on derivative accounting treatment. A counterparty may have a deterioration of credit below investment grade, potentially indicating that it is no longer probable that it will fulfill its obligations under a contract (e.g., make a physical delivery upon the contract's maturity). SFAS No. 133 specifies the requirements for derivative contracts to qualify for the NPNS scope exception. When performance is no longer probable, based on the deterioration of a counterparty's credit, the Company records the fair value of the contract on the balance sheet, with the corresponding amount recorded in the income statement.

Cash flow hedge derivative treatment is also impacted by a counterparty's deterioration of credit under SFAS No. 133 guidelines. If a forecasted transaction associated with a cash flow hedge is no longer probable of occurring, based on deterioration of credit, the Company would discontinue hedge accounting, record in earnings subsequent changes in the derivative's fair value and freeze amounts previously accounted for in Accumulated Other Comprehensive Income. If the transaction is remote of occurring, any amounts previously accounted for in Accumulated Other Comprehensive Income would be reclassified into earnings.

Should a counterparty file for bankruptcy, which could be considered a default under master arrangements, the Company may terminate related contracts. Derivative accounting entries previously recorded would be reversed in financial statements. The Company would compute any termination receivable or payables, based on the terms of existing master arrangements.

The Company computes credit reserves at a master agreement level (i.e. WSPP, ISDA or NAESB) by counterparty. The Company considers external credit ratings and market factors, such as credit default swaps and bond spreads in determination of reserves. The Company recognizes that external ratings may not always reflect how a market participant perceives a counterparty's risk of default. The Company uses both default factors published by S&P and factors derived through analysis of market risk, which reflect the application of an industry standard recovery rate. The Company selects a default factor by counterparty at an aggregate master agreement level based on a weighted average default tenor for that counterparty's deals. The default tenor is used by weighting fair values and contract tenors for all deals for each counterparty and coming up with an average value. The default factor used is dependent upon whether the counterparty is in a net asset or a net liability position after applying the master agreement levels.

The Company applies the counterparty's default factor to compute credit reserves for counterparties that are in a net asset position. Moreover, the Company applies its own default factor to compute credit reserves for counterparties in a net liability position. The Company's S&P rating at March 31, 2009 was BBB. Credit reserves are booked as contra accounts to unrealized gain (loss) positions. As of March 31, 2009, the Company was in a net liability position with the majority of counterparties, so the default factors of counterparties did not have a significant impact on reserves for the year.

INTEREST RATE RISK

The Company believes its interest rate risk primarily relates to the use of short-term debt instruments, variable-rate notes and leases and anticipated long-term debt financing needed to fund capital requirements. The Company manages its interest rate risk through the issuance of mostly fixed-rate debt of various maturities. The Company utilizes bank borrowings, commercial paper and line of credit facilities to meet short-term cash requirements. These short-term obligations are commonly refinanced with fixed-rate bonds or notes when needed and when interest rates are considered favorable. The Company may enter into swap instruments or other financial hedge instruments to manage the interest rate risk associated with these debts. The Company did not have any swap instruments outstanding as of March 31, 2009; however from time to time the Company may enter into treasury lock or forward starting swap contracts to hedge interest rate exposure related to an anticipated debt issuance. The ending balance in other comprehensive income related to the forward starting swaps and previously settled treasury lock contracts at March 31, 2009 is a net loss of \$7.8 million after tax and accumulated amortization. This compares to a loss of \$7.9 million in other comprehensive income after-tax and accumulated amortization

at December 31, 2008. All financial hedge contracts of this type are reviewed by senior management and presented to the Securities Pricing Committee of the Board of Directors and are approved prior to execution.

Item 4. **Controls and Procedures**

PUGET SOUND ENERGY

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Under the supervision and with the participation of PSE's management, including the President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, PSE has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of March 31, 2009, the end of the period covered by this report. Based upon that evaluation, the President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer of PSE concluded that these disclosure controls and procedures are effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in PSE's internal control over financial reporting during the quarter ended March 31, 2009, that have materially affected, or are reasonably likely to materially affect, PSE's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. **Legal Proceedings**

See the section titled "Proceedings Relating to the Western Power Market" under "Other" of Management's Discussion and Analysis of Financial Conditions and Results of Operations of this Report on Form 10-Q. Contingencies arising out of the normal course of the Company's business exist at March 31, 2009. Litigation is subject to numerous uncertainties and PSE is unable to predict the ultimate outcome of these matters.

Item 1A. **Risk Factors**

There have been no material changes from the risk factors set forth in Part I, Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Item 6. **Exhibits**

See Exhibit Index for list of exhibits.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PUGET SOUND ENERGY, INC.

/s/ James W. Eldredge

James W. Eldredge
Vice President, Controller and Chief
Accounting Officer

Date: May 5, 2009

Chief accounting officer and officer duly authorized to
sign this report on behalf of registrant

EXHIBIT INDEX

- 4.1** Fortieth through Sixtieth Supplemental Indentures defining the rights of the holders of Puget Sound Energy's Electric Utility First Mortgage Bonds (incorporated herein by reference to Exhibits 4.3 through 4.23 to PSE's Registration Statement on Form S-3, dated March 13, 2009, Commission File No. 333-157960).
- 4.2** Indenture of First Mortgage, dated as of April 1, 1957, defining the rights of the holders of Puget Sound Energy's Gas Utility First Mortgage Bonds (incorporated herein by reference to Exhibit 4.25 to PSE's Registration Statement on Form S-3, dated March 13, 2009, Commission File No. 333-157960).
- 4.3** First, Sixth, Seventh, Sixteenth and Seventeenth Supplemental Indenture to the Gas Utility First Mortgage (incorporated herein by reference to Exhibits 4.26 through 4.30 to PSE's Registration Statement on Form S-3, dated March 13, 2009, Commission File No. 333-157960).
- 10.1* First Amendment dated as of October 4, 1961 to Power Sales Contract between Public Utility District No. 1 of Chelan County, Washington and Puget Sound Energy, Inc., relating to the Rocky Reach Project.
- 10.2* First Amendment dated February 9, 1965 to Power Sales Contract between Public Utility District No. 1 of Douglas County, Washington and Puget Sound Energy, Inc., relating to the Wells Development.
- 10.3* Contract dated November 14, 1957 between Public Utility District No. 1 of Chelan County, Washington and Puget Sound Energy, Inc., relating to the Rocky Reach Project.
- 10.4* Power Sales Contract dated as of November 14, 1957 between Public Utility District No. 1 of Chelan County, Washington and Puget Sound Energy, Inc., relating to the Rocky Reach Project.
- 10.5* Power Sales Contract dated May 21, 1956 between Public Utility District No. 2 of Grant County, Washington and Puget Sound Energy, Inc., relating to the Priest Rapids Project.
- 10.6* First Amendment to Power Sales Contract dated as of August 5, 1958 between Puget Sound Energy, Inc. and Public Utility District No. 2 of Grant County, Washington, relating to the Priest Rapids Development.
- 10.7* Power Sales Contract dated June 22, 1959 between Public Utility District No. 2 of Grant County, Washington and Puget Sound Energy, Inc., relating to the Wanapum Development.
- 10.8* Agreement to Amend Power Sales Contracts dated July 30, 1963 between Public Utility District No. 2 of Grant County, Washington and Puget Sound Energy, Inc., relating to the Wanapum Development.
- 10.9* Power Sales Contract executed as of September 18, 1963 between Public Utility District No. 1 of Douglas County, Washington and Puget Sound Energy, Inc., relating to the Wells Development.
- 10.10* Construction and Ownership Agreement dated as of July 30, 1971 between The Montana Power Company and Puget Sound Energy, Inc.

- 10.11* Operation and Maintenance Agreement dated as of July 30, 1971 between The Montana Power Company and Puget Sound Energy, Inc.
- 10.12* Contract dated June 19, 1974 between Puget Sound Energy, Inc. and P.U.D. No. 1 of Chelan County.
- 10.13+ Form of Executive Employment Agreement between Puget Sound Energy, Inc. and each of Eric M. Markell, Kimberly J. Harris, Jennifer L. O'Connor, James W. Eldredge, Donald E. Gaines and Bertrand A. Valdman (incorporated herein by reference to Exhibit 10.1 to Current Report on Form 8-K dated April 3, 2009).
- 12.1* Statement setting forth computation of ratios of earnings to fixed charges (2004 through 2008 and 12 months ended March 31, 2009) for PSE.
- 31.1* Chief Executive Officer certification of Puget Sound Energy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2* Chief Financial Officer certification of Puget Sound Energy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1* Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2* Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

** Previously filed with a report or registration statement that is more than 30 years old and therefore refiled with, or incorporated by reference into, this report.

+ Management contract or compensating plan or arrangement.

AMENDMENT NO. 1
TO
POWER SALES CONTRACT
BETWEEN
PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON
AND
PUGET SOUND POWER AND LIGHT COMPANY

This Contract Amendment, made and entered into as of the 4th day of October, 1961, by and between Public Utility District No. 1 of Chelan County, Washington (hereinafter called the "District"), a municipal corporation organized and existing under the laws of the State of Washington, and Puget Sound Power and Light Company (hereinafter called the "Purchaser"), a private corporation organized and existing under the laws of the State of Washington (formerly a Massachusetts corporation).

W I T N E S S E T H :

WHEREAS, the parties hereto entered into a Power Sales Contract dated as of November 14, 1957, which contract is in full force and effect, providing, inter alia, for the sale of power and energy from the District's Rocky Reach Hydroelectric Project (Federal Power Commission Licensed Project No. 2145), now under construction and hereinafter referred to as the "Project"; and

WHEREAS, as an integral part of the Project, the District has constructed a 230 KV transmission line to connect the generating station of the Project with the transmission facilities of Bonneville Power Administration (hereinafter referred to as "Bonneville") at Bonneville's Columbia Substation, which transmission line establishes an additional point of interconnection between the transmission facilities of the Project and the transmission facilities of Bonneville; and

WHEREAS, the parties hereto desire to amend said Power Sales Contract to provide for additional points of delivery of power and energy from the Project to the Purchaser under said Power Sales Contract from the 230 KV transmission facilities of the Project and to agree upon other matters made necessary as a result of the construction of said transmission line.

NOW, THEREFORE, for and in consideration of the premises and of the covenants and undertakings of the parties hereinafter set forth, and subject to the provisions of the District's Bond Resolutions No. 1412 and No. 1860, and to the provisions of the Federal Power Commission License No. 2145, the parties hereto covenant and agree that said Power Sales Contract be and the same hereby is amended by deleting the whole of Section 12 thereof and substituting in lieu thereof a new Section 12 to read as follows:

"Section 12. Points of Delivery. The power and energy to be made available to the Purchaser by the District hereunder shall be delivered at 230 KV and at the purchaser's request delivered at (a) the Project switchyard at the point or points of termination of any non-Project transmission lines and/or (b) any point where the 230 KV transmission facilities of the Project connect with non-Project facilities and/or (c) other points of delivery as may be agreed upon from time to time; provided, however, that except as provided in the next succeeding paragraph of this Section 12 the power and energy to be delivered to the Purchaser at all points of delivery specified in (b) above shall not exceed the capacity of Project transmission facilities between the Project switchyard and all said points of delivery multiplied by the Purchaser's Allotment; the amount so determined being hereinafter referred to as 'Purchaser's Share of Transmission Capacity.'

"Each Purchaser of power and energy from the Project shall have the right, without additional charge by the District, to use or assign to another such Purchaser its Purchaser's Share of Transmission Capacity to transmit Project and/or non-Project power and energy. During any time transmission capacity is not used or assigned by a Purchaser entitled to the same or any transmission capacity is made available by opposed power flow, such capacity shall be divided among Purchasers desiring the same in proportion to their Purchaser's Allotments."

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals as of the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN
COUNTY, WASHINGTON

By /s/ Ivan J. Compton
President

(SEAL)

ATTEST:

/s/ L. J. Richardson
Secretary

PUGET SOUND POWER AND LIGHT COMPANY

By /s/ L. E. Karrer
Vice President

(SEAL)

ATTEST:

/s/ Ralph M. Davis
Secretary

AMENDMENT TO
POWER SALES CONTRACT

Executed by
PUBLIC UTILITY DISTRICT NO. 1 OF
DOUGLAS COUNTY, WASHINGTON
AND
PUGET SOUND POWER & LIGHT COMPANY

THIS AMENDMENT is made and entered into as of the 9th day of February, 1965 between Public Utility District No. 1 of Douglas County, Washington (hereinafter called "Douglas"), a municipal corporation of the State of Washington, and Puget Sound Power & Light Company (hereinafter called the "Purchaser"), a corporation organized and existing under the laws of the State of Washington:

W i t n e s s e t h :

Whereas, Douglas and the Purchaser have heretofore entered into a contract (hereinafter called the "Power Sales Contract"), as of the 18th day of September, 1963, and Douglas and the other three Purchasers have heretofore entered into similar contracts, to provide for the sale by Douglas, and the purchase by the Purchasers, of power and energy to be produced by the Wells Project in excess of the amounts required to provide for the actual and prospective needs of Douglas; and

Whereas, Douglas holds a license, issued July 12, 1962, as amended, from the Federal Power Commission for Project No. 2149 which, together with an order of said Commission, permits the inclusion in the electric generating plant of three generating units in addition to the initial seven generating units included therein; and

Whereas, Douglas proposes to issue additional bonds to provide funds for defraying the cost of acquisition, construction and installation of such three additional generating units; the First Bond Resolution permits additional bonds to be issued for such purpose, payable from the revenues of the Project on a parity with the 1963 Bonds and secured by an equal charge and lien on such revenues; and the First Bond Resolution requires, among other things, as conditions precedent to the issuance of such additional bonds that Douglas shall have in effect contracts for the sale of power and energy available from such additional generating units, which contracts, among other things, shall contain terms with respect to payments for such power and energy, no less favorable to Douglas than the terms of the Power Sales Contracts; and

Whereas, Douglas and the Purchasers desire to amend the Power Sales Contracts to provide for the sale and purchase of the additional power and energy available from such three additional generating units upon the same terms and conditions as are applicable to the sale and purchase of the power and energy available from the initial seven generating units; and

Whereas, Douglas has the responsibility and the authority for the financing, construction and operation of such three additional generating units;

Now, Therefore, For and in Consideration of the Mutual Covenants and Agreements Herein Contained, It is Agreed by and Between the Parties Hereto as Follows:

Article I. Definitions of Terms used in this Amendment.

As used in this Amendment, the term "Power Sales Contracts" shall mean the Power Sales Contract and the similar contracts entered into, as of the 18th day of September, 1963, with the other Purchasers.

All other terms used in this Amendment shall have the respective meanings set forth in Section 2 or elsewhere in the Power Sales Contract except as otherwise provided in Article II of this Amendment.

Article II. Amendment of Definitions in the Power Sales Contract.

The definitions contained in Section 2 of the Power Sales Contract are hereby amended as follows:

(1) "Wells Project". For purposes of Sections 18 and 19 of the Power Sales Contracts, and for purposes of the terms "Commencement of Normal Routine Operation" and "Initial Date of Delivery" as such terms are used throughout the Power Sales Contracts, "Wells Project" shall have the meaning set forth in Section 2(c) of the Power Sales Contracts; but for all other purposes of the Power Sales Contracts (including, but without limitation, for purposes of the terms "Wells Project Output" and "Cost of Acquisition and Construction"), "Wells Project" shall have the meaning defined in said Section 2(c) but shall also include, in addition to the initial seven generating units, the three additional generating units being provided from the proceeds of the 1965 Bonds.

(2) "Revenue Bonds" shall mean the 1963 Bonds issued under the First Bond Resolution, and the 1965 Bonds issued under the First Supplemental Resolution, for the purpose of paying the Cost of Acquisition and Construction and any other bonds (including bonds referred to in Section 5(c) hereof) which, by the terms of the First Bond Resolution, are permitted to be issued payable from the revenues of the Wells Project on a parity with the 1963 Bonds and secured by an equal charge and lien on such revenues. The term "1963 Bonds" shall mean the \$184,000,000 principal amount of Wells Hydroelectric Revenue Bonds, Series of 1963; and the term "1965 Bonds" shall mean the additional bonds issued under the First Supplemental Resolution to provide funds, among other things, to defray the cost of acquisition, construction and installation of such three additional generating units.

(3) "Cost of Acquisition and Construction" shall mean all costs of acquisition, construction, installation and financing of the Wells Project, heretofore or hereafter paid or accrued, including but not limited to:

(a) Working capital of Douglas in the amount of \$1,500,000; provided that if it shall at any time appear that the amount of working capital on hand is in excess of that which is necessary or in excess of anticipated requirements in the future, such amount may be reduced as referred to in Section 6(g) hereof;

(b) Establishing a Reserve Account in the Bond Fund pursuant to the First Bond Resolution to the extent of one year's interest on the 1963 Bonds and a reserve account in the bond fund for the 1965 Bonds pursuant to the First Supplemental Resolution to the extent of one year's interest on the 1965 Bonds;

- (c) Establishing a Reserve and Contingency Fund in the amount of \$5,000,000 pursuant to the First Bond Resolution;
- (d) Interest accruing on the 1963 Bonds until Commencement of Normal Routine Operation or until January 1, 1969, whichever is later, and interest accruing on the 1965 Bonds until September 1, 1972, except for such interest as is payable by the Purchasers as part of Annual Power Costs for the Interim Delivery Period; and
- (e) All other items relating to payment of costs in connection with the acquisition, construction, installation and financing of the Wells Project to the extent such items constitute "Cost of Construction" as defined in Section 6.9 of the First Bond Resolution or "Cost of Additional Units" as defined in Section 1.2 C of the First Supplemental Resolution.

(4) Section 2(m) of the Power Sales Contract is amended to read as follows:

"(m) 'Bond Resolution' shall mean collectively the First Bond Resolution, the First Supplemental Resolution and all other resolutions adopted by Douglas authorizing the issue of Revenue Bonds. The term 'First-Bond- Resolution' shall mean Resolution No. 688 adopted by Douglas on October 4, 1963, a certified copy of which has been delivered to the Purchaser; and the term 'First Supplemental Resolution' shall mean Resolution No. 1096, adopted by Douglas on February 9, 1965, a certified copy of which has been delivered to the Purchaser."

Article III. Other Amendments to the Power Sales Contract.

Section 1 of the Power Sales Contract is amended to read as follows:

"Section 1. Term of Contract. This contract shall be in full force and effect until midnight of August 31, 2018, or until the 1963 Bonds, all Completion Bonds as defined in the First Bond Resolution, and the 1965 Bonds are paid or provision is made for the retirement thereof, whichever is later."

Clause (ii) of Section 5 (b) (2) of the Power Sales Contract is amended to read as follows:

"(ii) that proportion (not exceeding 100%) of the interest and principal payments accruing during the Interim Delivery Period on all outstanding Revenue Bonds (other than interest accruing on the 1965 Bonds during the Interim Delivery Period and prior to September 1, 1972) which the number of generating units installed, successfully tested as required by the specifications, except for the index tests, and made ready and available for normal continuous operation bears to the number seven (7), provided that the seventh unit shall not be deemed to be so ready until the Commencement of Normal Routine Operation."

Section 19 of the Power Sales Contract is amended by adding thereto the following sentence: "Douglas further agrees to proceed diligently with the financing of the three additional generating units and, subject to Uncontrollable Forces, plans to complete the acquisition, construction and installation of such three additional generating units by March 1, 1969."

Section 26 of the Power Sales Contract is amended to read as follows:

"Section 26. Modification of Contract Terms. It is recognized by the parties hereto that, by virtue of the Bond Resolution, this contract cannot be amended, modified or otherwise altered by agreement of the parties in any manner that will impair or adversely affect the security afforded by the provisions of this contract for the purchase and sale of a portion of Wells Project Output for the payment of the principal, interest and premium, if any, on Revenue Bonds as they respectively become payable, as long as any of the Revenue Bonds are outstanding and unpaid or until provision is irrevocably made for the payment thereof."

In Witness Whereof, the parties hereto have caused this agreement to be executed by their proper officers respectively, being thereunto duly authorized, and their respective corporate seals to be hereto affixed, the day and year first above written.

Public Utility District No. 1 of
Douglas County, Washington

(Seal)

By /s/ Lloyd McLean
President

By /s/ Michael Doneen
Vice President

Attest:

/s/ Howard Prey
Secretary

Puget Sound Power & Light Company

(Seal)

By /s/ Ralph M. Davis
President

Attest:

/s/ J. H. King
Asst. Secretary

CONTRACT BETWEEN PUBLIC UTILITY DISTRICT

NO. 1 OF CHELAN COUNTY, WASHINGTON, AND

PUGET SOUND POWER & LIGHT COMPANY

THIS CONTRACT, Made and entered into this 14th day of November, 1957, by and between PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON (hereinafter called the "District"), a municipal corporation organized and existing under the laws of the State of Washington, and PUGET SOUND POWER & LIGHT COMPANY (hereinafter called "Puget"), a private utility corporation organized and existing under the laws of the State of Massachusetts,

WITNESSETH:

WHEREAS, the District has heretofore, to wit: on January 6, 1956, entered into two power contracts with Puget, one contract for the purchase, sale and interchange of power and energy between the parties thereto in connection with the Rock Island Hydro-Electric Production System of the District, created by Resolution of the District No. 292, and the Columbia River-Rock Island Hydro-Electric System created by Resolution of the District No. 1137, which power contract is hereinafter referred to as the "Rock Island Contract," and the other contract for the sale of power and energy by the District to Puget from the District's Federal Power Commission licensed project No. 2145, known as the Rocky Reach Hydro-Electric Power Project, which power contract is hereinafter referred to as the "Rocky Reach Contract"; and

WHEREAS, the District and Puget on the twentieth day of November, 1956, entered into a Supplemental Power Contract (hereinafter referred to as "Supplemental Power Contract"), modifying and supplementing the Rock Island Contract and the Rocky Reach Contract; and

WHEREAS, the Commissioners of the District on the twentieth day of November, 1956 adopted Resolution No. 1412, providing a plan and system for the acquisition and construction of an electric utility system known as the Rocky Reach Hydro-Electric System (Federal Power Commission licensed project No. 2145) and pursuant thereto issued \$23,100,000 of revenue bonds (hereinafter referred to as "Series of 1956 Bonds") to defray a portion of the cost of the acquisition and construction of the Rocky Reach Hydro-Electric Power Project (hereinafter referred to as the "Project"), and

WHEREAS, at the time said Supplemental Power Contract was entered into and said Resolution No. 1412 of the District was adopted, it was contemplated that the balance of the Project could be financed by the issuance of \$227,500,000 Subsequent Series Bonds with a resultant estimated average annual cost of power of not exceeding Nineteen and 93/100 Dollars (\$19.93) per kilowatt year (and not exceeding Twenty-one and 75/100 Dollars (\$21.75) per kilowatt year during any twelve (12) months' period ending July first); and

WHEREAS, under the terms of said Rocky Reach Contract as modified and supplemented, neither the District nor Puget was obligated to proceed with the construction of the Project or to take power therefrom if such power costs should exceed those specified in the Supplemental Power Contract; and

WHEREAS, said Project cannot be financed and constructed with resultant power costs within said limitations on the cost of power and the District is unable, within the framework of said Rocky Reach Contract as supplemented and modified by the Supplemental Power Contract to proceed with the construction of the Project and to perform in accordance with the terms of said Rocky Reach Contract as so supplemented and modified, and it is in the interest of the District, Puget and the holders of Series of 1956 Bonds that the construction of the Project proceed expeditiously and to that end the Rocky Reach Contract and Supplemental Power Contract be cancelled and superseded by the within contract; and

WHEREAS, the execution of this contract will enable the District to enter into Power Sales Contracts for the sale of power from the Project to others and for the District to proceed with the financing and construction of the Project, which would not otherwise be possible, and thereby to improve the security of said bondholders,

NOW, THEREFORE, for and in consideration of the premises and of the covenants and undertakings of the parties hereinafter set forth, the parties hereto covenant and agree as follows:

SECTION 1.

The Rocky Reach Contract and the Supplemental Power Contract are hereby cancelled and superseded by the within contract.

SECTION 2. Definitions.

(A) The term "Rocky Reach Hydro-Electric System Revenue Bonds" shall mean the electric revenue bonds issued or partly issued and to be issued by the District and at any time outstanding for the purpose of providing funds for the payment of all costs of the District incurred in connection with the financing, acquisition and construction of the Project, including, but without limitation, amounts required to pay interest on all of said bonds during the estimated period of construction and for such additional period or periods thereafter as shall be specified in the resolution or resolutions authorizing the issuance of said bonds, to provide working capital, to repay any advances made by Puget or others in connection with the investigation, development and/or construction of the Project which are repayable out of the proceeds of said bonds, and to provide the amounts required for the Reserve Account in the Bond Fund and for the Reserve and Contingency Fund as provided for in the resolution or resolutions authorizing the issuance of said bonds, and shall include Series of 1956 Bonds and Subsequent Series Bonds.

(B) The term "Subsequent Series Bonds" shall mean the Rocky Reach Hydro-Electric System Revenue Bonds to be issued by the District pursuant to a resolution or resolutions to be adopted as authorized under the provisions of Resolution No. 1412, to pay all of the estimated costs of the financing, acquisition and construction of the Project in the aggregate principal amount estimated to be necessary for that purpose when supplemented by the proceeds of the Series of 1956 Bonds, including, but without limitation, amounts required to pay the costs and expenses enumerated in paragraph (A) of this Section 2.

(C) The term "Spillway Section of the Project" shall mean that portion of the Project acquired and constructed with the proceeds of the Series of 1956 Bonds, including but not limited to the east concrete spillway section and abutment section, concrete retaining walls, lands, easements, flood rights and water rights.

(D) The term "Stage 1 Construction" shall mean that portion of the construction of the Project as described in the Districts Invitation For Bids For Stage 1 Construction Rocky Reach Hydro-Electric Power Project, dated June 15, 1956, the Contract Documents relating thereto, and the applicable addenda.

SECTION 3.

Puget has heretofore paid to the District, as an advance partial payment for power and energy to be made available to Puget from the Project, the sum of One Million and Five Hundred Thousand Dollars (\$1,500,000), which amount, together with any future advances of like kind, shall promptly be repaid to Puget from the proceeds of the Subsequent Series Bonds initially underwritten.

SECTION 4.

Until the District has issued, sold and delivered the Subsequent Series Bonds, or until the indebtedness evidenced by the Series of 1956 Bonds has been paid or refunded, whichever is earlier, Puget agrees that, in the event of deficiency in the Bond Fund created and established by Resolution No. 1412 for the payment of the Series of 1956 Bonds, it will pay to the District in addition to all other payments by Puget to the District under the Rock Island Contract, in monthly installments beginning not earlier than July 1, 1958, an annual surcharge on the amounts payable by Puget to the District pursuant to Section 4 of the Rock Island Contract (hereinafter referred to as the "Surcharge"), in an amount equal to the sum of the following costs of the District:

(a) The amounts required in any year to make up any deficiency in the amounts required by the provisions of Resolution No. 1412 to be paid into the Bond Fund for the payment of the principal of, and interest, and premium, if any, on the Series of 1956 Bonds at any time outstanding;

(b) The amounts annually required to pay the necessary costs and expenses of maintenance of the Spillway Section of the Project, and

(c) The amounts annually required to pay governmental taxes, assessments or other similar charges, or reasonable payments in lieu thereof, lawfully imposed upon or incurred by the District by reason of the additional payments herein provided to be made by Puget to the District as provided in subparagraphs (a) and (b) of this Section 4, and by reason of the ownership by the District of the Spillway Section of the Project.

Puget shall be entitled to credit on the amounts so to be paid in an amount equal to the interest received by the District by reason of the investment of moneys in the Reserve Account in the Bond Fund created by Resolution No. 1412 for the Series of 1956 Bonds, and any miscellaneous net revenues derived by the District by reason of the ownership of the Spillway Section of the Project; provided that during the period of construction of Stage 1 Construction the interest received by the District by reason of the investment of moneys in said Reserve Account shall be transferred to the Construction Fund for the Project.

Sixty per cent (60%) of any such payments when received by the District shall be deposited in the Revenue Fund created by said Resolution No. 292, and forty per cent (40%) thereof in the Revenue Fund created by said Resolution No. 1137, and, subject to the requirements of said Resolutions Nos. 292 and 1137, an amount equal to each of said amounts shall promptly be transferred by the District from said respective Revenue Funds to the Bond Fund created by Resolution No. 1412 for the Series of 1956 Bonds.

The billings provided for in Section 9 of said Rock Island Contract shall include the Surcharge provided for in this

Section 4. Amounts payable by Puget to the District pursuant to paragraph (a) of this Section 4 shall be paid on or before the twentieth day of each calendar month in which such payment is required.

If the District takes power and energy from the Rock Island Plant under the provisions of said Rock Island Contract, the District agrees to pay to Puget from that portion of the revenues received by the District from the ownership and operation of the Rock Island Plant, other than revenues received from Puget, including the revenues from the sale of power and energy from said Rock Island Plant to other systems of the District, in addition to all other payments payable by the District to Puget under said Rock Island Contract, that proportionate part of the Surcharge which Puget shall have paid pursuant to this Section 4 that the District's payments under Section 7 of the Rock Island Contract bear to Puget's payments under Section 4 of the Rock Island Contract.

If and when the District issues, sells and delivers all of the Subsequent Series Bonds, or the indebtedness evidenced by the Series of 1956 Bonds has been paid or refunded, then the undertakings of the parties hereto as set forth in Sections 4 and 5 hereof shall thereupon terminate and shall be of no further force or effect.

SECTION 5.

The District agrees that on and after December 16, 1958, or on and after such earlier date as the District is able to obtain delivery of power and energy from the Bonneville Power Administration in amounts sufficient to serve the load requirements of the District's distribution system, the District will not take power and energy from the Rock Island Plant pursuant to Section 6 of the Rock Island Contract, and the District will not at any time after the date hereof serve any notice, pursuant to said Section 6, to take power and energy after December 16, 1958, or such earlier date as the District is able to obtain delivery of power and energy from Bonneville Power Administration as aforesaid in excess of the following amounts, to wit:

A. From December 16, 1958, or such earlier date, until December 31, 1966, 12,000 kilowatts or such portion thereof as is required by the District in addition to the power and energy obtainable from the Bonneville Power Administration under rates, terms and conditions consistent with sound business practices and which will properly and advantageously contribute to the conduct of the business of the District, to serve the load requirements of the District's Distribution System; and

B. Thereafter as set forth in the table below, viz:

Year of Withdrawal	Amounts – Not More Than:
1967	15,500 KW
1968	24,500 KW
1969	34,000 KW
1970	44,000 KW
1971	55,500 KW
1972	67,500 KW
1973	80,500 KW
1974	94,500 KW
1975	110,000 KW
1976 and thereafter during the life of the Rock Island Power Contract	124,500 KW

The term "load requirements of the District's Distribution System" as used herein shall mean the power and energy required to serve the loads specified in Section 6 of the Rock Island Contract and the load in Douglas County, Washington, in connection with the construction of the Rocky Reach Project.

SECTION 6. Rock Island Contract.

The Rock Island Contract is hereby amended as follows:

1. Section 4 thereof is hereby amended to include in the payments to be made by Puget to the District pursuant to said Section 4 the payments to be made by Puget to the District pursuant to Section 4 hereof, the payment of which shall be enforceable in the manner provided in Section 9 thereof.

2. Section 6 thereof is amended to conform to the provisions of Section 5 hereof.

3. Section 7 thereof is amended to conform to the provisions of Section 4 hereof relating to the payments by the District to Puget for the payment by the District of its proportionate share of the Surcharge on power and energy of the Rock Island Plant taken by the District under the terms of Section 5 hereof.

4. Section 9 thereof relating to billings is amended to conform to the provisions of Section 4 hereof relating to billings.

5. Section 10 thereof with reference to the use of moneys in the Revenue Funds of the Rock Island Plant is hereby amended to permit the transfer of the Surcharge to the Bond Fund created by Resolution No. 1412 for the Series of 1956 Bonds, pursuant to the provisions of Section 4 hereof.

6. The last paragraph of Section 14 thereof is hereby amended to permit the use of the revenues of the System and the Production System (as such systems are defined in said Rock Island Contract) to be used, to the extent of the Surcharge, as is herein provided in Section 4 hereof.

7. Section 14 thereof is amended by changing the period at the end of the first paragraph of said Section to a comma and adding the words, "and the proceeds of any policies of insurance covering any such loss of revenue shall be paid into the Revenue Fund and credited against the payments required to be made by Puget to the District pursuant to Section 4 hereof, and such credit shall be reflected in billings pursuant to Sections 4 and 7 hereof."

Except as specifically amended herein, said Rock Island Contract shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1
OF CHELAN COUNTY, WASHINGTON

By /s/ L. J. Richardson
President

ATTEST:

/s/ Ivan J. Compton
Secretary

PUGET SOUND POWER & LIGHT COMPANY

By /s/ Frank McLaughlin
President

ATTEST:

/s/ Ralph M. Davis
Secretary

POWER SALES CONTRACT

between

PUBLIC UTILITY DISTRICT NO. 1
OF CHELAN COUNTY, WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

THIS POWER SALES CONTRACT, made and entered into as of the fourteenth day of November, 1957, by and between PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON (hereinafter called the "District"), a municipal corporation organized and existing under the laws of the State of Washington, and PUGET SOUND POWER & LIGHT COMPANY (hereinafter called the "Purchaser"), a private corporation organized and existing under the laws of the State of Massachusetts,

WITNESSETH

WHEREAS, the District is authorized by law to own and operate an electric public utility system or systems for the purpose of furnishing the District and the inhabitants thereof and other persons, including public and private corporations within or without its limits, with electric current for all uses; and

WHEREAS, the Commission of the District on the 20th day of November, 1956, adopted Resolution No. 1412 providing a plan and system for the acquisition and construction of an electric utility system known as the Rocky Reach Hydro-Electric System (Federal Power Commission Licensed Project No. 2145) and pursuant thereto issued \$23,100,000 of bonds to defray a portion of the cost of the acquisition and construction of the Rocky Reach Hydro-Electric Power Project (hereinafter defined as the "Project"), and expects to issue additional bonds in the estimated amount of approximately \$260,000,000 pursuant to a resolution of the District, to obtain the monies estimated to be necessary to complete the acquisition and construction of said Project, a certified copy of each of said resolutions having been delivered to the Purchaser; and

WHEREAS, said Project will initially have seven (7) turbogenerators with total peaking capability of approximately 775,000 kilowatts or more, and associated transmission and transformation facilities connecting the Project with the system of the Bonneville Power Administration (hereinafter referred to as "Bonneville"), and with the District's Rock Island Hydro-Electric Project (Federal Power Commission Licensed Project No. 943), the latter of which in turn is connected through transmission and transformation facilities of the District to the District's Lake Chelan Hydro-Electric Project (Federal Power Commission Licensed Project No. 637).

NOW, THEREFORE, for and in consideration of the premises and of the covenants and undertakings of the parties hereinafter set forth, and subject to the provisions of the hereinabove described bond resolutions and license, and to the laws of the State of Washington, the parties hereto covenant and agree as follows:

SECTION 1. Definitions

As used in this contract, the following words and phrases shall have the meanings hereinafter set forth, unless the context shall clearly indicate that another meaning is intended:

(A) The term "Project." shall mean the Rocky Reach Hydro-Electric Power Project licensed by the Federal Power Commission as Project No. 2145 Washington, and any amendments thereto, and extensions or renewals thereof, or licensed under a new or annual license upon expiration thereof, and authorized to be acquired and constructed by the District pursuant to Resolution No. 1412 adopted by the Commission of the District November 20, 1956, except as otherwise provided in Section 23 of this contract.

(B) The term "Generator Bus" shall mean the point on the low-voltage side of the Project generating station's transformer banks at which point the electric output of the Project is measured.

(C) The term "Rocky Reach Project Output" (hereinafter referred to as "Project Output") shall mean the amount of power and energy, including reactive power, produced by said Project at any time during the term of this contract under the operating conditions which exist at that time; and after deductions for station use and losses, service to Project supervisors' cottages in the vicinity of the Project, replacement of power and energy due to tailwater encroachment on the District's Lake Chelan Hydro-Electric Project not exceeding 4,000 kilowatts of annual average energy so long as License No. 2145 for the Project is not amended so as to adversely affect the District's Lake Chelan Hydro-Electric Project, and replacement of power and energy for losses if required by law to be made available to the owner of the proposed Wells Project; provided, however, for the purposes of Section 5 and Section 15 hereof with respect to scheduling of power and energy, including reactive power, and pondage, Project Output shall be deemed to mean the power and energy capable of being produced under the conditions above specified in this paragraph (C) of this Section 1.

(D) The term "Uncontrollable Forces" shall mean any cause reasonably beyond the control of either party to this contract and which by the exercise of due diligence such party is unable to prevent or overcome, including but not limited to an act of God, fire, flood, explosion, strike, sabotage, an act of the public enemy, civil or military authority including court orders, injunctions, and orders of government agencies with proper jurisdiction, insurrection or riot, an act of the elements, failure of equipment, or inability to obtain or ship materials or equipment because of the effect of similar causes on suppliers or carriers.

(E) The term "Rocky Reach Hydro-Electric System Revenue Bonds" (sometimes hereinafter referred to as the "Bonds") shall mean the electric revenue bonds issued or partly issued and to be issued by the District and at any time outstanding for the purpose of providing funds for the payment of all costs of the District incurred in connection with the financing, acquisition and construction of the Project, including, but without limitation, amounts required to pay interest on all of said Bonds during the estimated period of construction and for such additional period or periods thereafter as shall be specified in the resolution or resolutions authorizing the issuance of said Bonds, to provide working capital, to repay any advances made by the District, Puget Sound Power & Light Company or others in connection with the investigation, development and/or construction of the Project which are repayable out of the proceeds of said Bonds, and to provide the amounts required for the Reserve Account in the Bond Fund and for the Reserve and Contingency Fund as provided for in the resolution or resolutions authorizing the issuance of said Bonds, and shall include the bonds referred to in paragraphs (F) and (G) of this Section 1.

(F) The term "Series of 1956 Bonds" shall mean the Rocky Reach Hydro-Electric System Revenue Bonds, Series of 1956, issued by the District in the aggregate principal amount of \$23,100,000 pursuant to Resolution No. 1412 adopted November 20, 1956 for the purpose of defraying a portion of the cost of acquiring and constructing the Project

(G) The term "Subsequent Series Bonds" shall mean the Rocky Reach Hydro-Electric System Revenue Bonds to be issued by the District pursuant to a resolution or resolutions to be adopted as authorized under the provisions of Resolution No. 1412, to pay all of the estimated costs of the financing, acquisition and construction of the Project in the aggregate principal amount estimated to be necessary for that purpose and which have been issued prior to the Date of Commercial Operation of the Project, when supplemented by the proceeds of the Series of 1956 Bonds, including but without limitation, amounts required to pay the costs and expenses enumerated in paragraph (E) of this Section.

(H) The term "Purchasers" shall mean Puget Sound Power & Light Company, Aluminum Company of America, Portland General Electric Company, Pacific Power & Light Company, and The Washington Water Power Company and, with the consent of the District, shall include additional purchasers of a percentage share of Project Output under contracts similar to this contract.

(I) The words "Date of Commercial Operation", and any clause or phrase referring to the commencement of commercial operation of the Project, shall mean the day the District is ready to deliver power and energy from the last of the initial seven (7) generating units to be installed in the Project after each of said seven (7) units has been installed and has been placed in normal continuous operation.

SECTION 2. Term of Contract

This contract shall be in full force and effect as of the date of execution thereof until the Series of 1956 Bonds and the Subsequent Series Bonds are paid or provision is made for the retirement thereof in accordance with Section 14.2 of the resolutions authorizing the issuance of said bonds, or fifty (50) years from and after the Date of Commercial Operation, whichever is later.

SECTION 3. Construction of Project

The District will diligently proceed with the construction of the Project until it is completed, except to the extent that such construction is delayed or impeded by reason of Uncontrollable Forces. The District estimates that the first and seventh generating units in the Project will be ready for commercial operation on the following dates:

1st Unit	–	July 15, 1961
7th Unit	–	May 15, 1962

The District will prepare and submit to the Purchaser monthly reports of progress during the period of construction of the Project and quarterly reports including data as to the date of expected completion of the Project and the comparison of estimated construction time and cost with the estimates made prior to commencing construction and shall promptly advise the Purchaser of any substantial engineering and construction problems as they arise.

Purchaser, together with other purchasers may also at its or their option, maintain at its or their expense an observer at the Project who shall be given full access at reasonable times to the Project and to all plans, records or other documents under the control of the District relating to the Project.

SECTION 4. Coordinated Operation of the Project

Subject to the provisions of the license issued by the Federal Power Commission for the Project, the stream flow of the Columbia River, water storage and flood rights relating to the Project, and the operating and maintenance requirements of the Project consistent with good practice, the District agrees that it will during the term of this contract maintain and operate the Project in consultation with the Purchaser as provided for in Section 9 hereof. It is the intent of the parties hereto that, subject to the requirements of Section 5 hereof, the District shall operate and maintain the Project so as to produce the maximum power and energy, including reactive power, usable in and coordinated to the load requirements of the parties hereto and of all other purchasers of power and energy from the Project, and to the maximum feasible extent with the Northwest Power Pool, that the Project is capable of producing; provided, the District in order to prevent injury to persons or to avoid damage to property or equipment, may in an emergency without consultation with the Purchaser, temporarily interrupt or reduce deliveries of power and energy hereunder but only for so long as such emergency shall exist, and shall promptly notify the Purchaser of the extent of and reason for such interruption or reduction. Prior to the expiration of the license for the Project issued by the Federal Power Commission the District shall apply for, and use and continue to use its best efforts to obtain, a new license or annual licenses authorizing it to maintain and operate the Project for a term which shall not be less than the unexpired term of this contract.

SECTION 5. Power and Energy To Be Made Available To Purchaser – Scheduling

Beginning on the Date of Commercial Operation and thereafter for the duration of this contract, the District agrees to make available to the Purchaser at the Point of Delivery designated in Section 12 hereof, power and energy from the Project in an amount equal to fifty per centum (50%) of the Project Output, less transmission and transformation losses between the Generator Bus and the Point of Delivery associated with such amount; provided, that the District may, upon giving Purchaser at least three (3) years' prior written notice of any withdrawal, withdraw from the Purchaser percentages of the Project Output up to an aggregate of eleven and one-tenth per centum (11.1%) of the Project Output for ultimate utilization in Chelan and Douglas Counties, but in no event shall any notice of withdrawal be given before the Date of Commercial Operation.

The District agrees to make available to the Purchaser and the Purchaser agrees to take from the District, in addition to the power and energy made available as provided in the preceding paragraph of this Section 5, power and energy in amounts up to the following additional percentages of Project Output, less transmission and transformation losses between the Generator Bus and the Point of Delivery associated with such amounts, which the District does not retain for ultimate utilization in Chelan and Douglas Counties, for the periods of time set opposite each percentage, to-wit:

2.2% July 1, 1967 to the termination of this contract, plus an additional 2.4% July 1, 1972 to the termination of this contract, plus an additional 2.2% July 1, 1977 to the termination of this contract,

provided, that the District, at least two (2) years prior to the beginning of each such period, shall have given the Purchaser written notice as to the percentage, up to the maximum of each of the foregoing amounts, to be made available to the Purchaser. The District reserves the right to withdraw for ultimate utilization in Chelan and Douglas Counties the additional percentages of Project Output made available to the Purchaser pursuant to the provisions of this paragraph of this Section 5 on three (3) years' advance written notice; provided, however, that no such notice for the withdrawal of any such additional percentages shall be given until two (2) years after the beginning of any period in which the additional percentage applies.

The foregoing amounts of power and energy made available to the Purchaser pursuant to the preceding paragraphs of this Section 5, and the corresponding related percentages of the Project Output, are hereinafter referred to as the "Purchaser's Share of Project Output" and the "Purchaser's Allotment", respectively. The Purchaser's Allotment of all initial Purchasers is set forth in Exhibit "A", hereto attached.

The Purchaser shall be entitled to the use of a share of the total usable pondage at the Project (hereinafter called "Purchaser's Allotment of Pondage"). Such share of the pondage shall be determined by multiplying the total equivalent energy of such pondage by Purchaser's Allotment. The District shall establish a pondage account for the Purchaser in an initial amount equal to the Purchaser's Allotment of Pondage.

The Purchaser, acting singly or in concert with other Purchasers, shall make available to the District at least eight (8) hours before 12:01 A.M. of each day an hourly schedule of requested total energy deliveries for that day. Such schedule and deliveries thereunder shall not exceed the Purchaser's Share of Project Output. Revisions in such schedule for any day may be made at any time on request to the District by the Purchaser during such day if such revisions are required by reason of changes in estimated requirements of the Purchaser's system and changes in such schedule shall be made as required to reflect actual river flow conditions at the Project. Deviations from the total scheduled production of the Project shall be held to a minimum by the District and corrected as promptly as possible on an hourly basis under conditions as nearly equivalent as possible to those obtaining when the deviation occurred. Such schedule shall be prepared in accordance with the following provisions:

(a) A base schedule shall be prepared, determined from the probable inflow water supply to the Project for that day, not including pondage;

(b) In addition to each daily base schedule established pursuant to paragraph (a) of this Section, a schedule of hourly use of pondage shall be prepared; provided, however, that such use of pondage shall not result in releases of water at the Project inconsistent with the provisions of Article 40 of Federal Power Commission License No. 2145 and shall not result in reducing said pondage account below zero nor increasing it above the initial amount. The Purchaser shall schedule equivalent energy to its pondage account in amounts sufficient to restore the account to its initial amount by 7:00 A.M. of the Monday following delivery from said account. The Purchaser's obligation to restore its pondage account shall be reduced proportionately when inflow of the river exceeds the hydraulic capacity of the Project and will be cancelled when spill occurs;

(c) The hourly schedule of requested total energy deliveries shall be the composite of the schedules referred to in paragraphs (a) and (b) of this Section 5.

SECTION 6. Payments by Purchaser to the District

From and after the date of Commercial Operation, the Purchaser agrees to pay to the District in annual amounts (adjusted for any changes in Purchaser's Allotment during the year) in monthly installments for power and energy made available to the Purchaser under this contract, which amounts shall be equal to the District's costs associated with the ownership, operation and maintenance of and renewals and replacements to the Project multiplied by the Purchaser's Allotment. Such costs shall include, but shall not be limited to, the following items of cost incurred or paid by the District in connection with the Project, whether or not the Project is inoperable or the operation thereof is interrupted, suspended, or interfered with, in whole or in part, during the term of this contract or during any portion of said term, to-wit:

(a) All expenses of the Project, less credits properly related thereto, chargeable to Operating Expense Accounts under the Uniform System of Accounts for Public Utilities and Licensees, as the same are prescribed by the Federal Power Commission at the date of the execution of this contract (hereinafter called the "Uniform System of Accounts"), except the expense enumerated in paragraph (e) of this Section. The term "Operating Expense Accounts" shall include renewals and replacements of "Minor Items of Property" as such term is used in the Uniform System of Accounts. Improvements and extensions to or any replacement of "Units of Property", as the latter term is used in the Uniform System of Accounts, shall be charged to the Reserve and Contingency Fund;

- (b) Governmental taxes, assessments, or other similar charges lawfully imposed upon or incurred by the District due to the District's ownership or operation of, or sale of power from, said Project, or voluntary payments in reasonable amounts in lieu of such taxes; and
- (c) An amount equal to the amount required to pay:
- (1) The principal of and interest on (to the extent that such interest is not paid from the Construction Fund), and premiums if any, which are required to be paid on the Rocky Reach Hydro-Electric System Revenue Bonds in accordance with the schedules of monies to be made available for bond retirement provided in the resolutions of the District authorizing the issuance of said bonds;
 - (2) Amortization of the indebtedness of the District to the Fiscal Agent of the District as the balance of the compensation of said Fiscal Agent for services rendered in connection with the development and financing of the Project;
 - (3) Amortization of the indebtedness of the District to the Attorney for the District as the balance of the compensation for legal services rendered in connection with the development and financing of the Project.

The indebtedness to be paid to the District's Fiscal Agent and Attorney, as provided in subparagraphs (2) and (3) above, shall not exceed thirty-five ten-thousandths of the net proceeds, exclusive of accrued interest, received by the District from the sale of all revenue bonds issued by it to pay all the remaining costs incurred in connection with the financing, acquisition and construction of the Project as defined in paragraph (A) of Section 1 of this contract, payable twenty-eight and three-quarters (28-3/4) ten-thousandths thereof in thirty (30) equal semi-annual installments, without interest to maturity, beginning on the tenth day of the seventh month following the month in which the Date of Commercial Operation occurs, and six and one-quarter (6-1/4) ten-thousandths thereof in ten (10) equal semi-annual installments beginning six months from the maturity date of the thirtieth (30th) semi-annual installment above described. In the event a portion of the monies required to pay all of the estimated remaining costs of the financing, acquisition and construction of the Project, as defined in paragraph (A) of Section 1 of this contract, is hereafter obtained by the District otherwise than as net proceeds received from the sale of revenue bonds issued by it, the monies so obtained shall for the purpose of this paragraph be considered the same as net proceeds received from the sale of revenue bonds issued by the District, but net proceeds received from the sale of revenue bonds thereafter issued by the District to repay the monies so obtained shall not be considered as net proceeds received from the sale of revenue bonds issued by the District.

The term "net proceeds" as used in this paragraph (c) shall mean the amount of money received by the District from such sales after deducting any amount representing accrued interest on the bonds so sold, and brokerage or placement fees payable to bankers for effecting such sales.

- (d) An amount equal to:
- (1) Fifteen per centum (15%) of the payments specified in subparagraph (1) of paragraph (c) of this Section or, during periods when such fifteen per centum (15%) of such payments is insufficient to enable the District to make the payments into the Reserve and Contingency Fund pursuant to the provisions of Section 6.4 of Resolution No. 1412 and paragraph D of Section 8 hereof, such other sums as may be necessary to enable the District to make said payments; plus
 - (2) The amounts required, if any, during the term of this contract for necessary renewals to and replacements of the Project which are in excess of the monies available in the Reserve and Contingency Fund together with any bond proceeds available for such purpose pursuant to the provisions of Section 7 hereof and the proceeds of any applicable insurance;
 - (3) Such additional amounts, if any, as shall be mutually agreed upon between the parties hereto.
- (e) Any cost of or reasonable accruals for payment of any assessments or agreed payments for benefits received by the District for the account of the Project from upstream storage or other headwater improvements on the Columbia River or its tributaries, of the nature now provided for in Section 10(f) of the Federal Power Act. Any accruals for the foregoing purposes will be set aside into a "Contingent Operating and Maintenance Reserve Fund", and any such assessments or agreed payments shall be charged against the Contingent Operating and Maintenance Reserve Fund to the extent of such accruals for the year involved; and provided, further, that the difference between the amount accrued and the amount of any such assessments for upstream benefits when actually determined by the Federal Power Commission, or its successor, or the amount of such agreed payment when made, shall be accounted for, billed to and paid by or credited to the Purchaser, in the same manner and on the same basis that accounting, billing and payment would have been made therefor if such cost had been determined during the period in which such benefits were received.

From the aggregate of the foregoing amounts there shall be deducted any credits (not deducted pursuant to paragraph (a) of this Section 6) by reason of the receipt of any revenues and other income derived from sources other than the direct sale of power from the Project, excluding from such credits revenues from investment of monies in the Reserve Account in the Bond Funds created and to be created by the resolutions of the District authorizing the Rocky Reach Hydro-Electric System Revenue Bonds and in the Reserve and Contingency Fund created by Section 6.4 of Resolution No. 1412 of the District and in the Construction Fund created by Section 6.6 of Resolution No. 1412. The revenues so derived from the investment of monies in said Funds shall accrue to said respective Funds. If the amounts included in paragraph (b) of this Section 6 result in a cost to the Project exceeding that which would otherwise result if all of the Project Output were sold to public utility customers for resale, any such excess shall be collected from the customer, the sale to which results in such excess, and the amounts so collected shall constitute a credit hereunder.

The amounts payable by the Purchaser to the District pursuant to subparagraph (1) of paragraph (c) of this Section 6 shall not commence until the first calendar month in which the interest on the Bonds referred to in said subparagraph is not payable from the Construction Fund to be created by resolution of the District authorizing the issuance of said Bonds; and shall be paid in substantially equal monthly installments on or before the twentieth (20th) day of each calendar month for such month as advance payments on account of the bills to be submitted by the District, pursuant to Section 22 hereof. Notwithstanding any provision of this contract, it is not intended that Purchaser by this contract assumes any obligation or liability as guarantor, endorser, surety or otherwise, in respect to the securities issued or to be issued by the District.

SECTION 7. Issuance of Additional Bonds

The District agrees that, should the costs to the District in connection with any unusual loss or damage or major renewals of or replacements to the Project be in excess of the monies then in the Reserve and Contingency Fund and proceeds of insurance policies, if any, covering such loss or damage, the District will issue additional bonds payable from the revenues of the Project to pay that portion of such costs which exceeds the sum of (a) the proceeds of insurance policies, if any, and (b) the monies then in the Reserve and Contingency Fund in excess of \$2,000,000 provided the District can then legally issue such bonds and that such bonds can be marketed. The District shall take all reasonable steps to establish the legality of and to sell such bonds. Any resolution authorizing the issuance of such bonds, or additional bonds for the acquisition or construction of additions and betterments to or extensions of the Project, shall provide for annual payments into a special fund for the payment of the principal of, interest on, and premium if any, on said bonds over a period of time which shall not be less than the estimated service life of the facilities to be acquired or constructed from the proceeds thereof, which annual payments shall be as nearly equal as practicable in each year in which provision is made for the retirement of principal. Such bonds shall be included in the definition of "Rocky Reach Hydro-Electric System Revenue Bonds" for the purpose of determining the annual power costs of the District set forth in Section 6 hereof and the payments to be made by Purchaser to the District pursuant to subparagraph (1) of paragraph (c) and subparagraph (1) of paragraph (d) of said Section 6.

SECTION 8. Project Revenues – Special Funds

The District agrees that it will maintain the special funds created and established by Resolution No. 1412, which resolution authorized the Series of 1956 Bonds, and that like funds will be created and established by the resolution authorizing the Subsequent Series Bonds (and any bonds issued to defray the cost of additions and betterments or major replacements to the Project that shall be required to maintain it in good and efficient operating condition by reason of any unusual loss or damage to the Project for which funds are not available from the proceeds of insurance or from the Reserve and Contingency Fund), which funds and the purposes thereof are as follows:

- A. A Construction Fund, and a Construction Interest Account in said Fund, into which Fund there shall be deposited all amounts received or collected prior to the Date of Commercial Operation as specified in Section 6.1 of the resolution authorizing the Subsequent Series Bonds and the proceeds of sale of all Rocky Reach Hydro-Electric System Revenue Bonds, except:
1. A sum not to exceed Two Million Dollars (\$2,000,000) to be deposited in the Revenue Fund mentioned in paragraph B of this Section 8;
 2. An amount of cash equal to the largest amount required to be paid or set aside in the Interest Account in the Bond Fund created for the payment of each series of such Bonds (hereinafter referred to in subparagraph 1 of paragraph C of this Section 8)

with respect to any such series of Bonds in any twelvemonth period from the date of such Bonds to the final maturity date thereof. Monies in the Construction Fund from time to time shall be used only for the purpose of paying interest on said Bonds to the Date of Commercial Operation and for six (6) months thereafter, and for paying, or reimbursing payments made in connection with, costs of construction of the Project. Surplus monies remaining in the Construction Fund after paying or providing for the payment of the foregoing amounts shall be paid into the Reserve and Contingency Fund (hereinafter mentioned in paragraph D of this Section 8) in addition to all other payments required to be paid therein;

B. A Revenue Fund into which shall be placed initially Two Million Dollars (\$2,000,000) from the proceeds of sale of the Subsequent Series Bonds for working capital, and into which all income, revenues, receipts and profits derived by the District from the operation of the Project subsequent to the Date of Commercial Operation shall be deposited;

C. A Bond Fund for each series of said Bonds into which the District will transfer from the Construction Fund or from the Revenue Fund in substantially equal monthly installments the amounts required annually by such resolutions for the purpose of paying the principal of, interest on, and premium if any, on the Rocky Reach Hydro-Electric System Revenue Bonds in accordance with their terms, which shall include:

1. An Interest Account in each of the Bond Funds into which there shall be paid in equal monthly installments the amount required to pay the interest on the Bonds semi-annually. During the period prior to the Date of Commercial Operation and for six months thereafter the interest on the Bonds shall be paid out of the Construction Interest Account in the Construction Fund;

2. A Reserve Account in each of the Bond Funds for the Series of 1956 Bonds, the Subsequent Series Bonds, and each other series of bonds issued thereafter. There has been, or there will be, paid into the Reserve Account for each such series of bonds from the proceeds of sale of each such series an amount of cash equal to the largest amount of interest to be paid on such series of bonds, respectively, during any twelve-month period from the date of such series of bonds to the final maturity thereof. Such Reserve Accounts shall thereafter be maintained at all times at said amounts by additional payments from the Revenue Fund as may become necessary as long as any of such Bonds or additional bonds are outstanding.

The Reserve Account: in the Bond Fund for the Series of 1956 Bonds shall be used for the purpose of making up any deficiencies in the Interest Account and the Bond Retirement Account in said Bond Fund, and the Reserve Account in the Bond Fund for the Subsequent Series Bonds shall be used for the purpose of making up any deficiency in the Interest Account in said Bond Fund.

Any monies in the Reserve Accounts in the Bond Funds in excess of the minimum amounts required to be maintained therein may, and when such excess monies amount to One Hundred Thousand Dollars (\$100,000) or more shall, be used at least semi-annually to retire Bonds by call for redemption, or for the purchase of Bonds at prices not exceeding the then applicable call price. During the period prior to the Date of Commercial Operation and for six months after said date, any excess monies in the Reserve Account shall be transferred to the Construction Fund;

3. Bond Retirement Accounts in the Bond Funds into which shall be paid monthly the amounts specified in paragraph B of Section 6.2 of each of the aforesaid bond resolutions, which amounts shall be used for the purpose of retiring Bonds by call for redemption or purchase as therein stated;

D. The Reserve and Contingency Fund into which there shall be paid Sixty-Six Thousand Six Hundred Sixty-Six Dollars and Sixty-Seven Cents (\$66,666.67) per month beginning with the first month after the Date of Commercial Operation until the balance therein is equal to Eight Million Dollars (\$8,000,000), and thereafter, and during the remainder of the term of this contract, such amounts payable monthly as may be required to maintain said fund in that amount, such later payments, however, not to exceed the amount of the first monthly payment. After all of the Bonds are retired, any amounts in the Reserve and Contingency Fund in excess of \$8,000,000 shall be ratably applied to reduce the payments to be made by the Purchaser pursuant to Section 6 hereof.

The monies in the Reserve and Contingency Fund shall be used for the following purposes:

1. To make up any deficiency in the Bond Funds;
2. To pay the cost of renewals and replacements to the Project;
3. To pay the cost of additions to and extensions of the Project, excepting the cost of the additional facilities referred to in Section 23 hereof;
4. To pay extraordinary operation and maintenance costs in connection with the Project.

All monies in the Reserve and Contingency Fund in excess of Eight Million Dollars (\$8,000,000) shall be used for retiring Rocky Reach Hydro-Electric System Revenue Bonds in the manner provided in the resolutions authorizing the issuance of said Bonds, at least annually.

Should any amount remain in any of the funds established in connection with the Project, including working capital and all reserves, in excess of outstanding obligations against such funds at the expiration of this contract, there shall be refunded to the Purchaser, as excess payment for power and energy theretofore purchased, a share of such remainders determined by multiplying the total thereof by the percentage of the Project Output to which the Purchaser is entitled pursuant to the provisions of this contract immediately prior to the expiration of the term thereof as specified in Section 2 hereof.

SECTION 9. Project Purchaser's Committee – Arbitration

(a) In order that the Purchasers may, in an orderly way, participate in problems relating to the Project, there is hereby established the Project Purchasers' Committee (herein called the "Committee"). The Purchaser and each of the other Purchasers are entitled to representation on the Committee and may each appoint a representative to attend Committee meetings. A Chairman shall be elected by the members of the Committee. The Committee will meet regularly as determined by the Committee, for the purpose of discussing the problems with respect to said Project and may make recommendations to the District with reference thereto. Special meetings may be called by the Chairman and shall be called by the Chairman at the request of the District or upon the request of members of the Committee representing one-third (1/3) of the power purchased by the members. All meetings will be held in Wenatchee, Washington, or at such other place or places as may be determined by the Committee. The District shall not be liable for any cost or expense of the Committee or any member thereof.

(b) The District shall give the Committee reasonable notice, in no case less than thirty (30) days except in the event of an emergency requiring immediate action, whenever it proposes to replace items of major equipment in or to construct additions or betterments to or extensions of said Project, or to enter into additional new or special contractual arrangements relating to and substantially modifying the operation of said Project, or the cost of power therefrom.

(c) The District will give due consideration to the recommendations of the Committee. In considering said recommendations, the District shall give due regard to the objective of achieving from said Project the optimum electric power production consistent with economy, reliability and facility of operation and the District's statutory duties. If in the opinion of the Committee the District has given inadequate consideration to its informal recommendations, written recommendations may be made to the District whenever such recommendations are approved in writing by members of the Committee representing Purchasers who are purchasing two-thirds (2/3) of the power purchased by the Purchasers. Such written recommendations shall be forwarded to the District with appropriate supporting data. The District shall take action on such recommendations within a reasonable time by adopting, modifying, or rejecting such recommendations. If the District modifies or rejects said recommendations it shall notify the Committee of its action in writing, giving the reasons therefor.

(d) If the District modifies or rejects a written recommendation of the Committee dealing with matters which may be arbitrated as set forth in subparagraph (e) hereof, and made in accordance with the procedures set forth in subparagraph (c) hereof, the Committee may, by affirmative vote of members of the Committee representing Purchasers who purchase two-thirds (2/3) of the power purchased by the Purchasers, submit the recommendation to a board of arbitrators. The board of arbitrators shall be composed of three (3) persons, one of whom shall be appointed by the District, one of whom shall be appointed by the affirmative vote of members of the Committee representing Purchasers who are purchasing more than one-half (1/2) of the power purchased by the Purchasers, and the third person shall be appointed by the two persons so appointed. In the event said two members cannot agree upon the appointment of a third person, then such third person shall be appointed by the Chief Justice of the Supreme Court of the State of Washington. The procedure for arbitration shall be governed by the laws of the State of Washington. Insofar as the parties hereto may legally do so, they agree to abide by the decision of said board; provided, that the District shall not be bound by any decision of a board of arbitration to the extent that such decision is retroactive beyond the date when the matter arbitrated was made the subject of written recommendation of the Committee.

(e) The matters which may be arbitrated in accordance with subparagraph (d) hereof shall consist of all matters pertaining to the maintenance, and operation of or additions or betterments to, or extensions of, or replacements or renewals to, the Project, insurance to be carried on said Project (which in no event shall be less than that required under the terms of the bond resolution), amounts to be charged to the cost of operating the Project as a result of voluntary payments in lieu of taxes and all other matters materially affecting the cost of power to the Purchasers, except such of said matters as are by law vested exclusively in the discretion of the District.

(f) In the event this Section 9 or any paragraph, sentence, clause or phrase thereof shall be finally adjudicated by a court of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this Section or such part thereof so adjudicated to be invalid had not been included herein.

SECTION 10. Board of Consulting Engineers on Construction Problems

The District shall appoint and maintain during the construction of the Project a Board of five (5) Consulting Engineers of outstanding ability and national reputation, which shall include two (2) engineers selected from a list of not less than four (4) such engineers submitted by the Committee to the District.

SECTION 11. Increase of Purchaser's Allotment

In the event of a Default (as hereinafter defined) by any of the other Purchasers, the Purchaser's Allotment at that time shall be automatically increased, which increase shall be effective for the remaining term of this contract, pro rata with that of the other Purchasers, but the cumulative total of all such increases on account of Defaults shall never exceed twenty-five per centum (25%) of the Purchaser's Allotment immediately prior to such Default (excluding from the Purchaser's Allotment for this purpose any increases made therein under the provisions of this Section 11); provided, however, that the Purchaser's Allotment including the cumulative total of all such increases and all increases made pursuant to any other provision of this contract shall never exceed fifty-six and eight-tenths per centum (56.8%) of the Project Output. For the purposes of this Section 11, the District shall be considered a Purchaser and its Purchaser's Allotment at the time of Default shall be equal to that percentage of the Project Output which remains after deducting the total of the percentages representing all other Purchaser's Allotments, at the time of Default, from the Project Output.

The term "Default" as used herein shall mean the failure by any one of the Purchasers to make the payments specified in Section 6 hereof and contemporaneously with said failure to make payments there shall exist, with respect to that one of the Purchasers, any one or more of the following conditions:

(a) An order, judgment or decree shall be entered by any court of competent jurisdiction:

(1) Appointing a receiver, trustee or liquidator for any of the Purchasers or the whole or any substantial part of the properties of any of the Purchasers;

(2) Approving a petition filed against any of the Purchasers under the provisions of an Act to Establish a Uniform System of Bankruptcy Throughout the United States, Approved July 1, 1898, as amended;

(3) Granting relief to any of the Purchasers under an amendment to said Bankruptcy Act which shall give relief similar to that afforded by said Act; or

(4) Assuming custody or control of the whole or any substantial part of any of the Purchaser's properties under the provisions of any other law for the relief or aid of debtors;

and such order, judgment or decree shall not be vacated or set aside or stayed (or, in case custody or control is assumed by said order, such custody or control shall not otherwise be terminated), within sixty (60) days from the date of the entry of such order, judgment or decree.

(b) Any of the Purchasers shall:

(1) Admit in writing its inability to pay its debts generally as they become due;

(2) File a petition in bankruptcy;

(3) Make an assignment for the benefit of its creditors;

(4) Consent to the appointment of a receiver of the whole or any substantial part of its properties;

(5) Be adjudicated a bankrupt on the basis of a petition in bankruptcy filed against it;

(6) File a petition or an answer seeking relief under any amendment to said Bankruptcy Act which shall afford relief substantially similar to that afforded by said Act; or

(7) Consent to the assumption by any court of competent jurisdiction under the provisions of any other law for the relief or aid of debtors of custody or control of any of the Purchasers or of the whole or any substantial part of its properties;

provided, that if prior to an imminent default by any of the Purchasers it shall demonstrate to the satisfaction of the District and the other Purchasers receiving in the aggregate at least two-thirds (2/3) of the balance of the Project Output its inability to pay for its Purchaser's Allotment and its ability to pay for a smaller Purchaser's Allotment, then it shall be allowed to thereafter take such smaller Purchaser's Allotment and shall be thereafter liable for the same in the same manner as for its Purchaser's Allotment prior thereto; and, in such event, the automatic increase in the Purchaser's Allotment as above provided shall apply only to the difference between the prior Purchaser's Allotment and such lesser Purchaser's Allotment of that one of the Purchaser's threatened with default,

(c) If any of the other Purchasers defaults, and the Purchaser's Allotment is automatically increased in accordance with this Section, the Purchaser either individually or as a member of a group shall have a right of recovery from that one of the Purchasers in default for such amount as the Purchaser may sustain as a loss or damage by reason of such default and may commence such suit, action or proceeding as may be necessary or appropriate to recover the amount of said loss or damage.

SECTION 12. Point of Delivery

The power and energy to be made available to the Purchaser by the District hereunder shall be delivered at the high-voltage side of the transformer banks located at the generating station of the Project. Other points of delivery within Chelan County may be agreed upon from time to time, Purchaser agreeing to pay the cost of delivering power and energy to any point of delivery other than that herein specified if facilities in addition to initial Project facilities are required for such purpose.

SECTION 13. Metering

The District shall provide and maintain suitable meters at the Generator Bus of the Project to measure the amounts of power and energy including reactive power produced by the Project. The District shall also arrange for suitable metering at other points as may be mutually agreed to by the parties hereto.

The District shall cause such metering equipment to be tested at least once every two (2) years. If the Purchaser requests additional tests and inspections of such metering equipment to be made, the costs thereof shall be paid by the Purchaser unless such metering on tests shows the measurement made by such metering equipment used during the tests varied more than two per centum (2%) from the measurement made by the standard meter used in such tests. Either party will give the other reasonable notice of the time when any such tests and inspections are to be made in order that both parties may be properly represented at each such test or inspection.

SECTION 14. Character of Service

Power and energy made available hereunder shall be in the form of three-phase current alternating at a frequency of approximately sixty (60) cycles per second, and deliveries thereof shall be made at approximately 230 kv, or such other voltage as may be mutually agreed upon by the parties hereto.

SECTION 15. Reactive Power

The District will make available at the Point of Delivery the reactive power included in the Purchaser's Share of Project Output and additional reactive power at any time to the extent that said Purchaser elects to reduce deliveries of power and energy within the Purchaser's Share of Project Output. Voltage levels at the Project will be maintained in coordination with the Purchaser's system and other interconnected systems.

SECTION 16. Continuity of Service

The District shall maintain continuous service to Purchaser, but may temporarily interrupt or reduce deliveries of electric energy hereunder if the District determines that such interruption or reduction is necessary or desirable in the case of emergencies, or in order to install equipment in, make repairs, replacements, investigations and inspections of, or perform other maintenance work on the Project. Except in the case of an emergency and in order that the Purchaser's operations will not be unreasonably interfered with, the District shall give the Purchaser reasonable notice of any such interruption or reduction, the reason therefor, and the probable duration thereof.

SECTION 17. Notices

Any notice or demand by the Purchaser or the Project Purchasers' Committee under this contract shall be deemed properly given if mailed (certified or registered), postage prepaid, or telegraphed to the Manager of Public Utility District No. 1 of Chelan County, Wenatchee, Washington, and any notice or demand by the District under this contract shall be deemed properly given if mailed (certified or registered), postage prepaid, or telegraphed to the Purchaser at its office in the City of Seattle, Washington. The designation of the name and address to which any such notice or demand is to be directed may be changed at any time, and from time to time, by either party by similar notice.

SECTION 18. Assignment of Contract

This contract shall inure to the benefit of, and shall be binding upon, the respective successors and assigns of the parties to this contract. No assignment or transfer of this contract shall relieve the parties hereto of any obligation incurred hereunder.

SECTION 19. Accounting

The District shall cause proper books of account to be kept for the District showing as a separate utility system the accounts of the Project and in accordance with the rules and regulations prescribed by any governmental agency authorized to prescribe such rules, including the Division of Municipal Corporations of the State Auditor's Office of the State of Washington, or other State department or agency succeeding to such duties of the State Auditor's Office, and in accordance with the Uniform System of Accounts prescribed by the Federal Power Commission or other Federal agency having jurisdiction over electric public utility companies owning and operating properties similar to the electric properties operated by the District, whether or not the District is required by law to use such system of accounts, and all such accounting records shall be available for inspection and utilization by the duly authorized representatives of the Purchaser at all reasonable times. The District shall supply monthly to the Purchaser such reports of the operation and maintenance of the Project as the Purchaser may from time to time reasonably request. The District shall cause such books of account to be audited by independent certified public accountants, experienced in electric utility accounting and of national reputation, to be employed by the District. The audits to be made by such certified public accountants, as above mentioned, shall be made annually and shall cover each calendar year during the term of this contract, beginning with the year in which the Date of Commercial Operation occurs, and shall be completed within one hundred twenty (120) days following the end of each such calendar year. A copy of each such annual audit, including any recommendations of the accountants with respect thereto, shall be made available by the District to the Purchaser.

SECTION 20. Operation and Maintenance of Project

The District will maintain the Project in good operating condition at all times except to the extent prevented by Uncontrollable Forces and will make renewals and replacements thereof, as needed. In the event of any failure of or damage whatsoever to facilities of the Project, or any reduction in the delivery of power and energy therefrom for any cause whatsoever, the District agrees that it will, with due diligence, expedite the repair or replacement of said facilities or remedy the condition causing such reduction to the end that the delivery of power and energy as required by this contract will be re-established as soon as reasonably possible. When requested by the Purchaser and to the extent reasonable to do so under all of the circumstances, the District shall also use its best efforts to obtain the necessary replacement power and energy at the lowest possible cost for so long a period of time as any deficiency exists for the causes heretofore stated in this Section 20. The cost of such replacement power and energy shall be paid by the Purchaser in addition to all other costs to be paid by the Purchaser in accordance with the other provisions of this contract.

The District shall operate and maintain the Project in an efficient, economical and workmanlike manner and consistent with good business and operating practices followed by other electric utilities in the Pacific Northwest. The costs of operation and maintenance shall at all times be reasonable and consistent with the costs of operation and maintenance of similar electric facilities by public and private agencies in the Pacific Northwest.

Authorized representatives of the Purchaser shall have reasonable access to the entire Project for the purpose of inspection, and all books and records pertaining to the operation and maintenance of the Project shall be made available to the Purchaser by the District at all reasonable times for inspection and utilization.

Maintenance, repairs, renewals and replacements shall be scheduled and performed by the District with the intent of obtaining the optimum operation of the Project as required to meet the respective requirements of all purchasers of power and energy from the Project, and shall be performed at all times in a prudent and economical manner.

The parties hereto hereby agree to cooperate on matters relating to operation, maintenance and repair of the Project and the power resources of the Purchaser, as such matters relate to said operation and maintenance of the Project in coordination with the operation and maintenance of the power resources of the Purchaser and other interconnected generating systems, to assure continued maximum production of usable power and energy in the most efficient manner from the Project with the reservoir, generating and transmission facilities and water available at the generating stations of the parties.

Calculation of the transmission and transformation losses referred to in Section 5 hereof shall be made by the District using factors to be agreed upon by representatives of the parties hereto.

The District shall not voluntarily sell or otherwise dispose of the Project or any portion thereof so as to impair the obligation of the District to make available to Purchaser Purchaser's Share of Project Output hereunder or perform any act that would adversely affect the rights of the Purchaser hereunder.

SECTION 21. Insurance

The District agrees promptly to take all necessary steps to procure at the earliest practicable time and thereafter to maintain in effect at all times insofar as reasonably possible to do so, adequate insurance with responsible insurers under policies with losses payable to the District for the benefit of the District and the Purchaser as their respective interests may appear, to protect and insure against:

- (a) Employer's liability to the extent not covered by the Workmen's Compensation Act of the State of Washington. The District shall comply with the provisions of the Workmen's Compensation Act of the State of Washington;
- (b) Public liability of the District for bodily injury and property damage;
- (c) Physical damage due to fire;
- (d) All risks of physical damage to property and equipment during transportation and installation;
- (e) All risks of physical damage and loss in excess of an appropriate deductible amount, arising from perils not covered by the above insurance to the extent available at reasonable cost;
- (f) Other risks as deemed necessary.

To the extent not covered by the foregoing insurance, the District agrees to procure and keep in effect at all times such policies of insurance, and in such amounts, as shall be required by the terms of the bond resolutions authorizing the issuance of Rocky Reach Hydro-Electric System Revenue Bonds.

SECTION 22. Billing

Prior to the tenth (10th) day of each calendar month after the Date of Commercial Operation, the District shall mail to the Purchaser a bill showing in detail:

- (a) The amounts due for the prior month pursuant to Section 6 hereof except the amounts due pursuant to paragraph (c)(1) of said Section 6;
- (b) The amount due in the prior month pursuant to paragraph (c)(1) of Section 6 hereof, as provided in said Section 6; and each bill shall reflect any advance payment by Purchaser pursuant to Section 6 hereof.

The balance due upon said bill shall be due and payable by the Purchaser on or before the twentieth (20th) day of said month or on or before the tenth (10th) day following the date of mailing said bill, whichever is the later (which date is hereinafter referred to as the "Due Date"). Failure to receive a bill shall not release the Purchaser from liability for payment. If payment in full is not made on or before the Due Date, a delayed payment charge of two per centum (2%) of the unpaid amount of the bill will be made, except that, in the case of a bona fide dispute as to the amount of the bill, the delayed

payment charge shall be applicable only to the portion thereof admittedly due and not paid.

Except as to any portion of a bill which may in good faith be disputed by the Purchaser, the District may, whenever a bill or portion thereof remains unpaid after thirty (30) days' advance notice of said delinquency in writing by registered mail, discontinue service to the Purchaser until such bill is paid, or at its option, cancel the contract. No such discontinuance of service or cancellation shall affect the Purchaser's liability for any charges accrued prior thereto, nor be deemed to waive any right of the District to damages.

If at any time service is discontinued as provided in this Section 22, the Purchaser agrees that it will nevertheless continue to make the payments required to be paid by it to the District the same as though service had not been discontinued.

Remittances received by mail will be accepted without assessment of the two per centum (2%) delayed payment charge, provided the postmark indicates payment was mailed on or before the Due Date. If the Due Date is on a Sunday or a holiday, the following business day shall be the last day on which payment can be made without the addition of the delayed payment charge.

A final accounting for each calendar year shall be rendered to the Purchaser by the District on or before May 15 of the succeeding year. Any balance due the District shall be paid within thirty (30) days from the date of mailing said final accounting. Settlement for any credit due the Purchaser shall be made promptly after such final accounting has been rendered as aforesaid.

SECTION 23. Installation of Additional Units

(a) From time to time during the term hereof the District may propose to expand the Project by installing additional generating facilities. Whenever the District proposes to so expand the Project it shall give notice in writing of such intent to the Purchaser stating:

- (1) The estimated cost of such additional generating facilities;
- (2) The proposed method of financing the cost of said facilities;
- (3) The estimated additional power and energy which would be available as a result of the installation of said

facilities;

(4) The estimated incremental cost (i.e., the costs which will be incurred as a result of installing the proposed additional facilities, which costs would not be incurred were such proposed additional facilities not installed) of said additional power and energy on an annual basis; and

- (5) The estimated construction period for the installation of said facilities.

The notice shall also contain other available pertinent information.

(b) The Purchaser shall have the option of purchasing a share of said additional power and energy determined by multiplying the total additional power and energy by the Purchaser's Allotment as it may exist from time to time pursuant to the provisions of Sections 5 and 11 hereof, and may exercise such option by giving written notice to the District on or before the expiration of ninety (90) days from the receipt of said written notice from the District. Failure to exercise its option to purchase additional power and energy which would be available from the installation of additional generating facilities proposed by the District at any time shall not be construed to waive the rights of the Purchaser to a share of the additional power and energy which would be available from additional facilities proposed for installation by the District at a later date.

(c) If the Purchaser exercises its option to take its share of said additional power and energy, it shall pay for said additional power and energy a percentage of the incremental annual cost of said additional facilities corresponding to the per cent the share of additional power and energy which it purchases is to the total additional power and energy available as a result of the installation of the additional facilities. If the Purchaser does not elect to take additional power and energy which would be available from the installation of additional generating facilities, it shall continue to receive the same amount of power and energy and pay the same annual power cost therefor as if such additional generating facilities had not been installed.

(d) If, after the Purchaser shall have exercised its option as aforesaid, the District shall determine that it is not economically feasible for it to install additional generating facilities as proposed, the District shall be under no obligation to do so and shall so notify the Purchaser.

(e) Notwithstanding any other provisions of Section 23 hereof, whenever the District is compelled to install additional facilities at or in the Project by any order or decision of the Federal Power Commission or any State or Federal government agency with authority to issue or make and enforce such an order or decision, the Purchaser shall share the benefits and costs resulting from the installation of said additional facilities in the same manner and to the same extent as if the Purchaser had voluntarily exercised its option to purchase the power and energy resulting from said installation as provided earlier in Section 23 hereof.

SECTION 24. District's Bond Resolution and License

It is recognized by the parties hereto that the District in its operation of the Project and in the delivery of the power hereunder to the Purchaser, must comply with the requirements of the resolutions authorizing the issuance of the Rocky Reach Hydro-Electric System Revenue Bonds and with the license for the construction and operation of the Project as issued by the Federal Power Commission and amendments thereof from time to time made and it is therefore accordingly agreed that this contract is made subject to the terms and provisions of said resolutions and license. The District shall not, without the written consent of the Purchaser, amend, modify or otherwise change said resolutions or apply for or consent to an amendment, modification or change of said license if such amendment, modification or change would be to the disadvantage of the Purchaser; provided, however, that the District shall in due course make application to the Federal Power Commission for amendment of the Rocky Reach license (Project No. 2145) to permit the change in capacity of generating units initially installed from 90,000 kilowatts each to 101,650 kilowatts each (nameplate rating).

SECTION 25. Liability of Parties

The District and the Purchaser each assumes full responsibility and liability for the maintenance and operation of its respective properties and shall indemnify and save harmless the other party from all liability and expense on account of any and all damages, claims or actions, including injury to or death of persons, arising from any act or accident in connection with the installation, presence, maintenance, and operation of the property and equipment of the indemnifying party; provided, that any liability which is incurred by the District through the operation and maintenance of the Project and not covered by insurance shall be paid solely from the revenue of the said Project, and any payments made by the District to satisfy such liability shall become part of the annual power costs as set forth in Section 6 hereof.

At all times that the District is taking a percentage of the Project Output it shall have all of the rights and obligations of a Purchaser under this contract, except those set forth in Sections 9, 22 and 23 hereof. The percentage of the Project Output taken by the District at any time shall be deemed to be that percentage of the Project Output which remains at that time after deducting the total of the percentages representing all other Purchaser's Allotments.

SECTION 26. Conflict of Laws

The parties hereto agree that this contract shall be governed by the laws of the State of Washington.

SECTION 27. Waiver of Default

Any waiver at any time by either party hereto of its rights with respect to the other party or with respect to any other matters arising in connection with this contract shall not be considered a waiver with respect to any subsequent default or matter.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals as of the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1
OF CHELAN COUNTY, WASHINGTON

(SEAL)

By /s/ L. J. Richardson
President

ATTEST:

/s/ Ivan Compton
Secretary

PUGET SOUND POWER & LIGHT COMPANY

(SEAL)

By /s/ Frank McLaughlin
President

ATTEST:

/s/ Ralph M. Davis
Secretary

EXHIBIT "A"
Distribution of Project Output

<u>Purchasers</u>	Percent of Project Output Sold			
	Date of Commercial Operation to and Including June 30, 1967	July 1, 1967 to and Including June 30, 1972	July 1, 1972 to and Including June 30, 1977	Thereafter during the remainder of the term of the Contracts
Puget Sound Power & Light Company (1)	50.0	52.2	54.6	56.8
Aluminum Company of America	23.0	23.0	23.0	23.0
Portland General Electric Company	16.0	14.7	13.3	12.0
Pacific Power & Light Company	7.1	6.5	5.9	5.3
The Washington Water Power Company	<u>3.9</u>	<u>3.6</u>	<u>3.2</u>	<u>2.9</u>
	100.0	100.0	100.0	100.0

(1) – Subject to the provisions of Section 5 of the Power Sales Contract between Puget Sound Power & Light Company and the District.

POWER SALES CONTRACT

Executed by

PUBLIC UTILITY DISTRICT NO. 2

OF GRANT COUNTY WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

INDEX TO SECTIONS

Section

1.	Term of Contract
2.	Definitions and Explanations of Terms
3.	Amount of Energy and Power Sold
4.	Annual Power Costs
5.	Payment for Power Sold
6.	Scheduling of Deliveries
7.	Point of Delivery
8.	Voltage Control and Reactive Deliveries
9.	Character and Continuity of Service
10.	Metering and Transmission Losses
11.	Accounts
12.	Information to be Made Available to the Purchaser
13.	Priest Rapids Advisory Committee – Arbitration
14.	Insurance
15.	Operation and Maintenance
16.	Board of Consulting Engineers on Construction Problems
17.	Construction and Financing Contracts
18.	Completion of Construction
19.	Additional Facilities
20.	Wanapum Development
21.	Adjustment of Power Allocation
22.	Liability of Parties
23.	Waiver of Default
24.	Notices and Computation of Time
25.	Modification of Contract Terms
26.	District's Bond Resolution and License
27.	Conflict of Laws
28.	Assignment of Contract
29.	Uniformity of Power Sales Contract
EXHIBIT "A"	Distribution of the Priest Rapids Development Output
EXHIBIT "B"	Escrow Instructions

P O W E R S A L E S C O N T R A C T

Executed by

PUBLIC UTILITY DISTRICT NO. 2

OF GRANT COUNTY, WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

This contract, entered into this 21st day of May, 1956, by Public Utility District No. 2 of Grant County, Washington (hereinafter called "the District"), a municipal corporation of the State of Washington, and Puget Sound Power & Light Company (hereinafter called "the Purchaser"), a corporation organized and existing under the laws of the State of Massachusetts.

WITNESSETH:

WHEREAS the District is a municipal corporation organized under the laws of the State of Washington and authorized to construct and operate electric generating plants and transmission lines and to supply electric energy to other electric utilities and, as specifically authorized by Public Law 544 – 83rd Congress, to develop the Priest Rapids Hydroelectric Project on the Columbia River; and

WHEREAS the District has been granted a license by the Federal Power Commission for the construction, operation and maintenance of Project No. 2114, consisting of the Priest Rapids Development and the Wanapum Development, with the structures, fixtures, equipment and facilities, used or useful in the maintenance and operation of the Project; and

WHEREAS the Purchaser desires to purchase power and energy from the District and the District desires to sell power and energy from said Project; and

WHEREAS the District has the responsibility and authority for the financing, construction and operation of said Priest Rapids Development and said Wanapum Development; and

WHEREAS said Public Law 544 and the said Federal Power Commission License provide that the District shall offer a reasonable portion of the power and energy from the said Project for sale in neighboring states.

NOW, THEREFORE, the parties hereto, for and in consideration of the mutual covenants and agreements herein contained, hereby agree as follows:

SECTION 1. TERM OF CONTRACT.

(a) This contract shall be in full force and effect from the date of its execution and until midnight of October 31, 2005.

(b) After October 31, 2005, the Purchaser shall have the right of first refusal to purchase that proportionate part of the Priest Rapids Development Output which is then in excess of the actual and prospective needs of the District for service to ultimate consumers within the service area of the District, which the Purchaser's Power Allocation as of October, 2005 shall bear to the total power allocations of all of the Purchasers; provided, however, that nothing herein contained shall be construed to limit or waive any rights which the agencies in neighboring states would have had to purchase power after October 31, 2005, in the absence of this subsection (b) of Section 1. In the event this Section 1(b) or any sentence, clause or phrase thereof shall be adjudicated by a court of last resort and of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this section or such part thereof so adjudicated to be invalid had not been included herein.

SECTION 2. DEFINITIONS AND EXPLANATIONS OF TERMS.

As used herein:

(a) "Contract Year" shall mean the twelve-month period commencing at 12:01 A.M. on September 1, of each year, except that the first contract year shall begin on the date that the District makes available power and energy hereunder, and end at 12:01 A.M. on the following September 1.

(b) "Priest Rapids Development" shall mean those properties and facilities consisting of the Priest Rapids dam, site, reservoir, switchyard and power plant, including all generating facilities associated therewith up to and including the first eight (8) main turbine generator units each with a name-plate rating of approximately 78,750 kilowatts, and associated transmission facilities consisting of two 230 KV transmission lines and terminal facilities interconnecting the Priest Rapids switchyard and the Bonneville Power Administration's Midway Substation and an undivided one-half interest in the interconnecting facilities between the Priest Rapids switchyard and the Wanapum switchyard.

(c) "Wanapum Development" shall mean those properties and facilities consisting of the Wanapum dam, site, reservoir, switchyard and power plant, including all generating facilities associated therewith up to and including the first eight (8) main turbine generator units each with a nameplate rating of approximately 71,250 kilowatts, and associated transmission facilities in the immediate vicinity of said switchyard and an undivided one-half interest in the interconnecting facilities between Priest Rapids switchyard and Wanapum switchyard.

(d) "Project" shall mean those properties and facilities known as the Priest Rapids Development, the Wanapum Development, and all associated transmission facilities interconnecting said Developments and the transmission facilities which interconnect the Developments with the electric utility facilities of Purchasers and the Bonneville Power Administration in the immediate vicinity of said Developments.

(e) "Priest Rapids Development Output" shall mean the amount of power and energy produced by said Development during the term of this contract under the operating conditions which exist during said term including periods when the said Development may be inoperable, after corrections for encroachment, station and Project use, and depletions required by said Federal Power Commission License.

(f) "Wanapum Development Output" shall mean the amount of power and energy produced by said Development during the term of this contract under the operating conditions which exist during said term including periods when the said Development may be inoperable after corrections for encroachment, station and Project use, and depletions required by said Federal Power Commission License.

(g) The word "Month" shall mean a calendar month.

(h) "Purchaser's Power Allocation" shall mean the percentage of the Priest Rapids Development Output purchased and sold under this contract as set forth in Section 3 hereof as adjusted in accordance with Section 21 hereof.

(i) "Debt Service" shall mean with respect to any period the amount to be paid or accrued during said period to retire the principal of and pay the interest and premium, if any, on all Revenue Bonds or other evidences of indebtedness issued at any time by the District for the purpose of paying the Cost of Acquisition and Construction and on all bonds issued pursuant to the Bond Resolution in the manner provided in said Resolution.

(j) "Uncontrollable Forces" shall mean any cause beyond the control of the District, and which by the exercise of due diligence the District is unable to prevent or overcome, including but not limited to an act of God, fire, flood, explosion, strike, sabotage, an act of the public enemy, civil or military authority, including court orders, injunctions, and orders of government agencies with proper jurisdiction, insurrection or riot, an act of the elements, failure of equipment, or inability to obtain or ship materials or equipment because of the effect of similar causes on suppliers or carriers.

(k) The term "Purchasers" shall mean the Purchaser and other agencies or companies which enter into contracts with the District to buy a percentage share of the Priest Rapids Development Output, all as listed under the heading "Purchasers" in Exhibit "A", entitled "Distribution of the Priest Rapids Development Output," attached hereto and made a part hereof.

(1) "Revenue Bonds" shall mean the bonds issued by the District to obtain funds to pay the cost of Acquisition and Construction and for other purposes, all as authorized by the Bond Resolution.

(m) "Cost of Acquisition and Construction" shall mean all costs of acquisition, construction and financing of the Priest Rapids Development, heretofore or hereafter paid or accrued, including but not limited to:

(1) Working Capital in the amount of three million dollars (\$3,000,000) from which the cost of preliminary surveys, investigations, engineering and other fees and expenses may hereafter be incurred for the Wanapum Development in an amount not to exceed one and one-half million dollars (\$1,500,000) but if so used shall be reimbursed in the amount used at the time the Wanapum Development is financed;

(2) Establishing the Reserve Account in the Bond Fund pursuant to the Bond Resolution;

(3) Interest accruing on said revenue bonds prior to and during construction of said Development;

(4) All fees and expenses properly paid or incurred in connection with said Development;

(5) The cost of preliminary surveys, investigations, engineering and other fees and expenses heretofore properly incurred for the Project;

(6) The cost of all facilities included explicitly or implicitly in the Priest Rapids Development by the definition in Section 2(b) hereof, whenever constructed or installed.

(n) The term "Uniform System of Accounts" shall mean the Uniform System of Accounts prescribed by the Federal Power Commission for Electric Utilities and Licensees in effect at the time this agreement is executed.

(o) The term "Bond Resolution" shall mean the resolution adopted by the District authorizing the sale of Revenue Bonds to provide funds to pay the cost of Acquisition and Construction and other purposes in connection with the Priest Rapids Development, and providing the terms and conditions thereof, a certified copy of which has been delivered to the Purchaser.

(p) The term "Initial Date of Delivery" shall mean 12:01 A.M. of the day the District is ready to deliver power and energy hereunder from one or more generating units which shall have been installed, tested and, in the opinion of the District, are ready for continuous operation as provided in Section 9 hereof.

SECTION 3.

AMOUNT OF ENERGY AND POWER SOLD.

(a) The District agrees to sell to the Purchaser and the Purchaser agrees to purchase, solely from the gross revenues of the Purchaser's light and power system, for the benefit of consumers in the State of Washington, subject to adjustment in accordance with Section 21 hereof, eight per cent (8%) of the Priest Rapids Development Output. Deliveries will be made insofar as possible as requested by the Purchaser all as provided in Section 6 hereof; provided that such deliveries, together with deliveries requested by all other Purchasers (including deliveries to the District pursuant to its reservation under subsection (b) of Section 3 hereof):

- (1) Will be possible of fulfillment under the terms of said Federal Power Commission License;
- (2) Will not exceed the capability of the Development or subject it or its operation to undue hazard.

(b) The District reserves thirty-six and one-half per cent (36-1/2%) of the said Priest Rapids Development Output and shall be entitled to the power and energy thus reserved and to the rights and privileges associated therewith and subject to the same obligations, including those provided in Section 21 hereof, but excepting those recited in Section 13 hereof, as it would have if the District were one of the Purchasers and had rights, privileges and obligations similar to those of the Purchasers. The District covenants and agrees that it will establish, maintain and collect rates or charges for the power and energy reserved by it from the Development as provided in Section 3(b) hereof, which shall be fair and nondiscriminatory and adequate to provide revenues sufficient to enable the District to pay its pro-rata share of the Annual Power Costs. All revenues derived by the District from the sale of the output of the Development to the Purchasers, together with payments by the District for power and energy reserved by it from the Development, shall be segregated, deposited and held separate and apart from all other revenues of the District.

SECTION 4.

ANNUAL POWER COSTS.

(a) "Annual Power Costs" as used in this contract shall be deemed to mean all of the District's costs resulting from the ownership, operation, maintenance of and renewals and replacements to the Priest Rapids Development, including, but not limited to, the items of cost hereinafter mentioned in this Section 4 that are incurred or paid by the District during each Contract Year in connection with said Development, to-wit:

- (1) Amounts required to be set aside by the District for the payment of Debt Service as required by the Bond Resolution;
- (2) An amount not to exceed six hundred thousand dollars (\$600,000) per annum to be placed in a Reserve for Contingencies, Renewals and Replacements, until the sum of six million dollars (\$6,000,000) in principal amount has been accumulated. The moneys in such Reserve Fund shall also be used for the purpose of making up any deficiency in the Reserve Account in the Bond Fund as established in the Bond Resolution. In the event of withdrawals from the Reserve for Contingencies, Renewals and Replacements, the funds withdrawn shall be replaced at the rate of not to exceed six hundred thousand dollars (\$600,000) in any one year;
- (3) Amounts which may be required to pay for the prevention or correction of any unusual loss or damage or for major replacements to keep said Development in good operating condition to the extent that such costs are not covered by insurance, and by the Reserve for Contingencies, Renewals and Replacements. In the event of any such unusual loss or damage, or major replacement which will cost in excess of the amount of money then in said reserve, plus insurance proceeds, and plus two million dollars (\$2,000,000), the District shall issue equal lien (pari passu) bonds payable from the revenues of the said Development to pay the portion of such costs which shall exceed insurance proceeds, if any, provided, that such bonds can then be legally issued and can be sold;
- (4) An amount which when added to the Annual Costs itemized in Sections 4(a)(2) and 4(a)(3) hereof will equal fifteen per cent (15%) of the annual Debt Service during the applicable Contract Year. Such amount shall be used by the District: first, for the purpose of making up any deficiency in the Bond Fund as established by the Bond Resolution; second, to supplement the six hundred thousand dollars (\$600,000) payment into the Reserve Fund for Contingencies, Renewals and Replacements provided for in Section 4(a)(2) to the extent that withdrawals from said reserve in the previous Contract Year exceeded six hundred thousand dollars (\$600,000); and third, to retire bonds issued pursuant to the Bond Resolution prior to maturity;
- (5) All costs of producing and delivering power and energy (excluding depreciation) not accounted for by the payments out of funds and reserves specified in the foregoing subsections and properly chargeable to said Priest Rapids Development in accordance with the Uniform System of Accounts, less any credits against the said costs by reason of net revenues from other sources than the direct sale of power, and also less any credits for interest charged during construction, all as provided for in said Uniform System of Accounts; provided, however, that income from interest earned on reserve funds, credited to Account No. 525, Revenue from Sinking and Other Funds, as defined in said Uniform System of Accounts, shall be used by the District at least annually to accumulate and maintain the reserve funds specified in Sections 4(a)(2) and 4(a)(4) hereof, or for the retirement of Revenue Bonds issued by the District pursuant to the Bond Resolution.

(b) Any payment received by the District as a result of the taking of the whole or any portion of the output of the Priest Rapids Development by any state or federal government agency shall be used by the District to reduce the Annual Power Costs or to retire bonds issued pursuant to the Bond Resolution, whichever shall be proper under the circumstance existing at the time of said taking. It is the intention of the parties hereto that insofar as possible the Annual Power Costs paid by the Purchaser shall be reduced in proportion to the loss of availability of power and energy as a result of such taking.

(c) Should any amount remain in any of the funds established in connection with the Priest Rapids Development, including working capital and all reserves, in excess of outstanding obligations against such funds at the expiration of this contract, there shall be refunded to the Purchaser as excess payment for power and energy theretofore purchased a share of such remainders determined by multiplying the total thereof by the percentage of the Priest Rapids Development Output to which the Purchaser is entitled on October 31, 2005.

SECTION 5.

PAYMENT FOR POWER SOLD.

(a) On or before one hundred and twenty (120) days prior to the Initial Date of Delivery and on or before one hundred and twenty (120) days prior to the beginning of each Contract Year thereafter, the District shall prepare and mail to the Purchaser a pro forma statement showing:

- (1) The Initial Date of Delivery and the dates when each then uncompleted generating unit of the Priest Rapids Development is scheduled for completion (Not applicable after the completion of the construction of said Development);
- (2) A detailed estimate of the Annual Power Costs of said Development for the following Contract Year, provided, that the estimate of the Annual Power Costs for any period prior to the date that eight (8) generating units are completed, installed and continuously operating shall be made in accordance with Section 5(h) hereof;
- (3) An amount obtained by multiplying the estimated Annual Power Costs by the Purchaser's Power Allocation. This amount (expressed in dollars) is hereinafter referred to as the "Purchaser's Estimated Cost;"
- (4) The amount of the equal monthly payments to be made by the Purchaser to pay said Purchaser's Estimated Cost during said Contract Year. Said statement shall be in lieu of the issuance of monthly bills to the Purchaser by the District.

(b) In the event of the interruption or reduction of power and energy production of the Development, resulting in the collection by the District of insurance or other proceeds as indemnity for such interruption or reduction, the District shall credit the Purchaser's pro-rata share of such proceeds to the Purchaser's account to be applied toward the reduction of the Purchaser's monthly payments.

(c) In the event of extraordinary receipts or payments of unusual costs substantially affecting the Annual Power Costs during any Contract Year, the District shall prepare and mail to the Purchaser a revised estimate of Annual Power Costs which shall supersede the previous estimate of Annual Power Costs as a basis for the Purchaser's monthly payments for the balance of that Contract Year.

(d) Said monthly payments shall be due and payable at the office of the District at Ephrata, Washington, on the twentieth day of the month in which the Initial Date of Delivery occurs, and the twentieth day of each month thereafter, whether or not the Priest Rapids Development is then operating; provided, that for the first month in which payment is due, subject to the provisions of Section 5(h) hereof when applicable, the Purchaser may reduce said payment to an amount equal to the Purchaser's Estimated Cost divided by the number of days in the first Contract Year and multiplied by the

number of days in such first month during which the District makes power and energy available hereunder.

(e) If payment in full is not made on or before the close of business on the twentieth day of the month, a delayed-payment charge of two percent (2%) of the unpaid amount due will be made. Remittances received by mail will be accepted without assessment of the two per cent (2%) delayed-payment charge provided the postmark indicates the payment was mailed on or before the twentieth day of the month. If the twentieth day of the month is a Sunday or a holiday, the next following business day shall be the last day on which payment may be made without the addition of the delayed-payment charge. Except as to any portion of a monthly payment which may in good faith be disputed by the Purchaser, the District may, whenever any amount due remains unpaid subsequent to the thirtieth day after the due date and after giving thirty (30) day's advance notice in writing, discontinue deliveries to the Purchaser until such bill and any subsequent payments which have become due are paid. No such discontinuance shall relieve the Purchaser from any of its obligations under this contract; provided, that until the power allocation of the Purchaser has been reallocated under the provisions of Section 21 hereof, the District shall sell the power and energy made available by such discontinuance for the account of the Purchaser.

(f) On or before one hundred twenty (120) days after the end of each Contract Year the District will submit to the Purchaser a detailed statement of the actual Annual Power Costs for said Contract Year, based on the annual audit of the accounts of the Priest Rapids Development provided for in Section 11 hereof, and will compare said actual Annual Power Costs with the estimated Annual Power Costs for said Contract Year; provided, that the actual Annual Power Costs for any period prior to the date that eight (8) generating units are completed, installed and continuously operating shall be computed in accordance with Section 5(h) hereof. If said actual costs exceed said estimated costs, the District shall bill the Purchaser for an amount equal to such excess multiplied by the Purchaser's Power Allocation for said Contract Year, and the Purchaser agrees to pay said bill promptly. If said actual costs are less than said estimated costs, the District shall give credit to the Purchaser against the current charges for power of an amount equal to such difference between said actual costs and said estimated costs multiplied by the Purchaser's Power Allocation for said Contract Year; provided, that if said comparison is made following the expiration of this contract, the District shall make a cash refund of such amount to the Purchaser.

(g) The District shall pay into the Revenue Fund established by the Bond Resolution that share of the Annual Power Costs of the Priest Rapids Development determined by multiplying said Annual Power Costs by the percentage of the Priest Rapids Output reserved by the District in accordance with Section 3(b) hereof. Payments by the District as specified in this Section 5(g) shall be made by the District out of revenues from the sale of its reserved share of the Priest Rapids Development Output specified in Section 3(b) hereof.

(h) During the period of construction of said Development, after the completion of the first generating unit, the estimated Annual Power Costs from which the Purchaser's Estimated Cost is computed and the actual Annual Power Costs from which adjustments specified in Section 5(d) are computed shall be determined by adding:

- (1) All of the costs included in subsections (a) (3) and (a)(5) of Section 4 not properly chargeable to construction; and
- (2) That proportion of the amount required to pay the interest on the Revenue Bonds for the Contract Year, that the number of generating units completed, installed and continuously operating bears to the number 8.

SECTION 6. SCHEDULING OF DELIVERIES.

It is the intent of the parties hereto that the power and energy purchased hereunder by the Purchaser shall be fully coordinated with other resources available to the Purchaser and with the resources of other Purchasers and that the operation of the Priest Rapids Development shall be coordinated with the operation of the Northwest Power Pool. Scheduling of generation from said Development shall be as requested by the Purchaser, acting singly or as a member of a group of Purchasers, subject to the limitations set forth in this section and in other sections of this contract.

The Purchaser, acting singly or as a member of a group of Purchasers, shall make available to the District at least eight (8) hours before 12:01 A.M. of each day an hourly schedule of desired total energy deliveries for that day. Such schedule shall be based upon the probable water supply to said Development and the resulting probably output. Revisions in the schedule may be made at any time upon the request of the Purchaser if required by changes in estimated river flows or system loads. Deviations from schedules for the Priest Rapids Development Output shall be held to a minimum by the District and corrected for as promptly as possible on an hourly basis under conditions as nearly equivalent as possible to those obtaining when the deviations occurred.

The schedules requested by the Purchaser shall be in accordance with the following:

- (a) The net hourly schedule for delivery or spill shall be within the limitations of the Purchaser's Power Allocation and the Purchaser's allocation of the minimum discharge;
- (b) The Purchaser shall be entitled to a share of that part of the Priest Rapids Development Output resulting from the inflow of the stream each hour determined by multiplying said part of said Development Output by the Purchaser's Power Allocation;
- (c) The Purchaser shall be entitled to a share of the pondage available at the Priest Rapids Development (hereinafter called the Purchaser's Allocation of Pondage), determined by multiplying the total of said pondage available by the Purchaser's Power Allocation;
- (d) The Purchaser may schedule more or less than its share of said Development Output determined in accordance with subsection 6(b) hereof by scheduling from or to a pondage account established for each Purchaser. The aggregate amount of the energy scheduled from the pondage account shall not exceed the Purchaser's Allocation of Pondage determined in accordance with subsection 6(c) hereof and shall subsequently require the scheduling of an equivalent amount of energy to the account for refill by 7:00 A.M. on the following Monday. Scheduling by the Purchaser to its pondage account shall be only against its prior accumulated pondage draft. Refill obligations shall be reduced proportionately when the inflow of the stream exceeds the hydraulic capacity of the Development and will be cancelled when spill occurs.

SECTION 7. POINT OF DELIVERY.

Electric power and energy to be delivered hereunder shall be made available to the Purchaser at:

- (a) The 230 KV bus of the Bonneville Power Administration's Midway Sub-station; or, at the option of the Purchaser, at either
- (b) The 230 KV bus of the switchyard, when constructed, of the Priest Rapids Development; or
- (c) The 230 KV bus of the switchyard, when constructed, of the Wanapum Development.

SECTION 8. VOLTAGE CONTROL AND REACTIVE DELIVERIES.

The District shall maintain voltage levels at the Priest Rapids Development to best coordinate with the systems of the Purchasers and the systems operated by members of the Northwest Power Pool.

Reactive kilovolt-amperes shall be made available up to the capability of the equipment of said Development, consistent with the power generation and voltage level schedule for said Development at the time.

The Purchaser is entitled at any time to a share of the reactive output available at the time of maximum power output from said Development determined by multiplying the total reactive output by the Purchaser's Power Allocation specified in Section 3 hereof. The Purchaser may take additional reactive deliveries when available, or otherwise by reducing deliveries of power from said Development to the Purchaser so as to provide the additional reactive capability.

SECTION 9. CHARACTER AND CONTINUITY OF SERVICE.

Power and energy supplied hereunder shall be approximately 230 KV, three-phase, alternating current, at approximately sixty cycles per second. The District may temporarily interrupt or reduce deliveries of electric energy to the Purchaser if the District determines that such interruption or reduction is necessary in case of emergencies. In order to install equipment in, make repairs to, replacements, investigations and inspections of, or perform other maintenance work on the Priest Rapids Development, and in order that operations of the Purchasers will not be unreasonably interrupted or interfered with, the District, after consulting with the Purchaser regarding any such planned interruption or reduction, giving the reason there-for and stating the probable duration thereof, will to the best of its ability schedule such interruption at a time which will cause the least interference to the operations of the Purchaser and the operations of other Purchasers of power from said Development.

Except as interrupted by Uncontrollable Forces or as provided otherwise by this section, power and energy shall be made available in accordance with this agreement at all times during the term of this contract commencing with the Initial Date of Delivery.

SECTION 10. METERING AND TRANSMISSION LOSSES.

(a) The District shall provide and maintain suitable meters in the generator leads of the power plant of the Priest Rapids Development to indicate and record the output of said Development. The Priest Rapids Development Output shall be determined from totalized readings from said meters after making corrections specified in Section 2(e) hereof. The District shall also arrange for suitable metering at the point of delivery specified in Section 7 hereof or at other points as agreed upon. Meters shall be read by the District or an agent of the District and records thereof shall be made available to the Purchaser as may be reasonably required.

(b) All deliveries of power and energy hereunder shall be measured as though they were made at the low voltage side of the transformers in the power house of the Development. All losses of power and energy purchased hereunder resulting from transformation and transmission shall be borne by the Purchaser.

SECTION 11. ACCOUNTS.

The District agrees to keep accurate records and accounts for the Priest Rapids Development in accordance with the Uniform System of Accounts and in accordance with the rules and regulations prescribed by the Division of Municipal Corporations of the State Auditor's Office of the State of Washington, separate and apart from its other accounting records. Said accounts shall be the subject of an annual audit by a firm of certified public accountants, experienced in electric utility accounting and of national reputation, to be employed by the District. Said annual audit shall cover the transactions of the Contract Year.

A copy of each annual audit, including all recommendations of the accountants, shall be furnished by the District to the Purchaser.

SECTION 12. INFORMATION TO BE MADE AVAILABLE TO THE PURCHASER.

(a) All drawings, designs, plans, specifications, and terms of contracts relating to the construction and operation of the Priest Rapids Development are or will be placed on file in the office of the District at Ephrata, Washington and will be open to inspection by the Purchaser.

(b) All agreements and data relating to the financing of said Development may be examined by the Purchaser at the office of the District.

(c) All operating and financial records and reports relating to the said Development may be examined by the Purchaser at the office of the District.

(d) Policies of Insurance carried by the District pursuant to Section 14 hereof shall be available at the office of the District for inspection by the Purchaser.

(e) The Purchaser's representatives shall at all times be given reasonable access to said Development.

SECTION 13. PRIEST RAPIDS ADVISORY COMMITTEE – ARBITRATION.

(a) In order that the Purchasers may, in an orderly way, participate in problems relating to the Priest Rapids Development, there is hereby established the Priest Rapids Advisory Committee (herein called the "Committee"). The Purchaser and each of the other Purchasers are entitled to representation on the Committee and may each appoint a representative to attend Committee Meetings. A Chairman shall be elected by the members of the Committee. The Committee will meet regularly on the Monday following the first Tuesday of each month, or as otherwise determined by the Committee, for the purpose of discussing the problems with respect to said Development and may make recommendations to the District with reference thereto. Special meetings shall be called by the Chairman at the request of the District or upon the request of members of the Committee representing two-thirds (2/3) of the power purchased by the members. All meetings will be held at the office of the District at Ephrata, Washington, or at such other place or places as may be determined by the Committee.

(b) Except in the event of an emergency requiring immediate action, the District shall give to the Committee reasonable notice, in no case less than thirty (30) days, whenever it proposes to replace items of major equipment in or to construct additions to or extensions of said Development, or to enter into additional new or special contractual arrangements relating to and substantially modifying the operation and Annual Power Costs of said Development.

(c) The District will give due consideration to the recommendations of the Committee. In considering said recommendations, the District shall give due regard to the objective of achieving from said Development the optimum electric power production consistent with economy, reliability and facility of operation and the District's statutory duties. If in the opinion of the Committee the District has given inadequate consideration to its informal recommendations, written recommendations may be made to the District whenever such recommendations are approved in writing by members of the Committee representing Purchasers who are purchasing two-thirds (2/3) of the power purchased by the members. Such written recommendations shall be forwarded to the District with appropriate supporting data. The District shall take action on such recommendations within a reasonable time by adopting, modifying, or rejecting such recommendations. If the District modifies or rejects said recommendations it shall notify the Committee of its action in writing, giving the reasons therefor.

(d) If the District modifies or rejects a written recommendation of the Committee dealing with matters which may be arbitrated as set forth in Section 13(e) hereof, and made in accordance with the procedures set forth in Section 13(c) hereof, the Committee may, by affirmative vote of members of the Committee representing Purchasers who purchase two-thirds (2/3) of the power purchased by the members, submit the recommendation to a board of arbitrators. The board of arbitrators shall be composed of three (3) persons, one of whom shall be appointed by the District, one of whom shall be appointed by majority vote of the Committee, and the third person to be appointed by the two persons so appointed. In the event said two members cannot agree upon the appointment of a third person, then such third person shall be appointed by the Chief Justice of the Supreme Court of the State of Washington.

The procedure for arbitration shall be governed by the laws of the State of Washington. Insofar as the parties hereto may legally do so, they agree to abide by the decision of said board; provided, that the District shall not be bound by any decision of a board of arbitration to the extent that such decision is retroactive beyond the date when the matter arbitrated was made the subject of written recommendation of the Committee.

(e) The matters which may be arbitrated in accordance with Section 13(d) hereof shall consist of all matters pertaining to the maintenance, operation, additions, replacements and renewals, insurance to be carried on said Development and its operation (which in no event shall be less than that required under the terms of the Bond Resolution), and subsequent financing and refinancing of the said Development, except such matters which are by law vested exclusively in the discretion of the District. All written Committee recommendations not approved by the District with respect to amounts to be charged to the Priest Rapids Development as a result of voluntary payments in lieu of taxes or other voluntary donations made by the District may be arbitrated in accordance with Section 13(d) hereof.

(f) In the event this Section 13 or any paragraph, sentence, clause or phrase thereof shall be adjudicated by a court of last resort and of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this section or such part thereof so adjudicated to be invalid had not been included herein.

SECTION 14. INSURANCE.

The District agrees to obtain and maintain in full force and effect during the term of this contract, to the extent available at reasonable cost, adequate insurance with responsible insurers with policies payable to the District for the benefit of the District and the Purchasers as their respective interests may appear, against:

- (1) Obligations of the District under the Workmen's Compensation law of the State of Washington, and employer's liability;
- (2) Public liability for bodily injury and property damage;
- (3) Physical loss or damage to the Priest Rapids Development on replacement cost basis;

- (4) Business Interruption loss to the District and/or the Purchasers resulting from delay in completion of the Development, interruption or reduction of generation or transmission of power and energy caused by such physical loss, damage or destruction; and
- (5) Any other insurance determined to be necessary.

SECTION 15. OPERATION AND MAINTENANCE.

The District covenants and agrees that it will operate and maintain the Priest Rapids Development in an efficient and economical manner, consistent with good business and operating practices of comparable developments.

SECTION 16. BOARD OF CONSULTING ENGINEERS ON CONSTRUCTION PROBLEMS.

The District shall establish a Board of five (5) Consulting Engineers during the construction of the Priest Rapids Development, which shall include two (2) engineers of outstanding ability and national reputation, selected by the District from a list of not less than four (4) such engineers submitted by the Committee to the District.

SECTION 17. CONSTRUCTION AND FINANCING CONTRACTS.

The District agrees that prior to commencing construction of the Priest Rapids Development it will have completed financing of said Development, shall have let the major contracts for the construction thereof, and shall have obtained adequate completion bonds for each of said contracts. If said financing is not completed by May 4, 1957, then the Purchaser may cancel this contract by giving written notice to the District.

SECTION 18. COMPLETION OF CONSTRUCTION.

The District agrees to proceed diligently with the financing and construction of the Priest Rapids Development and, subject to Uncontrollable Forces, plans to complete the Priest Rapids Development by September 12, 1961.

SECTION 19. ADDITIONAL FACILITIES.

(a) From time to time during the term hereof the District may propose to expand the Priest Rapids Development by installing additional generating facilities. Whenever the District proposes to so expand the Development, it shall give notice in writing or such intent to the Purchaser stating:

- (1) The estimated cost of such additional generating facilities;
- (2) The proposed method of financing the cost of said facilities;
- (3) The estimated additional power and energy which would be available as a result of the installation of said facilities;
- (4) The estimated incremental cost (i.e. the costs which will be incurred as a result of installing the proposed additional facilities, which costs would not be incurred were such proposed additional facilities not installed) of said additional power and energy on an annual basis; and
- (5) The estimated construction period for the installation of said facilities.

The notice shall also contain other available pertinent information.

(b) The Purchaser shall have the option of purchasing a share of said additional power and energy determined by multiplying the total additional power and energy by the Purchaser's Power Allocation, specified in Section 3 hereof, and may exercise such option by giving written notice to the District on or before the expiration of ninety (90) days from the receipt of said written notice from the District. The District shall give a second notice to the Purchaser if any of the other Purchasers shall fail to exercise its option for its full share of said power and energy, and the Purchaser may, by giving written notice to the District within sixty (60) days after the receipt of the second notice from the District, have its respective share of said power and energy increased either in proportion or, as shall be mutually agreed upon, so as to make available to the Purchaser and to the other Purchasers power and energy available as a result of any of the other Purchasers failing to elect to take its full share of said additional power and energy; provided, that such increases shall not be inconsistent with the provisions of said Public Law 544 and said Federal Power Commission License concerning the offering of a reasonable amount of the capacity and power output of the Project for sale in states neighboring the State of Washington. The District, in addition to its share of said additional power and energy determined by multiplying the total amount of said additional power and energy by the per cent reservation specified in Section 3(b) hereof, shall be entitled to the additional power and energy which the Purchaser and other Purchasers shall not elect to take in accordance with the foregoing provision. Failure to exercise its option to purchase additional power and energy which would be available from the installation of additional generating facilities proposed for installation by the District at a later date.

(c) If the Purchaser exercises its option to take its share of said additional power and energy, it shall pay for said additional power and energy a percentage of the incremental annual cost of said additional facilities corresponding to the per cent the share of additional power and energy which it purchases is to the total additional power and energy available as the result of the installation of the additional facilities. If the Purchaser does not elect to take additional power and energy which would be available from the installation of additional generating facilities it shall continue to receive the same amount of power and energy and pay the same annual power cost therefor as if such additional generating facilities had not been installed.

(d) If, after the Purchaser shall have exercised its option as aforesaid, the District shall determine that it is not economically feasible for it to install additional generating facilities as proposed, the District shall be under no obligation to do so and shall so notify the Purchaser.

(e) Notwithstanding any other provisions of Section 19, hereof, whenever the District is compelled to install additional facilities at or in the Priest Rapids Development by any order or decision of the Federal Power Commission or any state or federal government agency with authority to issue or make and enforce such an order or decision, the Purchaser shall share the benefits and costs resulting from the installation of said additional facilities in the same manner and to the same extent as if the Purchaser had voluntarily exercised its option to purchase the power and energy resulting from said installation as provided earlier in Section 19 hereof.

SECTION 20.

WANAPUM DEVELOPMENT.

(a) Whenever the District proposes to construct the Wanapum Development, it shall give notice in writing of its proposal to the Purchaser nine (9) months in advance of the proposed start of construction. Such notice shall supplement the information made available to the Purchaser in accordance with Section 12 hereof and shall state:

- (1) The estimated Cost of Acquisition and Construction of the Wanapum Development;
- (2) The proposed method of financing said Cost of Acquisition and Construction of the Wanapum Development;
- (3) The estimated additional power and energy which would be available as a result of the construction of the Wanapum Development;
- (4) The estimated cost of said additional power and energy on an annual basis; and
- (5) The estimated dates of starting and completing the construction of the Wanapum Development.

The notice shall contain any other available pertinent information.

(b) As a part of the consideration for the execution of this contract, the Purchaser shall have the option of purchasing a share of the additional power and energy resulting from the construction of the Wampum Development, determined by multiplying the total of such additional power and energy by the Purchaser's Power Allocation specified in Section 3 hereof, and shall exercise such option by giving written notice to the District on or before ninety (90) days from the receipt of said written notice from the District. The District shall give a second notice to the Purchaser if any of the other Purchasers does not elect to take its full share of said additional power and energy and the Purchaser may, by giving written notice to the District within sixty (60) days after receipt of the second notice from the District, have its respective share of said power and energy proportionately increased, or increased as shall be mutually agreed upon, so as to make available to the Purchaser and other Purchasers power and energy available as a result of any of the other Purchasers failing to elect to take its full share of said additional power and energy; provided, that such increases shall not be inconsistent with the provisions of said Public Law 544 and said Federal Power Commission License concerning the offering of a reasonable amount of the capacity and power output of the Project for sale in states neighboring the State of Washington. The District, in addition to its share of said additional power and energy available as a result of the construction of the Wanapum Development, determined by multiplying the total amount of said additional power and energy by the per cent reservation specified in Section 3(b) hereof, shall be entitled to the additional power and energy which the Purchaser and other Purchasers shall not elect to take in accordance with the foregoing provision.

(c) If the Purchaser exercises its option to purchase additional power and energy to become available as a result of the construction of the Wanapum Development, the parties hereto shall execute a contract identical in all pertinent respects to this contract for the sale of the power from the Priest Rapids Development except that it shall refer to the Wanapum Development instead of to the Priest Rapids Development. The Purchaser and the District shall place in escrow the executed contract by means of escrow instructions identical in all pertinent respects to Exhibit "B" attached hereto and made a part hereof.

(d) It is the intention of the parties hereto that when the Wanapum Development is constructed, its operation shall be integrated with the operation of the Priest Rapids Development as required by said Public Law 544 and said Federal Power Commission License for the Priest Rapids Project. It is agreed that all benefits accruing to the Project as a result of such integration shall be shared equally by the two Developments. It is also agreed that all joint costs of the two Developments shall be equitably allocated between them and such allocation shall be reviewed by the Advisory Committee as provided in Section 13 hereof. All payments for the encroachment of the Wanapum Development upon the Rock Island project (i.e. that project constructed under Federal Power Commission License Number 943) shall be chargeable solely to the Wanapum Development.

(e) The parties hereto agree that if operation of the Priest Rapids Development with the maximum controlled headwater level of 486.5 feet above mean sea level (determined by reference to the United States Coast and Geodetic Survey Sea Level Datum of 1929 with supplemental additions of 1947) causes encroachment on the tailwater of the Wanapum Development, located at or upstream from the location shown on the License application drawings which were filed with the Federal Power Commission by the District on June 27, 1955 (approximately mile 415 on the Columbia River), the Priest Rapids Development shall compensate the Wanapum Development in kind and coincidentally for one-half of the loss to the Wanapum Development of capacity and power output. The Priest Rapids Development shall compensate the Wanapum Development in kind and coincidentally for all loss of capacity and power output at the Wanapum Development caused by controlled headwater levels above said level of 486.5 feet at the Priest Rapids Development. If the Wanapum Development is located downstream from the location shown on the said License application drawings, it shall be compensated in kind and coincidentally for losses of capacity and power output due to encroachment by the Priest Rapids Development only to the extent that such encroachment would have occurred at the location shown on the said application drawings.

SECTION 21.

ADJUSTMENT OF POWER ALLOCATION.

The Purchaser's Power Allocation shall be automatically increased pro-rata with that of the other Purchasers, not in excess of a cumulative maximum of twenty-five per cent (25%) thereof, in the event of a Default (as hereinafter defined) by any of the other Purchasers. The term "Default" as used herein shall mean the failure by any one of the Purchasers to make the payments specified in Section 5 hereof and contemporaneously with said

failure to make payments there shall exist, with respect to that one of the Purchasers, any one or more of the following conditions:

- (a) An order, judgment or decree shall be entered by any court of competent jurisdiction:
 - (1) Appointing a receiver, trustee or liquidator for any of the Purchasers or the whole or any substantial part of the properties of any of the Purchasers;
 - (2) Approving a petition filed against any of the Purchasers under the provision of an Act to Establish a Uniform System of Bankruptcy Throughout the United States, Approved July 1, 1898, as amended;
 - (3) Granting relief to any of the Purchasers under an amendment to said Bankruptcy Act which shall give relief similar to that afforded by said Act; or
 - (4) Assuming custody or control of the whole or any substantial part of any of the Purchaser's properties under the provision of any other law for the relief or aid of debtors; and such order, judgment or decree shall not be vacated or set aside or stayed (or, in case custody or control is assumed by said order, such custody or control shall not otherwise be terminated), within sixty (60) days from the date of the entry of such order, judgment or decree.
- (b) Any of the Purchasers shall:
 - (1) Admit in writing its inability to pay its debts generally as they become due;
 - (2) File a petition in bankruptcy;
 - (3) Make an assignment for the benefit of its creditors;
 - (4) Consent to the appointment of a receiver of the whole or any substantial part of its properties;
 - (5) Be adjudicated a bankrupt on the basis of a petition in bankruptcy filed against it;
 - (6) File a petition or an answer seeking relief under any amendment to said Bankruptcy Act which shall afford relief substantially similar to that afforded by said Act; or
 - (7) Consent to the assumption by any court of competent jurisdiction under the provisions of any other law for the

relief or aid of debtors of custody or control of any of the Purchasers or of the whole or any substantial part of its properties; provided, that if prior to an imminent default by any of the Purchasers it shall demonstrate to the satisfaction of the District and the other Purchasers receiving in the aggregate at least two-thirds (2/3) of the balance of the Priest Rapids Development Output its inability to pay for its Power Allocation and its ability to pay for a smaller Power Allocation, then it shall be allowed to thereafter take such smaller Power Allocation and shall be thereafter liable for the same in the same manner as for its original Power Allocation; and, in such event, the automatic increase in the Purchaser's Power Allocation as above provided shall apply only to the difference between the original Power Allocation and such lesser Power Allocation of that one of the Purchasers threatened with default.

(c) If any of the other Purchasers defaults, and the Purchaser's Power Allocation is automatically increased in accordance with this section, The Purchaser either individually or as a member of a group shall have a right of recovery from that one of the Purchasers in default for such amount as the Purchaser may sustain as a loss or damage by reason of such default and may commence such suit, action or proceeding as may be necessary or appropriate to recover the amount of said loss or damage.

SECTION 22.

LIABILITY OF PARTIES.

The District and the Purchaser each assumes full responsibility and liability for the maintenance and operation of its respective properties and shall indemnify and save harmless the other party from all liability and expense on account of any and all damages, claims or actions, including injury to or death of persons, arising from any act or accident in connection with the installation, presence, maintenance, and operation of the property and equipment of the indemnifying party; provided, that any liability which is incurred by the District through the operation and maintenance of the Priest Rapids Development and not covered by insurance shall be paid solely from the revenue of the said Development, and any payments made by the District to satisfy such liability shall become part of the Annual Power Cost as set forth in Section 4(a)(5) hereof.

SECTION 23.

WAIVER OF OF DEFAULT.

Any waiver at any time by either party to this contract of its rights with respect to any default of the other party hereto, or with respect to any other matter arising in connection with such contract, shall not be considered a waiver with respect to any subsequent default or matter.

SECTION 24.

NOTICES AND COMPUTATION OF TIME.

Any notice or demand, except those provided for in Section 6 hereof, by the Purchaser under this contract to the District shall be deemed properly given if mailed postage prepaid and addressed to Public Utility District No. 2 of Grant County, Washington, at Ephrata, Washington; any notice or demand by the District to the Purchaser under this contract shall be deemed properly given if mailed postage prepaid and addressed to Puget Sound Power & Light Company, at Seattle, Washington; and in computing any period of time from such notice, such period shall commence at 12:00 P.M. (midnight) on the date mailed. The designations of the name and address to which any such notice or demand is directed may be changed at any time and from time to time by either party by giving notice as above provided.

SECTION 25.

MODIFICATION OF CONTRACT TERMS.

It is recognized by the parties hereto that, by virtue of the Bond Resolution, this contract cannot be amended, modified or otherwise altered by agreement of the parties in any manner that will impair or adversely affect the security afforded by the provisions of this contract for the purchase and sale of power for the payment of the principal, interest, and premium, if any, on said Bonds as they respectively become payable, so long as any of said bonds are outstanding and unpaid or until provision is irrevocably made for the payment thereof.

SECTION 26.

DISTRICT'S BOND RESOLUTION AND LICENSE.

It is recognized by the parties hereto that the District in its operation of the Priest Rapids Development and in the delivery of the power hereunder to the Purchaser, must comply with the requirements of the Bond Resolution and with the License for the construction and operation of the Development as issued by the Federal Power Commission and amendments thereof from time to time made and it is therefore accordingly agreed that this Power Sales Contract is made subject to the terms and provisions of said resolution and License. The District shall not, without the written consent of the Purchaser, amend, modify or otherwise change the Bond Resolution if such amendment, modification or change would be to the disadvantage of the Purchaser.

SECTION 27.

CONFLICT OF LAWS.

The parties hereto agree that this contract shall be governed by the laws of the State of Washington.

SECTION 28.

ASSIGNMENT OF CONTRACT.

This contract shall inure to the benefit of, and shall be binding upon the respective successors and assigns of the parties to this contract. No assignment or transfer of this contract shall relieve the parties hereto of any obligation incurred hereunder.

SECTION 29.

UNIFORMITY OF POWER SALES CONTRACTS.

The Purchaser hereunder shall be considered as one of several Purchasers under contracts similar to this agreement and it is understood and agreed that all of said contracts for the sale and purchase of power shall be uniform in all material respects in their terms, conditions and provisions with the exception of Purchaser's Power Allocations. If any of said contracts are amended or replaced so that they contain terms or conditions more favorable than those granted to the Purchaser under this contract, then this contract shall be amended to include the same terms and conditions so granted to any of the other Purchasers, provided, however, that the District shall have the right to sell power and energy reserved by it pursuant to Section 3(b) hereof on such terms and conditions as it shall elect and subject to the requirements of Section 3(b) hereof nothing herein shall be construed to require the District to offer equal terms and conditions to the Purchaser.

PUBLIC UTILITY DISTRICT NO. 2
OF GRANT COUNTY, WASHINGTON

(SEAL)

ATTEST:

by /s/ Wm. Schempp
Secretary

By /s/ F. Wm. Arlt
President

PUGET SOUND POWER & LIGHT COMPANY

(SEAL)

ATTEST:

By /s/ Walter S. Zachary
Secretary

By /s/ Frank McLaughlin
President

EXHIBIT "A"

Distribution of the Priest Rapids Development Output

<u>Purchasers</u>	<u>Percent of Priest Rapids Development Output Sold</u>
Cowlitz County, Public Utility District No. 1 of Eugene Water and Electric Board	2.0 1.7
Forest Grove, City of	.5
Kittitas County, Public Utility District No. 1 of	.4
McMinnville, City of	.5
Milton-Freewater, City of	.5
Pacific Power and Light Co.	13.9
Portland General Electric Co.	13.9
Puget Sound Power and Light Co.	8.0
Seattle, City of	8.0
Tacoma, City of	8.0
Washington Water Power Co.	<u>6.1</u>
Aggregate Percentage of Priest Rapids Development Output Sold to Purchasers	63.5

EXHIBIT "B"

ESCROW INSTRUCTIONS

To:

The Peoples National Bank of Washington

Grant County Branch

Ephrata, Washington

Re: Priest Rapids Project

Gentlemen:

Pursuant to the negotiations which have been carried on between Public Utility District No. 2 of Grant County, Washington (hereinafter referred to as the "District") and _____ (hereinafter referred to as the "Purchaser") and other utility systems providing electric service to the residents of the States of Washington, Oregon and Idaho, looking toward the sale and purchase of the output of the above Project, we enclose herewith and attach hereto an executed contract (in duplicate) setting forth the terms and conditions under which the Purchaser will take and pay for _____ per cent of the output of the Wanapum Development portion of said Project.

The enclosed contract is delivered to you in escrow and one executed copy shall be delivered to the District and one executed copy to the Purchaser when you shall have received written authority, or telegraphed instructions from the Purchaser to release the same. If you shall not have received such written authority or telegraphed instructions by _____ the enclosed contract shall be destroyed by you.

Yours very truly,

By

PUBLIC UTILITY DISTRICT NO, 2 OF GRANT COUNTY

By

Accepted this ____ day of _____, 1956.

THE PEOPLES NATIONAL BANK OF WASHINGTON

By

Authorized Officer

FIRST AMENDMENT TO POWER SALES CONTRACT

Executed by

PUBLIC UTILITY DISTRICT NO. 2
OF GRANT COUNTY, WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

This agreement entered into this 5th day of August 1958, by Public Utility District No. 2 of Grant County, Washington (hereinafter called "the District"), a municipal corporation of the State of Washington, and Puget Sound Power & Light Company (hereinafter called "the Purchaser"), a corporation organized and existing under the laws of the State of Massachusetts.

WITNESSETH:

WHEREAS, the parties hereto did enter into a Power Sales Contract dated the 21st day of May, 1956, relating to the sale of a portion of the output of the Priest Rapids Development, and said contract contemplated that the Priest Rapids Development initially would consist of eight (8) generating units; and

WHEREAS, it now appears that ten (10) instead of eight (8) generating units can be installed initially in the Priest Rapids Development; and

WHEREAS, it appears that the initial installation of two additional generating units in the Priest Rapids Development as a part of the construction of the Development will not impair or adversely affect the security afforded the bondholders by the provisions of the May 21, 1956 contract between the parties hereto, or by the Bond Resolution adopted by the District June 19, 1956.

NOW, THEREFORE, in consideration of the agreements hereinafter set forth and the performance thereof, the parties hereto do agree:

-I-

That the Purchaser hereby consents to the installation of and the District agrees to install ten (10) rather than eight (8) generating units in the Priest Rapids Development.

-II-

That the Power Sales Contract between the parties dated May 21, 1956, shall apply to ten (10) rather than eight (8) generating units and the reference to "the first eight (8) main turbine generator units" in Section 2(b) thereof be and it is hereby amended to "the first ten (10) main turbine generator units."

-III-

That Section 5 of the Power Sales Contract between the parties dated May 21, 1956, shall remain unchanged.

-IV-

That this agreement shall not become effective until all of the Power Purchasers named in Exhibit "A" to the Power Sales Contract between the parties dated May 21, 1956, have entered into agreements with the District identical in effect to this agreement.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be executed by their duly authorized officers the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 2
OF GRANT COUNTY, WASHINGTON

(SEAL)

By /s/ F. Wm. Arlt
President

ATTEST:

By /s/ Wm. Schempp
Secretary

PUGET SOUND POWER & LIGHT COMPANY

By /s/ Frank McLaughlin
Executive Vice President (Title)

(SEAL)

ATTEST:

By /s/ Ralph M. Davis
Secretary (Title)

WANAPUM POWER SALES CONTRACT

Executed by

PUBLIC UTILITY DISTRICT NO. 2

OF GRANT COUNTY, WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

INDEX TO SECTIONS

Section

1.	Term of Contract
2.	Definitions and Explanations of Terms
3.	Amount of Energy and Power Sold
4.	Annual Power Costs
5.	Payment for Power Sold
6.	Scheduling of Deliveries
7.	Point of Delivery
8.	Voltage Control and Reactive Deliveries
9.	Character and Continuity of Service
10.	Metering and Transmission Losses
11.	Accounts
12.	Information to be Made Available to the Purchaser
13.	Advisory Committee – Arbitration
14.	Insurance
15.	Operation and Maintenance
16.	Board of Consulting Engineers on Construction Problems
17.	Construction and Financing Contracts
18.	Completion of Construction
19.	Additional Facilities
20.	Project Integration
21.	Adjustment of Power Allocation
22.	Liability of Parties
23.	Waiver of Default
24.	Notices and Computation of Time
25.	Modification of Contract Terms
26.	District's Bond Resolution and License
27.	Conflict of Laws
28.	Assignment of Contract
29.	Uniformity of Power Sales Contract
Exhibit "A"	Distribution of the Wanapum Development Output
Exhibit "B"	Agreement of August 8, 1955, between Puget Sound Power & Light Company, Public Utility District of Chelan County and Public Utility District of Grant County
Exhibit "C"	Escrow Instructions

WANAPUM POWER SALES CONTRACT

Executed by

PUBLIC UTILITY DISTRICT NO. 2

OF GRANT COUNTY, WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

This contract, entered into as of the 22nd day of June, 1959, by Public Utility District No. 2 of Grant County, Washington (hereinafter called "the District"), a municipal corporation of the State of Washington, and Puget Sound Power & Light Company (hereinafter called "the Purchaser"), a corporation organized and existing under the laws of the State of Massachusetts.

WITNESSETH:

WHEREAS the District is a municipal corporation organized under the laws of the State of Washington and authorized to construct and operate electric generating plants and transmission lines and to supply electric energy to other electric utilities and, as specifically authorized by Public Law 544 – 83rd Congress, to develop the Priest Rapids Hydroelectric Project on the Columbia River; and

WHEREAS the District has been granted a license by the Federal Power Commission for the construction, operation and maintenance of Project No. 2114, consisting of the Priest Rapids Development and the Wanapum Development, with the structures, fixtures, equipment and facilities used, or useful, in the maintenance and operation of the Project; and which license, together with all amendments thereto, are hereinafter referred to collectively as the "Federal Power Commission License;" and

WHEREAS the Purchaser desires to purchase power and energy from the District and the District desires to sell power and energy from said Project; and

WHEREAS the District has the responsibility and authority for the financing, construction and operation of said Priest Rapids Development and said Wanapum Development; and

WHEREAS said Public Law 544 and the said Federal Power Commission License provide that the District shall offer a reasonable portion of the power and energy from the said Project for sale in neighboring states: that a reasonable portion of the power has been offered for sale.

NOW, THEREFORE, the parties hereto, for and in consideration of the mutual covenants and agreements herein contained, hereby agree as follows:

SECTION 1. TERM OF CONTRACT

(a) This contract shall be in full force and effect from the date of its execution and until midnight of October 31, 2009.

(b) After October 31, 2009, the Purchaser shall have the right of first refusal to purchase that proportionate part of the Wanapum Development Output which is then in excess of the actual and prospective needs of the District for service to ultimate consumers within the service area of the District, which the Purchaser's Power Allocation as of October, 2009 shall bear to the total power allocations of all of the Purchasers; provided, however, that nothing herein contained shall be construed to limit or waive any rights which the agencies in neighboring states would have had to purchase power after October 31, 2009, in the absence of this subsection (b) of Section 1. In the event this subsection 1(b), or any sentence, clause or phrase thereof shall be adjudicated by a court of last resort and of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this section or such part thereof so adjudicated to be invalid had not been included herein.

SECTION 2. DEFINITIONS AND EXPLANATIONS OF TERMS

(as used herein)

(a) "Contract Year" is a term used herein to define fiscal periods under this contract from and after "Completion of Construction." "Contract Year" shall mean, generally, a twelve month period commencing at 12:01 A.M. on September 1 of each year except, however, that the first Contract Year hereunder shall commence on the date of Completion of Construction and shall end at 12:01 A.M. on the following September 1.

(b) "Priest Rapids Development" shall mean those properties and facilities consisting of the Priest Rapids dam, site, reservoir, switchyard (if constructed) and power plant, including all generating facilities associated therewith up to and including the first ten (10) main turbine generator units each with a nameplate rating of approximately 78,850 kilowatts, and associated transmission facilities consisting of three 230 KV transmission lines and terminal facilities interconnecting the Priest Rapids power plant and the Bonneville Power Administration's Midway Substation and an undivided one-half (1/2) interest in any District-owned interconnecting facilities between the Priest Rapids power plant or switchyard (if constructed) and the Wanapum switchyard.

(c) "Wanapum Development" shall mean those properties and facilities consisting of the Wanapum dam, site, reservoir, switchyard and power plant, including all generating facilities associated therewith, up to and including ten (10) main turbine generator units each with a nameplate rating of approximately 83, 125 kilowatts, and transmission facilities as may be required to fully integrate with the Priest Rapids Development, and to deliver power in accordance with Section 7 hereof, and any interconnecting transmission facilities to connect with the Bonneville Power Administration facilities in the vicinity of the Project.

(d) "Project" shall mean those properties and facilities known as the Priest Rapids Development, the Wanapum Development, and all associated transmission facilities owned by the District interconnecting the Priest Rapids and Wanapum Developments and the transmission facilities which interconnect the Priest Rapids and Wanapum Developments with the electric utility facilities of Purchasers and the Bonneville Power Administration in the vicinity of the Priest Rapids and Wanapum Developments.

(e) "Priest Rapids Development Output" shall mean the amount of power and energy produced by the Priest Rapids Development during the term of the Priest Rapids contract under the operating conditions which exist during said term, including periods when the Priest Rapids Development may be inoperable, after corrections for encroachment, station and Project use, and depletions required by said Federal Power Commission License.

(f) "Wanapum Development Output" shall mean the amount of power and energy produced by, or received for the account of, the Wanapum Development during the term of this contract under the operating conditions which exist during said term, including periods when the Wanapum Development may be inoperable, after corrections for encroachment, station and Project use, and depletions required by said Federal Power Commission License.

(g) "Month" shall mean a calendar month.

(h) "Purchaser's Power Allocation" shall mean the percentage of the Wanapum Development Output purchased and sold under this contract as set forth in Section 3 hereof and as adjusted in accordance with Section 21 hereof.

(i) "Debt Service" shall mean with respect to any period the amount to be paid or accrued during said period to retire the principal of and pay the interest and premium, if any, on all Revenue Bonds or other evidences of indebtedness issued at any time by the District for the purpose of paying the Cost of Acquisition and Construction and on all bonds issued pursuant to the Bond Resolution in the manner provided in said Resolution.

(j) "Uncontrollable Forces" shall mean any cause beyond the control of the District, and which by the exercise of due diligence the District is unable to prevent or overcome, including but not limited to an act of God, fire, flood, explosion, strike, sabotage, an act of the public enemy, civil or military authority, including court orders, injunctions, and orders of government agencies with proper jurisdiction, insurrection or riot, an act of the

elements, failure of equipment, or inability to obtain or ship materials or equipment because of the effect of similar causes on suppliers or carriers.

(k) "Purchasers" shall mean the Purchaser and other agencies or companies which enter into contracts with the District to buy a percentage share of the Wanapum Development Output, all as listed under the heading "Purchasers" in Exhibit "A", entitled "Distribution of the Wanapum Development Output," attached hereto and made a part hereof.

(l) "Revenue Bonds" shall mean the bonds issued by the District to obtain funds to pay the cost of Acquisition and Construction and for other purposes in connection with the Wanapum Development, all as authorized by the Bond Resolution.

(m) "Cost of Acquisition and Construction" shall mean all costs of acquisition, construction and financing of the Wanapum Development, heretofore or hereafter paid or accrued, including but not limited to:

(1) Working capital in the amount of one million five hundred thousand dollars (\$1,500,000); provided, that if it shall at any time appear to the District that the amount of working capital on hand is in excess of that which is necessary or in excess of anticipated requirements in the future, the District may transfer all or any of such excess to the Reserve Account of the Bond Fund established by the Bond Resolution;

(2) Establishing the Reserve Account in the Bond Fund pursuant to the Bond Resolution;

(3) Interest accruing on Revenue Bonds prior to and during construction of the Wanapum Development;

(4) All fees and expenses properly paid or incurred in connection with the Wanapum Development;

(5) The cost of preliminary surveys, investigations, engineering and other fees and expenses properly incurred for the Wanapum Development;

(6) The cost of all facilities included explicitly or implicitly in the Wanapum Development by the definition in subsection 2(c) hereof, whenever constructed or installed; and

(7) Establishing the Reserve and Contingency Fund by depositing the initial two million dollars (\$2,000,000) in such fund pursuant to the Bond Resolution.

(n) "Uniform System of Accounts" shall mean the Uniform System of Accounts prescribed by the Federal Power Commission for Electric Utilities and Licensees in effect at the time this agreement is executed.

(o) "Bond Resolution" shall mean the resolution adopted by the District authorizing the sale of Revenue Bonds to provide funds to pay the Cost of Acquisition and Construction and other purposes in connection with the Wanapum Development, and providing the terms and conditions thereof, a certified copy of which has been delivered to the Purchaser.

(p) "Initial Date of Delivery" shall mean 12:01 A.M. of the day the District is ready to deliver power and energy hereunder from one or more generating units which shall have been installed, successfully tested as required by the plans and specifications, and, in the opinion of the District, are ready for continuous operation as provided in Section 9 hereof.

(q) "Completion of Construction" shall mean the date the last of the ten (10) initial generating units of the Wanapum Development shall have been installed, successfully tested as required by the plans and specifications, and, in the opinion of the District, made ready for continuous operation as provided in Section 9 hereof.

(r) "Initial Delivery Period" shall mean the period of time commencing on the Initial Date of Delivery and ending at 12:01 A.M. on January 1, 1965.

(s) "Interim Delivery Period" shall mean the period of time commencing at 12:01 A.M. on January 1, 1965 and ending on the date of Completion of Construction (which date coincides with the date of commencement of the first Contract Year hereunder).

SECTION 3. AMOUNT OF ENERGY AND POWER SOLD

(a) The District agrees to sell to the Purchaser and the Purchaser agrees to purchase, solely from the gross revenues of the Purchaser's light and power system, for the benefit of consumers in the State of Washington, subject to adjustment in accordance with Section 21 hereof, ten and eight-tenths percent (10.8%) of the Wanapum Development Output. Deliveries will be made insofar as possible as requested by the Purchaser, all as provided in Section 6 hereof; provided, that such deliveries, together with deliveries requested by all other Purchasers (including deliveries to the District pursuant to its reservation under subsection (b) of Section 3 hereof):

(1) Will be possible of fulfillment under the terms of said Federal Power Commission License; and

(2) Will not exceed the capability of the Development or subject it or its operation to undue hazard.

(b) The District reserves thirty six and one-half percent (36-1/2%) of the said Wanapum Development Output and shall be entitled to the power and energy thus reserved and to the rights and privileges associated therewith and subject to the same obligations, including those provided in Section 21 hereof, but excepting those recited in Section 13 hereof, as it would have if the District were one of the Purchasers and had rights, privileges and obligations similar to those of the Purchasers. The District covenants and agrees that it will establish, maintain and collect rates or charges for the power and energy reserved by it from the Wanapum Development as provided in subsection 3(b) hereof, which shall be fair and nondiscriminatory and adequate to provide revenues sufficient to enable the District to pay its pro-rata share of the Annual Power Costs. All revenues derived by the District from the sale of the Wanapum Development Output to the Purchasers, together with payments by the District for power and energy reserved by it from the Development, and all revenues from the Wanapum Development from sources other than the sale of power, shall be segregated, deposited and held separate and apart from all other revenues of the District, and shall be devoted to the payments provided for in the Bond Resolution.

SECTION 4. ANNUAL POWER COSTS

(a) "Annual Power Costs" as used in this contract shall be deemed to mean all of the District's costs resulting from the ownership, operation, maintenance of and renewals and replacements to the Wanapum Development, including, but not limited to, the items of cost hereinafter mentioned in this Section 4 that are incurred or paid by the District during each Contract Year in connection with the Wanapum Development, to-wit:

(1) Amounts required to be set aside by the District for the payment of Debt Service as required by the Bond Resolution;

(2) An amount not to exceed six hundred thousand dollars (\$600,000) per annum to be placed in the Reserve and Contingency Fund established under the Bond Resolution until the sum of six million dollars (\$6,000,000) in principal amount has been accumulated. The moneys in such Reserve and Contingency Fund shall be used for the purpose of:

(i) Making up any deficiency in the Reserve Account in the Bond Fund as established in the Bond Resolution;

(ii) Pay cost of contingencies, including the prevention or correction of any unusual loss or damage, renewals and replacements; and

(iii) Pay the cost of construction of any additional transmission and switching facilities for the delivery of power as required by Section 7 herein.

In the event of withdrawals from the Reserve and Contingency Fund, the funds withdrawn shall be replaced at the rate of not to exceed six hundred thousand dollars (\$600,000) in any one year;

(3) Amounts which may be required to pay for the prevention or correction of any unusual loss or damage, and for major replacements, to keep the Wanapum Development in good operating condition to the extent that such costs are not covered by insurance and the Reserve and Contingency Fund. In the event of any such unusual loss or damage or major replacement which will cost in excess of the amount

of money then in said fund, plus insurance proceeds, and plus two million dollars (\$2,000,000), the District shall issue equal lien (pari passu) bonds payable from the revenues of the Wanapum Development to pay the portion of such costs which shall exceed insurance proceeds, if any; provided, that such bonds can then be legally issued and can be sold;

(4) An amount which when added to the Annual Power Costs itemized in subsection 4(a)(2) and 4(a)(3) hereof will equal fifteen percent (15%) of the annual Debt Service during the applicable Contract Year. Such amount shall be used by the District; first, for the purpose of making up any deficiency in the Bond Fund as established by the Bond Resolution; second, to supplement the six hundred thousand dollar (\$600,000) payment into the Reserve and Contingency Fund provided for in subsection 4(a)(2) to the extent that withdrawals from said fund in the previous Contract Year exceeded six hundred thousand dollars (\$600,000); and, third, to retire, prior

to maturity, bonds issued pursuant to the Bond Resolution; and

(5) All costs of producing and delivering power and energy from the Wanapum Development (excluding depreciation) not accounted for by the payments out of funds and reserves specified in the foregoing subsections of this Section 4 and properly chargeable to said Wanapum Development in accordance with the Uniform System of Accounts, less any credits against the said costs by reason of net revenues from other sources than the direct sale of power, and also less any credits for interest charged during construction, all as provided for in said Uniform System of Accounts; provided, however, that investment income shall be applied as provided for in the Bond Resolution.

(b) Any payment received by the District as a result of the taking of the whole or any portion of the output of the Wanapum Development by any state or federal government agency shall be used by the District to reduce the Annual Power Costs or to retire, prior to maturity, bonds issued pursuant to the Bond Resolution, whichever shall be proper under the circumstance existing at the time of said taking. It is the intention of the parties hereto that insofar as possible the Annual Power Costs paid by the Purchaser shall be reduced in proportion to the loss of availability of power and energy as a result of such taking.

(c) Should any amount remain in any of the funds established in connection with the Wanapum Development, including working capital and all reserves in excess of outstanding obligations against such funds at the expiration of this contract, there shall be refunded to the Purchaser, as excess payment for power and energy theretofore purchased, a share of such remainders determined by multiplying the total thereof by the percentage of the Wanapum Development Output to which the Purchaser is entitled on October 31, 2009.

SECTION 5.

PAYMENT FOR POWER SOLD

(a) On or before one hundred twenty (120) days prior to the estimated date of Completion of Construction, and on or before one hundred twenty (120) days prior to the beginning of each Contract Year thereafter, the District shall prepare and mail the Purchaser a pro forma statement showing:

- (1) The estimated date of Completion of Construction of the Wanapum Development. This need not be shown after the first statement; provided, that the District shall keep the Purchaser advised at all times of changes in such estimated date, as well as of the actual date of Completion of Construction when this occurs;
- (2) A detailed estimate of the Annual Power Costs of the Wanapum Development for the following Contract Year;
- (3) An amount obtained by multiplying the estimated Annual Power Costs by the Purchaser's Power Allocation. This amount (expressed in dollars) is hereinafter referred to as the "Purchaser's Estimated Cost;" and
- (4) The amount of the equal monthly payments to be made by the Purchaser to pay said Purchaser's Estimated Cost during said Contract Year.

Said statement shall be in lieu of the issuance of monthly bills to the Purchaser by the District.

(b) In the event of the interruption or reduction of power and energy production of the Wanapum Development, resulting in the collection by the District of insurance or other proceeds as indemnity for such interruption or reduction, the District shall credit the Purchaser's pro-rata share of such proceeds to the Purchaser's account to be applied toward the reduction of the Purchaser's monthly payments.

(c) In the event of extraordinary receipts or payments of unusual costs substantially affecting the Annual Power Costs during any Contract Year, the District shall prepare and mail to the Purchaser a revised estimate of Annual Power Costs which shall supersede the previous estimate of Annual Power Costs as a basis for the Purchaser's monthly payments for the balance of that Contract Year.

(d) Said monthly payments shall be due and payable at the office of the District at Ephrata, Washington, on the twentieth day of the month in which the date of Completion of Construction occurs, and the twentieth day of each month thereafter, whether or not the Wanapum Development is then operating; provided, that for the first month in which payment is due, the Purchaser may reduce said payment to an amount equal to the Purchaser's Estimated Cost divided by the number of days in the first Contract Year and multiplied by the number of days in such first month included within said Contract Year.

(e) If payment in full is not made on or before the close of business on the twentieth day of the month, a delayed-payment charge of two percent (2%) of the unpaid amount due will be made. Remittances received by mail will be accepted without assessment of the two percent (2%) delayed-payment charge if the postmark indicates the payment was mailed on or before the twentieth day of the month. If the twentieth day of the month is a Sunday or a holiday, the next following business day shall be the last day on which payment may be made without the addition of the delayed-payment charge. Except as to any portion of a monthly payment which may in good faith be disputed by the Purchaser, the District may, whenever any amount due remains unpaid subsequent to the thirtieth day after the due date and after giving thirty (30) days' advance notice in writing, discontinue deliveries to the Purchaser until such bill and any subsequent payments which have become due are paid. No such discontinuance shall relieve the Purchaser from any of its obligations under this contract; provided, that until the power allocation of the Purchaser has been reallocated under the provisions of Section 21 hereof, the District shall use its best efforts to sell the power and energy made available by such discontinuance for the account of the Purchaser.

(f) On or before one hundred twenty (120) days after the end of each Contract Year the District will submit to the Purchaser a detailed statement of the actual Annual Power Costs for said Contract Year, based on the annual audit of the accounts of the Wanapum Development provided for in Section 11 hereof, and will compare said actual Annual Power Costs with the estimated Annual Power Costs for said Contract Year. If said actual costs exceed said estimated costs, the District shall bill the Purchaser for an amount equal to such excess multiplied by the Purchaser's Power Allocation for said Contract Year, and the Purchaser agrees to pay said bill promptly. If said actual costs are less than said estimated costs, the District shall give credit to the Purchaser against the current charges for power of an amount equal to such difference between said actual costs and said estimated costs multiplied by the Purchaser's Power Allocation for said Contract Year; provided, that if said comparison is made following the expiration of this contract, the District shall make a cash refund of such amount to the Purchaser.

(g) The District shall pay into the Revenue Fund established by the Bond Resolution that share of the Annual Power Costs of the Wanapum Development determined by multiplying said Annual Power Costs by the percentage of the Wanapum Development Output reserved by the District in accordance with subsection 3(b) hereof. Payments by the District as specified in this subsection 5(g) shall be made by the District out of revenues from the sale of its reserved share of the Wanapum Development Output specified in subsection 3(b) hereof.

(h) For purposes of payment for power and energy from the Wanapum Development during the Interim Delivery Period, the said Interim Delivery Period shall be considered and treated the same as if it were a Contract Year (without regard to the actual length of the period) subject to the conditions and provisions contained in this subsection 5(h); provided, that with respect to the Interim Delivery Period the estimated Annual Power Costs from which the Purchaser's monthly power payments are computed and the actual Annual Power Costs from which adjustments specified in subsections 5(d) and 5(f) hereof are computed shall be determined by adding together the following components:

(1) All of the costs included in subsections (a)(3) and (a)(5) of Section 4 not properly chargeable to Cost of Acquisition and Construction of the Wanapum Development; and

(2) That proportion of the amount required to pay those costs included in subsections (a)(1), (a)(2) and (a)(4) of Section 4, that the number of generating units completed, installed, successfully tested as required by the plans and specifications, and placed in continuous operation as provided in Section 9 hereof bears to the number ten (10).

The pro forma statement to be prepared and delivered to the Purchaser under subsection 5(a) hereof shall, in this case, relate to the whole of the Interim Delivery Period, and shall be furnished to the Purchaser not less than thirty (30) days nor more than sixty (60) days prior to January 1, 1965. The District shall prepare and mail the Purchaser a revised statement and estimate of Annual Power Costs for the Interim Delivery Period, which shall supersede any prior estimate thereof as a basis for the Purchaser's monthly payments for the balance of such delivery period if and when any of the following contingencies occurs: If the District shall receive extraordinary receipts or revenues or pay or incur unusual costs or expenses which substantially affect the amount of the estimated Annual Power Costs; or if there shall be any substantial change in the date of Completion of Construction, as estimated by the District.

The monthly payments provided for in the original or revised estimate shall be due and payable at the office of the District at Ephrata, Washington, on the twentieth day of January, 1965, and on the twentieth day of each month thereafter to and including the month in which occurs the actual date of Completion of Construction whether or not the Wanapum Development is then operating.

As soon as practicable after the end of the actual Interim Delivery Period the District will mail the Purchaser a detailed statement of the actual Annual Power Costs for such actual Interim Delivery Period (computed in

accordance with this subsection 5(h) and based on an interim audit of the accounts of the Wanapum Development as provided for in Section 11 hereof, but covering only the actual Interim Delivery Period) and will compare such actual costs of the actual Interim Delivery Period, with the District's estimated Annual Power Costs for the estimated Interim Delivery Period. Any difference in amount between said actual costs and estimated costs shall promptly be adjusted and accounted for as between the Purchaser and the District in the manner provided for in subsection 5(f) hereof, and any such accounting and adjustment shall make proper allowance for the fact that the Purchaser may not have been required to pay all of the monthly payments toward such estimated costs for the reason that the actual date of Completion of Construction may have substantially preceded the date estimated by the District for such Completion of Construction.

(i) During the Initial Delivery Period the District's power costs shall be determined by adding together the following costs and expenses paid or incurred by the District in connection with the Wanapum Development, namely:

(1) The District's costs and expenses directly resulting from its owning (but not including depreciation, debt service, nor costs properly chargeable to acquisition or construction), operating and maintaining in proper repair the Wanapum Development, and generating power and energy from any generating units which have been installed and placed in operation and delivering the said power and energy to one or more of the points of delivery as specified in Section 7 hereof;

(2) The cost to the District of obtaining and maintaining in effect insurance as provided for in Section 14 hereof;

(3) The costs and expenses paid or incurred by the District for or in connection with prevention or correction of any unusual loss or damage, or for major replacements to keep the generating units in operation, to the extent such costs are not covered by insurance and other funds, including the Construction Fund established under the Bond Resolution, available for such purpose; and

(4) The amount of any bonus payments the District may become obligated to pay the Contractor engaged to install the generating units in accordance with the provisions of SC-5 of the construction contract (Contract Documents 184-1, including Addenda 1 to 9, inclusive) for making generating units available for production of power and energy in the period prior to 12:01 A.M., September 1, 1964. (Any monies received by the District under this subsection 5(i)(4), together with any sums received by the District as liquidated damages under the construction contract, shall be forthwith paid by the District to the Construction Fund, and the said bonus provisions of the construction contract will not be modified or amended without consent of the Purchaser.)

The Purchaser shall be obligated to pay the District ten and eight-tenths percent (10.8%) of the District's said power costs, and shall be entitled to receive during all of said Initial Delivery Period its Purchaser's Power Allocation. For this purpose the District shall prepare and mail to the Purchaser a statement showing the costs and expenses paid or incurred by it in the preceding calendar month or portion of calendar month under this subsection 5(i) and the Purchaser shall pay the District the amount of its percentage, above specified, of the total of such costs and expenses. If payment of the amount so due is not made by the tenth day after receipt of the statement by the Purchaser a late payment charge computed in the manner specified in subsection 5(e) hereof shall be applicable.

(j) In no event shall the Purchaser be obligated to pay to the District any sum or amount with respect to or toward any of the costs and expenses set forth in subsection 5(i)(4) hereof which the District may have incurred or paid in connection with the Wanapum Development prior to September 1, 1963.

SECTION 6. SCHEDULING OF DELIVERIES

(a) It is the intent of the parties hereto that the power and energy purchased hereunder by the Purchaser shall be fully coordinated with other resources available to the Purchaser and with the resources of other Purchasers and that the operation of the Wanapum Development shall be coordinated with the operation of the Northwest Power Pool. Scheduling of generation from the Wanapum Development shall be as requested by the Purchaser, acting singly or as a member of a group of Purchasers, subject to the limitations set forth in this section and in other sections of this contract.

(b) The Purchaser, acting singly or as a member of a group of Purchasers, shall make available to the District at least eight (8) hours before 12:01 A.M. of each day an hourly schedule of desired total energy deliveries for that day. Such schedule shall be based upon the probable water supply to the Wanapum Development and the resulting probable output. Revisions in the schedule may be made at any time upon the request of the Purchaser if required by changes in estimated river flows or system loads. Deviations from schedules for the Wanapum Development Output shall be held to a minimum by the District and corrected for as promptly as possible on an hourly basis under conditions as nearly equivalent as possible to those obtaining when the deviations occurred.

(c) The schedules requested by the Purchaser shall be in accordance with the following:

(1) The net hourly schedule for delivery or spill shall be within the limitations of the Purchaser's Power Allocation and the Purchaser's allocation of the minimum discharge;

(2) The Purchaser shall be entitled to a share of that part of the Wanapum Development Output resulting from the inflow of the stream each hour determined by multiplying said part of the Wanapum Development Output by the Purchaser's Power Allocation;

(3) The Purchaser shall be entitled to a share of the pondage available at the Wanapum Development (hereinafter called the "Purchaser's Allocation of Pondage"), determined by multiplying the total of said pondage available by the Purchaser's Power Allocation; and

(4) The Purchaser may schedule more or less than its share of the Wanapum Development Output determined in accordance with subsection 6(b) hereof by scheduling from or to a pondage account established for each Purchaser. The aggregate amount of the energy scheduled from the pondage account shall not exceed the Purchaser's Allocation of Pondage determined in accordance with subsection 6(c) hereof and shall subsequently require the scheduling of an equivalent amount of energy to the account for refill by 7:00 A.M. on the following Monday. Scheduling by the Purchaser to its pondage account shall be only against its prior accumulated pondage draft. Refill obligations shall be reduced proportionately when inflow of the stream exceeds the hydraulic capacity of the Wanapum Development and will be cancelled when spill occurs.

SECTION 7. POINT OF DELIVERY

Electric power and energy to be delivered hereunder shall be made available to the Purchaser, at its option, exercisable from time to time, at any one or more of the following points:

(1) The 230 KV bus of the Bonneville Power Administration's Midway Substation;

(2) The 230 KV bus of the switchyard of the Wanapum Development;

(3) The 230 KV bus of the switchyard (when constructed) of the Priest Rapids Development;

provided, that if at any time transmission capacity is inadequate to permit the District to satisfy any such options which are exercised, the District shall diligently proceed to increase such transmission capacity as necessary.

SECTION 8. VOLTAGE CONTROL AND REACTIVE DELIVERIES

(a) The District shall maintain voltage levels at the Wanapum Development to best coordinate with the systems of the Purchasers and the systems operated by members of the Northwest Power Pool.

(b) Reactive kilovolt-amperes shall be made available up to the capability of the equipment of the Wanapum Development, consistent with the power generation and voltage level schedule for the Wanapum Development at the time.

(c) The Purchaser is entitled at any time to a share of the reactive output available at the time of maximum power output from the Wanapum Development determined by multiplying the total reactive output by the Purchaser's Power Allocation specified in Section 3 hereof. The Purchaser may take additional reactive deliveries when available, or otherwise by reducing deliveries of power from the Wanapum Development to the Purchaser so as to provide the additional reactive capability.

SECTION 9. CHARACTER AND CONTINUITY OF SERVICE

(a) Power and energy supplied hereunder shall be approximately 230 KV, three-phase, alternating current, at approximately sixty cycles per second. The District may temporarily interrupt or reduce deliveries of electric energy to the Purchaser if the District determines that such interruption or reduction is necessary in case of emergencies. In order to install equipment in, make repairs to, replacements, investigations and inspections of, or perform other maintenance work on the Wanapum Development, and in order that operations of the Purchasers will not be unreasonably interrupted or interfered with, the District, after consulting with the Purchaser regarding any such planned interruption or reduction, giving the reason therefor and stating the probable duration thereof, will to the best of its ability schedule such interruption at a time which will cause the least interference to the operations of the Purchaser and the operations of other Purchasers of power from the Wanapum Development.

(b) Except as interrupted by Uncontrollable Forces or as provided otherwise by this section, power and energy shall be made available in accordance with this agreement at all times during the term of this contract commencing with the Initial Date of Delivery.

SECTION 10. METERING AND TRANSMISSION LOSSES

(a) The District shall provide and maintain suitable meters in the generator leads of the power plant of the Wanapum Development to indicate and record the output of the Wanapum Development. The Wanapum Development Output shall be determined from totalized readings from said meters after making corrections specified in subsection 2(f) hereof. The District shall also arrange for suitable metering at the point of delivery specified in Section 7 hereof or at other points as agreed upon. Meters shall be read by the District or an agent of the District and records thereof shall be made available to the Purchaser as may be reasonably required.

(b) All deliveries of power and energy hereunder shall be measured as though they were made at the low voltage side of the transformers in the power house of the Wanapum Development. All losses of power and energy purchased hereunder resulting from transformation and transmission shall be borne by the Purchaser.

SECTION 11. ACCOUNTS

(a) The District agrees to keep accurate records and accounts of the Wanapum Development in accordance with the Uniform System of Accounts and in accordance with the rules and regulations prescribed by the Division of Municipal Corporations of the State Auditor's office of the State of Washington, separate and apart from its other accounting records. Said accounts shall be the subject of an annual audit by a firm of certified public accountants, experienced in electric utility accounting and of national reputation, to be employed by the District. The transactions with respect to each Contract Year shall be subject to such an audit. In addition, such an audit shall be prepared to cover all transactions relating to the Interim Delivery Period, as well as a separate audit covering transactions relating to the Initial Delivery Period.

(b) A copy of each such audit, including all recommendations of the accountants, shall be furnished by the District to the Purchaser promptly after the same shall have been prepared.

SECTION 12. INFORMATION TO BE MADE AVAILABLE TO THE PURCHASER

(a) All drawings, designs, plans, specifications and terms of contracts relating to the construction and operation of the Wanapum Development are or will be placed on file in the office of the District at Ephrata, Washington and will be open to inspection by the Purchaser.

(b) All agreements and data relating to the financing of the Wanapum Development may be examined by the Purchaser at the office of the District.

(c) All operating and financial records and reports relating to the Wanapum Development may be examined by the Purchaser at the office of the District.

(d) Policies of Insurance carried by the District pursuant to Section 14 hereof shall be available at the office of the District for inspection by the Purchaser.

(e) The Purchaser's representatives shall at all times be given reasonable access to the Wanapum Development.

SECTION 13. ADVISORY COMMITTEE – ARBITRATION

(a) In order that Purchasers may, in an orderly way, participate in problems relating to the Wanapum Development, there is hereby established the Wanapum Advisory Committee (herein called "the Committee"). The Purchaser and each of the other Purchasers are entitled to representation on the Committee and may each appoint a representative to attend Committee meetings. A Chairman shall be elected by the members of the Committee. The Committee will meet regularly on the Monday following the first Tuesday of each month, or as otherwise determined by the Committee, for the purpose of discussing the problems with respect to the Wanapum Development and may make recommendations to the District with reference thereto. Special meetings shall be called by the Chairman at the request of the District or upon the request of members of the Committee representing one-third (1/3) of the power purchased by the members. All meetings will be held at the office of the District at Ephrata, Washington, or at such other place or places as may be determined by the Committee.

(b) Except in the event of an emergency requiring immediate action, the District shall give to the Committee reasonable notice, in no case less than thirty (30) days, whenever it proposes to replace items of major equipment in or to construct additions to or extensions of the Wanapum Development, or to enter into additional new or special contractual arrangements relating to and substantially modifying the operation or Annual Power Costs of the Wanapum Development.

(c) The District will give due consideration to the recommendations of the Committee. In considering said recommendations, the District shall give due regard to the objective of achieving from the Wanapum Development the optimum electric power production consistent with economy, reliability and facility of operation and the District's statutory duties. If in the opinion of the Committee the District has given inadequate consideration to its informal recommendations, written recommendations may be made to the District whenever such recommendations are approved in writing by members of the Committee representing Purchasers who are purchasing two-thirds (2/3) of the power purchased by all Purchasers. Such written recommendations shall be forwarded to the District with appropriate supporting data. The District shall take action on such recommendations within a reasonable time by adopting, modifying or rejecting such recommendations. If the District modifies or rejects said recommendations it shall notify the Committee of its action in writing, giving the reasons therefor.

(d) If the District modifies or rejects a written recommendation of the Committee dealing with matters which may be arbitrated as set forth in subsection 13(e) hereof, and made in accordance with the procedures set forth in subsection 13(c) hereof, the Committee may, by affirmative vote of members of the Committee representing Purchasers who purchase two-thirds (2/3) of the power purchased by all Purchasers, submit the recommendation to a board of arbitrators. The board of arbitrators shall be composed of three (3) persons, one of whom shall be appointed by the District, one of whom shall be appointed by majority vote of the Committee, and the third person to be appointed by the two persons so appointed. In the event said two members cannot agree upon the appointment of a third person, then such third person shall be appointed by the Chief Justice of the Supreme Court of the State of Washington. The procedure for arbitration shall be governed by the laws of the State of Washington. Insofar as the parties hereto may legally do so, they agree to abide by the decision of said board; provided, that the District shall not be bound by any decision of a board of arbitration to the extent that such decision is retroactive beyond the date when the matter arbitrated was made the subject of written recommendation of the Committee.

(e) The matters which may be arbitrated in accordance with subsection 13(d) hereof shall consist of all matters pertaining to the maintenance, operation, additions, replacements and renewals, insurance to be carried on the Wanapum Development and its operation (which in no event shall be less than that required under the terms of the Bond Resolution), and subsequent financing and refinancing of the Wanapum Development, except such matters which are by law vested exclusively in the discretion of the District. All written Committee recommendations not approved by the District with respect to amounts to be charged to the Wanapum Development as a result of voluntary payments in lieu of taxes or other voluntary donations made by the District may be arbitrated in accordance with subsection 13(d) hereof.

(f) In the event this Section 13 or any paragraph, sentence, clause or phrase thereof shall be adjudicated by a court of last resort and of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this section or such part thereof so adjudicated to be invalid had not been included herein.

SECTION 14. INSURANCE

The District agrees to obtain and maintain in full force and effect during the term of this contract, to the extent available at reasonable cost, adequate insurance with responsible insurers with policies payable to the District for the benefit of the District and the Purchasers as their respective interests may appear, against:

- (1) Obligations of the District under the Workmen's Compensation law of the State of Washington, and employer's liability;
- (2) Public liability for bodily injury and property damage;
- (3) Physical loss or damage to the Wanapum Development on replacement cost basis;
- (4) Business interruption loss to the District and/or the Purchasers resulting from delay in completion of the Wanapum Development and from interruption or reduction of generation or transmission of power and energy caused by physical loss, damage or destruction; and
- (5) Any other insurance determined to be necessary.

SECTION 15. OPERATION AND MAINTENANCE

The District covenants and agrees that it will operate and maintain the Wanapum Development in an efficient and economical manner, consistent with good business and operating practices of comparable developments.

SECTION 16. BOARD OF CONSULTING ENGINEERS ON CONSTRUCTION PROBLEMS

The District shall establish a Board of five (5) Consulting Engineers during the construction of the Wanapum Development, which shall include two (2) engineers of outstanding ability and national reputation, selected by the District from a list of not less than four (4) such engineers submitted by the Committee to the District.

SECTION 17. CONSTRUCTION AND FINANCING CONTRACTS

The District agrees that prior to commencing construction of the Wanapum Development it will have completed financing of the Wanapum Development, shall have let the major contract for the construction thereof, and shall have obtained adequate completion bonds for said contract. Harza Engineering Company has prepared the plans and specifications for the Wanapum Development (Contract Documents 184-1, including Addenda 1 to 9, inclusive). The District agrees that it will not (without the consent of the Purchasers of a majority of the power and energy sold by the District to Purchasers as indicated in Exhibit "A" attached hereto) modify, amend, or waive full compliance with, nor make the election provided in GC-23 of, the said plans and specifications, in any material respect, insofar as the said plans and specifications pertain to the manufacture, installation, testing and acceptance of all items of major equipment (turbines, generators, governors and transformers).

SECTION 18. COMPLETION OF CONSTRUCTION

The District agrees to proceed diligently with the financing and construction of the Wanapum Development and, subject to Uncontrollable Forces, plans to complete the Wanapum Development by January 1, 1965.

SECTION 19. ADDITIONAL FACILITIES

(a) From time to time during the term hereof the District may propose to expand the Wanapum Development by installing additional generating facilities. Whenever the District proposes to so expand the Wanapum Development it shall give notice in writing of such intent to the Purchaser stating:

- (1) The estimated cost of such additional generating facilities;
- (2) The proposed method of financing the cost of said facilities;
- (3) The estimated additional power and energy which would be available as a result of the installation of said facilities;
- (4) The estimated incremental cost (i.e. the costs which will be incurred as a result of installing the proposed additional facilities, which costs would not be incurred were such proposed additional facilities not installed) of said additional power and energy on an annual basis; and
- (5) The estimated construction period for the installation of said facilities.

The notice shall also contain other available pertinent information.

(b) The Purchaser shall have the option of purchasing a share of said additional power and energy determined by multiplying the total additional power and energy by the Purchaser's Power Allocation, specified in Section 3 hereof, and may exercise such option by giving written notice to the District on or before the expiration of ninety (90) days from the receipt of said written notice from the District. The District shall give a second notice to the Purchaser if any of the other Purchasers shall fail to exercise its option for its full share of said power and energy, and the Purchaser may, by giving written notice to the District within sixty (60) days after the receipt of the second notice from the District, have its respective share of said power and energy increased either in proportion or, as shall be mutually agreed upon, so as to make available to the Purchaser and to the other Purchasers power and energy available as a result of any of the other Purchasers failing to elect to take its full share of said additional power and energy; provided, that such increases shall not be inconsistent with the provisions of said Public Law 544 and said Federal Power Commission License concerning the offering of a reasonable amount of the capacity and power output of the Project for sale in states neighboring the State of Washington. The District, in addition to its share of said additional power and energy determined by multiplying the total amount of said additional power and energy by the percent reservation specified in subsection 3(b) hereof, shall be entitled to the additional power and energy which the Purchaser and other Purchasers shall not elect to take in accordance with the foregoing provision. Failure to exercise its option to purchase additional power and energy which would be available from the installation of additional generating facilities proposed by the District at any time shall not be construed to waive the rights of the Purchaser to a share of the additional power and energy which would be available from additional facilities proposed for installation by the District at a later date.

(c) If the Purchaser exercises its option to take its share of said additional power and energy, it shall pay for said additional power and energy a percentage of the incremental annual cost of said additional facilities corresponding to the percent the share of additional power and energy which it purchases is to the total additional power and energy available as the result of the installation of the additional facilities. If the Purchaser does not elect to take additional power and energy which would be available from the installation of additional generating facilities it shall continue to receive the same amount of power and energy and pay the same annual power cost therefor as if such additional generating facilities had not been installed.

(d) If, after the Purchaser shall have exercised its option as aforesaid, the District shall determine that it is not economically feasible for it to install additional generating facilities as proposed, the District shall be under no obligation to so do and shall so notify the Purchaser of such determination.

(e) Notwithstanding any other provisions of Section 19 hereof, whenever the District is compelled to install additional facilities at or in the Wanapum Development by any order or decision of the Federal Power Commission or any state or federal government agency with authority to issue or make and enforce such an order or decision, the Purchaser shall share the benefits and costs resulting from the installation of said additional facilities in the same manner and to the same extent as if the Purchaser had voluntarily exercised its option to purchase the power and energy resulting from said installation as provided earlier in Section 19 hereof.

SECTION 20. PROJECT INTEGRATION

(a) It is the intention of the parties hereto that when the Wanapum Development is constructed, its operation shall be integrated with the operation of the Priest Rapids Development as required by said Public Law 544 and said Federal Power Commission License for the Project. It is agreed that all benefits accruing to the Project as a result of such integration shall be shared equally by the Priest Rapids and Wanapum Developments. It is

also agreed that all joint costs of the Priest Rapids and Wanapum Developments shall be equitably allocated between them and that such allocation shall be reviewed by the Advisory Committee as provided in Section 13 hereof. In the event compensation becomes due the owners of the Rock Island Hydroelectric Project, in accordance with that certain agreement dated the 8th day of August, 1955 between Puget Sound Power and Light Company, Public Utility District No. 1 of Chelan County, and Public Utility District No. 2 of Grant County (a conformed copy of which is attached hereto as Exhibit "B" and incorporated herein by reference) because of encroachment on the Rock Island Project, such compensation, if in power and energy, will proportionately reduce the amount of power and energy to be available to Purchaser under Section 3 herein, but shall not reduce the amount required to be paid by Purchaser under Section 5 herein.

(b) The parties hereto agree that if operation of the Priest Rapids Development with the maximum controlled headwater level of 486.5 feet above mean sea level (determined by reference to the United States Coast and Geodetic Survey Sea Level Datum of 1929 with supplemental additions of 1947) causes encroachment on the tailwater of the Wanapum Development, located at or upstream from the location shown on the License application drawings which were filed with the Federal Power Commission by the District on June 27, 1955 (approximately mile 415 on the Columbia River), the Priest Rapids Development shall compensate the Wanapum Development in kind and coincidentally for one-half (1/2) of the loss to the Wanapum Development of capacity and power output. The Priest Rapids Development shall compensate the Wanapum Development in kind and coincidentally for all loss of capacity and power output at the Wanapum Development caused by controlled headwater levels above said level of 486.5 feet at the Priest Rapids Development. If the Wanapum Development is located downstream from the location shown on the said License application drawings, it shall be compensated in kind and coincidentally for losses of capacity and power output due to encroachment by the Priest Rapids Development only to the extent that such encroachment would have occurred at the location shown on the said application drawings.

SECTION 21. ADJUSTMENT OF POWER ALLOCATION

The Purchaser's Power Allocation shall be automatically increased pro-rata with that of the other Purchasers, not in excess of a cumulative maximum of twenty-five percent (25%) thereof, in the event of a Default (as hereinafter defined) by any of the other Purchasers. The term "Default" as used herein shall mean the failure by any one of the Purchasers to make the payments specified in Section 5 hereof and contemporaneously with said failure to make payments there shall exist, with respect to that one of the Purchasers, any one or more of the following conditions:

- (a) An order, judgment or decree shall be entered by any court of competent jurisdiction:
 - (1) Appointing a receiver, trustee or liquidator for any of the Purchasers or the whole or any substantial part of the properties of any of the Purchasers;
 - (2) Approving a petition filed against any of the Purchasers under the provision of an Act to Establish a Uniform System of Bankruptcy Throughout the United States, Approved July 1, 1898, as amended;
 - (3) Granting relief to any of the Purchasers under an amendment to said Bankruptcy Act which shall give relief similar to that afforded by said Act; or
 - (4) Assuming custody or control of the whole or any substantial part of any of the Purchaser's properties under the provisions of any other law for the relief or aid of debtors;

and such order, judgment or decree shall not be vacated or set aside or stayed (or, in case custody or control is assumed by said order, such custody or control shall not otherwise be terminated) within sixty (60) days from the date of the entry of such order, judgment or decree.

- (b) Any of the Purchasers shall:
 - (1) Admit in writing its inability to pay its debts generally as they become due;
 - (2) File a petition in bankruptcy;
 - (3) Make an assignment for the benefit of its creditors;
 - (4) Consent to the appointment of a receiver of the whole or any substantial part of its properties;
 - (5) Be adjudicated a bankrupt on the basis of a petition in bankruptcy filed against it;
 - (6) File a petition or an answer seeking relief under any amendment to said Bankruptcy Act which shall afford relief substantially similar to that afforded by said Act; or
 - (7) Consent to the assumption by any court of competent jurisdiction under the provisions of any other law for the relief or aid of debtors of custody or control of any of the Purchasers or of the whole or any substantial part of its properties;

provided, that if prior to an imminent Default by any of the Purchasers it shall demonstrate to the satisfaction of the District and the other Purchasers receiving in the aggregate at least two-thirds (2/3) of the balance of the Wanapum Development Output its inability to pay for its Power Allocation and its ability to pay for a smaller Power Allocation, then it shall be allowed to thereafter take such smaller Power Allocation and shall be thereafter liable for the same in the same manner as for its original Power Allocation; and, in such event, the automatic increase in the Purchaser's Power Allocation as above provided shall apply only to the difference between the original Power Allocation and such lesser Power Allocation of that one of the Purchasers threatened with Default.

(c) If any of the other Purchasers Defaults, and the Purchaser's Power Allocation is automatically increased in accordance with this section, the Purchaser either individually or as a member of a group shall have a right of recovery from that one of the Purchasers in Default for such amount as the Purchaser may sustain as a loss or damage by reason of such Default and may commence such suit, action or proceeding as may be necessary or appropriate to recover the amount of said loss or damage.

SECTION 22. LIABILITY OF PARTIES

The District and the Purchaser each assumes full responsibility and liability for the maintenance and operation of its respective properties and shall indemnify and save harmless the other party from all liability and expense on account of any and all damages, claims or actions, including injury to or death of persons, arising from any act or accident in connection with the installation, presence, maintenance and operation of the property and equipment of the indemnifying party; provided, that any liability which is incurred by the District through the operation and maintenance of the Wanapum Development and not covered by insurance shall be paid solely from the revenues of the Wanapum Development, and any payments made by the District to satisfy such liability shall become part of the Annual Power Cost as set forth in subsection 4(a)(5) hereof.

SECTION 23. WAIVER OF DEFAULT

Any waiver at any time by either party to this contract of its rights with respect to any Default of the other party hereto, or with respect to any other matter arising in connection with such contract, shall not be considered a waiver with respect to any subsequent Default or matter.

SECTION 24. NOTICES AND COMPUTATION OF TIME

Any notice or demand, except those provided for in Section 6 hereof, by the Purchaser under this contract to the District shall be deemed properly given if mailed postage prepaid and addressed to Public Utility District No. 2 of Grant County, Washington, at Ephrata, Washington; any notice or demand by the District to the Purchaser under this contract shall be deemed properly given if mailed postage prepaid and addressed to Puget Sound Power & Light Company, at Seattle, Washington; and computing any period of time from such notice, such period shall commence at 12:00 P.M. (midnight) on the date mailed. The designations of the name and address to which any such notice or demand is directed may be changed at any time and from time to time by either party giving notice as above provided.

SECTION 25. MODIFICATION OF CONTRACT TERMS

It is recognized by the parties hereto that, by virtue of the Bond Resolution, this contract cannot be amended, modified or otherwise altered by agreement of the parties in any manner that will impair or adversely affect the security afforded by the provisions of this contract for the purchase and sale of power for the payment of the principal, interest and premium, if any, on any bonds issued thereunder as they respectively become payable, so long as any of said bonds are outstanding and unpaid or until provision is irrevocably made for the payment thereof.

SECTION 26.

DISTRICT'S BOND RESOLUTION AND LICENSE

It is recognized by the parties hereto that the District in its operation of the Wanapum Development and in the delivery of the power hereunder to the Purchaser, must comply with the requirements of the Bond Resolution and with the Federal Power Commission License, and it is therefore accordingly agreed that this Power Sales Contract is made subject to the terms and provisions of the Bond Resolution and said License. The District shall not, without the written consent of the Purchaser, amend, modify or otherwise change the Bond Resolution if such amendment, modification or change would be to the disadvantage of the Purchaser.

SECTION 27.

CONFLICT OF LAWS

The parties hereto agree that this contract shall be governed by the laws of the State of Washington.

SECTION 28.

ASSIGNMENT OF CONTRACT

This contract shall inure to the benefit of, and shall be binding upon the respective successors and assigns of the parties to this contract. No assignment or transfer of this contract shall relieve the parties hereto of any obligation incurred hereunder.

SECTION 29.

UNIFORMITY OF POWER SALES CONTRACTS

(a) The Purchaser hereunder is one of several Purchasers who have exercised an option, previously granted by the District, in accordance with Section 20 of that certain Power Sales Contract between the parties hereto dated the 21st day of May, 1956 to purchase power from the Wanapum Development. Options similar, except as to percentage of power, have been exercised by the following Purchasers:

- Cowlitz County, Public Utility District No. 1 of Eugene Water and Electric Board
- Forest Grove, City of
- McMinnville, City of
- Milton-Freewater, City of
- Pacific Power & Light Company
- Portland General Electric Company
- Puget Sound Power & Light Company
- The Washington Water Power Company

(b) The City of Tacoma exercised a similar option but subsequently released the District from any obligation to supply power from the Wanapum Development. The City of Seattle and Public Utility District No. 1 of Kittitas County failed to exercise similar options. All the portions of the Wanapum Development Output covered by the option to City of Tacoma, City of Seattle and Public Utility District No. 1 of Kittitas County have been reallocated to the Purchasers listed in subsection (a) above, pursuant to the Power Sales Contract dated May 21, 1956.

(c) It is understood and agreed that all of said contracts for the sale and purchase of power shall be uniform in all material respects in their terms, conditions and provisions with the exception of Purchaser's Power Allocations. If any of said contracts are amended or replaced so that they contain terms or conditions more favorable than those granted to the Purchaser under this contract, then this contract shall be amended to include the same terms and conditions so granted to any of the other Purchasers; provided, however, that the District shall have the right to sell power and energy reserved by it pursuant to subsection 3(b) hereof on such terms and conditions as it shall elect and subject to the requirements of subsection 3(b) hereof nothing herein shall be construed to require the District to offer equal terms and conditions to the Purchaser.

PUBLIC UTILITY DISTRICT NO. 1
OF CHELAN COUNTY, WASHINGTON

(SEAL)

By /s/ Wm. Schempp
President

ATTEST:

By /s/ Paul Nichart
Secretary

PUGET SOUND POWER & LIGHT COMPANY

By /s/ L. E. Karrer
Executive Vice President (Title)

(SEAL)

ATTEST:

By /s/ Ralph M. Davis
Secretary (Title)

Distribution of the Wanapum Development Output

<u>Purchasers</u>	<u>Percent of Wanapum Development Output Sold</u>
Cowlitz County, Public Utility District No. 1 of Eugene Water and Electric Board	2.7 2.3
Forest Grove, City of	0.7
McMinnville, City of	0.7
Milton-Freewater, City of	0.7
Pacific Power & Light Company	18.7
Portland General Electric Company	18.7
Puget Sound Power & Light Company	10.8
The Washington Water Power Company	<u>8.2</u>
Aggregate Percentage of Wanapum Development Output Sold to Purchasers	63.5

THIS AGREEMENT, entered into this 8th day of August, 1955, between PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON (hereinafter referred to as "Grant"), PUGET SOUND POWER & LIGHT COMPANY, a Massachusetts corporation (hereinafter referred to as "Puget") and PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON (hereinafter referred to as "Chelan").

WITNESSETH:

WHEREAS, Grant has filed an application under the Federal Power Act for a license for a proposed water power project (No. 2114) to be known as the Priest Rapids Hydroelectric Development and located on the Columbia River to consist of two similar projects to be known as the Priest Rapids Project (river mile 397 from mouth of the Columbia River) and the Wanapum Project (river mile 415), both of which are jointly designated by the Federal Power Commission as Project No. 2114 and

WHEREAS, Puget and Chelan severally own and are joint licensees of the Rock Island Hydroelectric Project on the Columbia River (Project No. 943), which is upstream from the proposed Priest Rapids Hydroelectric Development; and

WHEREAS, the Wanapum Project will adversely affect the Rock Island Project and the Federal Power Commission has fixed August 18, 1955, as the last date upon which protests may be filed against the granting of a license for Priest Rapids Hydroelectric Development and in the absence of the within agreement Puget and Chelan would file protests against the granting of such license.

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained, the parties hereto agree as follows:

1. Grant agrees to fully compensate Puget and Chelan and each of them or their successors in interest in the Rock Island Project for all loss, damage and expense which Puget and Chelan or either of them or their successors in interest in the Rock Island Project shall sustain or incur by reason of the construction or operation of said Priest Rapids Hydroelectric Development or any part thereof. That wherever the term "Puget and Chelan" is used in this agreement the same shall include either or their successors in interest.

2. Without limiting the generality of the foregoing, Grant agrees regarding loss of power and energy, to compensate Puget and Chelan for all loss in the generation of power and energy at the Rock Island Project which shall result from the backwater of the Wanapum Project, by delivering to Puget and Chelan the amount of power and energy so lost at the Rock Island Project, which deliveries by Grant shall be made into the respective transmission systems of Puget and Chelan simultaneously with the occurrences of the losses at the Rock Island Project to the end that the amount of power and energy available to Puget and Chelan from the Rock Island Project, plus the deliveries to Puget and Chelan as aforesaid, shall at all times equal the power and energy which would have been available to Puget and Chelan at the Rock Island Project in the absence of said Priest Rapids Hydroelectric Development.

3. In consideration of the undertaking, and commitment of Grant herein contained, Puget and Chelan agree not to protest the granting of Grant's application for a license for said Priest Rapids Hydroelectric Development.

4. The parties hereto agree that the obligations of the within agreement shall be included in any license which the Federal Power Commission shall issue to Grant for said Priest Rapids Hydroelectric Development and each party hereto hereby requests that the obligations of the within agreement be included as conditions of such license. Notwithstanding the fact that such license may be issued without inclusion of the obligations of the within agreement as conditions of such license, the obligations of the within agreement shall continue after the issuance of such license.

5. The obligations of Grant hereunder shall be binding upon its successors in interest in the Priest Rapids Hydroelectric Development or any part thereof, and the benefits of this agreement shall inure to the successors in interest respectively of Puget and Chelan in the said Rock Island Project.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed by their proper officers respectively, being thereunto duly authorized, and their respective corporate seals to be hereto affixed, the day and year first above written.

ATTEST:
By /s/ Wm. Schempp
Secretary

PUBLIC UTILITY DISTRICT NO. 2
OF GRANT COUNTY, WASHINGTON
By /s/ F. Wm. Arlt
President

ATTEST:
By /s/ D. J. Torrance
Assistant Secretary

PUGET SOUND POWER & LIGHT COMPANY
By /s/ Frank McLaughlin
President

ATTEST:
By /s/ Ivan J. Compton
Secretary

PUBLIC UTILITY DISTRICT NO. 1
OF CHELAN COUNTY, WASHINGTON
By /s/ L. J. Richardson
President

ESCROW INSTRUCTIONS

To:

The Peoples National Bank of Washington

Grant County Branch

Ephrata, Washington

Re: Wanapum Development

Gentlemen:

Pursuant to the negotiations which have been carried on between Public Utility District No. 2 of Grant County, Washington (hereinafter referred to as "the District"), and Puget Sound Power & Light Company (hereinafter referred to as "the Purchaser"), and other utility systems providing electric service to the residents of the states of Washington, Oregon and Idaho, looking toward the sale and purchase of the output of the above Development, we enclose herewith and attach hereto an executed contract (in duplicate) setting forth the terms and conditions under which the Purchaser will take and pay for ten and eight-tenths percent (10.8%) of the output of the Wanapum Development.

The enclosed contract is delivered to you in escrow and one executed copy shall be delivered to the District and one executed copy to the Purchaser when you shall have received written authority, or telegraphed instructions from the Purchaser to release the same. If you shall not have received such written authority or telegraphed instructions by December 1, 1959 the enclosed contract shall be destroyed by you. Authorized representatives of either party to the contract may examine the same while it remains in your custody

Yours very truly,

PUGET SOUND POWER & LIGHT COMPANY

By

(Title)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY

By

President

Accepted this ____ day of June, 1959.

THE PEOPLES NATIONAL BANK OF WASHINGTON

By

Authorized Officer

Public Utility District of Grant County

WM. SCHEMPP, PRESIDENT
 GEO. SCHUSTER, VICE PRESIDENT
 PAUL NEIHART, SECRETARY
 ERIC D. PETERSON, ASSISTANT SECRETARY
 D. T. MARTIN, COMMISSIONER
 E. B. GIBBONS, MANAGER
 R. R. RIES, SUPERVISOR OF PRODUCTION
 E. L. DOUGLASS, AUDITOR

EPHRATA, WASHINGTON

P.O. BOX 878
 PHONE: SK 4-3541

July 30, 1963

Puget Sound Power & Light Company
 P. O. Box 535
 Bellevue, Washington

Attention: Mr. D. H. Knight

AGREEMENT TO AMEND POWER SALES CONTRACTS

Gentlemen:

The District proposes to refund the Wanapum Hydro-Electric Revenue Bonds, Series of 1959 (the 1959 Bonds) heretofore issued under and pursuant to Resolution No. 474, adopted by the Commission of the District on June 30, 1959 (the 1959 Resolution) by the issuance of its Wanapum Hydroelectric Refunding Revenue Bonds, Series of 1963 (the 1963 Bonds) under and pursuant to a bond resolution, being Resolution No. 1485 of the District (the 1963 Resolution) to be adopted by the Commission of the District. The Commission of the District will adopt the 1963 Resolution in substantially the form of the proposed Resolution No. 1485, a copy of which has been furnished to you, and you will promptly receive a certified copy of such resolution after its adoption.

The proposed refunding is to be accomplished as provided in the 1963 Resolution. Until such refunding is accomplished, the 1963 Bonds will be secured, as provided in the 1963 Resolution, by United States Treasury obligations dated October 1, 1957 and maturing October 1, 1969 and bearing interest at the rate of four per centum (4%) per annum and United States Treasury obligations dated June 20, 1963 and maturing August 15, 1970 and bearing interest at the rate of four per centum (4%) per annum or other United States Treasury obligations maturing not later than August 15, 1972. The 1963 Bonds will not be a lien upon nor charge against the revenues of the Wanapum Development until (i) the 1959 Bonds now outstanding have been paid or redeemed in accordance with the provisions of the 1959 Resolution and (ii) all additional bonds, including Completion Bonds, which may hereafter be issued under the 1959 Resolution have been paid or redeemed in accordance with the provisions of the 1959 Resolution or the discharge of the latter shall have been otherwise legally effectuated. The 1959 Bonds will not be refunded unless both the 1959 Bonds and the 1963 Bonds are fully current, and unless all expenses and charges, including interest, incurred or accrued, in connection with the refunding have been paid or provision for payment has been made out of moneys available for such purpose.

In order for the District to issue the 1963 Bonds, it is necessary for the Power Purchasers under the Wanapum Power Sales Contracts dated as of June 22, 1959, to agree to an amendment of said Contracts. Accordingly, upon execution of this Letter Agreement by you, subsections (i), (1) and (o) of Section 2 of the Wanapum Power Sales Contract between you and the District shall be amended, such amendment to become effective immediately upon and only upon payment or redemption in accordance with the 1959 Resolution of the 1959 Bonds and all additional bonds, including Completion Bonds, hereafter issued under the 1959 Resolution or the discharge of the latter shall have been otherwise legally effectuated, as follows:

- (i) "Debt Service" shall mean with respect to any period the amount to be paid or accrued during said period to retire the principal of and pay the interest and premium, if any, on all Wanapum Hydroelectric Refunding Revenue Bonds, Series of 1963, issued by the District for the purpose of refunding the Wanapum Hydro-Electric Revenue Bonds, Series of 1959, heretofore issued under and pursuant to Resolution No. 474 adopted by the Commission of the District on June 30, 1959, and on all bonds issued pursuant to the Bond Resolution in the manner provided in said Bond Resolution and other evidences of indebtedness issued by the District for the purpose of paying the Cost of Acquisition and Construction of the Wanapum Development.
- (1) "Revenue Bonds" shall mean the Wanapum Hydroelectric Refunding Revenue Bonds, Series of 1963, issued for the purpose of refunding the Wanapum Hydro-Electric Revenue Bonds, Series of 1959, and any additional bonds issued under and in accordance with the terms of the Bond Resolution.
- (o) "Bond Resolution" shall mean Resolution No. 1485 of the District adopted by the Commission of the District on July 30, 1963 authorizing the issuance and sale of Wanapum Hydroelectric Refunding Bonds, Series of 1963 and providing the terms and conditions thereof, and authorizing the issuance of additional bonds thereunder for other purposes in connection with the Wanapum Development, a certified copy of which has been delivered to the Purchaser.

In addition, it is also necessary for the Power Purchasers under the Reserve Share Power Sales Contracts dated as of June 22, 1959, to agree to an amendment of said Contracts. Accordingly, upon execution of this Letter Agreement by you, the Reserve Share Power Sales Contract between you and the District shall be amended, such amendment to become effective immediately upon and only upon the payment or redemption in accordance with the 1959 Resolution of the 1959 Bonds and all additional bonds, including Completion Bonds, hereafter issued under the 1959 Resolution, or the discharge of the latter shall have otherwise been legally effectuated, as follows:

An additional paragraph shall be added to subsection (b) of Section 2 and shall read as follows:

"Section 2 of the Wanapum Contract shall refer to Section 2 of said Wanapum Contract as amended."

If you agree to amendment of the said Wanapum Power Sales Contract and the Reserve Share Power Sales Contract, as hereinabove set forth, please indicate your agreement by executing this Letter Agreement in the space provided below and deliver a copy of this Letter Agreement to us.

Very truly yours,

PUBLIC UTILITY DISTRICT NO. 2 OF
GRANT COUNTY, WASHINGTON

By /s/ Wm. Schempp
President

Attest:

/s/ Paul Nichart

Secretary

/s/ Paul Nichart

The undersigned does hereby agree to amendment of the Wanapum Power Sales Contract and the Reserved Share Power Sales Contract as hereinabove set forth; said amendment to become effective only upon compliance with the conditions above set forth.

PUGET SOUND POWER & LIGHT COMPANY

By /s/ Ralph M. Davis
President

Attest:

/s/ C. B. Schoeggl

Secretary

POWER SALES CONTRACT

Executed by

PUBLIC UTILITY DISTRICT NO. 1 OF
DOUGLAS COUNTY, WASHINGTON

and

PUGET SOUND POWER & LIGHT COMPANY

THIS AGREEMENT made and entered into as of the 18th day of September, 1963, between Public Utility District No. 1 of Douglas County, Washington (hereinafter called "Douglas") a municipal corporation of the State of Washington, and Puget Sound Power & Light Company (hereinafter called the "Purchaser") a corporation organized and existing under the laws of the State of Washington:

W i t n e s s e t h :

Whereas, Douglas is a municipal corporation organized under the laws of the State of Washington and authorized to construct and operate electric generating plants and transmission lines and to supply electric energy to other electric utilities and to develop the Wells Hydroelectric Project on the Columbia River; and

Whereas, Douglas has heretofore obtained a license, issued July 12, 1962, from the Federal Power Commission (FPC) for Project No. 2149 (Wells Project), a hydroelectric generating station to be constructed on the Columbia River between Douglas and Chelan Counties, with the structures, fixtures, equipment and facilities used or useful in the maintenance and operation of said Project; and

Whereas, Douglas has heretofore granted an option to the Purchaser to purchase 31.3% of the power and energy produced by the Wells Project and the Purchaser desires to exercise said option on the terms and conditions hereinafter provided; and

Whereas, in order to provide funds for the completion of the construction of the Wells Project, Douglas desires to enter into contracts for the sale of the power and energy to be produced by the Wells Project in excess of the amounts required to provide for the actual and prospective needs of Douglas and the Purchaser desires to purchase such power and energy; and

Whereas, Douglas has the responsibility and authority for the financing, construction and operation of the Wells Project;

Now, Therefore, for and in Consideration of the Mutual Covenants and Agreements Herein Contained, it is Agreed by and Between the Parties Hereto as Follows:

Section 1. Term of Contract. This contract shall be in full force and effect until midnight of August 31, 2018, or until the 1963 Bonds and Completion Bonds as defined in the First Bond Resolution are paid or provision is made for the retirement thereof, whichever is later.

Section 2. Definitions and Explanations of Terms (as Used Herein).

(a) "Contract Year" is a term used herein to define fiscal periods under this contract and shall mean a twelve-month period commencing at 12:01 A.M., on September 1 of each year, except, however, that the first Contract Year hereunder shall commence on January 1, 1969 or the Commencement of Normal Routine Operation, whichever is later, and shall end at 12:01 A.M. on the following September 1.

(b) "License" shall mean the Federal Power Commission License for Project No. 2149 (Wells Project), issued July 12, 1962, as from time to time amended.

(c) "Wells Project" shall mean the "Project" as such term is defined in Section 1.1.E of the First Bond Resolution and shall include, among other things, an electric generating plant and associated facilities on the Columbia River at approximately river mile 516 from the mouth of said river at the Wells site in Douglas and Chelan Counties, Washington, as authorized by the License; said generating plant to have an installed nameplate rating of approximately 494,200 kilowatts, and said generating plant and associated facilities to include, but not be limited to, an earth embankment damming the present Columbia River channel; a single concrete structure constituting a power house, spillway, switchyard and fish facilities, including the initial installation of 7 generating units with provision for a total of 10 generating units, and 11 spillway openings; another earth embankment extending from the central concrete structure to an abutment on the west side of the Columbia River; a reservoir, waterways, fish ladders and other fish protective devices; associated transmission, transformation and switching facilities including two 230 kv transmission lines to or in the vicinity of the Rocky Reach switchyard in Douglas County; railroad siding, shops, warehouses, construction camp, offices, and dwellings; and all other structures, fixtures, equipment or facilities used or useful in the construction, maintenance and operation of the Wells Hydroelectric Project; and all necessary water rights, development rights, permits and licenses, easements, rights-of-way, flowage rights and rights permitting the storage of water, riparian rights and shore rights.

(d) "Wells Project Output" shall mean the amount of power and energy produced by, or received for the account of the Wells Project during the term of this contract under the operating conditions which exist during said term, including periods when the Wells Project may not be operable or operating, after corrections for station and project use, depletions for encroachments, and any adjustments resulting from the requirements of the License or from orders of governmental agencies having power to make and enforce such orders.

(e) "Month" shall mean a calendar month.

(f) "Purchaser's Power Allocation" shall mean the percentage of Wells Project Output purchased and sold under this contract as set forth in Section 3 hereof and as adjusted in accordance with Section 21 hereof.

(g) "Debt Service" shall mean, with respect to any period, the aggregate of the amounts required by the Bond Resolution to be paid or accrued during said period into the special fund or funds created by the Bond Resolution for the sole purpose of paying the principal of and premium, if any, and interest on all the Revenue Bonds from time to time outstanding as the same shall become due and of retiring said Bonds prior to maturity in the manner provided in the Bond Resolution.

(h) "Uncontrollable Forces" shall mean any cause beyond the control of Douglas, and which by the exercise of due diligence Douglas is unable to prevent or overcome, including but not limited to an act of God, fire, flood, explosion, strike, sabotage, an act of the public enemy, civil or military authority, including court orders, injunctions, and orders of governmental agencies with proper jurisdiction, insurrection or riot, an act of the elements, failure of equipment, or inability to obtain or ship materials or equipment because of the effect of similar causes on suppliers or carriers.

(i) "Purchasers" shall mean the Purchaser and other companies which enter into contracts with Douglas to buy a percentage share of Wells Project Output, all as listed under the heading "Purchasers" in Exhibit "A", entitled "Distribution of Wells Project Output", attached hereto and made a part hereof.

(j) "Revenue Bonds" shall mean the bonds issued by Douglas under the First Bond Resolution for the purpose of paying the Cost of Acquisition and Construction and any bonds (including bonds referred to in Section 5(c) hereof) which, by the terms of the First Bond Resolution, are permitted to be issued payable from the revenues of the Wells Project on a parity with the bonds issued and sold pursuant to the First Bond Resolution and secured by an equal charge and lien on such revenues; except that, unless otherwise agreed to in writing by the Purchasers, Revenue Bonds shall not include bonds issued pursuant to Section 9.1.F2(d) of the First Bond Resolution or bonds issued to refund bonds so issued.

(k) "Cost of Acquisition and Construction" shall mean all costs of acquisition, construction, installation and financing of the Wells Project, heretofore or hereafter paid or accrued, including but not limited to:

(1) Working capital in the amount of One Million Five Hundred Thousand Dollars (\$1,500,000); provided, that if it shall at any time appear that the amount of working capital on hand is in excess of that which is necessary or in excess of anticipated requirements in the future, such amount may be reduced as referred to in subsection 6(g) hereof;

(2) Establishing a Reserve Account in the Bond Fund pursuant to the First Bond Resolution to the extent of one (1) year's interest on the Revenue Bonds;

(3) Establishing a Reserve and Contingency Fund in the amount of \$5,000,000 pursuant to the First Bond Resolution;

(4) Interest accruing on Revenue Bonds until Commencement of Normal Routine Operation or until January 1, 1969, whichever is later, except for such interest as is payable by the Purchasers as part of Annual Power Costs for the Interim Delivery Period; and

(5) All other items relating to payment of costs in connection with the acquisition, construction, installation and financing of the Wells Project to the extent such items constitute "Cost of Construction" as defined in Section 6.9 of the First Bond Resolution.

(l) "Uniform System of Accounts" shall mean the Uniform System of Accounts prescribed by the Federal Power Commission for Electric Utilities and Licensees in effect at the time this contract is executed.

(m) "Bond Resolution" shall mean collectively the First Bond Resolution and all other resolutions adopted by Douglas authorizing the issue of Revenue Bonds. The term "First Bond Resolution" shall mean Resolution No. 688 adopted by the District on October 4, 1963, a certified copy of which has been delivered to the Purchaser.

(n) "Initial Date of Delivery" shall mean 12:01 A.M. of the day the Wells Project is capable of delivering power and energy hereunder from one or more generating units which shall have been installed, successfully tested as required by the specifications, except for the index tests, and, in the opinion of Douglas, the one or more generating units are ready and available for normal continuous operation.

(o) "Commencement of Normal Routine Operation" shall mean 12:01 A.M. of the day the Wells Project is capable of delivering power and energy hereunder from all of the initial seven generating units which shall have been installed, successfully tested as required by the specifications, except for the index tests, and, in the opinion of Douglas, the Wells Project with such seven generating units is ready and available for normal continuous operation.

(p) "Initial Delivery Period" shall mean the period of time commencing on the Initial Date of Delivery and ending at 12:01 A.M. on January 1, 1969.

(q) "Interim Delivery Period" shall mean the period of time commencing at 12:01 A.M. on January 1, 1969 or the Initial Date of Delivery, whichever is later, and ending with the Commencement of Normal Routine Operation.

(r) "Okanogan" shall mean Public Utility District No. 1 of Okanogan County, Washington, and its successors in interest.

Section 3. Amount of Wells Project Output Sold.

(a) Douglas agrees to sell to the Purchaser and the Purchaser agrees to purchase 31.3 per cent (31.3%) of Wells Project Output during the term of this contract subject to adjustment as provided in Section 21 hereof.

(b) After the expiration of the term of this contract, the Purchaser shall have the right of first refusal to purchase that proportion of the part of the output of the Wells Project which is then, as determined by Douglas, in excess of the actual and prospective needs of Douglas for service to customers for use within the service area of Douglas, and for delivery to Okanogan for use within the service area of Okanogan under the terms of its agreement with Okanogan, which the Purchaser's Power Allocation immediately prior to such expiration shall bear to the then total power allocations of all the Purchasers. In the event this subsection 3(b), or any sentence, clause or phrase thereof shall be adjudicated by a court of last resort and of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this subsection or such part thereof so adjudicated to be invalid had not been included herein.

Section 4. Amount of Energy and Power Reserved. Douglas hereby reserves thirty-eight per cent (38%) of Wells Project Output, and shall be entitled to the power and energy thus reserved and to the rights and privileges associated therewith and subject to the same obligations, including those provided in Section 21 hereof but excepting those recited in Section 14 hereof, as it would have if Douglas were one of the Purchasers and had the same rights, privileges and obligations as the Purchasers. Douglas covenants and agrees that it will establish, maintain and collect rates or charges for power and energy and other services, facilities and commodities sold, furnished or supplied by it through any of its electric properties, which shall be fair and non-discriminatory and adequate to provide revenues sufficient to enable Douglas to pay its pro rata share of the Annual Power Costs and all other charges and obligations payable from such revenues. All moneys received by Douglas from the sale of Wells Project Output to the Purchasers, together with payments by Douglas for power and energy reserved by it from the Wells Project, and all other moneys received by Douglas from the sale of Wells Project Output, and from sources connected with the Wells Project other than from the sale of power, shall be segregated, deposited and held separate and apart from all other revenues of Douglas and shall be held in trust by Douglas for the uses and purposes specified in the Bond Resolution.

Section 5. Annual Power Costs.

(a) "Annual Power Costs", as used in this contract, shall be deemed to mean all costs and expenses of Douglas in connection with the Wells Project (excluding depreciation and items properly chargeable to Cost of Acquisition and Construction), whether or not the Wells Project is inoperable or the operation thereof is interrupted, suspended, or interfered with, in whole or in part, during the term of this contract or any portion of said term, including, but not limited to, the items of cost and expense of Douglas during each Contract Year in connection with the Wells Project hereinafter mentioned in this Section 5, to wit:

(1) amounts which must be set aside by Douglas for the payment of Debt Service as required by the Bond Resolution;

(2) an amount equal to ten percent (10%) of the total Debt Service during the applicable Contract Year (being equivalent to the amount which Douglas will agree in the First Bond Resolution to pay out of the Revenue Fund therein provided for into the Reserve and Contingency Fund as provided for in the First Bond Resolution, and to be used only for the purposes therein provided);

(3) amounts which Douglas is required to pay for extraordinary operation and maintenance costs of the Wells Project, including the prevention or correction of any unusual loss or damage (including major repairs) thereto, in order to keep the Wells Project in good operating condition, and for renewals, replacements, additions, betterments and improvements to the Wells Project and extensions thereof, to the extent that such amounts exceed the amount in said Reserve and Contingency Fund available to make or provide for such payments, including any insurance proceeds payable in respect of such unusual loss or damage or of loss or damage to the property being repaired, renewed or replaced and available to make or provide for such payments; and

(4) all costs of producing and delivering power and energy from the Wells Project (including but not limited to ordinary operation and maintenance costs but excluding depreciation) not accounted for by the payments out of funds and reserves specified in the foregoing clauses of this Section 5(a) and properly chargeable to the Wells Project in accordance with the Uniform System of Accounts.

(b) Notwithstanding the provisions of the foregoing subsection 5(a), the term "Annual Power Costs", as used in this contract, shall mean:

(1) for the Initial Delivery Period, all costs and expenses (not including depreciation, Debt Service and items properly chargeable to Cost of Acquisition and Construction) of Douglas in connection with the ownership, operation and maintenance of the Wells Project during the Initial Delivery Period; and

(2) for the Interim Delivery Period, (i) all costs and expenses (not including depreciation, Debt Service and items properly chargeable to Cost of Acquisition and Construction) of Douglas in connection with the ownership, operation and maintenance of the Wells Project during the Interim Delivery Period; (ii) that proportion (not exceeding 100%) of the interest and principal payments accruing during the Interim Delivery Period on all outstanding Revenue Bonds which the number of generating units installed, successfully tested as required by the specifications, except for the index tests, and made ready and available for normal continuous operation bears to the number seven (7), provided that the seventh unit shall not be deemed to be so ready until the Commencement of Normal Routine Operation. For the purpose of this clause (ii), during the Interim Delivery Period interest payments shall be deemed to have accrued on a daily basis, and principal payments shall be deemed to have accrued on a daily basis during the 12-month period prior to their due date; and the applicable proportion shall be determined from time to time as additional generating units are so installed, tested, except for the index tests, and made ready and available; and (iii) 10% of the aggregate amount payable pursuant to the foregoing clause (ii).

(c) If the amounts described in Section 5(a)(3) hereof exceed the amount in said Reserve and Contingency Fund, including the insurance proceeds referred to in Section 5(a)(3), plus One Million Dollars (\$1,000,000), Douglas agrees that it will, at the request of the Purchasers, fund the full sum by which such amounts exceed such insurance proceeds, if any, by the issuance and sale of equal lien (pari passu) bonds payable from the revenues of the Wells Project; provided that such bonds can then be legally issued and can be sold; and provided further that unless all the Purchasers otherwise agree in writing, such bonds shall mature no earlier than the expiration of the service life of the facilities financed from the proceeds of such bonds, as determined by the Consulting Engineer (acting under the First Bond Resolution) at the time of issuance.

(d) Any payment or compensation received by Douglas as a result of the taking or depletion of any portion of Wells Project Output by any state or federal government agency shall be allocated to the payment of Annual Power Costs over the term of such taking, or the remaining term of this contract if the period of taking is for the remaining term of this contract. In the event such taking or depletion is of the whole of Wells Project Output for the remaining term of this contract, any payment or compensation to Douglas received by Douglas shall be applied in the manner and to the extent required in the First Bond Resolution as though such payment was received for the sale or other disposition of the Wells Project.

(e) Should any amount remain in any of the funds established in connection with the Wells Project, including working capital and all reserves in excess of outstanding obligations against such funds at the expiration of the term of this contract, there shall be refunded to the Purchaser, as excess payment for its share of Wells Project Output theretofore purchased, a share of such remainders determined by multiplying the total thereof by the percentage of Wells Project Output to which the Purchaser is entitled immediately prior to such expiration.

Section 6. Payment for Well Project Output Sold.

(a) Not less than thirty (30) nor more than sixty (60) days prior to the estimated date of commencement of the Interim Delivery Period, and on or before one hundred twenty (120) days prior to January 1, 1969, or the estimated date of Commencement of Normal Routine Operation, whichever is later, and on or before one hundred twenty (120) days prior to the beginning of each Contract Year thereafter, Douglas shall prepare and mail to the Purchaser a pro forma statement showing:

(1) The estimated date of Commencement of Normal Routine Operation. This need not be shown after the first statement; provided, that Douglas shall keep the Purchaser advised at all times of changes in such estimated date, as well as of the actual date of Commencement of Normal Routine Operation when this occurs;

(2) A detailed estimate of the Annual Power Costs of the Wells Project for the Interim Delivery Period or for the following Contract Year, as the case may be, accompanied by a copy of the operating and capital budgets upon which such estimate is based;

(3) An amount obtained by multiplying the estimated Annual Power Costs by the Purchaser's Power Allocation. This amount (expressed in dollars) is hereinafter referred to as the "Purchaser's Estimated Cost"; and

(4) The amount of the equal monthly payments to be made by the Purchaser to pay the Purchaser's Estimated Cost during the estimated length of the Interim Delivery Period or during the following Contract Year, as the case may be. Said statement shall be in lieu of the issuance of monthly bills to the Purchaser by Douglas.

(b) In the event of extraordinary receipts or payments of unusual costs or other circumstances (including in the case of the Interim Delivery Period changes in the estimated date of Commencement of Normal Routine Operation or the dates or estimated dates when generating units are or are to be made ready for normal continuous operation) which substantially affect the Annual Power Costs during the Interim Delivery Period or any Contract Year, Douglas shall prepare and mail to the Purchaser a revised estimate of Annual Power Costs for the estimated balance of the Interim Delivery Period or the balance of such Contract Year which shall supersede the previous estimate of Annual Power Costs as a basis for the Purchaser's subsequent monthly payments.

(c) The Purchaser shall make said monthly payments as advances on account towards the payment of its share of the Annual Power Costs at the offices of Douglas at East Wenatchee, Washington,

(1) in the case of the Interim Delivery Period, not later than the last day of the month in which the Interim Delivery Period commences, and not later than the twentieth day of each month thereafter, to the month in which occurs the Commencement of Normal Routine Operation, and

(2) in the case of the first Contract Year and thereafter, not later than the last day of the month in which the Commencement of Normal Routine Operation occurs, or January 31, 1969, whichever is later, and not later than the twentieth day of each month thereafter,

whether or not the Wells Project is then operable or operating; provided that if the period which is the Interim Delivery Period or the first Contract Year commences other than on the first day of a month, the payment for the first month of such period shall be reduced to an amount equal to the Purchaser's Estimated Cost divided by the number of days in such period and multiplied by the number of days in the first month included within such period.

(d) If payment in full is not made on or before the close of business on the due date, a delayed-payment charge of two per cent (2%) of the unpaid amount due will be made. Remittances received by mail will be accepted without assessment of the two per cent (2%) delayed-payment charge if the postmark indicates the payment was mailed on or before the due date. If the due date is a Sunday or a holiday, the next following business day shall be the last day on which payment may be made or mailed without the addition of the delayed-payment charge. Except as to any portion of a monthly payment which may in good faith be disputed by the Purchaser, Douglas may, whenever any amount due remains unpaid subsequent to the thirtieth day after the due date and after giving thirty (30) days' advance notice in writing, discontinue deliveries to the Purchaser until such bill and any subsequent payments which have become due are paid. No such discontinuance shall relieve the Purchaser from any of its obligations under this contract; provided, that until the Purchaser's Power Allocation has been reallocated under the provisions of Section 21 hereof, Douglas shall use its best efforts to sell the power and energy made available by such discontinuance for the account of the Purchaser.

(e) Douglas shall pay into the Revenue Fund established by the Bond Resolution that share of the Annual Power Costs determined by multiplying the Annual Power Costs by the percentage of Wells Project Output reserved by Douglas in accordance with Section 4 hereof as it may be modified by Section 21 hereof.

(f) On or before one hundred twenty (120) days after the end of the Interim Delivery Period, Douglas will submit to the Purchaser a detailed statement of the actual Annual Power Costs for the Interim Delivery Period, based on the audit of the accounts of the Wells Project provided for in Section 12 hereof, and will compare such actual Annual Power Costs with the estimated Annual Power Costs for the Interim Delivery Period. If such actual costs exceed such estimated costs, Douglas shall bill the Purchaser for an amount equal to such excess multiplied by the Purchaser's Power Allocation for the Interim Delivery Period, and the Purchaser agrees to pay such bill promptly. If such estimated costs exceed such actual costs, Douglas shall give credit to the Purchaser for an amount equal to such excess multiplied by such Power Allocation, such credit to be given (in full until exhausted) against monthly payments commencing with the first monthly payment after the submission of such statement.

(g) On or before one hundred twenty (120) days after the end of each Contract Year, Douglas will submit to the Purchaser, based on the audit of the accounts of the Wells Project provided for in Section 12 hereof, a detailed statement of the actual Annual Power Costs for such Contract Year and a statement of the amount existing in the Revenue Fund created by the First Bond Resolution as of the close of such Contract Year. If the amount so existing in the Revenue Fund exceeds the required amount of working capital, Douglas shall give credit to the Purchaser for an amount equal to such excess multiplied by the Purchaser's Power Allocation for such Contract Year, such credit to be given (in full until exhausted) against monthly payments in the then current Contract Year; provided that, if Douglas and all the Purchasers shall agree thereto in writing, all or any part of such excess may be applied (and such credit shall be correspondingly reduced by such application) to the making of repairs, renewals, replacements, additions, betterments, improvements or extensions in connection with the Wells Project; and provided, further, that if such statement is submitted following the expiration of the term of this contract, Douglas shall thereupon make a cash refund of such amount to the Purchaser. If the required amount of working capital exceeds the amount so existing in the Revenue Fund, Douglas shall bill the Purchaser for an amount equal to such excess multiplied by such Power Allocation, and the Purchaser agrees to pay such bill promptly. As used in this subsection (g), the "required amount of working capital" shall be \$1,500,000, or such lesser amount (but not less than \$750,000) or such greater amount as may be agreed upon by Douglas and the Purchasers, and the amount existing in the Revenue Fund as of the close of any Contract Year shall be deemed to be the amount of the then excess of the current assets in the Revenue Fund over the current liabilities thereof determined in accordance with the Uniform System of Accounts; provided that such current liabilities shall not include Debt Service for the next following Contract Year.

(h) The Purchaser shall pay to Douglas for the Initial Delivery Period an amount determined by multiplying the Annual Power Costs for the Initial Delivery Period by the Purchaser's Power Allocation. For this purpose, Douglas shall prepare and mail monthly to the Purchaser a statement showing the portion of the Annual Power Costs allocable to the preceding month and the Purchaser shall pay Douglas its percentage thereof promptly. If payment of the amount so due is not made by the twentieth day after receipt of the statement by the Purchaser, a late-payment charge of two per cent (2%) of the unpaid amount due will be made. Remittances received by mail will be accepted without assessment of the two per cent (2%) delayed-payment charge if the postmark indicates the payment was mailed on or before the twentieth day after such receipt. On or before one hundred twenty (120) days after the end of the Initial Delivery Period, Douglas will submit to the Purchaser a detailed statement of the Annual Power Costs for the Initial Delivery Period, based on the audit of the accounts of the Wells Project provided for in Section 12 hereof, and will compare such Annual Power Costs with the aggregate of the monthly payments previously made by the Purchasers. If such actual costs exceed such aggregate payments, Douglas shall bill the Purchaser for an amount equal to such excess multiplied by the Purchaser's Power Allocation for the Initial Delivery Period, and the Purchaser agrees to pay such bill promptly. If such aggregate payments exceed such actual costs; Douglas shall promptly pay to the Purchaser an amount equal to such excess multiplied by such Power Allocation.

Section 7. Scheduling of Deliveries.

(a) Deliveries will be made insofar as possible as requested by the Purchaser, all as provided in this Section 7; provided, that such deliveries, together with deliveries requested by all other Purchasers (including deliveries to Douglas pursuant to its reservation under Section 4 hereof) will be possible of fulfillment under the terms of the License and will not exceed the capability of the Wells Project or subject it or its operation to undue hazard.

(b) It is the intent of the parties hereto that the power and energy purchased hereunder by the Purchaser shall be fully coordinated with other resources available to the Purchaser and with the resources of other Purchasers and that the operation of the Wells Project shall be coordinated with the operation of the Northwest Power Pool. Scheduling of generation from the Wells Project shall be as requested by the Purchaser, acting singly or as a member of a group of Purchasers, subject to the limitations set forth in this Section and in other Sections of this contract.

(c) The Purchaser, acting singly or as a member of a group of Purchasers, shall make available to Douglas at least eight (8) hours before 12:01 A.M. of each day an hourly schedule of desired total energy deliveries for that day. Such schedule shall be based upon the probable water supply to the Wells Project and the resulting probable output. Changes in the desired energy deliveries may be made at any time upon the request of the Purchaser if required by changes in estimated river flows or system requirements, and the Purchaser may request that such changes be made continuously through the use of automatic load control equipment. Deviations from schedule for Wells Project Output shall be held to a minimum by Douglas and corrected as promptly as possible on an hourly basis under conditions as nearly equivalent as possible to those obtaining when the deviations occurred.

(d) The schedules and deliveries requested by the Purchaser shall be in accordance with the following:

(1) The Purchaser shall not request the delivery of energy, or equivalent spill, at a rate in excess of an amount determined by multiplying the peaking capability of the Wells Project at the time of such request by the Purchaser's Power Allocation. The Purchaser shall request such deliveries at a rate not less than an amount determined by multiplying the total deliveries of energy, or equivalent spill, required to comply with the minimum discharge provisions of the License, by the Purchaser's Power Allocation; provided that, if the aggregate requests of all the Purchasers shall provide sufficient discharge from the Wells Project to comply with such provisions of the License, Douglas may not require the scheduling of additional delivery or spill by the Purchaser;

(2) The Purchaser shall be entitled to schedule a share of that part of Wells Project Output resulting from the inflow of the stream each hour determined by multiplying said part of Wells Project Output by the Purchaser's Power Allocation;

(3) The Purchaser shall be entitled to schedule a share of the pondage available at the Wells Project (hereinafter called the "Purchaser's Allocation of Pondage"), determined by multiplying the total pondage available by the Purchaser's Power Allocation; and

(4) The Purchaser may schedule more or less than its share of Wells Project Output determined in accordance with subsection 7(d)2 hereof by scheduling from or to a pondage account established for each Purchaser. The aggregate amount of the energy scheduled from the pondage account shall not exceed the Purchaser's Allocation of Pondage determined in accordance with subsection 7(d)3 hereof and shall subsequently require, except as all of the Purchasers shall otherwise agree, the scheduling of an equivalent amount of energy to the account for release by 7:00 A.M. on the following Monday. Scheduling by the Purchaser to its pondage account shall be only against its prior accumulated pondage draft. Refill obligations shall be reduced proportionately when inflow of the stream exceeds the hydraulic capacity of the Wells Project and will be cancelled when spill occurs.

Section 8. Points of Delivery. The power and energy to be made available to the Purchaser by Douglas hereunder shall be delivered at approximately 230 kv and at the Purchaser's request delivered at (a) the Wells Project's 230 kv bus at the point or points of connection with any non-Project transmission lines, and/or (b) any point where the 230 kv transmission facilities of the Wells Project connect with non-Project facilities in the vicinity of the Rocky Reach switchyard, and/or (c) other points of delivery as may be agreed upon from time to time by all of the Purchasers and Douglas; provided, however, that except as provided in the next succeeding paragraph of this Section, and until Douglas has had a reasonable opportunity to construct additional facilities if necessary to comply with Section 20 (f) hereof, the power and energy to be delivered to the Purchaser at all points of delivery specified in (b) above shall not exceed the capacity of the Wells Project transmission facilities between the Wells Project's 230 kv bus and all said points of delivery multiplied by the Purchaser's Power Allocation; the amount so determined to be hereafter referred to as "Purchaser's Share of Transmission

Capacity”.

Each Purchaser of a portion of Wells Project Output shall have the right, without additional charge by Douglas, to use or assign to another such Purchaser its Purchaser’s Share of Transmission Capacity to transmit Wells Project and/or non–Project power and energy. During any time transmission capacity is not used or assigned by a Purchaser entitled to the same or any transmission capacity is made available by opposed power flow such capacity shall be divided among Purchasers desiring the same in proportion to their respective power allocations.

Section 9. Voltage Control and Reactive Deliveries.

- (a) Douglas shall maintain voltage levels at the Wells Project to best coordinate with the systems of the Purchasers and the systems operated by members of the Northwest Power Pool.
- (b) Reactive kilovolt–amperes shall be made available up to the capability of the equipment of the Wells Project, consistent with the power generation and voltage level schedule for the Wells Project at the time.
- (c) The Purchaser is entitled at any time to a share of the reactive output equal to that available at the time of maximum power output from the Wells Project determined by multiplying the total reactive output by the Purchaser’s Power Allocation. The Purchaser may take additional reactive deliveries when available, or otherwise, by reducing deliveries of power from the Wells Project to the Purchaser so as to provide the additional reactive capability.

Section 10. Character and Continuity of Service.

- (a) Power and energy delivered hereunder shall be approximately 230 kv, three–phase alternating current, at approximately sixty cycles per second. Douglas may temporarily interrupt or reduce deliveries of electric energy to the Purchaser if Douglas determines that such interruption or reduction is necessary in case of emergencies, or in order to install equipment in, make repairs to, replacements, investigations and inspections of, or perform other maintenance work on the Wells Project. In order that operations of the Purchasers will not be unreasonably interrupted or interfered with, Douglas, after consulting with the Purchaser regarding any such planned interruption or reduction, giving the reason therefor and stating the probable duration thereof, will to the best of its ability schedule such interruption at a time which will cause the least interference to the operations of the Purchaser and the operations of the other Purchasers.
- (b) Except as interrupted by Uncontrollable Forces or as provided otherwise by this Section, the Purchaser’s share of Wells Project Output shall be made available in accordance with this contract at all times during the term of this contract commencing with the Initial Date of Delivery.

Section 11. Metering and Transmission Losses.

- (a) Douglas shall provide and maintain suitable meters in the generator leads of the power plant of the Wells Project to indicate and record the output of the Wells Project. Wells Project Output shall be determined from totalized readings from said meters and in accordance with the provisions of subsection 2(d) hereof. Douglas shall also arrange for suitable metering at the point of delivery specified in Section 8 hereof or at other points as agreed upon. Meters shall be read by Douglas or an agent of Douglas and records thereof shall be made available to the Purchaser as may be reasonably required.
- (b) The amounts of Wells Project Output delivered hereunder shall be determined as though they were made at the low voltage side of the power transformers of the Wells Project. All losses of power and energy from the Purchaser’s Power Allocation purchased hereunder resulting from transformation and transmission shall be borne by the Purchaser.

Section 12. Accounts.

- (a) Douglas agrees to keep accurate records and accounts of the Wells Project in accordance with the Uniform System of Accounts and in accordance with the rules and regulations prescribed by the Division of Municipal Corporations of the State Auditor’s office of the State of Washington, separate and apart from its other accounting records. Said accounts shall be the subject of an annual audit by a firm of certified public accountants, experienced in electric utility accounting and of national reputation, to be employed by Douglas. The transactions with respect to each Contract Year shall be subject to such an audit. In addition, such an audit shall be prepared to cover all transactions relating to the Interim Delivery Period, as well as a separate audit covering transactions relating to the Initial Delivery Period.
- (b) A copy of each such audit, including all recommendations of the accountants, shall be furnished by Douglas to the Purchaser promptly after the same shall have been prepared.

Section 13. Information to be Made Available to the Purchaser.

- (a) All drawings, designs, plans, specifications and terms of contracts relating to the construction and operation of the Wells Project are or will be placed on file in the office of Douglas at East Wenatchee, Washington, and will be open to inspection by the Purchaser.
- (b) All agreements and data relating to the financing of the Wells Project may be examined by the Purchaser at the office of Douglas.
- (c) All operating and financial records and reports relating to the Wells Project may be examined by the Purchaser at the office of Douglas.
- (d) Policies of insurance carried by Douglas pursuant to Section 15 hereof shall be available at the office of Douglas for inspection by the Purchaser.
- (e) The Purchaser’s representatives shall at all times be given reasonable access to the Wells Project.

Section 14. Advisory Committee—Arbitration.

- (a) In order that the Purchasers may, in an orderly way, participate in problems relating to the Wells Project, there is hereby established the Wells Advisory Committee (herein called the “Committee”). The Purchaser and each of the other Purchasers are entitled to representation on the Committee and may each appoint a representative to attend Committee meetings. A Chairman shall be elected by the members of the Committee. The Committee will meet regularly each month, or as otherwise determined by the Committee, for the purpose of discussing the problems with respect to the Wells Project and may make recommendations to Douglas with reference thereto. Special meetings shall be called by the Chairman at the request of Douglas or upon the request of any member of the Committee. All meetings will be held at the office of Douglas at East Wenatchee, Washington, or at such other place or places as may be determined by the Committee.
- (b) Copies of the operating and capital budgets referred to in subsection 6(a)(2) hereof shall be submitted to the Committee.
- (c) Except in the event of an emergency requiring immediate action, Douglas shall give to the Committee reasonable notice, in no case less than thirty (30) days, whenever it proposes to replace items of major equipment in or to construct additions, improvements or betterments to or extensions of the Wells Project, or to enter into additional new or special contractual arrangements relating to or substantially modifying the operation or Annual Power Costs of the Wells Project.

(d) Douglas will give due consideration to the recommendations of the Committee. In considering said recommendations, Douglas shall give due regard to the objective of achieving from the Wells Project the optimum electric power production consistent with economy, reliability and facility of operation and Douglas' statutory duties. Written recommendations may be made to Douglas whenever such recommendations are approved in writing by members of the Committee representing Purchasers who are purchasing forty-nine per cent (49%) or more of that part of the Wells Project Output purchased under this contract and the other contracts referred to in subsection 2(i) hereof by all Purchasers. Such written recommendations shall be forwarded to Douglas with appropriate supporting data. Douglas shall take action on such recommendations within a reasonable time by adopting, modifying or rejecting such recommendations. If Douglas modifies or rejects said recommendations it shall notify the Committee of its action in writing, giving the reasons therefor.

(e) If Douglas modifies or rejects a written recommendation of the Committee dealing with matters which may be arbitrated as set forth in subsection 14(f) hereof, and made in accordance with the procedures set forth in subsection 14(d) hereof, the Committee may, by affirmative vote of members of the Committee representing Purchasers who purchase forty-nine per cent (49%) or more of that part of Wells Project Output purchased under this contract and the other contracts referred to in subsection 2(i) hereof by all Purchasers, submit the recommendation to a board of arbitrators. The board of arbitrators shall be composed of three (3) persons, one of whom shall be appointed by Douglas, one of whom shall be appointed by majority vote of the members of the Committee, and the third person shall be appointed by the two persons so appointed. In the event said two persons cannot agree upon the appointment of a third person, then such third person shall be appointed by the Chief Justice of the Supreme Court of the State of Washington. The procedure for arbitration shall be governed by the laws of the State of Washington. Insofar as the parties hereto may legally do so, they agree to abide by the decision of said board; provided, that Douglas shall not be bound by any decision of a board of arbitrators to the extent that such decision is retroactive beyond the date when the matter arbitrated was made the subject of written recommendation of the Committee.

(f) Subject to the provisions of Section 22 hereof, the matters which may be arbitrated in accordance with subsection 14(e) hereof shall consist of all matters pertaining to the maintenance, operation, additions, betterments, extensions, improvements, replacements and renewals of the Wells Project, insurance to be carried on the Wells Project and its operation, financing and refinancing, voluntary payments in lieu of taxes or other voluntary donations made by Douglas, and any matter substantially adversely affecting Annual Power Costs, except, however, that this Section 14 shall not require Douglas to submit to arbitration any matter which Douglas cannot lawfully submit to arbitration.

(g) In the event this Section 14 or any paragraph, sentence, clause or phrase thereof shall be adjudicated by a court of last resort and of competent jurisdiction to be invalid or illegal, the remainder of this contract shall be unaffected by such adjudication, and all other provisions of this contract shall remain in full force and effect as though this Section or such part thereof so adjudicated to be invalid had not been included herein.

Section 15. Insurance. Douglas agrees to obtain and maintain in full force and effect during the term of this contract, to the extent available at reasonable cost, adequate insurance with responsible insurers with policies payable to Douglas for the benefit of Douglas and the Purchasers as their respective interests may appear, against:

- (1) Obligations of Douglas under the Workmen's Compensation Law of the State of Washington, and Employer's liability;
- (2) Public liability for bodily injury and property damage;
- (3) Physical loss or damage to the Wells Project;
- (4) Business interruption loss to Douglas and/or the Purchasers resulting from delay in completion of the Wells Project, and from interruption or reduction of generation or transmission of power and energy caused by physical loss, damage or destruction; and
- (5) Any other insurance determined to be necessary by Douglas and concurred in by the Purchasers who are purchasing sixty percent (60%) or more of that part of the Wells Project Output purchased under this contract and the other contracts referred to in subsection 2(i) hereof by all the Purchasers.

Section 16. Operation and Maintenance. Douglas covenants and agrees that it will operate and maintain the Wells Project in an efficient and economical manner, consistent with good business and operating practices of comparable non-federally owned hydroelectric projects on the Columbia River in the United States.

Section 17. Board of Consulting Engineers on Construction Problems. Douglas shall establish a Board of five, (5) Consulting Engineers during the construction of the Wells Project, which shall include two (2) engineers of outstanding ability and national reputation, selected by Douglas from a list of not less than four (4) such engineers submitted by the Committee to Douglas.

Section 18. Construction and Financing Contracts. Douglas agrees that prior to commencing construction of the Wells Project it will have completed the financing of the estimated Cost of Acquisition and Construction, shall have let the major contract for the construction thereof, and shall have obtained adequate surety bonds for the completion of said contract. Bechtel Corporation shall have prepared the plans and specifications for the Wells Project, and Messrs. Fraley and Leighton shall have prepared the plans and specifications for the office building included in the Wells Project, all of which plans and specifications shall have been subject to review by the Purchaser, and Douglas agrees that it will not (without the consent of the Purchasers who are purchasing sixty per cent (60%) or more of that part of the Wells Project Output purchased under this contract and the other contracts referred to in subsection 2(i) hereof by all the Purchasers) modify, amend or waive full compliance with, nor make any elections provided for in, the said plans and specifications, in any material respect.

Section 19. Completion of Construction. Douglas agrees to proceed diligently with the financing and construction of the Wells Project and, subject to Uncontrollable Forces, plans to complete the Wells Project by September 1, 1968.

Section 20. Additional Facilities.

(a) From time to time during the term hereof Douglas may propose to expand the Wells Project by installing additional generating facilities. Whenever Douglas proposes to so expand the Wells Project it shall give notice in writing of such intent to the Purchaser stating:

- (1) The estimated cost of such additional generating facilities;
- (2) The proposed method of financing the cost of said facilities;
- (3) The estimated additional power and energy which would be available as a result of the installation of said facilities;
- (4) The estimated incremental cost (i.e., the costs which will be incurred as a result of installing the proposed additional facilities, which costs would not be incurred were such proposed additional facilities not installed) of said additional power and energy on an annual basis; and
- (5) The estimated construction period for the installation of said facilities.

The notice shall also contain other available pertinent information.

(b) The Purchaser shall have the option of purchasing a share of said additional power and energy determined by multiplying the total additional output by the Purchaser's Power Allocation, and may exercise such option by giving written notice to Douglas on or before the expiration of ninety (90) days from the receipt of said written notice from Douglas. Douglas shall give a second notice to the Purchaser if any of the other Purchasers shall fail to exercise its option for its full share of said power and energy, and the Purchaser may, by giving written notice to Douglas within sixty (60) days after the receipt of the second notice from Douglas, have its respective share of said power and energy increased either in proportion or, as shall be mutually agreed upon, so as to make available to the Purchaser and to the other Purchasers power and energy available as a result of any of the other Purchasers failing to elect to take its full share of said additional power and energy. Douglas, in addition to its share of said additional output determined by multiplying the total amount of said additional power and energy by the percent reservation for Douglas specified in Section 4 hereof, shall be entitled to the additional power and energy which the Purchaser and other Purchasers shall not elect to take in accordance with the foregoing provision. Failure to exercise its option to purchase additional power and energy which would be available from the installation of additional generating facilities proposed by Douglas at any time shall not be construed to waive the rights of the Purchaser to a share of the additional power and energy which would be available from additional facilities proposed for installation by Douglas at a later date.

(c) If the Purchaser exercises its option to take its share of said additional power and energy, it shall pay for said additional power and energy a percentage of the incremental annual cost of said additional facilities corresponding to the percent share of additional power and energy which it purchases is of the total additional power and energy available as the result of the installation of the additional facilities. If the Purchaser does not elect to take additional power and energy which would be available from the installation of additional generating facilities it shall continue to receive the same percentage of Wells Project Output and pay the same Annual Power Costs therefor as if such additional generating facilities had not been installed.

(d) If, after the Purchaser shall have exercised its option as aforesaid, Douglas shall determine that it is not economically feasible for it to install additional generating facilities as proposed, Douglas shall be under no obligation to so do and shall so notify the Purchaser of such determination.

(e) Notwithstanding any other provisions of Section 20 hereof, whenever Douglas is compelled to install additional facilities at or in the Wells Project by any order or decision of the Federal Power Commission or any state or federal government agency with authority to issue or make and enforce such an order or decision, the Purchaser shall share the benefits and costs resulting from the installation of said additional facilities in the same manner and to the same extent as if the Purchaser had voluntarily exercised its option to purchase the power and energy resulting from the installation of additional generating facilities as provided above in Section 20 hereof.

(f) Douglas agrees that it will construct as a part of the Wells Project such transmission lines and such terminal facilities as are necessary to deliver power and energy from the Wells Project to the points of delivery specified in Section 8 of this contract and the similar contracts with the other Purchasers. The Purchaser hereby agrees that Douglas may at any time or from time to time construct as a part of the Wells Project (1) one 230/115-kv stepdown substation at the Wells Project and one 230/115-kv stepdown substation near the Rocky Reach switchyard with a combined capacity of not more than 250,000 kva, (2) one 115-kv transmission line approximately 10 miles long from the Wells Project to the vicinity of Brewster and Bridgeport, and (3) one 115-kv transmission line approximately 8 miles long from the vicinity of the Rocky Reach switchyard to the Eastmont area of Douglas County, including, in each case, necessary terminal facilities.

Section 21. Adjustment of Power Allocation. The Purchaser's Power Allocation shall be automatically increased pro rata with that of the other Purchasers, not in excess of a cumulative maximum of Twenty-Five Per Cent (25%) of its original percentage allocation specified in Exhibit "A" hereto, in the event of a Default (as hereinafter defined) by any one or more of the other Purchasers. If any of the other Purchasers defaults, and the Purchaser's Power Allocation is automatically increased in accordance with this Section, the Purchaser either individually or as a member of a group shall have a right of recovery from that one of the Purchasers in default for such amount as the Purchaser may sustain as a loss or damage by reason of such Default and may commence such suit, action or proceeding as may be necessary or appropriate to recover the amount of said loss or damage. The term "Default" as used herein shall mean the failure by any one of the Purchasers to make the payments specified in Section 6 hereof and contemporaneously with said failure to make payments there shall exist, with respect to that one of the Purchasers, any one or more of the following conditions:

(a) An order, judgment or decree shall be entered by any court of competent jurisdiction:

- (1) Appointing a receiver, trustee or liquidator for said Purchaser or the whole or any substantial part of the properties of said Purchaser;
- (2) Approving a petition filed against said Purchaser under the provision of an Act to Establish a Uniform System of Bankruptcy Throughout the United States, Approved July 1, 1898, as amended;
- (3) Granting relief to said Purchaser under an amendment to said Bankruptcy Act which shall give relief similar to that afforded by said Act; or
- (4) Assuming custody or control of the whole or any substantial part of the properties of said Purchaser under the provisions of any other law for the relief or aid of debtors;

and such order, judgment or decree shall not be vacated or set aside or stayed (or, in case custody or control is assumed by said order, such custody or control shall not otherwise be terminated) within sixty (60) days from the date of the entry of such order, judgment or decree;

(b) Said Purchaser shall:

- (1) Admit in writing its inability to pay its debts generally as they become due;
- (2) File a petition in bankruptcy;
- (3) Make an assignment for the benefit of its creditors;
- (4) Consent to the appointment of a receiver of the whole or any substantial part of its properties;
- (5) Be adjudicated a bankrupt on the basis of a petition in bankruptcy filed against it;
- (6) File a petition or an answer seeking relief under any amendment to said Bankruptcy Act which shall afford relief substantially similar to that afforded by said Act; or
- (7) Consent to the assumption by any court of competent jurisdiction under the provisions of any other law for the relief or aid of debtors of custody or control of such Purchaser or of the whole or any substantial part of its properties;

provided that if prior to an imminent Default by any Purchaser (hereinafter called the "Defaulting Purchaser"), the Defaulting Purchaser shall demonstrate, to the satisfaction of other Purchasers receiving in the aggregate at least two-thirds (T) of the Wells Project Output being purchased by Purchasers other than the Defaulting Purchaser under this contract and the other contracts referred to in subsection 2(i) hereof and to the satisfaction of Douglas, the inability of the Defaulting Purchaser to pay for its power allocation under its contract and its ability to pay for a smaller power allocation thereunder, then the Defaulting Purchaser shall be allowed thereafter to take such smaller power allocation thereunder and shall thereafter be liable thereunder for the smaller

power allocation in the same manner as for its previous power allocation thereunder; and, in such event, the automatic increase in the Purchaser's Power Allocation as above provided shall apply only to the amount of such decrease in power allocation of the Defaulting Purchaser.

Section 22. Additions, Betterments, Improvements and Extensions. Douglas may at its option make in any Contract Year additions, betterments or improvements to or extensions of the Wells Project costing in the aggregate not more than \$25,000, but may not make in such Contract Year such additions, betterments, improvements or extensions costing in the aggregate more than \$25,000 unless such excess amount shall have been approved in writing by Purchasers who are purchasing sixty per cent (60%) or more of the part of the Wells Project Output purchased under this contract and the other contracts referred to in subsection 2(i) hereof by all Purchasers. Notwithstanding the provisions of this Section 22, such approval of the Purchasers shall not be required in connection with the construction of the facilities referred to in Section 20 hereof.

Section 23. Liability of Parties. Douglas and the Purchaser each assumes full responsibility and liability for the maintenance and operation of its respective properties and shall indemnify and save harmless the other party from all liability and expense on account of any and all damages, claims or actions, including injury to or death of persons, arising from any act or accident in connection with the installation, presence, maintenance and operation of the property and equipment of the indemnifying party; provided, that any liability which is incurred by Douglas through the operation and maintenance of the Wells Project and not covered by insurance shall be paid solely from the revenues of the Wells Project, and any payments made by Douglas to satisfy such liability shall become part of the Annual Power Costs.

Section 24. Waiver of Default. Any waiver at any time by either party to this contract of its rights with respect to any default of the other party hereto, or with respect to any other matter arising in connection with such contract, shall not be considered a waiver with respect to any subsequent default, right or matter.

Section 25. Notices and Computation of Time. Any notice or demand, except those provided for in Section 7 hereof, by the Purchaser under this contract to Douglas shall be deemed properly given if mailed postage prepaid and addressed to Public Utility District No. 1 of Douglas County, Washington, at East Wenatchee, Washington; any notice or demand by Douglas to the Purchaser under this contract shall be deemed properly given if mailed postage prepaid and addressed to Puget Sound Power & Light Company, Attention Ralph M. Davis, President, P.O. Box 535, Bellevue, Washington; and computing any period of time from such notice, such period shall commence at 12:00 P.M. (midnight) on the date mailed. The designations of the name and address to which any such notice or demand is directed may be changed at any time and from time to time by either party giving notice as above provided.

Section 26. Modification of Contract Terms. It is recognized by the parties hereto that, by virtue of the Bond Resolution, this contract cannot be amended, modified or otherwise altered by agreement of the parties in any manner that will impair or adversely affect the security afforded by the provisions of this contract for the purchase and sale of a portion of Wells Project Output for the payment of the principal, interest and premium, if any, on Revenue Bonds as they respectively become payable, as long as any of the 1963 Bonds and Completion Bonds as defined in the First Bond Resolution are outstanding and unpaid or until provision is irrevocably made for the payment thereof.

Section 27. Douglas' Bond Resolution and License. It is recognized by the parties hereto that Douglas in its operation of the Wells Project and in the delivery of a portion of Wells Project Output hereunder to the Purchaser, must comply with the requirements of the Bond Resolution and with the License, and it is, therefore, accordingly agreed that this Power Sales Contract is made, and arbitration hereunder shall be, subject to the terms and provisions of the Bond Resolution and the License. Douglas shall not, without the written consent of the Purchaser, amend, modify or otherwise change the Bond Resolution if such amendment, modification or change would be to the disadvantage of the Purchaser. Except to the extent modification, amendment or change is permitted by this Section 27, said Bond Resolution shall continue to be binding upon Douglas so long as the Purchaser is purchasing power and energy during the term of this contract and irrespective of whether the Bonds have been redeemed. Douglas shall not, over the objection of the Purchaser, voluntarily accept or apply for an amendment or modification of the License.

Section 28. Conflict of Laws. The parties hereto agree that this contract shall be governed by the laws of the State of Washington.

Section 29. Assignment of Contract. This contract shall inure to the benefit of, and shall be binding upon the respective successors and assigns of the parties to this contract. No assignment or transfer of this contract shall relieve the parties hereto of any obligation incurred hereunder.

Section 30. Uniformity of Power Sales Contracts. The Purchaser is one of several Purchasers as follows:

Puget Sound Power & Light Company
Portland General Electric Company
Pacific Power & Light Company
The Washington Water Power Company

It is understood and agreed that all of said contracts for the sale and purchase of power shall be uniform in all material respects in their terms, conditions and provisions with the exception of the power allocation for each of the Purchasers. If any of said contracts are amended or replaced, then this contract shall, at the option of the Purchaser, be amended or replaced to conform to the changed or substituted contract; provided, however, that Douglas shall have the right to sell power and energy reserved by it pursuant to Section 4 hereof on such terms and conditions as it shall elect and nothing herein shall be construed to require Douglas to offer equal terms and conditions to the purchasers of such reserved power and energy.

In Witness Whereof, the parties hereto have caused this agreement to be executed by their proper officers respectively, being thereunto duly authorized, and their respective corporate seals to be hereto affixed, the day and year first above written.

Public Utility District No. 1 of
Douglas County, Washington

(Seal)

By /s/ Lloyd McLean
President

By /s/ Howard Prey
Vice President

Attest:

/s/ Ross A. Heminger
Secretary

(Seal)

Puget Sound Power & Light Company

By /s/ L. E. Karrer
Vice President

Attest:

/s/ C. B. Schoegg
Secretary

EXHIBIT "A"

Distribution of Wells Project Output

<u>Purchasers</u>	<u>Original Percentage Allocation</u>
Puget Sound Power & Light Company	31.3%
Portland General Electric Company	20.3%
Pacific Power & Light Company	6.9%
The Washington Water Power Company	3.5%
	<hr/>
	62%

CONSTRUCTION AND OWNERSHIP

AGREEMENT

INDEX

TITLE

WITNESSETH

1. Definitions
2. Ownership of Project
3. Design, Engineering and Construction Management
4. Construction
5. Construction Cost
6. Payment of Cost of Project
7. Accounting and Reports
8. Licenses and Permits
9. Insurance
10. Owners' Committee
11. Damage to or Destruction of Project: Disposition upon Abandonment
12. Liabilities
13. Defaults
14. Uncontrollable Forces
15. Waiver of Right to Partition
16. Transfer and Assignments: Secured Interests
17. Obligations Are Several
18. Successors and Assigns
19. Notices
20. Additional Documents
21. Capital Additions and Retirements
22. Construction of Additional Generating Units
23. Regulatory Approval
24. Arbitration
25. Rule Against Perpetuities or Similar Or Related Rules
26. Term

CONSTRUCTION AND OWNERSHIP

AGREEMENT

THIS AGREEMENT, made as of the 30th day of July 1971, by and between THE MONTANA POWER COMPANY, a Montana corporation, hereinafter referred to as "Montana" and PUGET SOUND POWER & LIGHT COMPANY, a Washington corporation, hereinafter referred to as "Puget".

WITNESSETH:

WHEREAS, the parties desire to establish the terms and conditions relating to their ownership, as tenants in common, and the planning, financing, acquisition, construction, operation and maintenance of the Colstrip Steam Electric Generating Project and related facilities, as hereinafter defined;

NOW, THEREFORE, for and in consideration of the mutual covenants and agreements herein stated and the performance thereof, all as hereinafter set forth, the parties hereto mutually agree as follows:

1. Definitions

- (a) "Project." Project means the coal-fired thermal generating plant, consisting of two units, each of 350 megawatt nominal rating and related facilities as described in Exhibit "A" attached hereto and the necessary real property, property rights, including access easements and appurtenances, as described in Exhibit "B" hereto, located near Colstrip, Montana.
- (b) "Project Agreements" means this Agreement together with the following agreements:
 - (i) Agreement for the Operation and Maintenance of Colstrip Steam Electric Generating Plant, hereinafter referred to as the "Operating Agreement";
 - (ii) Coal Supply Agreement, Colstrip Steam Electric Generating Project, hereinafter called the "Coal Agreement";
 - (iii) Transmission Agreement.
- (c) "Owners" shall mean Montana and Puget or their successor or assigns.
- (d) "Ownership Agreement" shall mean this Agreement.

2. Ownership of Project

Subject to the terms and conditions hereinafter set forth, ownership of the Project shall be as follows:

- (a) The Project other than coal shall be owned by the parties hereto as tenants in common, with each party's respective undivided interests being in the following percentages:

Montana – 50%
Puget – 50%

Such percentages are hereafter referred to as the "Ownership Percentages". Each Owner shall be entitled to schedule and take an amount of generation up to but not to exceed its Ownership Percentage of the Project's net generating capability.

- (b) All of the respective covenants and agreements set forth and contained in the Project Agreements are incorporated herein by this reference and shall bind and shall be and become the respective obligations of each Owner, its successors and assigns. It is the specific intention of this provision that, except for the parties' mutual Waiver of Right to Partition as set forth in subsection 15(b) of this Ownership Agreement, all of the covenants and conditions of all of the Project Agreements shall be personal to the parties and not covenants running with the land and shall be binding upon any party which acquires any rights, title or interest of any Owner of the Project in, to and under the Project Agreements, pursuant to subsections (b) through (e) of Section 16.

3. Design, Engineering and Construction Management

Montana has entered into a Contract for Engineering, Procurement and Construction with Bechtel Corporation, (hereinafter "Bechtel Contract") dated January 23, 1970. Puget became a party to said contract as of July 30, 1971. Unless otherwise agreed, Montana and Puget will retain on a continuous basis, the Bechtel Corporation or some other construction engineer or engineering firm of national reputation recognized for knowledge, skill and experience in the design and construction managements of electrical generating facilities until the parties mutually agree that the Project has been completed.

4. Construction

- (a) The Project shall be constructed at the lowest reasonable cost and in a prudent and skillful manner in accord both with standards prevailing in the utility industry for projects of a similar size and nature and with applicable laws and final orders or regulations of regulatory agencies having jurisdiction and substantially in accordance with the description set forth in the attached Exhibit "A". The Project shall substantially conform to designs, plans, specifications and construction schedules which have been or will be made available to the parties as such are available. It is intended that the contracts for purchase of equipment and construction of the Project shall be scheduled so as to provide for a date of initial test and operation of the Project, presently scheduled for May 1, 1975, for the first unit and May 1, 1976, for the second unit and for the commercial operation of the first unit of the Project not later than July 1, 1975, and for the completion and commercial operation of the second unit of the Project not later than July 1, 1976.
- (b) Any agreements, purchase contracts and orders entered into by Montana in its own name providing for the purchase of materials, equipment and services for the Project are hereby dedicated to the Project and ratified by Puget. Montana, with reasonable expedition as agent for itself and Puget, shall enter into additional contracts for such purposes as well as contracts for the construction of the Project; Montana will continue as agent for itself and Puget to incur obligations and make expenditures relating to the engineering and other services necessary for continued Project planning and engineering.
- (c) With the assistance of Puget, Montana on its own behalf as to its own interest and as agent for Puget shall supervise and perform engineering and other services in connection with the engineering and construction of the Project. Montana shall consult with Puget prior to making major decisions involving the design and other engineering, purchasing, subcontracting and construction of the Project.
- (d) As soon as practical after the execution of this Agreement, Montana shall submit to Puget an estimate of total cost and a schedule setting forth the estimated costs of constructing and completing the Project separately by months. Montana shall thereafter submit quarterly revisions of

such schedule to Puget, together with a summary report of the Construction Costs accumulated to date and other pertinent data including, when requested, copies of construction contracts, purchase orders and other agreements relating to construction progress.

(e) Montana will maintain, or cause to be maintained separately, appropriate documentation and records of all Project expenditures and charges made and incurred by Montana, together with all other charges, payments and any expenses or receipts relating to Project construction. Such records of Montana shall be made available for inspection by Puget at all reasonable times.

(f) Puget authorizes and directs Montana to schedule deliveries of appropriate quantities of coal and other fuel to permit testing of the first and second units of the Project as each said unit becomes ready therefor. Montana shall appropriately record coal and other fuel used for such purposes and furnish a copy of such record to Puget. Montana will schedule generation from testing to the Owners according to their respective Ownership Percentages.

(g) Surplus commodities, materials, equipment and the other personal property resulting from construction of the Project shall be disposed of in accordance with Section XVI(b) of the Operating Agreement.

5. Construction Cost

Construction Cost of the Project shall consist of payments made and obligations incurred by either party in connection with the construction, installation and acquisition of the Project, other than interest during construction, for:

(a) All costs of preliminary investigation in the Colstrip–Nichols area, land and land acquisition, water development, development labor and other costs, design, engineering, contractors' fees, construction labor, materials and supplies, operator and other personnel training, testing, preparation of Operation and Maintenance Manuals, and all other costs properly allocable to Construction Costs. Any net receipts relating to construction shall be credited against Construction Costs;

(b) All costs of insurance obtained pursuant to paragraph 9 hereof, and applicable to the period of construction;

(c) All costs relating to injuries and damage claims which may be payable and paid arising out of the construction of the Project less proceeds of insurance maintained under paragraph 9 hereof or under the Bechtel Contract;

(d) All federal, state or local taxes imposed upon the Project during the construction period but excluding state and federal net income taxes levied upon income derived by the Owners during said period;

(e) The cost of all services performed and materials furnished by Montana and Puget directly applicable to Project construction including:

(i) Payroll of employees, including principal department heads and officers based upon an actual time or other agreeable basis, including all normal and usual related employee benefit costs such as Social Security taxes, unemployment insurance expense, group life insurance, group hospitalization and medical insurance, pension funding expense, workmen's compensation, long-term disability and other insurance, vacations, holidays, sick leave, etc.;

(ii) Materials and supplies, including related purchasing and handling costs;

(iii) Travel expenses, including use of Owners' transportation equipment;

(iv) Construction power costs;

(v) Other miscellaneous costs.

(f) No administration and general expenses will be allocated to the Project during construction as all applicable overhead costs will be included with the direct costs charged to the Project under subsection (e) above.

6. Payment of Cost of Project

(a) Montana and Puget shall share Construction Costs according to their respective Ownership Percentages. Notwithstanding completion of the Project, each Owner shall remain liable for any claims arising out of the construction of the Project and shall be entitled to any refunds, repayments, settlements or other credits with such claims and credits divided according to their respective Ownership Percentage share.

(b) Montana shall submit to Puget a detailed accounting of all Construction Costs and receipts through June 30, 1972 and Puget shall submit such an accounting to Montana. Within fifteen (15) days after receipt of Montana's accounting, Puget shall make an initial advance to Montana equal to one-half (1/2) of the difference between Montana's statement and Puget's statement, subject to later verification and acceptance of said accountings. Montana's accounting shall include such carrying costs as are mutually agreed by the Owners.

(c) From and after the date hereof, not later than the 20th day of each month, Montana will notify Puget of the estimated sums required for disbursements on account of the construction of the Project during the succeeding calendar month.

(d) Montana will continue to process and pay Construction Costs on the Project in its usual manner. Montana and Puget will establish a system of advances mutually agreeable to both parties to provide Montana with funds to cover Puget's share of Project's cost.

7. Accounting and Reports

(a) Montana shall at all times maintain and appropriately preserve separate books of account containing detailed entries of all items of cost and receipts applicable to the construction of the Project. Accounting for all of such costs shall be in accordance with customary practices in the electric utility industry and the basic records and documents shall be made available to Puget for inspection at all reasonable times. Montana shall furnish to Puget upon request, photocopies of all construction contracts and purchase orders and of all accounting entries and vouchers in such detail as may be necessary in order that each Owner may properly record its percentage of the Construction Cost of the Project on such Owner's own books and records.

(b) Montana shall furnish to Puget monthly Construction Costs and progress reports and such other reports as may from time to time reasonably be requested by Puget. At the request of Puget, Montana shall provide certificates signed by a responsible officer of Montana or an individual designated by him for such signature setting forth the status of Project Construction costs and application of funds. The certificate shall be in such form and contain such information as is reasonably requested by Puget.

(c) Montana's books and records relating to Project Construction Costs shall be open to inspection by Puget or any independent auditors nominated by them. Either party may request an independent audit of such Project costs at any time during construction and at the completion thereof, the cost of which shall be a Construction Cost. The records shall also be made available on written request by any of the companies to independent auditors and representatives of any regulatory body or taxing authority having jurisdiction for inspection, copying, audit or other proper business requirements.

8. Licenses and Permits

Upon the expiration of any licenses or permits required for the ownership, construction, maintenance, or operation of the Project or in the event new such licenses or permits shall be required, the Owners as tenants in common agree to file timely applications for the same as may be necessary or appropriate, such licenses or permits to be held as tenants in common in accord with each parties' respective Ownership Percentage.

9. Insurance

(a) The Owners shall procure at the earliest practicable time and thereafter maintain in effect at all times hereinafter provided, to the extent available at reasonable cost and in accord with standards prevailing in the utility industry for projects of similar size and nature, adequate insurance coverage of the Project with responsible insurers, with each Owner as a named assured and with losses payable to the respective Owners for their benefit as their respective interests may appear, to protect and insure against: Workmen's Compensation and Employer's Liability, public liability for bodily injury and property damage, all risks of physical damage to property or equipment, including transportation and installation perils, and such other insurance as the Owners deem necessary, with reasonable limits and subject to appropriate exclusions and deductibles. Self insurance under the State of Montana's Workmen's Compensation laws may be substituted for the referenced Workmen's Compensation and Employee's Liability insurance and the Owners agree to cooperate to establish a procedure whereby the cost of such self insurance shall be levelized over a three to five year period.

(b) The premium costs for insurance coverages until the completion of construction shall be a Construction Cost of the Project, and shall thereafter be an operating expense and shall be borne by the Owners in their respective percentage interests.

(c) To the extent permitted by its insurance policies, each Owner waives any rights of subrogation against the other Owner, its agents and employees, for losses, costs, damages or expenses arising out of the construction, operation, maintenance, reconstruction or repair of the Project.

10. Owners' Committee

(a) As a means of securing effective cooperation, interchange of information and management of the property owned as tenants in common, on a prompt and orderly basis in connection with various administrative and technical problems which may arise from time to time under the terms and conditions of the Project Agreements, the Owners hereby establish an Owner's Committee.

(b) Each Owner shall notify the other Owner promptly of the designation of its representative on the Owners' Committee and of any subsequent change in its designation. Either of the Owners may, by written notice to the other Owner, designate an alternate or substitute to act as its representative, to act on the Committee in the absence of the regular member of the Committee, or to act on specified occasions or with respect to specified matters.

(c) The Owners' Committee shall have no authority to modify any of the provisions of this Agreement.

(d) The Owners' Committee shall meet at such times and places as agreed upon by the members or when requested by either Owner upon 10 days' notice in writing.

(e) Each Owner shall have the right through its officers, employees or agents to inspect the Project and Project records at any reasonable time and to require that the Project be constructed in accordance with the standards provided in paragraph 4.

11. Damage to or Destruction of Project: Disposition upon Abandonment

(a) If all or substantially all of the project be destroyed or damaged beyond repair or damaged to the extent that the cost of repair substantially exceeds the proceeds of insurance available for reconstruction or repair and the Owners do not agree to reconstruct or repair the Project, or if for any reason the Owners determine to abandon the Project, the salvageable portion of the Project and the plant site shall be disposed of in accordance with a procedure agreed upon by the Owners; the proceeds from such disposition shall be distributed to the Owners in accordance with their respective percentages; any demolition, removal and cleanup costs shall be charged against and borne by the Owners in accordance with their respective percentages; provided, however, that if either of the Owners of the Project elect to reconstruct the Project, the value of the Project shall be appraised by independent appraisers and an amount of money equal to such value multiplied by the percentage of such Owner not so electing shall be paid by the Owner so electing; such Owner so receiving payment shall convey its interest in the Project to the Owner so electing to reconstruct.

(b) In the event that less than substantially all of the Project shall be destroyed or damaged, and the cost of repair, restoration or reconstruction does not substantially exceed the proceeds of applicable insurance, unless otherwise agreed by Owners the Project shall be repaired, restored, or reconstructed by the Owners in such manner as to restore the Project to substantially the same general character and use as the original project.

12. Liabilities

(a) Each of the Owners releases the other Owner, its agents and employees, for any consequential losses or damages arising out of the construction, operation, maintenance, reconstruction and repair of the Project, including but not limited to loss of use and loss of profit.

(b) Any loss, cost, liability, damage and expense to the Owners or any Owner, other than damages to Owners resulting from loss of use and occupancy of the Project or any part thereof, resulting from the construction, operation, maintenance, reconstruction or repair of the Project and based upon injury to or death of persons or damage to or loss of property including the Project and other property of Owners or other parties, to the extent not covered by collectible insurance, shall be charged to Project Construction Costs or Project Operating Expenses, whichever may be appropriate.

13. Defaults

(a) Each Owner hereby agrees that it will make all payments and perform all other obligations by it to be made or performed pursuant to all of the terms, covenants and conditions contained in the several Project Agreements and that a default of any of the terms, covenants and conditions contained in any of the Project Agreements shall be an act of default under this Agreement.

(b) In the event either Owner shall dispute an asserted default by it, then such Owner shall make payment of any sums in dispute or perform the obligation in dispute but may do so under protest. Such protest shall be in writing and shall specify the reasons upon which the protest is based by copies thereof being mailed to the other Owner. Upon resolution of such dispute, then the payments advanced or made between Owners, as in this paragraph provided, shall be adjusted appropriately.

14. Uncontrollable Forces

No Owner shall be considered to be in default in the performance of any of the obligations hereunder; other than obligations of either Owner to pay costs and expenses, if failure of performance shall be due to uncontrollable forces. The term "uncontrollable forces" shall mean any cause beyond the control of the Owner affected and which, by the exercise of reasonable diligence, the party is unable to overcome, and shall include but not be limited to an act of God, fire, flood, explosion, strikes, labor disputes, labor or material shortages, sabotage, an act of the public enemy, civil or military authority, including court orders, injunctions, and orders of government agencies with proper jurisdiction prohibiting acts necessary to performance hereunder or permitting any such act only subject to unreasonable conditions, insurrection or riot, an act of the elements, failure of equipment, or inability to obtain or

ship materials or equipment because of the effect of similar causes on suppliers or carriers. Nothing contained herein shall be construed so as to require an Owner to settle any strike or labor dispute in which it may be involved. Any party rendered unable to fulfill any obligation by reason of uncontrollable forces shall exercise due diligence to remove such inability with all reasonable dispatch.

15. Waiver of Right to Partition

(a) The Owners and each of them shall accept title to the Project, as tenants in common, and agree that their interests therein shall be held in such tenancy in common.

(b) So long as the Project or any part thereof as originally constructed, reconstructed or added to is used or useful for the generation of electric power and energy, or to the end of the period permitted by applicable law, whichever first occurs, the Owners waive the right to partition whether by partition in kind or sale and division of the proceeds thereof, and agree that they will not resort to any action at law or in equity to partition and further waive the benefit of all laws that may now or hereafter authorize such partition of the properties comprising the Project. It is agreed this covenant shall be deemed to run with the land.

16. Transfer and Assignments: Secured Interests

The undivided interest of either Owner in the Project, and all or any part thereof, and in the Project Agreements, may be transferred and assigned as follows but not otherwise:

(a) To any mortgagee, trustee, or secured party, as security for bonds or other indebtedness of such Owner, present or future; and such mortgagee, trustee or secured party may realize upon such security in foreclosure or other suitable proceedings, and succeed to all right, title and interests of such Owner;

(b) To any investor-owned corporation or entity in the utility business into which or with which the Owner making the transfer may be merged or consolidated;

(c) To any corporation or entity the stock or ownership of which is wholly owned by the Owner making the transfer;

(d) To any other person; provided that the Owner shall first offer to transfer its interest or any part thereof to the other Owner, at the amount of, and on terms not less advantageous than, those of a bona fide offer from a buyer able and willing to purchase such Owner's interest. The offer shall remain open for the period specified by the Owner but not less than six (6) months;

(e) To any other person where the Owners consent to such transfer in advance in writing.

No transfer or assignment of any interest in the Project or any Project Agreement pursuant to subparagraphs (b) through (e) above may be made unless simultaneously the Owner's interest or part thereof in all other Project Agreements is similarly transferred or assigned to the same person or persons, and such person or persons have assumed in writing all the duties and obligations of the Owner transferring or assigning under this Agreement and under all other Project Agreements. Transfers or assignments shall not relieve an Owner of any obligation hereunder, except to the extent agreed in writing by all other Owners.

17. Obligations are Several

The duties, obligations and liabilities of Montana and Puget hereunder are intended to be several and not joint or collective and neither shall be jointly or severally liable for the acts, omission, or obligations of the other. Nothing herein contained shall be construed to create an association, joint venture, partnership, or impose a partnership duty, obligation or liability, between Montana and Puget. Neither party shall have a right or power to bind the other party without its express written consent, except as expressly provided in this Agreement. This Agreement shall be construed in accordance with the laws of the State of Montana.

18. Successors and Assigns

Subject to the restrictions on transfer and assignment herein provided, all of the respective covenants and obligations of each of the Owners shall be and become the respective obligations of the successors and assigns of each such Owner. It is the specific intention of this provision that all such covenants and obligations shall be binding upon any party which acquires any of the right, title or interest of either of the Owners in the Project pursuant to subsections (b) through (e) of Section 16.

19. Notices

Any notice, demand or request provided for in this Agreement served, given or made in connection therewith shall be deemed properly served, given or made if given in person or sent by registered or certified mail, postage prepaid, addressed to the party or parties at its or their principal place or places of business to the attention of the president or chief executive officer of Montana or Puget. Either party may at any time, and from time to time, change its designation of the person to whom notice shall be given by giving notice to the other party as hereinabove provided.

20. Additional Documents

Each Owner, upon request by the other Owner, shall make, execute and deliver any and all documents reasonably required to implement the terms of this Agreement.

21. Capital Additions and Retirements

Capital improvements, betterments, replacements and additions shall be made and accounted for as provided in Article XII of the Operating Agreement. Capital retirements shall be made as mutually agreed by the Owners.

22. Construction of Additional Generating Units and Provisions For Additional Facilities

(a) Each Owner shall have the right to install and operate on the Project land such facilities as are reasonably required to enable it to deliver to its own system the power to which it is entitled under the Project Agreements, and to establish interconnections between its system and that of the other Owner; provided, however, that the facilities of either Owner shall be so installed and operated as not to burden or unreasonably interfere with those of the other Owner or the Project, the construction on the Project land of generating units in addition to the first two units, or the ultimate full utilization of the land. In the event that an Owner proposes to install or operate facilities which would require the relocation of previously installed facilities of the other Owner, or of the Project, but would otherwise meet the requirements of the preceding sentence, the Owner desiring to install or operate such facilities shall have the right to call for such relocation if it bears the cost thereof.

(b) Montana either individually or jointly with other parties shall have the right to construct and operate on Project real property (subject to the provisions of subparagraph (c) giving Puget a right to participate therein) additional generating units and necessary appurtenances thereto; provided, however, that no unit with a planned net capability less than 180 MW shall be so constructed and operated without the consent of Puget and that any

additional generating units and related appurtenances shall be so installed and operated as not to burden or unreasonably interfere with the facilities of Puget, the Project, or the ultimate full utilization of the Project Site for electric power generation. In the event Montana individually or jointly with any other party decides to construct and operate an additional generating unit or units and appurtenances which would require the relocation of previously installed facilities of Puget or the Project, it shall have the right to call for or accomplish such relocation, as the case may be, if it bears the cost thereof. In connection with any such additional units Montana individually or jointly with other parties shall have the right to use any facilities installed as part of the Project and to modify such facilities for use in connection with the installation or operation of such additional generating units and appurtenances; provided, however, that such use of Project facilities shall not burden or unreasonably interfere with the Project, that the cost of any modification shall be borne by Montana, and that Montana shall pay to the Project Owners a reasonable monthly facilities' charge based on the portion of the Project facilities devoted to the use of the additional units as compared to the portion devoted to the generating units of the Project, which charge shall take into account such costs as capital and other carrying charges, depreciation, O & M, taxes, insurance and return on investment.

(c) To the extent Montana individually or jointly with any other party decides to construct and operate additional steam electric generating units at the Project Site, Puget shall have the right to participate in the ownership of such units to the extent it elects, but not to exceed fifty percent (50%) of the total ownership of each unit, under terms and conditions substantially similar to these Project Agreements taking into account intervening changes in construction, ownership and operating costs and conditions. Such right shall be exercised with respect to each individual additional generating unit at the time that Montana makes a firm decision to construct said additional unit and may not be cumulated for application against later generating units.

(d) In the event any or all of the next 1400 MW of such additional generation, not including generation from units agreed to be constructed under the Project Agreements, is not constructed on the Project Site but is constructed elsewhere in Montana by Montana using Colstrip coal, Puget shall have the right to participate in the ownership of such plants to the extent it elects but not to exceed fifty percent (50%) of the total ownership of each unit under terms and conditions substantially similar to these Project Agreements taking into account intervening changes in construction, ownership and operating costs and conditions. Such right to participate in off-site generation shall not extend, however to generating facilities owned in whole or in part by Montana constructed to serve a specific industrial load, generation developed or utilized as a by-product of an industrial process, generation undertaken jointly with another Montana utility, or generation undertaken jointly with a public or quasi public agency and any such generation in which Puget does not have a right to participate shall not reduce Puget's entitlement to participate in the aforementioned 1400 MW of additional generation; provided, however, that to the extent Puget has a right to participate in future generation under this subsection (d) it must exercise such right with respect to each individual additional generating unit at the time that Montana makes a firm decision to construct said additional unit and such right to participate may not be cumulated for application against later generating units.

(e) After Montana has offered to Puget the opportunity to participate in 1400 MW of additional generation under paragraphs (c) or (d) above, Puget shall have the right to participate in the ownership of any steam electric generation undertaken by Montana which uses Colstrip area coal to the extent it elects but not to exceed twenty-five percent (25%) of the total ownership in any such generation plant. Puget's right to participate shall be upon a right of first refusal basis whereby Montana will offer such right to Puget at the time that Montana makes a firm decision to construct an additional unit upon terms and conditions not less favorable to Puget than would be offered to any other bona fide proposed participant. Such right shall not extend, however, to generating facilities owned in whole or part by Montana constructed to serve a specific industrial load, generation developed as a by-product of an industrial process, generation undertaken jointly with another Montana utility, generation undertaken jointly with a public or quasi public agency or to generating facilities owned and operated solely by Montana.

(f) All of the rights of Puget described in paragraphs (d) and (e) above shall be subject to the following limitations:

(1) Such rights to participate shall terminate to the extent not previously exercised on June 1, 1992;

(2) If Puget elects to participate pursuant to subsections (c), (d), or (e) above, it will so advise Montana in writing within ninety (90) days of the receipt by it of written notice from Montana that it has made a firm decision. Prior to sending such notice, Montana shall make available to Puget any relevant information it has concerning the proposed plant;

(3) Such rights are not assignable by Puget to any other entity without the consent of Montana except to a corporation whose stock or other ownership is wholly owned by Puget or except to a successor corporation to Puget resulting from a corporate reorganization in which there is no substantial change in beneficial ownership;

(4) Such rights to the extent not previously exercised, may be withdrawn by Montana with respect to a proposed plant upon a sufficient showing of unsound financial or other adverse operating condition of Puget which has or may have a significant material bearing upon Puget's ability to perform its obligations and discharge its liabilities under agreements reasonably necessary to construct, own and operate such additional generating units;

(5) Montana, unless otherwise mutually agreed, shall be the Operator of any steam electric generating plants constructed under the terms of this Section 22; and

(6) Nothing contained in this Section 22 shall be construed to constitute a dedication of coal reserves owned by Western Energy Company, a subsidiary of Montana, nor an agreement to dedicate such reserves.

(g) (1) "Colstrip Area Coal" or "Colstrip Coal" as used in this Section 22 means those coal reserves now or hereafter owned or controlled by Western Energy Company, a Montana corporation, within the sections shown on Exhibit "C" attached;

(2) "Project Site" as used herein shall include the real property, property rights, easements and appurtenances described in Exhibit B.

23. Regulatory Approval

It is understood that transfers of property under this Agreement to another party hereto may be subject to the jurisdiction of state or federal regulatory agencies and this Agreement shall not be effective as to such transfers until approved by all regulatory authorities having jurisdiction.

24. Arbitration

Any controversies arising out of or relating to any of the Project Agreements other than the "Coal Agreement" including any failure of the Owners to agree with respect to any matter requiring Owners' agreements hereunder, which cannot be resolved through negotiations between the parties hereto within thirty (30) days after inception of the matter in dispute, shall be submitted to an Arbitrator, competent and experienced in electric utility industry accounting and operations. If the parties cannot mutually agree upon such Arbitrator, then upon petition of either party, such Arbitrator shall be appointed by the senior United States District Judge for the District of Montana. The arbitration shall be conducted under the rules of the American Arbitration Association. The Arbitrator shall render his decision in writing not later than thirty (30) days after the matter has been submitted to him, and such decision shall be conclusive and binding upon the parties. The costs incurred by any arbitration proceedings shall be borne equally by the Owners.

25. Rule Against Perpetuities Or Similar Or Related Rules

If the duration of any term or condition of the Project Agreements shall be subject to the rule against perpetuities or a similar or related rule then the effectiveness of such term or condition shall not extend beyond (i) the maximum period of time permitted under such rule, or (ii) the specific applicable

period of time expressed in this Agreement, whichever is shorter. For purposes of applying the rule against perpetuities or a similar or related rule the measuring lives in being shall be those of the officers of Montana listed by name on page 104, Schedule of Officers, of the annual report, FPC Form 1, filed by Montana with the Federal Power Commission for the year ended on December 31, 1971, and the officers of Puget listed by name on page 104, Schedule of Officers, of the annual report, FPC Form 1, filed by Puget with the Federal Power Commission for the year ended on December 31, 1971, together with all those officers' children that are living on the date of execution of the Project Agreements. As used in this paragraph the word "children" shall have its primary and generally accepted meaning of descendants of the first degree.

26. Term

This Agreement shall continue for so long as the Project or any part thereof as originally constructed, reconstructed or added to is used or useful for the generation of electric power and energy, or to the end of the period permitted by applicable laws, whichever first occurs.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in several counterparts.

PUGET SOUND POWER & LIGHT COMPANY

By /s/ Ralph M. Davis President

ATTEST:

/s/ W. Watson Secretary

THE MONTANA POWER COMPANY

By [Signature Illegible] President

ATTEST:

/s/ John C. Hauck Secretary

STATE OF WASHINGTON)
COUNTY OF KING) ss

On this 1st day of Sept, 1972, before me, the undersigned, a Notary Public in and for the State of Washington, personally appeared Ralph M Davis, known to me to be president of PUGET SOUND POWER & LIGHT COMPANY and acknowledged to me that he executed the within instrument on behalf of that corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Notarial Seal the day and year in this certificate first above written.

[Signature Illegible]
Notary Public for the State of Washington
Residing at Bellevue
My Commission expires: 5/3/73

STATE OF MONTANA)
COUNTY OF SILVER BOW) ss

On this 11th day of September, 1972, before me, the undersigned, a Notary Public in and for the State of Montana, personally appeared Geo. W. O'Connor, known to me to be the President of THE MONTANA POWER COMPANY and acknowledged to me that he executed the within instrument on behalf of that corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Notarial Seal the day and year in this certificate first above written.

[Signature Illegible]
Notary Public for the State of Montana
Residing at Butte, Montana
My Commission expires: July 17, 1974

EXHIBIT A

Construction and Ownership Agreement

Colstrip Units #1 and #2

DESCRIPTION OF PROJECT

The Project, located in Rosebud County, Montana, a coal-fired electric power plant, will consist of two 350 MW nominally rated units, each with a turbine-generator, coal-fired steam generator, condenser, pumps, motors, feedwater heaters, cooling tower, pollution control system, and main and auxiliary power systems; and facilities common to the two units, such as coal receiving and coal storage systems, water treating systems, water pipeline, intake and pumping system from the Yellowstone River, water storage facilities, ash handling and disposal systems, waste water disposal systems, roads, utility systems and other site development, offices, warehouses and machine shops, laboratory and all other appurtenances and structures required for the efficient and reliable operation of a modern steam-electric power plant up to and including the high voltage terminals of the main power transformers. The Project shall include trucks, automobiles, mobile equipment, machine shop equipment, laboratory equipment, spare parts and other miscellaneous personal property required for the efficient and reliable operation of a modern steam-electric power plant. The Project shall also include the Project lands described in Exhibit B, together with appurtenances, but excluding The Montana Power Company substation site shown thereon. The easements or other real property rights for the pipeline, intake and pumping station from the Yellowstone River shall be part of the Project and shall be described in a supplement to Exhibit B at the time acquired. Any necessary related facilities located off the Project lands described in Exhibit B, together with related real property rights, to the extent mutually agreed upon shall be a part of the Project and shall be described in a supplement to Exhibit B at the time acquired.

AGREEMENT FOR THE OPERATION AND MAINTENANCE OF
COLSTRIP STEAM ELECTRIC GENERATING PLANT

Index

I.	Term
II.	Definitions
III.	Operation – General
IV.	Operation – Employees
V.	Operation – Safety
VI.	Operation – Coal Fuel
	(a) General
	(b) Standby Coal Storage
	(c) Allocation of Coal Costs
VII.	Operations –Scheduling of Power & Energy
VIII.	Operation – Records
IX.	Operation – Water
X.	Maintenance – General
XI.	Scheduling of Outages
XII.	Working Capital Operating Funds and Capital Improvements Funds
XIII.	Maintenance – Spare Parts
XIV.	Operating and Maintenance Expenses and Accounting
XV.	Annual Review of O & M Costs
XVI.	Disposal of Waste or Surplus Commodities Materials, Equipment & Other Personal Property
XVII.	Uncontrollable Forces
XVIII.	Applicable Laws and Regulations
XIX.	Obligations are Several
XX.	Notices
XXI.	Execution
XXII.	Assignment

AGREEMENT FOR THE OPERATION AND MAINTENANCE OF
COLSTRIP STEAM ELECTRIC GENERATING PLANT
ROSEBUD COUNTY, MONTANA

THIS AGREEMENT made as of the 30th day of July, 1971, by and between THE MONTANA POWER COMPANY, a Montana corporation, hereinafter referred to as "Montana," and PUGET SOUND POWER & LIGHT COMPANY, a Washington corporation, hereinafter referred to as "Puget".

I. Term

This Agreement shall be effective and binding when executed and shall run concurrently with the Ownership Agreement and shall have the same term as that set forth in Section 26 of the Ownership Agreement.

II. Definitions

Wherever used in this Agreement:

"Owners", "Ownership Agreement", "Project" and "Project Agreements" shall be as defined in Section 1 of the Construction and Ownership Agreement executed concurrently herewith.

"Coal Supplier" shall mean WESTERN ENERGY COMPANY or its authorized representative or successor under the Coal Agreement which is defined in the Ownership Agreement.

"Ownership Percentage" shall be as defined in Section 2 of said Ownership Agreement.

III. Operation – General

(a) The Owners hereby appoint Montana (hereinafter "Operator") as the Operator of the Project on behalf of and for the account of all Owners. Except as otherwise herein provided Operator on behalf of the Owners shall operate and maintain the Project, hire all Project personnel, pay all operating, and maintenance expenses including labor payroll, flame stabilization fuel, water, materials and supplies, excepting coal fuel.

(b) Montana accepts appointment as Operator and agrees that it will operate and maintain the Project at the lowest reasonable cost and in a prudent and skillful manner in accord both with the standards prevailing in the utility industry for projects of a similar size and nature and with applicable laws and final orders or regulations of regulatory or other agencies having jurisdiction. It is recognized that the Operator must have the latitude necessary to operate and maintain the Project in such manner. Each Owner shall have the right to require that the Project be operated and maintained as provided in this paragraph.

(c) Unless Puget gives its consent in writing, Montana shall not assign or delegate its responsibilities as Operator herein to any other firm, person, corporation or other entity except to a wholly owned subsidiary of Montana or a successor to Montana which results from a corporate reorganization in which there has been no significant change in beneficial ownership.

IV. Operation – Employees

(a) All persons employed in the operation and maintenance of the Project, other than employees of independent contractors, shall be Montana employees, except as provided in subsection (e) hereof, and shall not be considered to be employees or agents of Puget.

(b) A force of able and efficient manpower shall be the responsibility of the Operator and, as employer of the force, Operator will have the authority to hire and fire personnel as necessary. The work force will be employed in the classifications necessary to operate and maintain the Project and its associated facilities. It will be the Operator's responsibility to negotiate any contracts entered into with unions and to set such wage scales for nonunion personnel as reasonably necessary to the operation.

(c) A training program shall be instituted by Operator to assure the availability of qualified personnel for the operation and maintenance of the Project. If such training program utilizes facilities of Montana other than Project facilities, the costs of such training shall be allocated on an equitable basis to Project costs hereunder. Operator agrees to make such training program and reasonable use of Project facilities available to employees of Puget for the purpose of training and the costs of such training shall be apportioned equitably between Puget and the Project.

(d) The Operator shall pay promptly all sums due employees or due any governmental or other agency on their behalf or on account of their employment and shall not permit any labor claims to become a lien against the property of the Owners, other than claims that are being contested in good faith.

(e) Puget shall have the right to furnish one full-time employee to fill a supervisory position. By mutual agreement between Puget and Operator, Puget may supply additional employees on a full-time or temporary basis. Said employees shall remain employees of Puget and may keep Puget advised concerning matters involving operation of the Project, but, with respect to their duties at the Project, said employees shall be under the supervision of and primarily responsible to the Project superintendent. Operator shall have no authority to fire Puget employees but may require that Puget transfer any employee from the Project. The salary and related costs of Puget employees shall be part of the operating expense of the Project and shared by the Owners in the same manner as other Project costs.

V. Operation – Safety

The Operator shall develop and sponsor an adequate safety program for protection of personnel and equipment. Good housekeeping shall be practiced. In the interests of safety, but subject to the rights of the other Owners to inspect the Project as provided in the Ownership Agreement, the Operator may control access to the premises as necessary or as may be prescribed by lawful authority.

VI. Operations – Coal Fuel

(a) General

(1) Each Owner agrees to timely provide the Operator with its coal delivery schedules to be furnished to the Coal Supplier under paragraph 3 of the "Coal Agreement". Owners authorize Operator to execute and deliver appropriate purchase orders to the Coal Supplier for said amounts to be delivered. The scheduling, delivery and payment for coal consumed in generation shall be as set forth in this Agreement and in the "Coal Agreement".

(2) Subject to the foregoing and as more specifically set forth hereinafter, Operator shall assume responsibility for the timely scheduling of coal supplies necessary to meet the generating requirements of the Owners pursuant to Section VII herein and to meet the Owners' respective coal storage requirements.

(b) Standby Coal Storage

(1) Each Owner shall have the right to use the coal storage area in the same proportion as its Ownership Interest in the Project. During any time any portion of such coal storage area is not being used by an Owner entitled to such use, it may be temporarily used by the other Owner; provided: that such use shall not interfere with an Owner's ability to schedule coal into its portion of the coal storage area; that if sufficient storage is not available to accommodate the coal scheduled into storage, the Owner temporarily using such area shall make such arrangements as are necessary in order to avoid any such interference, such as exchange of coal in storage for coal scheduled into storage or transferring coal in storage to the other Owner at the current cost of coal from the coal supplier; and that if an Owner suffers an economic loss in the form of increased coal costs or penalties assessed by the coal supplier

because of the other Owner's temporary use of storage in excess of its share, the Owner suffering such loss shall be made whole by Owner causing such loss.

(2) The Owners shall cooperate in scheduling of coal from the Supplier and scheduling of coal in and out of storage in order to minimize rehandling; for example, coal of one Owner already in storage may be exchanged with the other Owner for coal that is scheduled into storage.

(3) At least annually the Operator shall survey the coal in storage and determine its amount. If the coal in storage, as determined by such survey, is greater or less than the amount shown in the records maintained by the Operator, the amount in such records for each Owner will be increased or decreased pro rata, as the case may be, based upon the average of the daily balances of coal in storage for each Owner during the period since the last survey, or by such other method as may be agreed upon by the Owners. If such adjustment results in any Owner having a negative coal balance, such Owner shall make arrangements to eliminate its negative position as soon as reasonably possible.

(4) If casualty or other forces cause a sudden or rapid loss of coal in coal storage, such loss shall be estimated or surveyed, as may be appropriate in the circumstances, and shared by the Owners' pro rata, based upon the amount of coal of each in storage immediately preceding the loss, as shown in the records.

(c) Allocation of Coal Costs

(1) Operator shall, pursuant to the procedures established by the Owners' Committee, prepare a "Distribution Notice" to be provided to the Coal Supplier pursuant to subsection 7.2 of the Coal Agreement which notice shall be in a form to be mutually agreed upon. The Owners' Committee shall prescribe a procedure for equitably allocating the amount of coal consumed to each Owner in each twenty-four (24) hour period taking into account the daily average generation of each Owner and such adjustments as may be desirable to correct any inequities which might arise out of the method of plant loading and similar considerations.

(2) Complete records shall be kept by Operator as prescribed by the Owners' Committee, including the consumption of coal, the Btu content thereof, the amounts allocated to the respective Owners, the amounts in and out of storage and the amount each Owner has in storage.

(3) Annually Operator shall compute price adjustments for Btu content of coal pursuant to Section 8 of the Coal Agreement and furnish notification thereof to each Owner and to Coal Supplier.

(4) In the event of notification by Coal Supplier of any proposed adjustments for Cost Changes under Section 9 of the Coal Agreement, Owners shall meet to examine such proposal.

(5) In the event Owners are required to make additional payments to the Coal Supplier under subsection 7.5 or 7.8 of the Coal Agreement, such costs shall be divided equitably taking into account each Owner's deficiencies or surpluses in scheduling its respective share of 1,500,000 annual tons (or, for purposes of subsection 7.8 the "adjusted minimum annual tonnage" if applicable) any savings from sales of coal to third parties, and of the facts or circumstances including force majeure reasonably affecting such costs. In the event the Owners receive any credits from the Coal Supplier such credits shall be divided equitably taking into account each Owner's purchases of coal during the time period involved and such other facts and circumstances reasonably giving rise to such credits.

VII. Operations – Scheduling of Power and Energy

(a) Each Owner shall furnish its generation schedule to the Operator in accordance with the procedures hereinafter set forth and shall be entitled to schedule and take an amount of generation up to but not to exceed its Ownership Percentage of the Project's net generating capability. The total of such schedules shall be within the limits of the capability of the Project during the period covered by such schedules. Subject to the terms, covenants, and conditions contained in the Project Agreements, the Operator will operate the Project in accordance with such generation schedules.

(b) At least eight (8) hours before 12:01 a.m. of each day, the Owners shall make available to the Operator the hourly schedules of desired energy operation for the day. Changes in such scheduled energy operations may thereafter be made at any time by an Owner.

No Owner shall schedule a rate of change of its share of output greater than such Owner's Percentage of a rate of change which is within the ability of the Project to perform; provided, however, that if one Owner schedules a rate of change of output less than its percentage of such Project ability, the other Owner may schedule a rate of change of output greater than its percentage of such Project ability, subject to meeting a total rate of change of output which is within the ability of the Project to perform.

Any Owner desiring to schedule less than its Ownership Percentage of the minimum operating capability of each unit of the Project, when it is operating, may do so provided that such Unit's or Units' total scheduled output is at or above its overall minimum operating capability.

The Owners' Committee shall, as soon as necessary information is available, set a mutually agreeable minimum normal operating capability for each unit of the Project and shall establish rules with respect to each Owner's obligation to schedule its percentage of the minimum normal operating capability of each unit of the Project.

(c) The Operator shall hold deviations from schedule to a minimum. Unless otherwise agreed among the Owners, actual generation in any hour shall be apportioned among the respective Owners in proportion to the generation schedules of the respective Owners.

(d) When the actual or anticipated net electrical generating capability of the Project during any particular hour is for any reason reduced from its anticipated capability, and such reduced capability is less than the total amount scheduled, the amount of energy available to each Owner having a schedule for such hour, except as may otherwise mutually be agreed, shall be equal to such Owner's Ownership Percentage of the plants reduced generating capability, and the schedule for each such Owner shall be appropriately reduced for such hour. The Operator shall promptly notify each Owner of any change in operating limits or operating capability of any Project unit, and the respective Owners shall thereupon make any necessary changes in their respective generation schedules to conform such schedules to any limitation thereof arising out of the operation of this subparagraph (d).

VIII. Operation – Records

The Operator shall keep adequate records of Project operations as necessary to reflect the efficiency of Project operation and maintenance programs and to record generation of power, and shall keep such other records as required by regulatory authorities. All records shall be made available for inspection by the Owners as desired.

IX. Operation – Water

The Operator will operate and maintain the water pipeline and related facilities.

X. Maintenance – General

(a) It shall be the Operator's responsibility to maintain equipment, buildings, and other facilities associated with the Project in accordance with good utility practice, manufacturer's recommendations, and applicable State and Federal regulations.

(b) The Operator will maintain a work force of mechanics, machinists, welders, electricians, and other classifications as necessary to carry out a routine preventive maintenance program.

(c) Extraordinary maintenance may require work in excess of that required on a normal basis. The Operator will contract such extraordinary work or temporarily add to the Project maintenance force or both as necessary to accomplish the work.

XI. Scheduling of Outages

(a) Scheduled outages for major maintenance shall be as required by the manufacturers' applicable conditions of sale and delivery of the affected facilities and equipment or as the manufacturer may advise from time to time, unless otherwise agreed by the Owners' Committee.

(b) All outages for maintenance shall be scheduled at such times as shall be directed to the Operator by Owners' Committee, provided, however, that any outages required for maintenance affecting the safety of the Project shall be scheduled by the Operator as required.

XII. Working Capital Operating Funds and Capital Improvement Funds

(a) The Owners shall furnish working capital as required for operation and ordinary maintenance.

(b) Prior to commencement of commercial operation of the Project, Puget, upon not less than ten (10) days' notice, will advance to Operator one-half (½) of the minimum amount deemed necessary by Owners to provide working capital adequate for continuous operation of the Project. Such amount shall be mutually determined by Owners based upon the budgeted total operating costs of the Project, excluding fuel, for a forty-five (45) day period. This amount shall be reviewed periodically by the Owners to determine its adequacy.

(c) (i) On or before September 1 of each year, the Operator shall submit to the Owners a budget of its estimate of operation and maintenance costs, and fuel costs, other than coal, by calendar months for the operating year beginning January 1 next following. Such budget shall be subject to approval by the Owners which approval shall not unreasonably be withheld; if such approval is not given by November 1 in any such year, the Owners shall agree upon a revised budget not later than December 1 of such year. Each budget shall include such items of expenditure for replacement and repair of Project facilities as are normal to projects of a similar character and shall provide an adequate contingency item for emergency repairs and replacements. The Operator will submit budget revisions as may become necessary from time to time during any operating year which Owners shall promptly consider and which shall similarly be subject to approval by Owners. The budget will control expenditures for operating purposes through the ensuing year, except as may be required in an emergency.

The budget will list the work force and expense therefor, materials, supplies, and other expenses associated with the normal maintenance program. Extraordinary items of maintenance will be detailed to set forth the cost of labor required beyond that available from the regular force and other expense which will be incurred.

The maintenance budget shall include an additional 10% or an amount as mutually agreed by the Owners' Committee for contingencies to allow for expeditious handling of items of unforeseen maintenance, the delay of which would endanger equipment or personnel, or which would restrict production below the output required. Items of unforeseen maintenance for which an expenditure would be made from the contingent budget items which are estimated to cost \$50,000 or more will be referred to the Owners for approval before the expenditure is committed.

In the event of emergency or forced outages, reductions in Project capability, or instances of unforeseen maintenance restricting production below that required by the Owners during which repairs could be effected more rapidly by expenditure of overtime, the Owners will be individually notified, and those desiring accelerated repairs will equally share the expediting costs expended to return the Project to the required operating level at an earlier date.

(ii) On or before September 1 of each year, the Operator shall prepare a construction budget of items of capital improvements, betterments, replacements (other than normal replacements budgeted under the foregoing provisions of this subparagraph (c)) or other capital expenditures and retirements of facilities and equipment, relating to Project facilities as may be suggested or proposed by any Owner, for construction commencing during the year beginning January 1, next following. Upon unanimous approval of Owners of a construction budget the Owners will be responsible for payment of their respective percentage shares of the cost of any such improvement, betterment, capital expenditure or retirement so approved. Puget shall deposit funds in advance as necessary for construction and the Operator shall perform, or cause to be performed, such construction under procedures similar to the Project construction. The rights, titles and interests, including Ownership Percentage interest, of any Owner in and to any such capital additions, improvements, betterments or replacements shall be in the same percentage as the ownership interest provided in the Construction and Ownership Agreement. Proceeds from salvage shall be distributed to the Owners or with the unanimous approval of the Owners applied to obligations of the Project.

(iii) The Owners recognize that it will be necessary for continued operation of the Project, or to maintain the Project in operable condition, that the Operator be in a position to meet commitments for payroll, repairs and replacements, materials and supplies, services and other expenses of a continuing nature in order that it may fulfill its obligations to the Owners as Operator under this Agreement. Accordingly, notwithstanding the foregoing provisions of this subparagraph (c), the Operator may make all expenditures in the normal course of business, or in an emergency, as necessary for the proper and safe operation and maintenance of the Project; as soon as practicable after the making of any such expenditures the Operator shall make a full report thereof to Owners.

(d) Any action required by a final and binding order of any public authority having jurisdiction or in any emergency for the safety of the Project will be taken by the Operator.

(e) The Operator shall provide each Owner with regular monthly reports on construction, operation and maintenance of the Project. Each Owner shall have the right through its officers, employees or agents to inspect the Project and Project records at any reasonable time.

XIII. Maintenance – Spare Parts

A reasonable and adequate supply of spare parts will be provided by the Owners and stocked for maintenance of Project equipment. The Operator shall reorder items of stock used in the maintenance program as necessary.

XIV. Operating and Maintenance Expenses and Accounting

(a) The Operator will pay all operating and maintenance expenses of the Project.

(b) On or before the twenty-sixth (26th) day of each month, the Operator shall render to each Owner a statement showing for the preceding accounting month:

(1) All Project operation and maintenance expenses paid or accrued by the Operator during the preceding accounting month including but not limited to:

(i) The cost of all payroll including related payroll taxes of direct Project employees;

(ii) Payroll of Montana's employees, other than those customarily charged to Montana's administrative and general expenses, and other than direct Project employees, on an actual time basis including related payroll taxes such as social security taxes and unemployment insurance costs;

(iii) Materials and supplies including related purchasing and handling costs;

(iv) Reasonable traveling expense including use of Owner's transportation equipment;

(v) Any purchase power costs as agreed by the Owners' Committee;

(vi) Communication costs directly related to the Project;

(vii) Other miscellaneous costs.

(2) As a reimbursement for General Office electric system administrative and general expenses and related employee benefit costs indirectly applicable to the Project but not charged thereto, Montana will charge monthly to the Project costs a percentage of the total Project labor costs incurred during the previous month, which labor costs include a loading rate to cover pay for time not worked such as vacation, holidays, sick leave, etc. The applicable percentage rate shall be determined annually by agreement of the Owners and shall be based upon the Montana's actual costs during the previous year. The applicable rate shall be the quotient of dividing the total of the Montana's general office electric system annual charges to F.P.C. account 920 Administrative and General Salaries and account 921, Office Supplies and Expenses by the Montana's total annual electric system labor costs, including charges to construction, retirements and clearing accounts.

(c) On or about the fifth (5th) day after receipt of the Operator's said statement, Puget shall pay to Montana as Operator its Ownership Percentage share of the total operation and maintenance expenses shown on said statement.

(d) The Operator's said statement shall be by account classification in accordance with the Uniform System of Accounts prescribed for electric utilities by the Federal Power Commission, except as may be otherwise directed by the Owners; provided, however, that in the event differing requirements of differing Owners require additional accounting records, the Operator shall furnish such records as may reasonably be required for each

Owner's such purposes.

(e) It is recognized by the Owners that the A&G expense provision above is designed to reimburse Montana for normal and routine accounting and other supervisory costs related to the Project. In the event extraordinary matters requiring significant expenditure of time or expense by officers, other supervisory personnel of either Owner or outside consultants are necessary in order to preserve or protect the Project such as major administrative or legal proceedings, or similar matters, the Owners may, by mutual consent, permit such extraordinary costs to be charged directly to Project operating expenses in addition to the above A&G expenses, which consent shall not be unreasonably withheld.

XV. Annual Review of O&M Costs

At least annually, the Owners' Committee shall review the allocation of operation and maintenance costs under this Agreement to determine whether there are any material inequities and, if there are material inequities, shall devise a procedure for correcting the same.

XVI. Disposal of Waste or Surplus Commodities, Materials, Equipment and Other Personal Property

(a) The fly ash and the bottom ash and other by-products of combustion removed from boiler furnace will be disposed of by the Operator. The costs of such disposal shall be included as an operating expense and charged back to the Owners in proportion to their respective coal consumption.

(b) Any commodities, materials, including fly ash, equipment or other real or personal property which is produced from or is available from the Project and which is surplus to the then present or reasonably foreseeable future requirements of the Project may be sold or otherwise disposed of upon such terms and conditions and for such periods of time and the proceeds divided as may be approved by Owners.

(c) The foregoing shall not be applicable under any circumstances or in any manner to sale or disposal of electric energy.

XVII. Uncontrollable Forces

The Operator shall not be considered in default of any of its obligations hereunder if failure of performance shall be due to uncontrollable forces. The term "Uncontrollable Forces" shall mean any cause beyond the control of the Operator affected and which by the exercise of reasonable diligence, the Operator is unable to overcome, and shall include but not be limited to an act of God, fire, flood, explosion, strike, labor disputes, labor or material shortages, sabotage, an act of the public enemy, civil or military authority, including court orders, injunctions, and orders of government agencies with proper jurisdiction prohibiting acts necessary to performance hereunder or permitting any such act only subject to unreasonable conditions, insurrection or riot, an act of the elements, failure of equipment, or inability to obtain or ship materials or equipment because of the effect of similar causes on suppliers or carriers. Nothing contained herein shall be construed so as to require Operator to settle any strike or labor dispute in which it may be involved. Any party rendered unable to fulfill any obligation by reason of uncontrollable forces shall exercise due diligence to remove such inability with all reasonable dispatch.

XVIII. Applicable Laws and Regulations

The Operator in its performance of its obligations hereunder shall conform to all applicable laws, rules and regulations and, to the extent that its operations may be subject to the jurisdiction of State or Federal regulatory agencies, shall conform to the terms of valid and applicable orders of any such agencies.

XIX. Obligations are Several

The duties, obligations and liabilities of Montana and Puget hereunder are intended to be several and not joint or collective and neither shall be jointly or severally liable for the acts, omissions, or obligations of the other. Nothing herein contained shall be construed to create an association, joint venture, partnership, or impose a partnership duty, obligation or liability, between Montana and Puget. Neither party shall have a right or power to bind the other party without its express written consent, except as expressly provided in this Agreement. This Agreement shall be construed in accordance with the laws of the State of Montana.

XX. Notices

Any notice, demand, or request provided for in this Agreement served, given, or made in connection therewith, shall be deemed properly served, given or made if given in person or sent by registered or certified mail, postage prepaid, addressed to the party or parties at its principal place of business to the attention of the president or chief executive officer of Montana and Puget. Any party may at any time, and from time to time, change its designation of the person to whom notice shall be given by giving notice to all other parties as hereinabove provided.

XXI. Execution

This Agreement shall be effective and binding when executed by Montana and Puget as hereinabove provided.

XXII. Assignment

This Agreement may not be assigned except as provided in paragraph 16 of the Ownership Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in several counterparts.

PUGET SOUND POWER & LIGHT COMPANY

ATTEST:

/s/ W. Watson

Secretary

By /s/ D. H. Knight
Vice President

THE MONTANA POWER COMPANY

ATTEST:

/s/ John C. Hauck

Secretary

By /s/ Geo. W. O'Connor Secretary

STATE OF WASHINGTON)
)
COUNTY OF KING)

ss

On this 5th day of September, 1972, before me, the undersigned, a Notary Public in and for the State of Washington, personally appeared D. H. Knight, known to me to be Vice President of PUGET SOUND POWER & LIGHT COMPANY and acknowledged to me that he executed the within instrument on behalf of that corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Notarial Seal the day and year in this certificate first above written.

[Signature Illegible]
Notary Public for the State of Washington
Residing at Bellevue
My Commission expires: 12/1/73

STATE OF MONTANA)
)
COUNTY OF SILVER BOW)

ss

On this 11th day of September, 1972, before me, the undersigned, a Notary Public in and for the State of Montana, personally appeared Geo. W. O'Connor, known to me to be the President of THE MONTANA POWER COMPANY and acknowledged to me that he executed the within instrument on behalf of that corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Notarial Seal the day and year in this certificate first above written.

[Signature Illegible]
Notary Public for the State of Montana
Residing at Butte, Montana
My Commission expires: July 17, 1974

POWER CONTRACT – ROCK ISLAND JOINT SYSTEM

BETWEEN

PUBLIC UTILITY DISTRICT NO. 1

OF CHELAN COUNTY

and

PUGET SOUND POWER & LIGHT COMPANY

TABLE OF CONTENTS

POWER CONTRACT – ROCK ISLAND JOINT SYSTEM

Section Number	Title
	Recitals
2	Term of Contract
3	Construction of System II
4	Joint System Output, Joint System Peaking Capability and Joint System Pondage
	(A) System I
	(B) System II
	(C) Joint System Pondage
5	Payments by Puget to the District
	(A) System I
	(B) System II – Period Prior to Initial Date of Delivery
	(C) System II – Initial Delivery Period
	(D) System II – Interim Delivery Period
	(E) System II – Commercial Operating Period
	(F) Allocation of Operating Expenses
	(G) Allocation of Taxes and Other Charges
	(H) Debt Service Payments
	(I) Adjustment of Contract Debt Service
	(J) Computations for Partial Contract Years
6	Exhibits
7	Withdrawal of Power by the District
	(A) System I
	(B) System II
	(C) System II Surplus
8	Payments by District
	(A) System I
	(B) System II
9	Advance Payment for Power
10	Billings
11	Issuance of Additional Bonds
	(A) System I
	(B) System II
	(C) General
12	Establishment of Use of Funds
	(A) System I
	(B) System II
	(C) Investment
13	Books of Account and Auditing
14	Reactive Power
15	Operation, Maintenance, Engineering and Planning
	(A) Operation
	(B) Maintenance
	(C) Engineering and Planning
	(D) Inspection, Books and Records

16	Character of Service
17	Points of Delivery (A) System I (B) System II
18	Use of Rocky Reach Project Facilities
19	Scheduling
20	Metering (A) Generator Bus (B) Other Metering (C) Reading Meters (D) Testing
21	Losses
22	Electric Disturbances
23	Puget's Right to Use System I Facilities
24	District's Right to Use of Transmission Facilities (A) Original Facilities (B) Added Facilities (C) Limitations (D) Alternative Facilities
25	Rocky Reach Downstream Replacement Power (A) The District (B) Puget (C) System Responsibilities (D) Exchanges
26	Joint System Operations – Arbitration (A) Recommendations (B) Notices (C) Procedures (D) Matters to be Arbitrated (E) Divisibility
27	Notices
28	Benefited Parties
29	Amendment to Contract
30	District's Bond Resolution and License
31	Liabilities; Waiver of Subrogation (A) Releases (B) Charges (C) Waiver
32	Conflict of Laws
33	Waiver of Default
34	Insurance
35	Assignment of Contract
36	Force Majeure
37	Supersedence of June 8, 1962 Power Contract

Exhibits

POWER CONTRACT – ROCK ISLAND JOINT SYSTEM

THIS AGREEMENT made and entered into this 19th day of June 1974, by and between PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON (hereinafter called the "District"), a municipal corporation organized and existing under the laws of the State of Washington, and PUGET SOUND POWER & LIGHT COMPANY (hereinafter called "Puget"), a corporation organized and existing under the laws of the State of Washington;

RECITALS:

- 1. The District is authorized under the laws of the State of Washington to own and operate an electric public utility system or systems for the purpose of furnishing the District and the inhabitants thereof and any other person, including public and private corporations within or without its limits, with electric power and energy for all uses.
2. The District on December 20, 1955, adopted Resolution No. 1137 which resolution (i) established a plan and system for the ownership and operation of an electric utility system known as the Columbia River-Rock Island Hydro-Electric System, to consist of the generation and transmission facilities and related equipment to be acquired as a separate utility system pursuant to said resolution, and all additions, betterments and improvements to and extensions of said facilities added to said system by resolution of the Commission of the District through refunding of outstanding revenue bonds of the District issued pursuant to District Resolution No. 292, adopted by the Commission of the District on April 23, 1951, or constructed or acquired by the District and (ii) provided for the issuance and sale of \$31,830,000 principal amount of Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Issue of 1955, First Series.
3. Pursuant to Resolution No. 3443 adopted on May 24, 1962, the District issued and sold \$41,425,000 principal amount of Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Issue of 1955, Second Series, for the purpose of refunding the District's Rock Island Hydro-Electric System Electric Revenue Bonds, Series of 1951, and for the purpose of providing for the cost of the Dryden Development and for expenses incurred and to be incurred in connection with development of the hydroelectric power potential of Wenatchee River upstream from the Dryden Plant.
4. The District, by issuance and sale of said Second Series Bonds pursuant to said Resolution No. 3443, effected consolidation into the System as defined in Resolution No. 1137 of (i) the generation and transmission facilities and related properties of the Rock Island Hydro-Electric Production System, as defined in Resolution No. 292, (ii) the electric utility properties and assets of the Columbia River-Rock Island Hydro-Electric System, acquired pursuant to said Resolution No. 1137, and (iii) the electric utility properties and assets constituting the Dryden Generating Plant theretofore comprising a part of the District's Electric System.
5. The District and Puget were parties to a certain Power Contract (Rock Island) dated January 6, 1956, as amended, which contract was superseded by that certain Power Contract between the District and Puget dated June 8, 1962, as amended.
6. The District is aware of the serious long-range power shortage in the Pacific Northwest with the result that the District will not have an adequate power supply in the foreseeable future unless it develops additional power sources. In order to provide for the foreseeable future power needs of the District, the District has determined that expansion of the Rock Island Project on the Columbia River is the most feasible source of additional electric power and energy available to the District.
7. The District intends to expand the Rock Island Project which expansion includes adding a second powerhouse containing eight 54-MVA turbine generator units of horizontal shaft bulb type together with other equipment and facilities, all as more particularly set forth in Exhibit A to this contract.
8. The District has been granted an amendment to its license by the Federal Power Commission to expand the Rock Island Project, which license amendment was issued under date of March 29, 1974.
9. The District is issuing its revenue bonds in the approximate amount of \$207,500,000 pursuant to District Resolution No. 4950 adopted the 19th day of June 1974, in order to obtain the monies presently estimated to be necessary and sufficient, together with other available monies, to pay all costs of acquiring and constructing the proposed expansion of the Rock Island Project. In the event such monies are not sufficient to place the expansion facilities in commercial operation and complete such expansion, the District will use its best efforts to issue additional revenue bonds necessary and sufficient, for such purposes.

NOW, THEREFORE, for and in consideration of the mutual covenants and agreements herein contained and other good and valuable considerations, the parties hereto mutually covenant and agree as follows:

Section 1. Definitions. As used in this contract, the following words and phrases shall have the meanings hereinafter set forth unless the context shall clearly indicate that another meaning is intended.

- (A) "Added Facilities" shall mean the following transmission, substation and related facilities of System I:
(1) Squilchuck Substation and tap line.
(2) Coles Corner tap line.
(3) That part of the North Wenatchee Substation rated in excess of 33,000 kVA.
(4) That part of the Wenatchee Substation rated in excess of 45,000 kVA.
(5) Substation, tap lines and related facilities of System I constructed subsequent to the effective date of this contract pursuant to provisions of Section 24(B) hereof.
(B) "Bond Resolution" shall mean all resolutions adopted by the Commission of the District authorizing the issuance of outstanding System I Bonds and System II Bonds, including Refunding Bonds, and providing for the security therefor as such resolutions may be from time to time superseded, amended, modified, or supplemented in accordance with provisions thereof.
(C) "Bonneville" shall mean the United States of America, Department of the Interior, acting by and through the Bonneville Power Administrator, or any officer or agency succeeding to the powers and functions of the Bonneville Power Administrator as may be hereafter provided by law.
(D) "Contract Bonds Outstanding" for any series of Bonds shall mean the amount of said Bonds that would have been outstanding as shown in the computation of Contract Debt Service applicable to such series.
(E) "Contract Debt Service" with respect to any series of System II Bonds shall mean for any Contract Year an amount equal to the amount of annual interest and principal payments including premiums, if any, that would have been payable by the District on such series during said Contract Year computed on the assumptions that:
(1) An amount of principal, if any, equal to the amount of System II Reserve Funds and System II Working Capital provided from the proceeds of such series would mature on the date of final maturity of such series, with such principal amount not amortized but bearing interest only prior to the date of final maturity;
(2) The remaining amount of principal is assumed to be amortized on an essentially level annual debt service basis with the amortization period to be that specified in this contract for such series;
(3) The coupon rates used in the computation of Contract Debt Service requirements for bonds computed to mature in any Contract Year shall be, as nearly as practicable, the actual coupon rates for bonds of such series maturing in such year; provided, however, that if in any year prior to the last year of maturity of serial bonds of such series no bonds of such series actually mature, the coupon rates applicable to such year used in the computation of Contract Debt Service shall be determined by interpolation from actual coupon rates; provided, further, if the actual maturities of bonds are different from the assumed maturities and the actual coupon rates for any bonds are thereby affected, the coupon rates to be used in the computations of Contract Debt Service shall be those that would have been effective if actual maturities had been equal to assumed maturities; provided, further, however, that the amount of Contract Debt Service for any series of Refunding Bonds shall not exceed the amount of the Contract Debt Service on the series of bonds being refunded. Contract Debt Service on any series shall be initially computed within ten days after the issuance, and sale of such series and such computation shall show for each Contract Year the amount of Bonds of such series that would have been outstanding if actual maturities had had been equal to those assumed in such computation.
(F) "Contract Year" shall mean the twelve-month period commencing at 0001 hours Pacific Time on July 1 of each year during the term of this contract; provided, however, that the first Contract Year shall commence on July 1, 1974 and the last Contract Year shall end at 2400 hours Pacific Time on the last day of the term of this contract.
(G) "Date of Commercial Operation" of System II shall mean the date the District notifies Puget that it is ready to deliver power and energy from the last of eight (8) additional generating units to be installed in System II after each of said eight (8) units has been installed and in the opinion of the

District has been placed or is available to be placed in normal continuous operation at not less than 90% of the capability of each such generating unit which the District, in its opinion, expects to achieve upon completion of construction.

(H) "Date of Initial Financing" shall mean July 1, 1974.

(I) "District's Electric System" shall mean the District's distribution and transmission system as described in District Resolution No. 870 and all additions and betterments thereto and extensions thereof which have been made prior to the date of this contract and which are made in the future, including, without limitation, generating facilities, transmission facilities, distribution facilities, intangible plant and general plant facilities as those terms are used in the Uniform System of Accounts.

(J) "District's Other Power" shall mean the amount of the District's power flowing over Original Facilities and Added Facilities that is in excess of the District's Squilchuck Power.

(K) "District's Squilchuck Power" shall mean the amount of power shown on Exhibit D hereof and flowing over Original Facilities and Added Facilities.

(L) "District's System I Share" shall mean for any Contract Year the decimal fraction share of System I Output and System I Peaking Capability as set forth in column 1 of Exhibit B hereof.

(M) "District's System II Share" shall mean for any Contract Year the decimal fraction share of System II Output and System II Peaking Capability taken by the District in accordance with the provisions of Section 7(B) hereof.

(N) "Generator Bus" shall mean the point or points on the low voltage side of the Rock Island Project transformer banks at which Joint System Output and Joint System Peaking Capability are determined.

(O) "Initial Date of Delivery" shall mean 0001 hours Pacific Time on the date the District first notifies Puget that it is ready to deliver power and energy from one or more of the generating units which shall have been installed in System II and, in the opinion of the District, are available to be scheduled on a continuous operating basis.

(P) "Initial Delivery Period" shall mean the period of time beginning on the Initial Date of Delivery and ending 0001 hours Pacific Time on the date which is five years after the Date of Initial Financing.

(Q) "Interim Delivery Period" shall mean the period of time, if any, beginning on the Initial Date of Delivery or the date which is five years after the Date of Initial Financing, whichever is later, and ending on the Date of Commercial Operation.

(R) "Joint System" shall mean System I and System II.

(S) "Joint System Output" shall mean for any period of time the sum of the following:

(1) The amount of electric energy and reactive power capable of being produced by the Joint System from the inflow water supply to the Rock Island Project during such period, including test power, adjusted for the losses to the Generator Bus, under the operating conditions existing during such period, after deducting the amount of electric energy required for station service use and service to Rock Island supervisors' cottages and the amount of Rocky Reach Encroachment Power during such period;

(2) The amount of Joint System Wanapum Encroachment Power during such period; and
(3) The amount of Rocky Reach Downstream Replacement Power supplied by Puget and the District to System II during such period in accordance with Section 25 hereof.

(T) "Joint System Peaking Capability" shall mean at anytime the sum of the following:

(1) The maximum generating capability of the Joint System under the operating conditions existing at such time after deducting the amount of electric capacity required for station service use and service to Rock Island supervisors' cottages and the amount of Rocky Reach Encroachment Power at such time;

(2) The amount of Joint System Wanapum Encroachment Power at such time; and

(3) The amount of Rocky Reach Downstream Replacement Power supplied by Puget and the District to System II at such time.

(U) "Joint System Pondage" shall mean the total usable pondage of the Joint System.

(V) "Joint System Wapum Encroachment Power" shall mean the electric capacity and energy required to be delivered to the Rock Island Project by Public Utility District No. 2 of Grant County, Washington ("Grant") as compensation for the encroachment of the Wanapum Reservoir on the tailwater of the Rock Island Project.

(W) "Operating Expenses" shall mean all expenses (excluding depreciation expenses), less credits properly related thereto, chargeable to Operation and Maintenance Expense Accounts under the Uniform System of Accounts and shall include costs of renewals and replacements of Minor Items of Property as such term is used in the Uniform System of Accounts; provided, however, that in classification of such costs of renewals and replacements, the District shall adhere to practices generally followed by electric utilities operating like properties, including past practices of the District. Operating Expenses shall not include costs of improvements and extensions and costs for renewals and replacements of Retirement Units as the latter term is used in the Uniform System of Accounts.

(X) "Original Facilities" shall mean the following transmission, substation and related facilities of System I:

(1) McKenzie-Rocky Reach-Chelan 115-kV transmission line.

(2) McKenzie-North Wenatchee 115-kV transmission line.

(3) McKenzie-Summit 115-kV transmission line.

(4) Dryden-kV tap line.

(5) That part of the North Wenatchee Substation rated at 33,000 kVA.

(6) That part of the Wenatchee Substation rated at 45,000 kVA.

(7) McKenzie 115-kV Switching Station.

(Y) "outstanding" when used with reference to System I Bonds and System II Bonds shall have the meaning set forth in District Resolution No. 4950.

(Z) "Puget's System I Share" shall mean for any Contract Year the decimal fraction share of System I Output and System I Peaking Capability made available to Puget during such year and shall be determined by subtracting the District's System I Share from one (1.000).

(AA) "Puget's System II Share" shall mean for any Contract Year the decimal fraction share of System II Output and System II Peaking Capability made available to Puget during such year and shall be determined by subtracting the District's System II Share from one (1.000).

(BB) "Refunding Bonds" shall mean the principal amount of bonds issued and sold by the District to provide funds in amounts necessary (but no greater amounts than necessary) to refund, in whole or in part at any time any one or more series of outstanding System II Bonds including all costs and expenses of such refunding.

(CC) "Rock Island Project" shall mean the works, plants and facilities of the Columbia River-Rock Island Hydro-Electric System as defined in Resolution Nos. 1137, 3443 and 4950.

(DD) "Rocky Reach Downstream Replacement Power" shall mean the electric capacity and energy which would have been delivered to the Rock Island Project by the Rocky Reach Project or to the Rocky Reach Project by the Rock Island Project in accordance with provisions of Section 5A of the Rocky Reach Power Sales Contracts entered into as of November 14, 1957 as amended by Amendment entered into as of June 1, 1968, if System II had not been constructed. For the purpose of this contract, Rocky Reach Downstream Replacement Power delivered to the Rock Island Project shall be considered to be positive and Rocky Reach Downstream Replacement Power delivered to the Rocky Reach Project shall be considered to be negative.

(EE) "Rocky Reach Encroachment Power" shall mean the electric capacity and energy delivered to the Rocky Reach Project by the Rock Island Project as compensation for losses resulting from raising the maximum pool at the Rock Island Project above elevation (606.9 U.S.C. & G.S. Datum) (608.0 U.S.G.S. Datum) in accordance with provisions of Section 5A of the Rocky Reach Power Sales Contracts entered into as of November 14, 1957, as amended by Amendment entered into as of June 1, 1968.

(FF) "System I" shall mean:

(1) The generation and transmission facilities and related equipment, all properties real, personal and mixed, all other assets of the District's Columbia River-Rock Island Hydro-Electric System acquired and established pursuant to the District's Resolution Nos. 1137 and 3443 with proceeds of Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Issue of 1955, First Series and Second Series, and all additions, betterments and improvements thereto and extensions thereof except System II; and

(2) The electric utility properties and assets constituting the District's Dryden Generating Plant located on the Wenatchee River near Dryden in Chelan County, Washington.

(GG) "System I Bonds" shall mean the Columbia River–Rock Island Hydro–Electric System Revenue Bonds, Issue of 1955, First Series and Second Series issued pursuant to the District's Resolution Nos. 1137 and 3443, at any time outstanding, and any additional bonds or other evidences of indebtedness hereafter issued and outstanding in accordance with the provisions of Section 11(A) hereof.

(HH) "System I Output" shall mean for any period of time the sum of the following:

(1) The amount of electric energy and reactive power capable of being produced by System I during such period from the inflow water supply to the Rock Island Project if System II had not been constructed, adjusted for losses to the Generator Bus, under operating conditions existing during such period other than those operating conditions caused by raising the maximum pool elevation from 606.9 U.S.C. & G.S. Datum, after deducting the amount of electric energy which would have been required for station use and service to Rock Island supervisors' cottages if System II had not been constructed and until the Initial Date of Delivery or June 1, 1977, whichever is earlier, the amount of Rocky Reach Encroachment Power delivered during such period;

(2) The amount of System I Wanapum Encroachment Power during such period; and

(3) The amount of Rocky Reach Downstream Replacement Power which would have been delivered to the Rocky Reach Project and to the Rock Island Project during such period if System II had not been constructed.

Provided, however, that until the Initial Date of Delivery or June 1, 1977, whichever is earlier, System I Output shall be equal to Joint System Output.

(II) "System I Peaking Capability" shall mean at any time the sum of the following:

(1) Maximum generating capability of System I, which would have existed at such time if System II had not been constructed, under operating conditions existing at such time other than those conditions caused by raising the maximum forebay pool elevation from 606.9 U.S.C. & G.S. Datum, after deducting the electric capacity which would have been required for station use and Rock Island supervisors' cottages at such time;

(2) The amount of System I Wanapum Encroachment Power at such time; and

(3) The amount of Rocky Reach Replacement Power that would have been delivered to the Rocky Reach Project and to the Rock Island Project at such time if System II had not been constructed.

(JJ) "System I Pondage" shall mean at any time that portion of total pondage of the Joint System that would have been available between forebay elevations 602.9 and 606.9 U.S.C. & G.S. Datum and usable by System I if System II had not been constructed.

(KK) "System I Wanapum Encroachment Power" for any period shall mean the amount of Joint System Wanapum Encroachment Power that would have been received by the Rock Island Project during such period if System II had not been constructed, provided that the total of such amounts during any calendar week shall not exceed the amount of Joint System Wanapum Encroachment Power actually delivered to the Rock Island Project during such week.

(LL) "System II" shall mean the facilities described in Exhibit A hereto and all additions, betterments and improvements thereto and extensions thereof.

(MM) "System II Bonds" shall mean:

(1) Any outstanding electric revenue bonds issued at one time or from time to time by the District pursuant to the Bond Resolution for the purpose of providing funds for the payment of (a) the Cost of Construction as such term is defined in District Resolution No. 4950 and (b) amounts necessary to provide System II Reserve Funds; and

(2) Any outstanding electric revenue bonds or other evidences of indebtedness issued by the District under the Bond Resolution and in accordance with provisions of Section 11(B) hereof.

(NN) "System II Output" for any period of time shall mean the amount of electric energy and reactive power obtained by subtracting System I Output from the Joint System Output for such period of time.

(OO) "System II Peaking Capability" shall mean at any time the amount of electric capacity in kilowatts obtained from subtracting System I Peaking Capability from Joint System Peaking Capability at such time.

(PP) "System II Pondage" shall mean the quantity obtained by subtracting System I Pondage from Joint System Pondage.

(QQ) "System II Reserve Account" shall mean the account created and established by the District pursuant to provisions of the Bond Resolution for the purpose of providing a reserve for debt service.

(RR) "System II Reserve and Contingency Fund" shall mean the Columbia River–Rock Island Hydro–Electric System Expansion Reserve and Contingency Fund created and established by District Resolution No. 4950 as a reserve to be used in accordance with the provisions thereof.

(SS) "System II Reserve Funds" shall mean the System II Reserve Account and the System II Reserve and Contingency Fund.

(TT) "System II Revenue Account" shall mean the Revenue Account established by District Resolution No. 4950.

(UU) "System II Working Capital" shall mean the amount of funds set aside by the District in the System II Revenue Account as working capital pursuant to provisions of the Bond Resolution.

(VV) "Uncontrollable Forces" shall mean any cause reasonably beyond the control of the District including but not limited to an act of God, fire, flood,

explosion, strike, sabotage, an act of the public enemy, civil or military authority including court orders, injunctions, and orders of governments, failure of equipment, or inability to obtain or ship materials or equipment, which Uncontrollable Forces, by exercise of due diligence, the District could not reasonably have been expected to prevent or overcome.

(WW) "Uniform System of Accounts" shall mean the Uniform System of Accounts prescribed by the Federal Power Commission for Class A Public Utilities and Licensees in effect on January 1, 1973.

(XX) "Wenatchee River Properties" shall mean all property and assets acquired by the District with funds deposited in the special account provided for in Section 6.2(6) of District Resolution No. 3443, together with rents, income and receipts derived therefrom, and the accumulated earnings from investment of funds deposited in said special account, except the sum of \$7,111,000, and the earnings derived therefrom subsequent to the Initial Date of Financing.

Section 2. Term of Contract. This contract shall become effective on the date of delivery by the District of the first series of System II Bonds to, and payment therefor by the initial purchasers thereof and shall continue in full force and effect until 2400 hours Pacific Time on June 7, 2012 or until the Columbia River–Rock Island Hydro–Electric System Revenue Bonds, Issue of 1955, First Series, issued by the District pursuant to Resolution No. 1137 and the Columbia River–Rock Island Hydro–Electric System Revenue Bonds, Issue of 1955, Second Series issued by the District pursuant to Resolution No. 3443 are paid or provision is made for retirement thereof in accordance with said resolutions, whichever is later; provided, however, that any unpaid or undischarged obligation of either party to the other party, arising under the provisions and during the term hereof then due or accrued at the time of such termination shall continue to be due and payable until finally paid or discharged notwithstanding the termination thereof.

Section 3. Construction of System II. The District will use its best efforts to finance on a timely basis all of the Cost of Construction as that term is defined in District Resolution No. 4950 and will diligently proceed with the construction of System II until it is completed. The District estimates that the Initial Date of Delivery will be approximately August 1, 1977 and the Date of Commercial Operation will be approximately October 1, 1978.

The District will prepare or cause to be prepared and submit to Puget monthly reports of progress during the period of construction of System II and quarterly reports including data as to the date of expected completion of System II and a comparison of estimated construction time and cost with estimates made prior to commencing construction and shall promptly advise Puget of and consult with Puget on any substantial engineering and construction problems as they arise.

At its option and expense, Puget may maintain observers at the Rock Island Project who shall be given full access at reasonable times to the Project and to all plans, records or other documents under control of the District relating to the Project.

Section 4. Joint System Output, Joint System Peaking Capability and Joint System Pondage

(A) System I. The District shall make available to Puget for any period during each Contract Year, Puget's System I Share of System I Output and Puget's System I Share of System I Peaking Capability for such period.

(B) System II. The District shall make available to Puget for any period during each Contract Year Puget's System II Share of System II Output and Puget's System II Share of System II Peaking Capability for such period.

(C) Joint System Pondage.

- (1) During any period Puget shall be entitled to use a portion of the Joint System Pondage for regulation of Puget's System I Share of System I Output and Puget's System II Share of System II Output to meet its hourly load requirements during such period. The portion of Joint System Pondage available to Puget shall be equal to the sum of (i) System I Pondage multiplied by Puget's System I Share and (ii) System II Pondage multiplied by Puget's System II Share.
- (2) During any period the District shall be entitled to use a portion of the Joint System Pondage for regulation of the District's System I Share of System I Output and the District's System II Share of System II Output to meet its hourly load requirements during such period. The portion of Joint System Pondage available to the District shall be equal to the sum of (i) System I Pondage multiplied by the District's System I Share and (ii) System II Pondage multiplied by the District's System II Share.

Section 5. Payments by Puget to the District.

- (A) System I. Puget agrees to pay to the District, in monthly installments, for Puget's System I Share of System I Output and System I Peaking Capability made available to Puget pursuant to the provisions of Section 4(A) hereof, annual amounts for each Contract Year equal to the sum of the following items of cost incurred or paid by the District for such contract year in connection with System I whether or not the operation of System I is interrupted, suspended, or interfered with in whole or in part for any cause whatsoever during the term of this contract or during any portion of said time, to wit:
- (1) That portion, allocated to System I pursuant to provisions of Section 5(F) hereof, of Operating Expenses of the Joint System;
- (2) That portion, allocated to System I pursuant to the provisions of Section 5(G) hereof, of (i) governmental taxes, assessments or other similar charges, or payments in lieu thereof, lawfully imposed upon the District due to the District's ownership, operation or sale of power from the Joint System and (ii) any amounts paid by the District to any governmental agency for fire protection for the Joint System;
- (3) An amount equal to the amount annually required to pay principal of and interest on, and premiums, if any, which are required to be paid on System I Bonds;
- (4) The amount of the bonds issued to the Fiscal Agent of the District pursuant to District Resolution No. 1138 that mature during such Contract Year;
- (5) An amount equal to 11.675% of the payments specified in paragraph (3) of this Section 5(A) to be paid into the System I Reserve and Contingency Fund;
- (6) The amounts required, if any, for necessary renewals and replacements to System I which are in excess of monies available in the System I Reserve and Contingency Fund plus proceeds from any applicable insurance and plus proceeds from sale of additional bonds or proceeds of other financing or both as provided in Section 11(A) hereof.
- (7) An amount equal to \$31,250 annually for the period ending at 2400 hours Pacific Time on January 5, 2004;
- (8) All other costs, less credits properly related thereto, not included in the foregoing paragraphs (1) through (7) of this Section 5(A) associated with the ownership, operation and maintenance of and renewals and replacements to System I, including those essential and necessary to effect delivery of System I Output and System I Peaking Capability to the Points of Delivery to Puget and the Points of Delivery to the District as herein specified;
- (9) Such additional amounts, if any, as shall be mutually agreed upon between the parties.
- (B) System II – Period Prior to Initial Date of Delivery. All System II costs prior to the Initial Date of Delivery shall be charged to cost of construction of System II.
- (C) System II – Initial Delivery Period. During the Initial Delivery Period, Puget agrees to pay to the District, in monthly installments, for Puget's System II Share of System II Output and System II Peaking Capability made available to Puget pursuant to the provisions of Section 4(B) of this contract, annual amounts for each Contract Year equal to the sum of the following amounts for such Contract Year applicable to System II:
- (1) That portion of the amount of Operating Expenses of the Joint System which is in excess of the amount of Operating Expenses that System I would have incurred had System II not been constructed.
- (2) That portion, allocated to System II pursuant to provisions of Section 5(G) hereof, of (i) governmental taxes, assessments or other similar charges or payments in lieu thereof, lawfully imposed upon the District due to the District's ownership, operation or sale of power from the Joint System, and (ii) any amounts paid by the District to any governmental agency for fire protection for the Joint System;
- (3) Such additional amounts, if any, applicable to System II as shall be mutually agreed upon between the parties hereto.
- (D) System II – Interim Delivery Period. During the Interim Delivery Period, Puget agrees to pay to the District in monthly installments, for Puget's System II Share of System II Output and System II Peaking Capability made available to Puget pursuant to the provisions of Section 4(B) of this contract, annual amounts for each Contract Year equal to the sum of the following amounts for such Contract Year applicable to System II multiplied by Puget's System II Share:
- (1) That portion of the amount of Operating Expenses of the Joint System which is in excess of the amount of Operating Expenses that System I would have incurred had System II not been constructed.
- (2) That portion, allocated to System II pursuant to provisions of Section 5(G) hereof, of (i) governmental taxes, assessments or other similar charges or payments in lieu thereof, lawfully imposed upon the District due to the District's ownership, operation or sale of power from the Joint System and (ii) any amounts paid by the District to any governmental agency for fire protection for the Joint System;
- (3) The amount obtained by multiplying the following costs by the lesser of one (1) or the decimal fraction determined by dividing System II Peaking Capability of the generating units of System II that are, in the opinion of the District, ready and available to be scheduled on a continuous operating basis, by 414,000 kilowatts. For the purpose of this paragraph (3) the System II Peaking Capability shall be computed on the assumption that (i) all System I generating units are in full operation, (ii) inflow is 225,000 cubic feet per second, (iii) the Rock Island forebay pool elevation is 613.0 feet above mean sea level U.S.C. & G.S. Datum, (iv) the Wanapum forebay pool elevation is 571.5 feet above mean sea level U.S.C. & G.S. Datum, (v) Rocky Reach releases total 225,000 cubic feet per second and (vi) the generating units of System II that are available for operation are operating at 0.95 power factor.
- (a) For each series of System II Bonds issued prior to the date the Construction Engineer files the report pursuant to the provisions of Section 8.6 of District Resolution No. 4950, an amount equal to Contract Debt Service for such series less an amount equal to the product of the amount of System II Reserve Funds funded from proceeds of such series multiplied by the interest rate assumed for such System II Reserve Funds in such Contract Debt Service. The amortization period of such series for such Contract Debt Service shall be the lesser of 50 years or the number of years from the date of delivery of and payment for such series to the date which is 55 years after the Date of Initial Financing;
- (b) For each series of System II Bonds issued to finance renewals, replacements and additions to System II in accordance with paragraph (1) of Section 11(B) hereof, an amount equal to the Contract Debt Service for such series less an amount equal to the product of the amount of System II Reserve Funds funded from proceeds of such series multiplied by the interest rate assumed for such System II Reserve Funds in such Contract Debt Service. The amortization period of each series to be used in computing such Contract Debt Service shall be the number of years equal to the lesser of 50 years or the estimated service life of the facility which is acquired or constructed from proceeds of such series;
- (c) In the event any of the series of bonds referred to in the foregoing subparagraphs (a) and (b) of this paragraph (3) or this subparagraph (c) are refunded in accordance with paragraph (2) of Section 11(B) hereof, the annual amounts applicable to each such series of Refunding Bonds shall be equal to the lesser of the Contract Debt Service applicable to the bonds being refunded or the Contract Debt Service applicable to such series, less in each case an amount equal to the product of the amount of System II Reserve Funds funded from proceeds of such series multiplied by the interest rate assumed for such System II Reserve Funds in such Contract Debt Service. The amortization period of such series to be used in computing such Contract Debt Service shall be the amortization period for the bond issue being refunded by such series less the number of years between the date of delivery of and payment for such series of Refunding Bonds and the later of the date of delivery of and payment for such bonds being refunded or the date which is five years after the Date of Initial Financing.
- (4) Such additional amounts, if any, applicable to System II, as shall be mutually agreed upon between the parties hereto;

(5) From the aggregate of the foregoing amounts there shall be deducted any credits applicable to System II not credited to the Construction Fund pursuant to the provisions of District Resolution No. 4950 or not deducted pursuant to paragraph (1) of this Section 4(D) by reason of receipt of any revenues and other income applicable to System II and derived from sources other than direct sale of power from System II.

(6) For the purpose of the foregoing paragraph (3) of this Section 4(D) costs and payments shall be calculated and charged as if they had accrued on a daily basis.

(E) System II – Commercial Operating Period. Beginning on the later of the end of the Initial Delivery Period or the Date of Commercial Operation Puget agrees to pay to the District in monthly installments for Puget's System II Share of System II Output and System II Peaking Capability made available to Puget pursuant to the provisions of Section 4(B) of this contract annual amounts for each Contract Year equal to the sum of the following amounts for such Contract Year applicable to System II multiplied by Puget's System II Share, whether or not operation of System II is interrupted, suspended or interfered with in whole or in part for any cause whatsoever during such Contract Year.

(1) That portion allocated to System II pursuant to provisions of Section 5(F) hereof of Operating Expenses of the Joint System;

(2) That portion allocated to System II pursuant to provisions of Section 5(G) hereof, of (i) governmental taxes, assessments or other similar charges or payments in lieu thereof lawfully imposed upon the District due to the District's ownership, operation or sale of power from the Joint System and (ii) any amounts paid by the District to any governmental agency for fire protection for the Joint System;

(3) For each series of outstanding System II Bonds issued prior to the date the Construction Engineer files the report pursuant to the provisions of Section 8.6 of District Resolution No. 4950 an amount equal to the Contract Debt Service for such series. The amortization period of such series to be used in computing such Contract Debt Service shall be the lesser of 50 years or the number of years from the date of delivery of and payment for such series to the date which is 55 years after the Date of Initial Financing.

(4) For each series of outstanding System II Bonds issued to finance renewals, replacements and additions to System II in accordance with provisions of paragraph (1) of Section 11(B) hereof, an amount equal to Contract Debt Service for such series. The amortization period of such series to be used in computing such Contract Debt Service shall be the lesser of 50 years or the estimated service life of the facility which is acquired or constructed from proceeds of such series.

(5) In the event any of the series of outstanding bonds referred to in paragraphs (3) or (4) of this Section 5(E) or this paragraph (5) are refunded in accordance with paragraphs (2) and (3) of Section 11(B) hereof, the annual amounts applicable to each such series of Refunding Bonds shall be equal to the lesser of Contract Debt Service applicable to the bonds being refunded or Contract Debt Service applicable to such series. The amortization period of such series to be used in computing such Contract Debt Service shall be the amortization period for the bond issue being refunded by such series less the number of years between the date of delivery of and payment for such series of Refunding Bonds and the later of the date of delivery of and payment for such bonds being refunded or the date which is five years after the Date of Initial Financing.

(6) An amount equal to 10% of the amounts specified in paragraphs (3), (4) and (5) of this Section 5(E);

(7) Amounts required, if any, for necessary renewals and replacements which are in excess of monies available in the System II Reserve and Contingency Fund plus proceeds from any applicable insurance and plus proceeds from the sale of additional System II Bonds or proceeds of additional financing or both in accordance with paragraph (1) of Section 11(B) hereof;

(8) All other costs, less credits properly related thereto and excluding debt service costs on System II Bonds, not included in the foregoing paragraphs (1), (2), (6) and (7) of this Section 5(E) associated with ownership, operation and maintenance of System II and renewals and replacements to System II, including those essential and necessary to effect delivery of System II Output to System II Points of Delivery as herein specified;

(9) Such additional amounts, if any, applicable to System II as shall be mutually agreed upon between the parties hereto; and

(10) From the aggregate of the foregoing amounts, there shall be deducted any revenue or income of System II properly creditable to Account Nos. 451, 453, 454, 455 and 456 and 415, 416, 417, 418, 419 and 421 of the Uniform System of Accounts excluding (i) amounts properly credited to the Construction Fund pursuant to the provisions of District Resolution No. 4950 and (ii) gain on purchase of System II Bonds.

(F) Allocation of Operating Expenses. For the purpose of determining the Operating Expenses of System I and System II to be included in costs pursuant to paragraph (1) of Section 5(A) and paragraph (1) of Section 5(E), the following shall apply:

(1) For the period beginning on the Date of Commercial Operation and ending on the date of termination of this contract (i) 89% of the Operating Expenses of the Joint System chargeable to Account Nos. 535, 537, 538 and 539 of the Uniform System of Accounts shall be charged to System I and 11% shall be charged to System II, and (ii) all other Operating Expenses of the Joint System shall be charged to the System for which the expense was incurred;

(2) It is the intent of this Section 5(F) that Operating Expenses of the Joint System chargeable to System I be in the same amount as the Operating Expenses of System I would have been if System II had not been constructed. The allocation of charges provided for in this Section 5(F) shall be reviewed at the request of either party to the other not more frequently than once each Contract Year, and, adjusted, if necessary, to conform to this intent. Unless otherwise agreed by the parties to this contract, no such changes shall be effective for any period more than 6 months prior to the date on which the review request was made.

(G) Allocation of Taxes and Other Charges. For the purpose of determining costs of System I and System II pursuant to paragraph (2) of Sections 5(A),

5(C), 5(D) and 5(E), the portion of governmental taxes, assessments or other similar charges, or payments in lieu thereof lawfully imposed upon the District due to the District's ownership, operation or sale of power from the Joint System and any amounts paid by the District to any governmental agency for fire protection for the Joint System that is allocated to System II shall be that portion which will result in the amount of such costs of System I being the same as it would have been if System II had not been constructed. The balance of such costs of the Joint System shall be charged to System I. All such costs properly chargeable to Construction Costs of System II as defined in District Resolution No. 4950 shall not be charged to taxes and other charges of the Joint System for the purpose of computing Puget's annual payments hereunder

(H) Debt Service Payments.

(1) That portion of the amounts payable by Puget to the District for each Contract Year attributable to the amounts specified in paragraph (3) of Section 5(A) and paragraphs (3), (4) and (5) of Section 5(E) shall be paid in substantially equal monthly installments on or before the 20th day of each calendar month prior to billing for such month as advance payments on account of the bills to be submitted by the District pursuant to Section 10 hereof. That portion of the amounts payable by Puget to the District attributable to the amounts specified in paragraph (3) of Section 5(D) shall be paid on or before the 20th day of each calendar month prior to billing for such month as similar advance payments.

(2) In the event in any Contract Year that portion of the amounts payable by Puget to the District for such Contract Year attributable to the amounts specified in paragraphs (3) and (4) of Section 5(E) hereof ("First Amount") is less than the product obtained by multiplying Puget's System II Share by the District's actual payments for principal and interest for System II Bonds for such Contract Year ("Second Amount") then Puget agrees to pay the District the difference between the First Amount and the Second Amount.

(3) Notwithstanding any other provision of this contract, it is not intended that Puget by this contract assumes any obligation or liability as guarantor, endorser, surety or otherwise with respect to System I Bonds, System II Bonds or other securities issued by the District; provided, however, that Puget agrees that it will not sell, dispose of or otherwise utilize the Joint System Output and Joint System Peaking Capability in any way that would jeopardize the federal tax exempt status, pursuant to Internal Revenue Service Tax Ruling T:1:1:2:3 dated July 7, 1972, of those System II Bonds issued prior to the date that the Construction Engineer files the report pursuant to the provisions of Section 8.6 of District Resolution No. 4950, or, that would in any way jeopardize the federal tax exempt status of any other series of System II Bonds under federal laws and regulations that are not more restrictive with respect to the sale, disposition or utilization of Joint System Output and Joint System Peaking Capability than those existing on July 7, 1972.

(I) Adjustment of Contract Debt Service. Notwithstanding the provisions of Sections 5(D) and 5(E), if the proceeds from the issuance of any series of Bonds exceeds the amounts required for the purposes for which such series was issued, the amount of such excess shall be used to retire, by purchase or call, Bonds in advance of maturity and Contract Debt Service and Contract Bonds Outstanding applicable to such series shall be reduced to reflect such retirement.

In the event that any Bonds are purchased by the District at a discount either from the Sinking Fund established in the Bond Resolution or otherwise the amount of Contract Debt Service and Contract Bonds Outstanding shall be appropriately reduced to reflect such discount.

(J) Computations for Partial Contract Years. For the purposes of determining the amounts described in Section 5(D) and Section 5(E) hereof until the end of the Contract Year in which the Date of Commercial Operation occurs and for the last Contract Year hereof such amounts shall be deemed to have accrued on a daily basis and with respect to the amounts described in Section 5(D) hereof the applicable proportion thereof shall be determined from time to time as additional generating units are, in the opinion of the District, ready and available to be scheduled on a continuous operating basis.

Section 6. Exhibits. Exhibits A, B, C, D and E are by this reference incorporated herein and made a part of this contract as fully as though set forth verbatim in the body of this contract.

(A) System I. The District shall take from System I the District's System I Share of System I Output and System I Peaking Capability during each Contract Year.

(B) System II. The District reserves the right to withdraw from System II during each Contract Year up to fifty percent (50%) of System II Output and System II Peaking Capability for the purpose of furnishing the District and the inhabitants of Chelan County, including public and private corporations, with electric current for all uses for ultimate utilization therein, and for supplying electric current for ultimate use in Townships 26 and 27 North, Range 23 E.W.M., Douglas County, Washington, and in the vicinity of Stevens Pass in King County, Washington and in the vicinity of Colocum Pass in Kittitas County, Washington and in the Antoine Valley in Okanogan County, Washington; provided, that (i) the District shall give five years advance written notice of such withdrawal, (ii) no such notice shall be given which will provide for withdrawal of System II Output and System II Peaking Capability prior to the Contract Year commencing July 1, 2000, (iii) the amounts withdrawn pursuant to the first such notice shall not exceed ten percent (10%) of System II Output and System II Peaking Capability, (iv) no such notice shall be given pursuant to which the amounts withdrawn by the District for any Contract Year will exceed the amounts withdrawn by the District for the immediately preceding Contract Year by more than ten percent (10%) of System II Output and System II Peaking Capability, and (v) each withdrawal by the District of a share of System II Output shall be accompanied by an equal withdrawal of System II Peaking Capability.

(C) System II Surplus. Any portion of System II Output and System II Peaking Capability withdrawn by the District pursuant to Section 7(B) which is surplus to the requirements of the District for the purposes described in Section 7(B), shall first be offered for sale to Puget at the same cost as Puget would have been required to pay for such portion of System II Output and System II Peaking Capability if it had not been withdrawn and if not so purchased by Puget may be disposed of as the District shall determine, notwithstanding the provisions of Section 7(B) above.

Section 8. Payments by District.

(A) System I. (1) The District agrees to pay to Puget monthly installments, for System I Output and System I Peaking Capability made available to the District, annual amounts for each Contract Year calculated by multiplying the decimal fraction shown on Column 1 of Exhibit C for each Contract Year by the total of the following: (i) the total amount of the annual cost of System I chargeable to Puget in accordance with Section 5(A) hereof (without reducing such amount for any credit pursuant to the provisions of Section 9 hereof), (ii) less the amount specified in paragraph (7) of Section 5(A) and (iii) less the amount of payment to Puget by the District in accordance with paragraph (3) of this Section 8(A), whether or not the operation of System I is interrupted, suspended or interfered with in whole or in part for any cause whatsoever during the term of this Contract or during any portion of said term.

(2) Puget shall have no right, interest or claim to the Wenatchee River Properties or to the rents, income, receipts or proceeds of any sale or disposition thereof. In the event monies derived from the Wenatchee River Properties are used to pay any portion of System I costs or are deposited in or used in connection with any fund maintained for System I, thereby reducing System I costs, the full benefit thereof shall be reflected in a reduction in the District's share of System I costs.

(3) The District also agrees to pay to Puget each Contract Year in monthly installments an amount equal to the sum of the following amounts for such Contract Year:

(a) Revenues or income of System I properly creditable to Accounts 451, 453, 454, 455 and 456, inclusive, or to Accounts 415, 416, 417, 418, 419 and 421, inclusive, of the Uniform System of Accounts, excluding (i) revenues from investment of monies in the Bond Fund and in the Reserve and Contingency Fund established pursuant to District Resolution Nos: 1137 and 3443,

(ii) rents, income and receipts of Wenatchee River Properties and (iii) gain on purchase of System I Bonds;

(b) Revenues received by the District from sales of power and energy to serve Rock Island Project supervisors' cottages;

(c) All costs and expenses of the Wenatchee River Properties including renewals and replacements, if any, or such properties; and

(d) Governmental taxes, assessments or other similar charges or payments in lieu thereof lawfully imposed upon the District due to District's ownership or operation of the Wenatchee River Properties and any amounts paid by the District to any governmental agency for fire protection for the Wenatchee River Properties.

(4) Should the District from time to time require, from one or more of the District's Points of Delivery connected to that portion of the Joint System's 115-kV transmission facilities extending from the District's McKenzie switching station to Stevens Pass Summit, delivery of Squilchuck Power in excess of 20,000 kilowatts of coincidental clock-hour integrated demand, the District shall:

(a) Pay to Puget from funds other than funds of the Joint System the amount of any increased cost to Puget relating to transmission of power and energy from the Joint System caused by the District's taking in excess of said 20,000 kilowatts;

(b) Give Puget not less than eighteen (18) months prior written notice of the District's intention to take in excess of said 20,000 kilowatts; and

(c) Consult with Puget in advance on any changes in transmission system operating arrangements that may be thereby required in order to minimize the effect on Puget's system of the District's taking of such excess power and energy.

(5) For use by the District of each Added Facility, the District also agrees to pay to Puget in monthly installments annual amounts for each Contract Year equal to the product of the following:

(a) The amount of the District's Other Power at the time of the District's Electric System peak, divided by the total of (i) the amount of the District's Squilchuck Power and (ii) the amount of the District's Other Power; and

(b) An amount determined by multiplying the total investment of System I in each Added Facility by 0.085.

(6) The District covenants and agrees that it will establish, maintain and collect rates or charges for power and energy taken by the District from System I and sold or delivered to customers of the District other than Puget, including other systems of the District, which shall be adequate to provide revenues sufficient to enable the District to pay all amounts payable by the District to Puget as provided in this Section 8(A) and any other obligations payable from said revenues as the same severally become due and payable, and that all such revenues will be segregated, deposited and held separate and apart from all other revenues of the District arising out of the ownership of electric public utility properties other than System I and used only for System I purposes.

(B) System II. The District agrees to pay into the Revenue Fund to the credit of the System II Revenue Account in monthly installments, annual amounts equal to all of the District's annual costs associated with ownership, operation and maintenance of, and renewals and replacements to System II, including those essential and necessary to effect delivery of System II Output and System II Peaking Capability to the System II Points of Delivery as herein specified, not required to be paid by Puget under the provisions of Section 5 of this contract, including in such annual cost an amount to be paid into the System II Reserve and Contingency Fund equal to payments required to be made by Puget in accordance with provisions of paragraphs (6) and (7) of Section 5(E) hereof multiplied by the decimal fraction determined by dividing the District's System II Share by Puget's System II Share, whether or not operation of System II is interrupted, suspended or interfered with in whole or in part for any cause whatsoever during such Contract Year.

Section 9. Advance Payment for Power. The amount of advance payment by Puget for purchase of power credited to Puget on the District's books as of the effective date of this contract in accordance with Section 8 of the Power Contract dated June 8, 1962 between the District and Puget, will be carried forward on said books. The District agrees to credit against the amount annually payable by Puget as provided in Section 5(A) hereof an amount annually equal to \$31,250 computed and credited monthly until 2400 hours Pacific Time January 5, 2004, or until such time as the credit for advance payment for power has been reduced to zero.

Section 10. Billings. Billing for sums due the District from Puget in accordance with provisions of this contract shall be rendered monthly by the District upon an estimated basis for the preceding month and shall be paid by Puget at the office of the District in Wenatchee, Washington within twelve (12) days after the date of the bill. For practical purposes, but without changing any obligations of the parties hereto under this contract, the District will render net bills to Puget in order to facilitate settlement under Sections 5 and 8 of this contract, and amounts due Puget from the District in accordance with the provisions of this contract shall be computed monthly upon an estimated basis for the preceding month and shall be offset against amounts due to the District from Puget.

Each party shall submit to the other party such supporting data with regard to all bills under this contract as are reasonably necessary to enable the auditor or financial officer of such other party to effect proper accounting thereof.

A final accounting of all transactions in each calendar year shall be rendered to Puget by the District, and to the District by Puget, on or before May 15 of the succeeding year. Any balance due by either party to the other shall be paid within thirty (30) days from said May 15.

If payment of any bill rendered by either party to the other is not made in full on or before the close of business on the thirtieth (30th) day after the date of the bill, or if payment of any sum due in advance of billing is not paid when due as provided in this contract, a delayed-payment charge of two percent (2%), which shall be in addition to interest automatically accruing at the rate of six percent (6%) per annum of the unpaid amount of the bill, will be made (except that in case of a bona fide dispute as to the correct amount of the bill, the delayed-payment charge shall be applicable only to the

portion thereof admittedly due and not paid), provided, however, that such late payment charge shall not be assessed unless payment is not received on the first banking day following the date the District has notified Puget by telephone that payment when due has not been received.

Whenever a bill by either party to the other remains unpaid subsequent to the sixtieth (60th) day after the date of the bill (except as to such portion thereof which may in good faith be disputed), or whenever any amounts payable in advance of billing shall remain unpaid subsequent to the sixtieth (60th) day after such amount is due and payable as provided in this contract, the party to whom such bill or amount is payable may, thereafter upon giving thirty (30) days advance notice in writing, discontinue service to the other party until such bill is paid.

No such discontinuance of service shall affect either party's liability for any amounts accrued prior thereto, nor be deemed to waive any right to damages. If at any time service is discontinued to Puget as provided in this Section 10, Puget agrees that it will nevertheless continue to make the payments required to be paid by it to the District as though service had not been discontinued. In any suit or action by either party against the other, for breach of this contract or for recovery of any sums payable to the other party under this contract, the prevailing party shall be entitled to recover reasonable attorney's fees to be fixed by the Court.

Remittances received by mail will be accepted without assessment of the two percent (2%) delayed-payment charge or interest, provided the postmark indicates payment was mailed on or before the thirtieth (30th) day after the date of the bill or the due date of sums payable in advance of billing. If the thirtieth (30th) day after the date of the bill or the due date of sums payable in advance of billing is a Sunday or a Holiday, the next following business day shall be the last day on which payment can be made without addition of interest and the delayed-payment charge.

If a bill from the District to Puget remains unpaid subsequent to the 150th day after the date of the bill (except as to such portion which may in good faith be disputed), or whenever any amounts payable in advance of billing remain unpaid subsequent to the 150th day after such amount is due and payable as provided in this contract the District may, upon giving 30 days advance notice in writing, terminate this contract and Puget's rights hereunder unless Puget pays the bill or amounts payable in advance specified in such notice within said 30-day period.

If Puget fails to perform any of its obligations under this contract other than its obligations to make payments when due, the District may, upon giving 30 days advance notice in writing of such default, terminate this contract and Puget's rights hereunder unless Puget corrects such default within the 30-day period, or if the default is such that it cannot be corrected within 30 days, corrects such default within a reasonable period of time.

For the purpose of this Section 10, the "date of the bill" shall mean the date the bill was mailed, or if delivered by any other method, the date actually delivered.

Section 11. Issuance of Additional Bonds.

(A) System I.

(1) The District agrees that should the cost to the District in connection with any major loss or damage or major renewals of or replacements to System I or any major additions, improvements and betterments or modifications required by any governmental agency having jurisdiction to System I be in excess of monies then in System I Reserve and Contingency Fund plus proceeds of insurance policies, if any, covering such loss or damage, the District will, unless an alternative method of financing is mutually agreed upon, issue and sell additional bonds payable from the revenues of System I to pay that portion of such costs, including necessary reserves, which exceed the sum of (a) proceeds, if any, of insurance policies and (b) monies then in the System I Reserve and Contingency Fund, provided that the District can then legally issue such bonds and that such bonds can be marketed. If it is necessary to issue and sell additional bonds under the above described circumstances, the District shall take all reasonable steps to establish the legality of and to sell such bonds payable from the revenues of System I and on a parity with System II Bonds. The District shall fix the maturities of such bonds in such amounts and at such times that will result in total annual payments for interest and principal being approximately equal during the amortization period of the bonds. For the purpose of this Section 11(A), monies in System I Reserve and Contingency Fund shall not include amounts transferable from the Reserve Account in the System I Bond Fund. As used in this Section 11(A) and in Section 11(B) hereof the term "bond" or "bonds" shall mean bonds or other evidences of indebtedness or both.

(2) Puget agrees that the District shall have the right in the future to refund System I Bonds in order to effect cost savings and other policy objectives of the District, and agrees that it will negotiate in good faith necessary modifications to this contract in order to accomplish such refunding; provided that the refunding does not (i) result in an increase in the net annual payments required to be made by Puget under this contract, or (ii) result in an increase in the cost of power and energy to Puget from System I or (iii) prejudice Puget's right and interests with respect to the System I Revenue Fund, Bond Fund and Reserve and Contingency Fund as established pursuant to Resolution Nos. 1137 and 3443.

(B) System II.

(1) The District agrees that should the cost to the District in connection with any major loss or damage or major renewals of or replacements to System II or any major additions, improvements and betterments or modifications required by order of any governmental agency having jurisdiction to System II be in excess of monies then in System II Reserve and Contingency Fund plus the proceeds from insurance policies, if any, covering such loss or damage, the District will, unless an alternative method of financing is mutually agreed upon, issue additional bonds, payable from the revenues of System II on a parity with the System II Bonds, to pay that portion of such costs, including necessary reserves, which exceed the proceeds, if any, of insurance policies, provided that the District can then legally issue such bonds and that such bonds can be marketed. The District shall take all reasonable steps to establish the legality of and to sell such bonds.

(2) The District agrees that it will use its best efforts to issue and sell during the term of this contract one or more series of Refunding Bonds to refund or Advance Refund in whole or in part any one or more series of System II Bonds in order to obtain the optimum amounts of reductions in Contract Debt Service and in cost to the District and Puget for System II Output and System II Peaking Capability to the extent feasible and practicable.

If the District shall Advance Refund in whole or in part any series of System II Bonds, the District shall prepare a table similar to the table of Contract Bonds Outstanding applicable to the Advance Refunding Bonds but based on the assumption that the District would not Advance Refund such Bonds but would refund them on the first call date of such series at the same interest rate and costs of refunding as the interest rate and costs of refunding applicable to the Advance Refunding Bonds. Puget's payments under Section 5(B) hereof during the Contract Year beginning July 1, 2000 and each Contract Year thereafter during the remainder of

the term of this Contract shall be increased by an amount equal to the amount required to pay interest and principal on an amount of bonds equal to the difference between the computed amount of bonds that would be outstanding on June 30, 2012 as shown in such table and Contract Bonds Outstanding on June 30, 2012 for such series. Such increased amount shall be computed based on the following assumptions:

- (a) The interest rate on the bonds shall be the average interest rate of the Advance Refunding Bonds.
- (b) The bonds shall be retired over a 12-year period.
- (c) The sum of interest and principal payments for each year during such 12-year period shall be approximately equal.

For the purpose of this paragraph (2) the term Advance Refund shall mean the proceedings adopted and action taken to refund in whole or in part any one or more series of System II Bonds in advance of the first call date of such System II Bonds by defeasing such System II Bonds at the time of such advance refunding through the issuance of Refunding Bonds. The Refunding Bonds so issued are referred to in this paragraph (2) and paragraph (3) as Advance Refunding Bonds.

If the District shall refund or Advance Refund less than the whole amount of any series of System II Bonds, an appropriate adjustment shall be made in the amount of Contract Debt Service and Contract Bonds Outstanding applicable to the series of Bonds being partially refunded to reflect the effect of such refunding.

(3) Notwithstanding the other provisions of this Section 11(B) the District reserves the right to issue Refunding Bonds other than Advance Refunding Bonds to refund in whole any one or more of the series of System II Bonds at any time prior to maturity thereof, provided that such refunding shall not result in (i) an increase in any Contract Year in the net annual payments required to be made by Puget under this contract, or (ii) an increase in the cost of power and energy to Puget from System II. For the purposes of computing Contract Debt Service on each series of such Refunding Bonds, the amount of Bonds in such series shall not exceed the amount of Contract Bonds Outstanding applicable to each series of Bonds being refunded, plus the costs of such refunding, including in such costs the discount, if any, and deducting from such costs the premium, if any, on the Refunding Bonds.

(C) General. The District, in issuing Refunding Bonds shall act prudently and shall use its best efforts to issue such bonds at the lowest practicable costs consistent with the District's policy objectives sought to be achieved by such refunding.

Section 12. Establishment and Use of Funds.

(A) System I.

(1) The District agrees that it will maintain during the term of this contract the Revenue Fund created and established by District Resolution No. 1137 and the provisions of said Resolution 1137 applicable to the Revenue Fund are incorporated herein by reference. The District further agrees that it will pay into the Revenue Fund as promptly as practicable after receipt thereof, all income, revenues, receipts and profits derived by the District through the ownership and operation of the Joint System, including all amounts received from Puget and the District pursuant to the provisions of Sections 5 and 8 hereof, and all other monies required to be deposited in the Revenue Fund pursuant to District Resolution No. 1137 and the Bond Resolution, other than the amounts expressly required or permitted by District Resolution Nos. 1137 and 3443 and the Bond Resolution to be deposited in any other fund.

(2) The District agrees that it will maintain the System I Bond Fund created and established by Resolution No. 1137, so long as the System I Bonds are outstanding and unpaid, and that it will transfer monthly from the Revenue Fund to said Fund the amounts received from Puget pursuant to the provisions of paragraph (3) of Section 5(A) hereof.

(3) The District agrees that it will maintain during the term of this contract the System I Reserve and Contingency Fund created and established by Resolution No. 1137, into which will be transferred from the proceeds of the issuance of the first series of System II Bonds an amount sufficient as of the Date of Initial Financing to increase said Fund to \$2,928,735. The District agrees that it will transfer monthly from the Revenue Fund to the System I Reserve and Contingency Fund the amounts received from Puget pursuant to the provisions of paragraphs (5) and (6) of Section 5(A) hereof. Monies in the System I Reserve and Contingency Fund may be used solely for the purposes of:

- (a) Making up any deficiency which may occur in the Bond Fund of System I;
 - (b) Paying the cost of renewals to and replacements of System I;
 - (c) Paying extraordinary operation and maintenance costs of System I;
 - (d) Paying the cost of extensions of and betterments to the System to the extent of not more than \$25,000 in any calendar year, except for the acquisition and construction of extensions of and betterments to System I as provided for in Sections 23 and 24(B) of this contract, without the mutual agreement of the parties, and to any extent with such agreement, and
 - (e) Paying the cost of renewals to, replacements of, extensions of and betterments to System II to the extent that proceeds from sale of System II surplus property or salvage are deposited in the System I Reserve and Contingency Fund.
- Whenever the value of cash and investments in the System I Reserve and Contingency Fund exceeds 3.998% of the total amount of System I Bonds, the amount of such excess shall be withdrawn at least annually for the purchase or redemption of System I Bonds, so long as any System I Bonds are outstanding and unpaid.

The District agrees that it will not expend monies in the System I Reserve and Contingency Fund for extensions of or betterments to System I which are not reasonably necessary to the conduct of the business of such System, or which are uneconomical.

Monies in the System I Reserve and Contingency Fund shall be invested and reinvested by the District to the fullest extent practicable. All monies earned as a result of any such investment or reinvestment shall accrue to and be deposited in such Fund.

(4) The District agrees that it will maintain during the term of this Contract the Wenatchee River Development Fund, created and established in accordance with the provisions of Section 6.2(6) of Resolution No. 3443, and two accounts within such fund as follows:

(a) A Rock Island Expansion Account into which will be transferred \$7,111,000 as of the Date of Initial Financing. Said monies shall be set aside and paid from time to time as may be necessary to the System II Construction Fund Trustee for deposit to the System II Construction Fund. Prior to the payment of said sum to said Trustee it shall be invested by the District and the earnings from the investments thereof shall be retained in said Account. From said investment earnings there shall be paid into the Revenue Fund as a credit to System I costs the amount of said earnings to the extent of \$17,666.67 per month, plus all Operating Expenses in connection with the Dryden property (dam, headworks, irrigation canals and flumes). The transfers to the Construction Fund Trustee of the principal balance in said Account together with investment earnings shall be scheduled in a manner consistent with the cash flow requirements of construction of System II and shall be completed on the later of the date which is five years after Date of Initial Financing or the Date of Commercial Operation. In scheduling such transfers the District shall use its best efforts to maximize the amount of investment earnings in order to avoid, to the extent possible, any increase in costs to the District and Puget associated with System I prior to the Date of Commercial Operation of System II.

(b) A Wenatchee River Properties Account into which will be transferred the Wenatchee River Properties and all rent, income and receipts or proceeds of any sale or other disposition of the Wenatchee River Properties. Earnings from the investment of such monies may at the option of the District be retained in said Account and used for the purposes for which other monies in said Account may be used or may be paid into the Revenue Fund as directed by the District. Puget shall have no right, interest or claim to any monies in said Account or to earnings from investments of money therein or to any additions, improvements, facilities, properties or other assets acquired with monies from said Account. Notwithstanding the provisions of Sections 5 and 8 hereof any monies transferred from this Account into the Revenue Fund shall not be considered as credits, operating revenues or income of System I but may be used by the District to offset payments to Puget pursuant to the provisions of Section 8(A) hereof.

(5) Such other special funds and accounts of System I as may be required pursuant to provisions of System I Bond Resolution.

(B) System II.

(1) The District agrees that it will create and maintain during the term of this contract a separate account within the Revenue Fund to be known as the System II Revenue Account. All income, revenues, receipts and profits derived by the District through the ownership and operation of System II shall be credited to such Account. All costs to the District of the ownership and operation of System II shall be charged to said Account. Said account shall be established in the initial amount of \$750,000 from the proceeds of the sale of System II Bonds to be used as Working Capital.

After making all payments required to be made from the Revenue Fund pursuant to the provisions of the Bond Resolution, there may be transferred to the District from the Revenue Fund each Contract Year after the Date of Commercial Operation the amount, if any, by

which that portion of the amounts payable by Puget to the District for such Contract year attributable to the amounts specified in paragraphs (3), (4) and (5) of Section 5(E) hereof, exceed the sum of (i) payments made by the District for interest, principal and premium, if any, of Sys-II Bonds for such year and (ii) investment earnings on the Principal Account, Interest Account and Bond Retirement Account and any other account established for the purpose of retirement of System II Bonds by the Bond Resolution to the extent that such earnings reduce the payments in the foregoing clause (i) which would have been made by the District if there were no such earnings.

For purposes of this Section 12(B), principal payments shall be deemed to include payments into any account established pursuant to the provisions of the Bond Resolution authorizing System II Bonds for the purpose of retiring System II Bonds.

The District shall fix maturities and sinking fund requirements for System II Bonds in such amounts and at such times that the product obtained by multiplying the District's payments for principal and interest on all System II Bonds by Puget's System II Share shall not for any Contract Year exceed that portion of the amounts payable by Puget to the District for such Contract Year attributable to the amounts specified in paragraphs (3), (4) and (5) of Section 5(E) hereof. In the event Puget makes any payment pursuant to the provisions of Section 5(H)(2) hereof then the District shall concurrently reimburse Puget from other revenues of the District for the amount of any such payments.

(2) The District agrees that it will create and maintain during the term of this contract, System II Bond Funds pursuant to the provisions of the Bond Resolution, said Funds to be used solely for the purpose of paying the principal of, premium, if any, and interest on the System II Bonds and additional bonds issued on a parity therewith, and of retiring the System II Bonds and additional bonds issued on a parity therewith, prior to maturity. The District will transfer monthly from the Revenue Fund to said Funds the amounts required by the Bond Resolution.

(3) The District agrees that it will create and maintain during the term of this contract an Expansion Reserve and Contingency Fund (herein referred to as the System II Reserve and Contingency Fund) as a reserve to be used as provided in Section 6.4 of District Resolution No. 4950, provided, however, that except as otherwise specifically provided in this contract payment for the costs of extensions of and betterments to System II in excess of a cumulative amount of \$25,000 in any calendar year shall be made only with the consent of Puget; and, provided further, that any amount of the System II Reserve and Contingency Fund monies deposited in the System I Reserve Account, as that account is defined in Resolution Nos. 1137 and 3443, shall be reimbursed to the System II Reserve and Contingency Fund from the first revenues available for such purposes from System I.

Monies in the System II Reserve and Contingency Fund shall be invested and reinvested by the District to the fullest extent practicable in accordance with the provisions of District Resolution No. 4950. All monies earned as a result of any such investment or reinvestment prior to the Date of Commercial Operation shall accrue to and be deposited in the Construction Fund established by the District in Resolution No. 4950. After the Date of Commercial Operation, all monies earned as a result of any such investment or reinvestment shall accrue to and be deposited in the Revenue Fund.

The District agrees that it will not expend monies in the System II Reserve and Contingency Fund for extensions of or betterments to System II which are not reasonably necessary to the conduct of the business of such System or which are uneconomical.

The System II Reserve and Contingency Fund shall be established in the initial amount of \$3,000,000 from proceeds of issuance of System II Bonds and, subject to the provisions of Section 6.4 of District Resolution No. 4950, shall be maintained at said amount until the Date of Commercial Operation. If the amount in said Fund is less than \$3,000,000 on the Date of Commercial Operation, the District will transfer into said Fund, from the proceeds of the issuance of the first series of System II Bonds issued after the Date of Commercial Operation an amount equal to the difference between \$3,000,000 and the amount actually in said Fund on the Date of Commercial Operation. In addition to payments required to be made into such Fund by the District in accordance with provisions of Section 8(B) hereof, all payments by Puget pursuant to provisions of paragraph (6) of Section 5(E) hereof shall be deposited in such Fund. An amount equal to the excess in such Fund, at the end of any month after taking into account commitments or obligations of the District chargeable against such fund and which are expected to become due and payable within 90 days after the end of such month, over \$3,000,000 multiplied by Puget's System II Share for such month shall be credited against payments to be made by Puget pursuant to the provisions of Section 5(E) during the following month and the balance of such excess shall be credited to the District against payments to be made by the District pursuant to provisions of Section 8(B) during the following month.

(4) Such other special funds and accounts of System II as may be required pursuant to the provisions of System II Bond Resolution.

(5) The District will carry out the provisions of the following sections of District Resolution No. 4950 authorizing the issuance and sale of the first series of System II Bonds, and such sections are attached hereto as Exhibit E.

	Section 6.6	Construction Fund
Section 6.7	Investment of Monies in Construction Fund	
	Section 6.8	Cost of Construction
Section 6.10	Distribution of Monies in Construction Fund	
Section 6.11	Monies in Construction Fund pending application thereof.	

(C) Investment. The District agrees that, to the extent authorized by the Bond Resolution and all applicable laws, rules and regulations of governmental authorities, it will use its best efforts to invest and keep invested available funds of System I and System II to maximize interest earnings therefrom consistent with prudent investment practice and System I and System II needs.

Section 13. Books of Account and Auditing. The District shall cause proper books of account to be kept for the District showing as a separate utility system the accounts of the Joint System segregated to show separately the accounts of System I and System II in accordance with the rules and regulations prescribed by any governmental agency authorized to prescribe such rules, including the Division of Municipal Corporations of the State Auditor's Office of the State of Washington, or other State department or agency succeeding to such duties of the State Auditor's Office, and in accordance with the Uniform System of Accounts prescribed by the Federal Power Commission or other Federal agency having jurisdiction over electric public utility companies owning and operating properties similar to the electric properties operated by the District, whether or not the District is required by law to use such system of accounts, and such accounting records shall be available for inspection and utilization by the duly authorized representatives of Puget at all reasonable times. The District shall supply monthly to Puget such reports of the operation and maintenance of the Joint System and of System I and System II as Puget may from time to time reasonably request. The District shall cause such books of account to be audited by independent certified public accountants, experienced in electric utility accounting and of national reputation, to be employed by the District. The audits to be made by such independent certified public accountants, shall be made annually and shall cover each calendar year during the term of this contract shall be completed within one hundred twenty (120) days following the end of each such calendar year. A copy of each such annual audit, including any recommendations of the accountants with respect thereto, shall be made available by the District to Puget.

Section 14. Reactive Power. The parties recognize that voltage levels of the District's power system and other interconnected systems are affected by the amounts of reactive power supplied from the Joint System as well as from other sources. The District will operate the Joint System to provide reactive power necessary together with other reactive power made available to maintain proper voltage levels at the Points of Delivery. If it is determined by the parties hereto that the reactive power requirements of the loads of either the District or Puget are resulting in a reduction in kilowatt-hour output of the Joint System, the party responsible for such reactive power requirements shall at its own expense limit such reactive power requirements to a point that such kilowatt-hour output shall not be thereby reduced.

Section 15. Operation, Maintenance, Engineering and Planning.

(A) Operation. The parties hereto agree to cooperate on matters relating to operation, maintenance and repair of the Joint System. It is the intent of the parties hereto that the Joint System shall be operated to assure optimum availability of usable Joint System Output coordinated to the load requirements of Puget and the District and that capacity and energy made available hereunder to Puget and the District shall be fully coordinated with other resources available to the parties and with the Northwest Power Pool; provided, however, operation of the Joint System shall be subject to provisions of the Federal Power Commission License No. 943-Washington as now or hereafter amended or reissued and that certain agreement between the Great Northern Railway and the Washington Electric Company dated April 15, 1931 as now or hereafter amended.

(B) Maintenance. The District will use its best efforts to operate and maintain the Joint System in good operating condition at all times in an efficient, economical and workmanlike manner and consistent with good business and operating practices followed by other electric utilities in the Pacific Northwest, and will make renewals and replacements thereof as needed. Maintenance, repairs, renewals and replacements shall be scheduled and performed by the District with the intent of obtaining the optimum operation of the Joint System as required to meet the respective requirements of the parties hereto. The District, in order to prevent injury to persons or to avoid damage to property or equipment may in an emergency without consultation with Puget temporarily interrupt or reduce deliveries of electric energy hereunder but only for as long as such emergency shall exist. In the event of any failure of or damage whatsoever to facilities of the Joint System, or any reduction in the delivery of power and energy therefrom from causes other than water conditions, the District agrees that it will, with due diligence, expedite repair or replacement of said facilities or remedy the condition causing such reduction to the end that delivery of power and energy will be re-established as soon as reasonably possible.

(C) Engineering and Planning. The District shall advise and consult with Puget from time to time on matters relating to engineering studies, planing, operation of the Joint System and maintenance and repair thereof. Such matters shall include engineering studies as required to maintain or increase usable power and energy, exchange of operating information and data, cooperation with respect to unresolved problems, contractual arrangements with other utilities for storage and wheeling requirements, system operating studies and other related problems.

(D) Inspection, Books and Records. Authorized representatives of Puget shall at all reasonable times have access to the Joint System for the purpose of inspection, and all books and records pertaining to operation and maintenance of the Joint System shall be made available to Puget by the District at all reasonable times.

Section 16. Character of Service. Power and energy made available hereunder shall be in the form of three-phase current alternating at a frequency of approximately sixty (60) Hertz and deliveries thereof shall be at Points of Delivery to Puget and the District and at delivery voltages hereinafter specified.

- Section 17. Points of Delivery.
- (A) System I. The District will use the facilities of System I and System II as such facilities may from time to time exist to deliver System I Output and System I Peaking Capability to the System I Points of Delivery hereinafter specified:
- (1) To Puget: The System I Output and System I Peaking Capability made available to Puget pursuant to the provisions of Section 4(A) hereof, less transmission and transformation losses between the Generator Bus and Points of Delivery determined in accordance with the provisions of Section 21 hereof, shall be delivered at the following System I Points of Delivery and at the voltages specified:
- (a) Summit Point of Delivery:
Location – At the point of connection with Puget on the 115-kV transmission facilities of System I.
Delivery Voltage – Approximately 115 kV.
 - (b) Rocky Reach Points of Delivery:
Location – At the point or points of connection between the 230-kV bus at the District's Rocky Reach 230-kV switchyard and transmission facilities which are or may be available to Puget.
Delivery Voltage – Approximately 230 kV.
 - (c) McKenzie Point of Delivery:
Location – At the point of connection between the 115-kV bus at the District's McKenzie Switching Station and facilities which are or may be available to Puget.
Delivery Voltage – Approximately 115 kV.
 - (d) Chelan Interconnection Point of Delivery:
Location – At the point of connection between System I Rocky Reach-Chelan 115-kV transmission line and the District's Lake Chelan Hydro-Electric System.
Delivery Voltage – Approximately 115 kV.
 - (e) Valhalla Points of Delivery:
Location – At the points of connection between the facilities of System I and Bonneville's Valhalla Substation and the facilities of System II and Bonneville's Vahalla Substation.
Delivery Voltage – Approximately 115 kV.
 - (f) Other Points of Delivery:
At such other Points of Delivery and at such Delivery Voltages as the parties hereto may mutually agree upon from time to time.
- (2) To the District: System I Output and System I Peaking Capability taken by the District pursuant to the provisions of Section 7(A) hereof, less transmission and transformation losses between the Generator Bus and Points of Delivery, shall be delivered at the following Points of Delivery and at delivery voltages specified:
- (a) Wenatchee-North Wenatchee Points of Delivery:
Locations – At the low voltage side of the Wenatchee and North Wenatchee substations of System I.
Delivery Voltage – Approximately 34.5 kV.
 - (b) Dryden Point of Delivery:
Location – At the point of connection between the facilities of the District's Electric System and the facilities of System I in the vicinity of the Town of Dryden.
Delivery Voltage – Approximately 115 kV.
 - (c) Summit Point of Delivery:
Location – At the point of connection between the facilities of the District's Electric System and the facilities of System I at the Stevens Pass Summit.
Delivery Voltage – Approximately 115 kV.
 - (d) Berne Point of Delivery:
Location – At the point of connection between facilities of the District's Electric System and facilities of System I at the District's Berne Substation.
Delivery Voltage – Approximately 115 kV.
 - (e) McKenzie Points of Delivery:
Location – At the points of connection between the 115-kV bus at the District's McKenzie Switching Station and facilities which are or may be available to the District.
Delivery Voltage – Approximately 115 kV.
 - (f) Valhalla Point of Delivery:
Location – At the point of connection between facilities of System II and Bonneville's Valhalla Substation.
Delivery Voltage – Approximately 115 kV.
 - (g) Squilchuck Point of Delivery:
Location – At the low voltage side of the Squilchuck Substation of System I.
Delivery Voltage – Approximately 12.5 kV.
 - (h) Coles Corner Point of Delivery:
Location – At the point of connection between facilities of the District's Electric System and System I at the District's Coles Corner Substation.
Delivery Voltage – Approximately 115 kV.
 - (i) College Point of Delivery:
Location – At the point of connection between facilities of the District's Electric System and the facilities of System I in the vicinity of the District's College Substation.
Delivery Voltage – Approximately 115 kV.

- (j) Leavenworth Point of Delivery:
Location – At the point of connection between facilities of the District's Electric System and the facilities of System I in the vicinity of the Town of Leavenworth.
Delivery Voltage – Approximately 115 kV.
- (k) Other Rock Island–North Wenatchee Points of Delivery:
Location – At such other points on the 115–kV transmission lines of System I between the District's McKenzie Switching Station and the North Wenatchee Substation as the District directs.
Delivery Voltage – As the District determines.
- (l) Other Points of Delivery:
Location – At such other points on the 115–kV transmission lines of System I as the District directs between the District's McKenzie Switching Station and the Stevens Pass Summit and between the McKenzie Switching Station and the point of interconnection between the Rock Island–Rock Reach–Chelan transmission line and the District's Lake Chelan Hydro–Electric System.
Delivery Voltage – As the District determines.
- (B) System II. The District will use the facilities of System I and System II as such facilities may from time to time exist to deliver System II Output and System II Peaking Capability to the System II Points of Delivery hereinafter specified:
- (1) To Puget: The System II Output and System II Peaking Capability made available to Puget pursuant to the provisions of Section 4(b) hereof, less transmission and transformation losses between the Generator Bus and System II Points of Delivery determined in accordance with provisions of Section 21 hereof, shall be delivered at the following System II Points of Delivery and delivery voltages:
- (a) McKenzie Point of Delivery:
Location – At the point of connection between the 115–kV bus at the District's McKenzie Switching Station and facilities which are or may be available to Puget.
Delivery Voltage – Approximately 115 kV.
- (b) Valhalla Points of Delivery:
Location – At the points of connection between facilities of System I and Bonneville's Valhalla Substation and the facilities of System II and Bonneville's Valhalla Substation.
Delivery Voltage – Approximately 115 kV.
- (c) Other Points of Delivery:
At such other Points of Delivery and at such Delivery Voltages as the parties hereto may mutually agree upon from time to time.
- (2) To the District: System II Output and System II Peaking Capability made available to the District pursuant to the provisions of Section 7(B) hereof, less transmission and transformation losses between the Generator Bus and System II Points of Delivery shall be delivered at the following System II Points of Delivery voltages:
- (a) McKenzie Point of Delivery:
Location – At the point of connection between the 115–kV bus of the District's McKenzie Switching Station and facilities which are or may be available to the District.
Delivery Voltage – Approximately 115 kV.
- (b) Valhalla Point of Delivery:
Location – At the point of connection between facilities of System II and Bonneville's Valhalla Substation.
Delivery Voltage – Approximately 115 kV.
- (c) Other Points of Delivery:
At such other Points of Delivery and at such Delivery Voltages as the parties hereto may mutually agree upon from time to time.

Section 18. Use of Rocky Reach Project Facilities. The District will use the transmission facilities of the Rocky Reach Project as such facilities may from time to time exist to deliver System I Output and System I Peaking Capability to System I Points of Delivery; provided, however, that the use of such facilities to deliver power and energy to Puget pursuant to provisions of this contract shall be limited to the remaining capacity thereof (including capacity made available by opposed power flows) after first use by the District to deliver power and energy to the District's loads within Chelan and Douglas Counties and for deliveries of Rocky Reach Project power and energy and shall at all times be subject to provisions of the District's Bond Resolutions No. 1412, No. 1860 and No. 4198 and to the provisions of the license issued by the Federal Power Commission for Rocky Reach Project No. 2145 and to the provisions of all contracts entered into by the District for sale of power and energy produced by the Rocky Reach Project; and provided further, however, that if said use of facilities of the Rocky Reach Project to deliver System I Output and System I Peaking Capability to Puget hereunder should at any time result in increased cost or expense to the District or to the Rocky Reach Project or both, Puget shall reimburse the District for such increased cost or expense.

Section 19. Scheduling. Prior to 1600 hours of each work day, Puget shall make available to the District an hourly estimate of requested total energy deliveries from System I and from System II for the following day or days to and including the next work day. Such estimated schedule including revisions thereof and deliveries thereunder shall not exceed the sum of (i) Puget's System I Share of System I Output; (ii) the amount of energy in Puget's System I Share of System I Pondage available to Puget during such period; (iii) Puget's System II Share of System II Output; and (iv) the amount of energy in Puget's System II Share of System II Pondage available to Puget during such period. At no time shall the scheduled rate of such deliveries exceed the sum of (i) Puget's System I Share of System I Peaking Capability and (ii) Puget's System II Share of System II Peaking Capability. Revisions in such schedules for any day may be made by Puget (i) at any time on request to the District or (ii) continuously through appropriate use of automatic load control equipment or otherwise.

The District may schedule energy deliveries from System I and System II up to the sum of (i) the District's System I Share of System I Output; (ii) the amount of energy in the District's System I Share of System I Pondage available to the District during such period; (iii) the District's System II Share of System II Output; and (iv) the amount of energy in the District's System II Share of System II Pondage available to the District during such period. At no time shall the scheduled rate of such deliveries exceed the sum of (i) the District's System I Share of System I Peaking Capability and (ii) the District's System II Share of System II Peaking Capability.

Section 20. Metering. Unless otherwise agreed by the parties hereto metering shall be maintained by the District as follows:

(A) Generator Bus. The District shall provide and maintain suitable watt–hour, var–hour and recording demand meters on the Generator Bus at the power plants of System I and System II.

(B) Other Metering. The District shall provide and maintain suitable meters at the Summit Point of Delivery and at other points as may be necessary to carry out the terms of this contract.

(C) Reading Meters. The District shall read its meters mentioned in this contract at appropriate intervals so as to maintain a record of energy transactions under this contract.

(D) Testing. The District will test its metering equipment mentioned in this contract at least once every two (2) years and, if requested to do so by Puget, it will make additional tests or inspections of such metering equipment, the expense of which will be paid by Puget unless such additional tests or inspections show such metering equipment to be inaccurate as specified below. The District will give reasonable notice to Puget of the time when any such test or inspection is to be made. If any meter mentioned in this contract fails to register or if the measurement made by such meter during a test made, as provided above, varies by more than one per cent (1%) from the measurement made by the standard meter used in such test, adjustment shall be made correcting all measurements made by such inaccurate meter for (1) the actual period during which such inaccurate measurement was made, if such period can be determined, or (2) if not, the period immediately preceding the test of such meter which is equal to one–half the time from the date of the last preceding test of such meter; provided, however, that the period during which such correction is to be made shall not exceed six (6) months.

Section 21. Losses. The amounts of power and energy delivered to Puget at Puget's System I and System II Points of Delivery shall be adjusted for computed transmission and transformation losses between the Generator Bus and said Points of Delivery in accordance with the following:

- (1) For deliveries at the Summit Point of Delivery an amount equal to the metered quantities at said Point of Delivery multiplied by the appropriate loss factor;
- (2) For deliveries at the McKenzie Point of Delivery an amount equal to the scheduled quantities multiplied by appropriate loss factors.
- (3) For all deliveries not included in the foregoing paragraphs (1) and (2) no adjustment will be made. In developing said loss factors reverse flow shall be considered.

Section 22. Electric Disturbances. In the use of peaking capacity and energy delivered under this contract, the parties hereto agree that they will exert every effort to avoid causing electric disturbances which may be reasonably expected to result in damage to or impair service from the Joint System or electric facilities of the other party. In the event such disturbance shall occur, the party responsible will, at its own expense, install such equipment as is necessary to prevent or eliminate such disturbances.

Section 23. Puget's Right to Use System I Facilities. The District hereby grants to Puget for the term of this contract the right to use transmission facilities of System I for the purpose of continuing the coordination and integration of its operations with other utilities to the full extent that capacity is available therefor after delivering power and energy to the District and Puget pursuant to the provisions of Sections 17 and 24(A), 24(B) and 24(C) hereof; provided, however, that notwithstanding the provisions of Sections 17 and 24(A), 24(B) and 24(C) hereof, use by the District of the Rock Island–Rocky Reach–Chelan 115–kV transmission line of System I, for the purposes of delivering power and energy to the District and Puget pursuant to other provisions of this contract, shall not, at any time during the term hereof, reduce the thermal capacity of said line available for use by Puget pursuant to this Section 23 to an amount less than 80,000 kilovoltamperes; and provided further, that at the request of Puget the District will make such modifications to the Rocky Reach–Chelan section of said lines as are necessary to increase the thermal capacity thereof available to Puget for the purposes described in this Section 23 to an amount not less than 108,000 kilovoltamperes if sufficient funds are available for that purpose in the Reserve and Contingency Fund of System I and in accordance with the District's Resolution No. 1137 can be used for such purposes.

Section 24. District's Right to Use of Transmission Facilities.

(A) Original Facilities. Except as limited in Section 24(C) hereof, the District shall have the right to use at no additional cost to the District, the Original Facilities for the purpose of transmitting power and energy to the District and to and for the account of other systems of the District to the full extent that capacity is available therefor after delivering Joint System Output and Joint System Peaking Capability to the District and Puget pursuant to the other provisions of this contract.

(B) Added Facilities. The District shall have the right to use the Added Facilities for the purpose of transmitting power and energy to the District and to and for the account of other systems of the District to the full extent that capacity is available therefor after delivering Joint System Output and Joint System Peaking Capability to the District and Puget pursuant to the other provisions of this contract. The District may construct additional substation capacity and associated tap lines as Added Facilities; provided that each tap line shall not exceed one mile in length; and provided further, that the total amount of substation capacity included as Original Facilities and Added Facilities shall not exceed 200,000 kilovoltamperes of transformer maximum nameplate rating.

(C) Limitations. The District's right to the use of transmission facilities of System I shall be subject to the following limitations:

(1) The District's right to use of the McKenzie–Summit 115–kV transmission facilities existing on the date of this contract for purposes set forth in the foregoing Section 24(A) shall be limited to transmission of a maximum of 20,000 kilowatts of coincidental clock–hour integrated demand less the amount of the District's Squilchuck Power taken coincidentally by the District at the District's Points of Delivery connected to said transmission facilities; provided that during any time transmission capacity available to Puget pursuant to Section 23 hereof is not used by Puget, including any transmission capacity made available by opposed power flow, such capacity shall be available for use by the District.

(2) The District's right to use of the Rocky Reach–Chelan section of the Rock Island–Rocky Reach–Chelan 115–kV transmission facilities existing on the date of this contract for purposes set forth in the foregoing Section 24(A) shall be limited to transmission of a maximum of 28,000 kilowatts of coincidental clock–hour integrated demand less the amount of the District's Squilchuck power taken coincidentally by the District at the

District's Points of Delivery connected to said Rocky Reach–Chelan section of transmission line and shall be increased to not more than 37,000 kilowatts less the amount of the District's Squilchuck power taken coincidentally by the District at the District's Points of Delivery connected to said Rocky Reach–Chelan section of transmission line at such time as capacity available to Puget is increased to 108,000 kilovoltamperes as provided in Section 23 hereof, provided, however, that during any time the transmission capacity available to Puget pursuant to Section 23 hereof is not used by Puget, including any transmission capacity made available by opposed power flow, such capacity shall be available for use by the District.

(D) Alternative Facilities. Other systems of the District may construct additional facilities within the District's Electric System providing additional capacity for transmitting power to the Summit Point of Delivery to Puget and to the Chelan Interconnection Point of Delivery to Puget. In such an event, the District may use the transmission capacity of the McKenzie–Summit 115–kV transmission line and the Rocky Reach–Chelan section of the McKenzie–Rocky Reach–Chelan 115–kV transmission line in excess of amounts provided in Section 24(C) as limited by Section 23; provided, however, that Puget's transmission rights and capability over the McKenzie–Summit 115–kV transmission line and over such additional facilities after such construction shall be equivalent to Puget's transmission rights and capability over the McKenzie–Summit 115–kV transmission line prior to such construction and Puget's transmission rights and capability over the Rocky Reach–Chelan section of the McKenzie–Rocky Reach–Chelan 115–kV transmission line and over such additional facilities after such construction shall be equivalent to Puget's transmission rights and capability over such Rocky Reach–Chelan section prior to such construction.

Section 25. Rocky Reach Downstream Replacement Power.

(A) The District. The District shall make available to System II or System II shall make available to the District, as appropriate, each hour during the term hereof an amount of energy equal to the amount of Rocky Reach Downstream Replacement Power for such hour, if any, multiplied by the District's percentage withdrawal of the output of the District's Rocky Reach Project after deducting from such percentage the percentage of such output equivalent to the amount of power sold to the Public Utility District No. 1 of Douglas County, Washington (Douglas) pursuant to the provisions of the contract between the District and Douglas dated October 30, 1957, as amended, relating to the sale of such output.

(B) Puget. Puget shall make available to System II or System II shall make available to Puget, as appropriate, each hour during the term hereof an amount of energy equal to the amount of Rocky Reach Downstream Replacement Power for such hour, if any, multiplied by Puget's percentage purchase of the output of the Rocky Reach Project which percentage shall not include output assigned to Puget by any other Rocky Reach purchaser.

(C) System Responsibilities. System II shall make available to System I or System I shall make available to System II, as appropriate, each hour during

the term hereof an amount of energy equal to the amount of Rocky Reach Downstream Replacement Power for such hour, if any.

(D) Exchanges. During each hour that System II Output is less than the total of Rocky Reach Downstream Replacement Power plus the amount of Rocky Reach Encroachment Power for such hour, the District shall supply to System II an additional amount of energy equal to such difference multiplied by the District's System II Percentage and Puget shall supply to System II an additional amount of energy equal to such difference multiplied by Puget's System II Percentage. The amount of energy supplied to System II by each Party shall be returned to such Party from the first energy available from System II Output.

Section 26. Joint System Operations – Arbitration.

(A) Recommendations. Puget may make recommendations to the District with reference to matters concerning the Joint System. The District will give due consideration to recommendations of Puget. In considering such recommendations, the District shall give due regard to the objective of achieving the optimum electric power availability from the Joint System consistent with economy, reliability and facility of operation and the District's statutory duties. If, in the opinion of Puget, the District has given inadequate consideration to its informal recommendations,

written recommendations may be made to the District by Puget. Such written recommendations shall be forwarded to the District with appropriate supporting data. The District shall take action on such recommendations within a reasonable time by adopting, modifying or rejecting such recommendations. If the District modifies or rejects said recommendations, it shall notify Puget of its action in writing giving reasons therefor.

(B) Notices. The District shall give Puget reasonable notice, in no case less than thirty (30) days except in the event of an emergency requiring immediate action, whenever it proposes: (i) to replace items of major equipment in the Joint System, or (ii) to enter into new or special contractual arrangements relating to the Joint System and substantially modifying the operation of the Joint System or the cost of power therefrom, or (iii) to apply for or consent to an amendment, modification or change of the license for the Rock Island Project if such amendment, modification or change would materially modify the operation of the Joint System or increase the cost of power therefrom.

(C) Procedures. If the District modifies or rejects a written recommendation from Puget dealing with matters which may be arbitrated as set forth in Section 26(D) hereof, and made in accordance with the procedure set forth in Section 26(B) hereof, Puget may submit the recommendation to a Board of Arbitrators within 15 days of the date on which Puget receives written notice from the District of such modification or rejection. If Puget shall fail to seek arbitration within the aforesaid 15-day period its rights to arbitration hereunder shall be waived. The Board of Arbitrators shall be composed of three (3) persons, one of whom shall be appointed by the District, one of whom shall be appointed by Puget, and the third person shall be appointed by the two persons so appointed. In the event said two members do not agree upon the appointment of a third person, then such third person shall be appointed by the Chief Justice of the Supreme Court of the State of Washington. The procedure for arbitration shall be governed by the laws of the State of Washington. Insofar as the parties hereto may legally do so, they agree to abide by the decision of said Board; provided, that the District shall not be bound by any decision of the Board of Arbitration to the extent that such decision is retroactive beyond the date when the matter arbitrated was made the subject of written recommendation of Puget.

(D) Matters to be Arbitrated. Matters which may be arbitrated in accordance with the preceding Section 26(C) shall consist of all matters pertaining to the construction of, the maintenance and operation of, additions or betterments to, extensions of, replacements or renewals to the Joint System, insurance to be carried on said Joint System (which in no event shall be less than that required under the terms of the Bond Resolution), computation of Contract Debt Service and Contract Bonds Outstanding, amounts to be charged to the cost of operating the Joint System as a result of voluntary payments in lieu of taxes, amendment, modification or change of the Federal Power Commission license for the Rock Island Project and all other matters materially affecting the cost of power to Puget, except such of the matters hereinabove described in this paragraph as are by law vested exclusively in the discretion of the District.

(E) Divisibility. In the event this Section 26, or any paragraph, sentence, clause or phrase thereof, or Section 11(B) hereof or any paragraph, sentence, clause or phrase thereof, or any parts or all of both, shall be finally adjudicated by a court of competent jurisdiction to be invalid or illegal, the remainder of this contract shall remain in full force and effect as though such section or sections, or parts thereof so adjudicated to be invalid had not been included herein.

Section 27. Notices. Any notice, recommendation or demand by Puget under this contract shall be deemed properly given if given by registered mail, postage prepared, addressed to Public Utility District No. 1 of Chelan County, 327 North Wenatchee Avenue, Wenatchee, Washington 98801, and any notice, recommendation or demand by the District under this contract shall be deemed properly given if given by registered mail, postage prepaid, addressed to Puget Sound Power & Light Company, Puget Power Building, Bellevue, Washington 98009. The designation of the name and address to which any such notice, recommendation or demand is to be directed may be changed at any time and from time to time by either party by similar notice.

Section 28. Benefited Parties. This contract shall be binding upon and inure to the parties hereto, and their successors and assigns, and is not intended to and shall not confer upon any third party any rights or benefits hereunder. Nothing herein contained is intended to adversely affect any rights or benefits inuring to the holders from time to time of bonds of the District payable from the revenue of the System.

Section 29. Amendment of Contract. It is agreed by the parties hereto that no provision of this contract constitutes an amendment to or other action that will reduce the payments or extend the time of making payments that were provided for in that certain Power Contract (Rock Island) between the District and Puget dated January 6, 1956 (which contract was superseded by that certain Power Contract between the District and Puget dated June 8, 1962, which is in turn superseded by this contract on the date of delivery of and payment for System II Bonds, except for accrued and undischarged obligations of the parties thereunder), or otherwise impairs or adversely affects the rights of holders from time to time of the District's Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Issue of 1955, First Series.

It is further agreed by the parties hereto that no provision of this contract constitutes an amendment to or other action in connection with the June 8, 1962 Power Contract which in any manner adversely affects the security of the District's Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Issue of 1955 First Series and Second Series upon which holders from time to time of such bonds have relied as an inducement to purchase and hold said bonds.

The District and Puget agree that this contract shall not be amended, modified or otherwise altered by agreement of the parties in any manner that will adversely affect the security for System I Bonds afforded by the provisions of this contract covering the purchase and sale of power hereunder upon which the holders from time to time of said bonds have relied as an inducement to purchase and hold said bonds. The District and Puget agree that so long as any System II Bonds are outstanding, this contract shall not be amended, modified or otherwise altered by agreement of the parties in any manner which will reduce the payments or extend the time of payments provided herein or which will in any manner impair or adversely affect the rights of the holders from time to time of the System II Bonds.

Section 30. District's Bond Resolution and License. It is recognized by the parties hereto that the District in its operation of the Joint System and in delivery of power and energy hereunder to Puget and to the District, must comply with (i) requirements of Resolution Nos. 1137 and 3443 so long as any of the Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Issue of 1955, First Series and Second Series are outstanding, (ii) the requirements

of Resolution No. 4950 during the time that any of the Columbia River-Rock Island Hydro-Electric System Revenue Bonds, Series of 1974 are outstanding, (iii) the requirements of any of the District's Resolutions authorizing any other System I Bonds and System II Bonds during the period that any such bonds are outstanding, and (iv) the license for the construction and operation of Federal Power Commission License Project No. 943-Washington and amendments thereof from time to time made and with the provisions contained in renewals or reissuance of said license, and it is therefore accordingly agreed that this contract is made subject to terms and provisions of (i) each of said resolutions, during the time any bond issued pursuant to the provisions of such resolution are outstanding and (ii) said license, including renewals or reissue of said license. At the appropriate time the District shall make due and proper application for a renewal or reissuance of said license and make a diligent effort to obtain a renewal or reissuance of said license.

If, upon relicensing, Project No. 943-Washington is licensed to a licensee other than the District, and the new licensee is not required to assume and fulfill this contract, then this contract shall terminate on the date that the District ceases to operate the Rock Island Project and to make available from such project to Puget, Puget's System I Share of System I Output and System I Peaking Capability and Puget's System II Share of System II Output and System II Peaking Capability.

Section 31. Liabilities; Waiver of Subrogation.

(A) Releases. The District and Puget release each other, their agents and employees from any claim for loss or damage, arising out of the construction, operation, maintenance, reconstruction and repair of the Joint System due to negligence, including gross negligence, including any loss of profits or revenues, loss of use of power system, cost of capital, cost of purchased or replacement power, other substantially similar liability or other consequential loss or damage, but not any claim for loss or damage resulting from breach of any contract relating to the Joint System, including this contract, or for willful or wanton misconduct.

(B) Charges. Any loss, cost liability, damage and expense to the District or Puget or both, other than damages to either resulting from loss of use and occupancy of the Joint System or any part thereof, resulting from the construction, operation, maintenance, reconstruction or repair of the Joint System and based upon injury to or death of persons, or damage to or loss of property of others, to the extent not covered by collectible insurance, shall be charged to Cost of Construction, as defined in District Resolution No. 4950, or annual costs, whichever may be appropriate.

(C) Waiver. The District and Puget shall cause its insurers to waive any rights of subrogation against each other, their agents and employees for losses, costs, damages or expenses arising out of the construction, operation, maintenance, reconstruction or repair of the Joint System.

Section 32. Conflict of Laws. The parties hereto agree that this contract shall be governed by the laws of the State of Washington.

Section 33. Waiver of Default. Any waiver at any time by either party hereto of its rights with respect to the other party or with respect to any other matter arising in connection with this contract shall not be considered a waiver with respect to any subsequent default or matter.

Section 34. Insurance. The District agrees that it will, to the extent available at reasonable cost with responsible insurers and at least to the extent that similar insurance is usually carried by electric utilities operating like properties, keep or cause to be kept the works, plants and facilities comprising the properties of the Joint System and the operation thereof insured, with policies payable to the District for the benefit of the Joint System and Puget as their interest may appear, against risks of direct physical loss, damage to or destruction of the Joint System, against loss caused by suspension or interruption of generation or transmission of power and energy caused by such loss, damage or destruction and, against accidents, casualties, or negligence, which insurance shall include liability insurance and employers liability.

In the event of any loss or damage to properties of the Joint System covered by such insurance, (i) prior to the Date of Commercial Operation of System II, the District will transfer insurance proceeds received by the District covering damage or loss to System II to the System II Construction Fund; (ii) after the Date of Commercial Operation of System II, the District will transfer insurance proceeds received by the District covering loss or damage to System II to the System I Reserve and Contingency Fund and such proceeds, to the extent required, shall be applied to the cost of replacing such loss or repairing such damage and (iii) the District will transfer insurance proceeds received by the District covering loss or damage to System I to the System I Reserve and Contingency Fund. In case of loss of revenue covered by insurance, proceeds received by the District from any insurance policy or policies covering such loss of revenue shall be paid into the Revenue Fund to the credit of System I or System II costs, as appropriate.

Section 35. Assignment of Contract. This contract shall inure to the benefit of, and shall be binding upon the respective successors and assigns of the parties to this contract. No assignment or transfer of this contract shall relieve the parties hereto of any obligation incurred hereunder. Subject to the foregoing sentence, the interest of Puget under this contract may be assigned and transferred as set forth below, but not otherwise:

(A) To any mortgagee, trustee, or secured party, as security for bonds or other indebtedness of Puget, present or future, and such mortgagee, trustee or secured party may realize upon such security in foreclosure or other suitable proceedings and succeed to all right, title and interests of Puget;

- (B) To any corporation or other entity acquiring all or substantially all the property of Puget;
- (C) To any corporation or entity into which or with which Puget may be merged or consolidated;
- (D) To any corporation or entity, the stock or ownership of which is wholly owned by Puget; and
- (E) To any other person or entity with the prior written approval of the District.

Section 36. Force Majeure. The District shall not be liable for any default in the performance of its obligations under this contract, other than its obligations to make when due all payments required hereunder, due to Uncontrollable Forces. If the District is rendered unable to fulfill any obligations by reason of uncontrollable forces it shall exercise due diligence to remove such inability with all reasonable dispatch. Nothing contained herein shall be construed so as to require the District to settle any strike or labor dispute in which it may be involved.

Section 37. Supersedence of June 8, 1962 Power Contract. The June 8, 1962 Power Contract between the District and Puget relating to the Rock Island Project is superseded by this contract between Puget and the District and said June 8, 1962 Power Contract shall terminate on the effective date of this contract, provided, however, that all of the provisions of the June 8, 1962 Power Contract with respect to System I will remain in full force and effect until commencement of the first Contract Year under this contract, except that from and after 0001 hours on the Date of Initial Financing the District shall be relieved and release from the obligation to pay to Puget the sum of \$212,000 annually, or any part thereof, as provided in Section 7(b)(6) of the June 8, 1962 Power Contract, and any costs in connection with the Dryden property (dam, headworks, irrigation canals, flume).

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed by their proper officers respectively, being thereunto duly authorized and their respective corporate seals be hereto affixed the day and year first above written.

PUBLIC UTILITY DISTRICT NO. 1
OF CHELAN COUNTY, WASHINGTON

(Seal)

By /s/ [Signature Illegible]
President

Attest

By /s/ Robert McDougall
Vice President

/s/ Kirby Billingsly
Secretary

PUGET SOUND POWER & LIGHT COMPANY

By /s/ John W. Ellis
Executive Vice President

(Seal)

Attest:

/s/ W. Watson
Secretary

EXHIBIT A
SYSTEM II FACILITIES

- The facilities of System II shall include, but not be limited to, the following:
1. A second powerhouse in the location of the nonoverflow section, the spillway bays 33 through 37 and the right bank fish ladder containing eight 54-MVA turbine generator units of the horizontal shaft bulb type with generators housed in watertight enclosures in the water passages, together with necessary auxiliary equipment, controls, and appurtenances for the complete operation of these machines and two step-up power transformers each rated at 210 MVA. The powerhouse structure will be of the semi-outdoor type, having dimensions of approximately 470 x 130 feet exclusive of the erection area, with the draft tube extending an additional 70 feet downstream.
 2. Two single-circuit, 115-kV, 3-phase transmission lines from the powerhouse for a distance of approximately two miles to the District's existing McKenzie switchyard, and Bonneville Power Administration's Valhalla Substation and any other necessary transmission line.
 3. A new fish passage facility which will have inlets above the draft tubes at both ends of the second powerhouse and an inlet at the right abutment downstream of the draft tubes. All of the entrances will lead into a ladder located on the right side of the powerhouse with exit in the forebay along the right riverbank.
 4. Additional spillway crest gate sections and reinforced spillway structures with post-tensioned foundation anchors so that the forebay elevation may be raised to elevation 613.0 (USC &GS)
 5. Necessary changes in the left bank and middle fish facilities upstream for their proper functioning at the raised forebay level.
 6. Necessary modifications to the left bank retaining walls and other structures to accommodate the raised forebay level.
 7. Necessary modifications to spillway regulating gates and emergency gates, and the hoisting equipment resulting from raising of the forebay level and removal of spillway bays 33 through 37.
 8. Any additional parcels of land or rights to lands in the vicinity of the forebay as required for the higher reservoir elevation.
 9. Any other modifications for construction of the new powerhouse and adjacent areas in the forebay and tailrace as necessary for satisfactory operations.

EXHIBIT B
DISTRICT'S SYSTEM I SHARE

<u>Contract Year</u>	<u>Column 1</u>	<u>District's System I Share</u>
July 1, 1974 – June 30, 1975	0.129
July 1, 1975– June 30, 1976	0.129
July 1, 1976– June 30, 1977	0.129
July 1, 1977– June 30, 1978	0.129
July 1, 1978 – June 30, 1979	0.129
July 1, 1979 – June 30, 1980	0.129
July 1, 1980 – June 30, 1981	0.129
July 1, 1981 – June 30, 1982	0.129
July 1, 1982 – June 30, 1983	0.129
July 1, 1983 – June 30, 1984	0.150
July 1, 1984 – June 30, 1985	0.172
July 1, 1985 – June 30, 1986	0.193
July 1, 1986 – June 30, 1987	0.215
July 1, 1987 – June 30, 1988	0.236
July 1, 1988 – June 30, 1989	0.258
July 1, 1989 – June 30, 1990	0.279
July 1, 1990 – June 30, 1991	0.300
July 1, 1991 – June 30, 1992	0.322
July 1, 1992 – June 30, 1993	0.343
July 1, 1993 – June 30, 1994	0.365
July 1, 1994 – June 30, 1995	0.386
July 1, 1995 – June 30, 1996	0.408
July 1, 1996 – June 30, 1997	0.429
July 1, 1997 – June 30, 1998	0.451
July 1, 1998 – June 30, 1999	0.472
July 1, 1999 – June 30, 2000 and thereafter	0.500

EXHIBIT C

<u>Contract Year</u>		<u>Column 1</u>
July 1, 1974 – June 30, 1975	.....	0.086
July 1, 1975– June 30, 1976	.....	0.086
July 1, 1976– June 30, 1977	.....	0.086
July 1, 1977– June 30, 1978	.....	0.086
July 1, 1978 – June 30, 1979	.....	0.086
July 1, 1979 – June 30, 1980	.....	0.021
July 1, 1980 – June 30, 1981	.....	0.021
July 1, 1981 – June 30, 1982	.....	0.021
July 1, 1982 – June 30, 1983	.....	0.021
July 1, 1983 – June 30, 1984	.....	0.043
July 1, 1984 – June 30, 1985	.....	0.043
July 1, 1985 – June 30, 1986	.....	0.043
July 1, 1986 – June 30, 1987	.....	0.043
July 1, 1987 – June 30, 1988	.....	0.043
July 1, 1988 – June 30, 1989	.....	0.043
July 1, 1989 – June 30, 1990	.....	0.064
July 1, 1990 – June 30, 1991	.....	0.086
July 1, 1991 – June 30, 1992	.....	0.107
July 1, 1992 – June 30, 1993	.....	0.129
July 1, 1993 – June 30, 1994	.....	0.172
July 1, 1994 – June 30, 1995	.....	0.236
July 1, 1995 – June 30, 1996	.....	0.300
July 1, 1996 – June 30, 1997	.....	0.365
July 1, 1997 – June 30, 1998	.....	0.408
July 1, 1998 – June 30, 1999	.....	0.451
July 1, 1999 – June 30, 2000 and thereafter	.....	0.500

EXHIBIT D
DISTRICT'S SQUILCHUCK POWER

<u>Contract Year</u>	<u>District's Squilchuck Power MW</u>
July 1, 1974 – June 30, 1975	48
July 1, 1975– June 30, 1976	51
July 1, 1976– June 30, 1977	55
July 1, 1977– June 30, 1978	58
July 1, 1978 – June 30, 1979	62
July 1, 1979 – June 30, 1980	65
July 1, 1980 – June 30, 1981	72
July 1, 1981 – June 30, 1982	80
July 1, 1982 – June 30, 1983	87
July 1, 1983 – June 30, 1984	95
July 1, 1984 – June 30, 1985	102
July 1, 1985 – June 30, 1986	109
July 1, 1986 – June 30, 1987 and Thereafter	116

EXHIBIT E

SECTIONS OF DISTRICT RESOLUTION NO. 4950

SECTION 6.6. Construction Fund. There is hereby created a special fund of the District to be known as the "Columbia River-Rock Island Hydro-Electric System Expansion Construction Fund" (hereinafter referred to as the "Construction Fund") which shall be held in trust by the Construction Fund Trustee for the benefit of the District and the holders of the Bonds, as their interests may appear. There is also hereby created in the Construction Fund a special account to be known as the "Construction Interest Account"

A. Immediately upon the issuance and delivery of any Series of Bonds, there shall be paid into the Construction Fund such amount of the proceeds derived from the sale of such Series of Bonds as is to be applied to the payment of the Cost of Construction. The amount of said proceeds to be applied to the payment of interest on the Bonds shall be credited to the Construction Interest Account.

- B. From the proceeds derived from the 1974 Bonds there shall be deposited:
1. With the Construction Fund Trustee for credit to the Construction Interest Account an amount equal to the accrued interest on said Bonds paid as part of the purchase price thereof;
 2. With the Construction Fund Trustee for credit to the Construction Interest Account an amount equal to the interest to accrue on said Bonds from the date thereof to July 1, 1979, less the amount of the accrued interest paid into said Account pursuant to subparagraph 1 above, which shall be used to pay interest on said Bonds during such period;
 3. With the Bond Fund Trustee for credit to the Reserve Account in the Expansion Bond Fund an amount equal to the Reserve Account Requirement;
 4. Into the Expansion Reserve and Contingency Fund the sum of Three Million Dollars (\$3,000,000);
 5. Into the Original Reserve Fund an amount sufficient as of the date of delivery of and payment for the 1974 Bonds to increase said Fund to the amount required to be on deposit therein pursuant to the Basic Resolution, but only to the extent that moneys have theretofore been expended therefrom in connection with the Second Powerhouse.
 6. Into the Revenue Fund the sum of Seven Hundred Fifty Thousand Dollars (\$750,000) to be used for working capital; and
 7. With the Construction Fund Trustee for credit to the Construction Fund the balance of such Bond proceeds, which shall be applied to the Cost of Construction.

- C. From the proceeds derived from each Series of Bonds other than the 1974 Bonds, there shall be deposited:
1. With the Construction Fund Trustee for credit to the Construction Interest Account an amount equal to the accrued interest on said Bonds paid as a part of the purchase price thereof;
 2. With the Construction Fund Trustee for credit to the Construction Interest Account an amount which, together with amounts then in such Account, shall be equal to the interest to accrue on said Bonds and all other Bonds, if any, then outstanding, to July 1, 1979, or to the then estimated Date of Commercial Operation, whichever is later, less the amount of the accrued interest paid into said Account pursuant to subparagraph 1 above, which shall be used to pay interest on said Bonds during such period;
 3. With the Bond Fund Trustee for credit to the Reserve Account in the Expansion Bond Fund an amount equal to the Reserve Account Requirement; and
 4. With the Construction Fund Trustee for credit to the Construction Fund the balance of such Bond proceeds, which shall be applied to the Cost of Construction.

D. Moneys in the Construction Interest Account shall be used for the purpose of paying interest on the Bonds. On or before the 25th day of the month next preceding the maturity of an installment of interest on the Bonds the Construction Fund Trustee shall transfer from the Construction Interest Account to the Bond Fund Trustee for deposit in the Interest Account in the Expansion Bond Fund an amount which, together with any moneys theretofore received or held by the Bond Fund Trustee for that purpose, shall be sufficient to pay such next maturing installment of interest on said Bonds. If at any time moneys in the Construction Interest Account and other available moneys are inadequate for such purpose, the Construction Fund Trustee shall transfer from the Construction Fund to the Construction Interest Account such amount of moneys as is required to permit such transfer to the Bond Fund Trustee.

E. All moneys received by the District by reason of the breach of default of contractors in connection with the construction of the Second Powerhouse shall be paid to the Construction Fund Trustee for deposit in the Construction Fund.

SECTION 6.7. Investment of Moneys in Construction Fund. The Construction Fund Trustee may, and at the direction of the District shall, invest the moneys in the Construction Fund from time to time in Investment Securities, which Investment Securities shall mature, or which shall be subject to redemption at the option of the holder thereof, in not more than five (5) years from the date of purchase. Any investment made by the Construction Fund Trustee and any direction given by the District shall be made or given with due regard to the latest estimate of the Construction Engineer filed with or certified to the Construction Fund Trustee pursuant to Section 8.3 and Section 8.6 of this Resolution with respect to the amounts needed from time to time to pay Cost of Construction and the estimated dates of such payments. All interest earned by reason of such investments shall accrue to the Construction Fund. In the event moneys so invested are needed in the Construction Fund to meet obligations thereof for which funds are not otherwise available, then the Construction Fund Trustee shall sell, or present for redemption, said investments to the extent required to provide for such purpose. The Construction Fund Trustee shall not be liable for any depreciation in the value of any of such investments or deposits made at the direction of the District.

SECTION 6.8. Cost of Construction. Payment of the Cost of Construction shall be made from the moneys in the Construction Fund and from moneys made available therefor from the special account provided for by Section 6.2.6 of Resolution No. 3443 of the District adopted by the Commission of the District on May 24, 1962. For the purpose of this Resolution, the Cost of Construction shall include all costs of constructing, acquiring and installing the Second Powerhouse as generally described in Section 2.2 hereof and shall include, but not be limited to, the following:

- A. Paying or reimbursing the cost of preliminary surveys, investigations, engineering and other expenses and fees properly incurred for the Second Powerhouse.
- B. Paying the cost of obtaining any and all permits and licenses required by any governmental agency or authority having jurisdiction and any other licenses, permits, approvals or legal rights of any kind required for, or used or useful in the construction, acquisition and installation of the Second Powerhouse.
- C. Paying obligations incurred for labor and materials and to contractors, builders and to material suppliers in connection with the construction, acquisition and installation of the Second Powerhouse, for machinery and equipment, for the restoration and relocation of property damaged or destroyed in connection with such construction, for the removal or relocation of structures and for the clearing of lands.
- D. Paying the cost of acquiring by purchase, if such purchase shall be deemed expedient, and the amount of any deposit in court or award or final judgment in or any settlement or compromise of any proceeding to acquire by condemnation or by the exercise of the power of eminent domain such lands, property, rights of way, franchises, easements, or other interests in land as may be deemed by the District to be used or useful for the construction, acquisition, installation, maintenance and operation of the Second Powerhouse, options and partial payments thereon, the amounts of any damages incident to or consequent upon the construction, acquisition, installation, maintenance and operation of the Second Powerhouse, options and partial payments thereon, the amounts of any damages incident to or consequent upon the construction, acquisition, installation and operation of the Second Powerhouse.
- E. Paying interest on the Bonds accruing until July 1, 1979, or the Date of Commercial Operation, whichever is later.
- F. Paying the fees and expenses of the Construction Fund Trustee for all services rendered under this Resolution during the Period of Construction, and of the Bond Fund Trustee and of the Paying Agents for all services rendered under this Resolution until July 1, 1979 or the Date of Commercial Operation, whichever is later; taxes or other municipal or governmental charges lawfully levied or assessed against the Second Powerhouse and any taxes levied against property acquired therefor or payments required in lieu thereof, in each case to the Date of Commercial Operation, and premiums on insurance in connection with the construction of the Second Powerhouse during the Period of Construction.
- G. Paying the cost to the District of the performance of the duties of the Construction Engineer and the Consulting Engineer and other engineering and professional services rendered to the District in connection with the acquisition and construction of the Second Powerhouse and the placing of the Second Powerhouse in operation, or the issuance of Bonds therefor.

H. Paying or reimbursing the District for expenses incident and properly allocable to the acquisition and construction of the Second Powerhouse and the placing of the same in operation, including per diem compensation or salaries of the Commission, legal, engineering, financing, accounting and other professional expenses and fees, costs of printing and preparing and issuing the Bonds, wages of office and clerical employees, administrative management expenses, pension requirements, health and hospitalization insurance and all other items of expense not specified elsewhere in this Section which are incident and properly allocable to the acquisition and construction of the Second Powerhouse and placing the same in operation (including the premiums on any insurance and fidelity bonds required or obtained during construction), including miscellaneous fees and costs in connection with the acquisition of lands, rights of way, property rights, franchises, easements, costs of abstracts of title, title insurance, cost of surveys and appraisals.

I. Paying into the Expansion Reserve and Contingency Fund the amounts necessary to maintain said Fund at Three Million Dollars (\$3,000,000) on or prior to the Date of Commercial Operation.

Notwithstanding any other provision of this Resolution, prior to July 1, 1979, or the Date of Commercial Operation, whichever is later, the costs and expenses, including taxes of the District in connection with the operation and maintenance of the Second Powerhouse, and the cost of all repairs, renewals and replacements to the Second Powerhouse, shall be paid from the Construction Fund. Prior to July 1, 1979, or the Date of Commercial Operation, whichever is later, all revenues, income, receipts and other moneys derived from the operation of the Second Powerhouse shall be deposited in the Construction Fund.

In any event, amounts in the Construction Fund shall be applied to the payment when due of principal of and interest on the Bonds to the extent that other moneys are not available therefor and such amounts are hereby pledged as additional, payments to the Expansion Bond Fund to the extent required for any such deficiency.

SECTION 6.10. Distribution of Moneys in Construction Fund. As soon as practicable after the Construction Engineer shall have filed the report required by Section 8.4 hereof, any balance then remaining in the Construction Fund shall be used and applied by the Construction Fund Trustee as follows in the following order:

First, to pay to the Bond Fund Trustee for credit to the Interest Account in the Expansion Bond Fund that amount, if any, of the interest to accrue on the Bonds to July 1, 1979; and to the extent of any remainder of such balance,

Second, to set aside in the Construction Fund the amounts specified in such report pursuant to clauses (c), (d), (e), and (f) of Section 8.4 hereof, and to apply the same to the payment of the Cost of Construction in accordance with the provisions of Section 6.9 hereof; and to the extent of any remainder of such balance,

Third, to pay to the Bond Fund Trustee for deposit in the Reserve Account the amount of any deficiency in such Account; and to the extent of the remainder of such balance,

Fourth, to pay to the Bond Fund Trustee such remainder for credit to the Bond Retirement Account.

As soon as practicable after the Construction Engineer shall have led the report required by Section 8.5 hereof, the Construction Fund Trustee shall pay to the Bond Fund Trustee the amount specified in such report pursuant to clause (b) of such Section for deposit in the Reserve Account to the extent of any deficiency in such Account, and to the extent of any remainder of such amount the Construction Fund Trustee shall pay to the Bond Fund Trustee such remainder for credit to the Bond Retirement Account.

SECTION 6.11. Moneys in Construction Fund Pending the Application Thereof. The moneys in the Construction Fund and in the Construction Interest Account therein, pending their application as provided in this Resolution, shall be held in trust and shall be subject to a prior and paramount lien and charge in favor of the holders of the Bonds, and the holders of the Bonds shall have a valid claim on such moneys for the further security of said Bonds until paid out or transferred as herein provided.

PUGET SOUND ENERGY
STATEMENT SETTING FORTH COMPUTATIONS OF RATIOS OF
EARNINGS TO FIXED CHARGES
(Dollars in Thousands)

	12 Months Ended March 31,	Years Ended December 31,				
	2009	2008	2007	2006	2005	2004
Earnings Available For Fixed Charges:						
Pre-tax income:						
Income from continuing operations before income taxes	\$ 225,464	\$ 223,618	\$ 265,308	\$ 275,339	\$ 233,900	\$ 200,533
AFUDC – equity	(2,519)	(2,627)	(1,351)	(7,978)	(3,800)	(2,796)
AFUDC – debt	(7,862)	(8,610)	(12,614)	(15,874)	(9,493)	(5,420)
Total	\$ 215,083	\$ 212,381	\$ 251,342	\$ 251,487	\$ 220,607	\$ 192,317
Fixed charges:						
Interest expense	\$ 204,768	\$ 203,402	\$ 219,120	\$ 184,859	\$ 174,458	\$ 171,831
Other interest	2,519	2,627	1,351	7,978	3,800	2,796
Portion of rentals representative of the interest factor	11,834	11,775	9,199	9,151	5,234	5,424
Total	\$ 219,121	\$ 217,804	\$ 229,670	\$ 201,988	\$ 183,492	\$ 180,051
Earnings available for combined fixed charges	\$ 434,204	\$ 430,185	\$ 481,012	\$ 453,475	\$ 404,099	\$ 372,368
Ratio of Earnings to Fixed Charges	1.98x	1.98x	2.09x	2.25x	2.20x	2.07x

PUGET SOUND ENERGY
STATEMENT SETTING FORTH COMPUTATIONS OF RATIOS OF
EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS
(Dollars in Thousands)

	12 Months Ended					
	March 31,	Years Ended December 31,				
	2009	2008	2007	2006	2005	2004
Earnings Available for Combined Fixed Charges and Preferred Dividend Requirements:						
Pre-tax income:						
Income from continuing operations before income taxes	\$ 225,464	\$ 223,618	\$ 265,308	\$ 275,339	\$ 233,900	\$ 200,533
AFUDC – equity	(2,519)	(2,627)	(1,351)	(7,978)	(3,800)	(2,796)
AFUDC – debt	(7,862)	(8,610)	(12,614)	(15,874)	(9,493)	(5,420)
Total	\$ 215,083	\$ 212,381	\$ 251,342	\$ 251,487	\$ 220,607	\$ 192,317
Fixed charges:						
Interest expense	\$ 204,768	\$ 203,402	\$ 219,120	\$ 184,859	\$ 174,458	\$ 171,831
Other interest	2,519	2,627	1,351	7,978	3,800	2,796
Portion of rentals representative of the interest factor	11,834	11,775	9,199	9,151	5,234	5,424
Total	\$ 219,121	\$ 217,804	\$ 229,670	\$ 201,988	\$ 183,492	\$ 180,051
Earnings Available for Combined Fixed Charges and Preferred Dividend Requirements						
	\$ 434,204	\$ 430,185	\$ 481,012	\$ 453,475	\$ 404,099	\$ 372,368
Dividend Requirement:						
Fixed charges above	\$ 219,121	\$ 217,804	\$ 229,670	\$ 201,988	\$ 183,492	\$ 180,051
Preferred dividend requirements below	---	---	---	---	---	---
Total	\$ 219,121	\$ 217,804	\$ 229,670	\$ 201,988	\$ 183,492	\$ 180,051
Ratio of Earnings to Combined Fixed Charges and Preferred Dividends Requirement						
	1.98x	1.98x	2.09x	2.25x	2.20x	2.07x
Computation of Preferred Dividend Requirements:						
(a) Income from continuing operations before income taxes	\$ 225,464	\$ 223,618	\$ 265,308	\$ 275,339	\$ 233,900	\$ 200,533
(b) Net income before extraordinary items	\$ 166,809	\$ 162,736	\$ 191,127	\$ 176,650	\$ 146,840	\$ 126,192
(c) Ratio of (a) to (b)	1.3516	1.3741	1.3881	1.5587	1.5929	1.5891
(d) Preferred dividends ⁽¹⁾	\$ ---	\$ ---	\$ ---	\$ ---	\$ ---	\$ ---
Preferred dividend requirements [(d) multiplied by (c)]	\$ ---	\$ ---	\$ ---	\$ ---	\$ ---	\$ ---

⁽¹⁾ PSE does not have preferred dividends since 2003

⁽²⁾ PSE does not have any interest expense accrued on uncertain tax positions at March 31, 2009.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES–OXLEY ACT OF 2002

I, Stephen P. Reynolds, certify that:

I have reviewed this report on Form 10–Q of Puget Sound Energy, Inc.;

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d–15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) for the registrant and have:

- a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2009

/s/ Stephen P. Reynolds
Stephen P. Reynolds
President and Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES–OXLEY ACT OF 2002

I, Eric M. Markell, certify that:

I have reviewed this report on Form 10–Q of Puget Sound Energy, Inc.;

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d–15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) for the registrant and have:

- a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2009

/s/ Eric M. Markell
Eric M. Markell
Executive Vice President and
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES–OXLEY ACT OF 2002

In connection with the Report of Puget Sound Energy, Inc. (the “Company”) on Form 10–Q for the period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the “Form 10–Q”), I, Stephen P. Reynolds, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes–Oxley Act of 2002, that:

- (1) The Form 10–Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Form 10–Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 5, 2009

/s/ Stephen P. Reynolds
Stephen P. Reynolds
President and Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Report of Puget Sound Energy, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Form 10-Q"), I, Eric M. Markell, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 5, 2009

/s/ Eric M. Markell
Eric M. Markell
Executive Vice President and
Chief Financial Officer