City of Seattle

Gregory J. Nickels, Mayor

Seattle City Light
Jorge Carrasco, Superintendent

November 25, 2008

Stuart H. Clarke, Jr.
Senior Account Executive
Bonneville Power Administration
909 1st Avenue, STE 380
Seattle, WA 98104-9895

RE: Regional Dialogue Contracts (Power Sales Agreement, BPA Contract No. 09PB-13102 and Creditworthiness Agreement, Contract No. 09PB-13263)

Dear Mr. Clarke:

Thank you for your assistance in completing Regional Dialogue contract documents for Seattle City Light (Seattle). I would like to express my sincere appreciation of BPA's extraordinary management of the very long and complex Regional Dialogue Process over the past several years. I believe that the new product contracts and tiered rate methodology that resulted from this process will serve public power well over the next 20 years.

Seattle has been concerned that the BPA Administrator's 9(c) determination for the Centralia resource would not be known at the time of contract execution. Although a proposed decision was posted for public comment on November 18, the Administrator's final decision will not be known for a few more days. Nevertheless, Seattle has understood for more than two years that a favorable determination (that is, a "no export" finding) would be part of the total package proposed collectively by a large number of preference customers in the Public Power Council's original allocation proposal. This was one of several reasons that Seattle chose to actively support the Regional Dialogue process, including the development of the Tiered Rate Methodology, new product sales contracts and Residential Exchange settlement.

In addition to our concerns regarding 9(c), there are a number of issues with respect to the Slice contract that need to be addressed. We understand that BPA is prepared to address these issues and correct any errors in the contract starting next year. To guide that effort, please see attached list of things that should be cleaned up. Ideally, Seattle would like to make all necessary changes to the contract in the early part of the 2009 calendar year, well in advance of active power deliveries under the new agreement, so that each customer will understand clearly what contract terms and conditions it can count on after FY 2011.

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An equal employment opportunity, affirmative action employer. Accommodations for people with disabilities provided upon request.

Therefore, enclosed as requested are two signed, original Regional Dialogue Power Sales Agreements and one signed original Creditworthiness Agreement, duly submitted by Seattle prior to BPA Administrator's deadline of December 1, 2008, delivered to BPA in trust. Finally, enclosed, as required by BPA as a condition of the purchase of the Slice product, is the pertinent reliance letter with an attached legal opinion, both originating from Foster Pepper PLLC.

We are looking forward to working with BPA and the Slice customer group to implement the new contract. If you have any questions, please contact me at (206) 684-3243.

Sincerely,

Steven D. Kern
Power Supply & Environmental Affairs Officer

CMW
Enclosures:
1. Things That Should be Cleaned Up in the Regional Dialogue Slice/Block Power Sales Agreement;
2. Power Sales Agreement (2);
3. Creditworthiness Agreement (1)
4. Foster Pepper PLLC reliance letter with attached copy of legal opinion

cc: w/o enclosures
Steve Wright, BPA Administrator
Sarah Dennison-Leonard, consulting attorney

Things That Should Be Cleaned Up in the
Regional Dialogue Slice/Block Power Sales Agreement
(the "Slice Agreement")

[identified in the order in which the relevant provision appear in the Slice Agreement]

GLOBAL:

1. We need to make sure that all of the definitions that are intended to match definitions on the Tiered Rate Methodology (TRM), including the provisions copied into section 6.6 of the Slice Agreement, are synchronized to the corresponding provisions in the final TRM issued on November 10, 2008. Particularly critical is the definition of "Designated BPA System Obligations."

SPECIFIC:

2. Section 1, items 8 and 18: It does not make sense to include in a list of provisions that are take effect before delivery begins in 2011 these two items that are merely labeled as "Intentionally Left Blank." These should be deleted altogether and the other items no the list should be appropriately renumbered.

3. Section 2.4: The definition of "Absolute Operating Constraint" does not provide meaningful guidance and should be made clearer.

4. Section 2.7: It may make more sense for the definition of "Actual Tier 1 System Generation" to refer to "RP Augmentation," rather than "RHWM Augmentation."

5. Section 2.24: For consistency, the definition of "Block Product" should refer to "Total Retail Load" instead of "regional consumer load."

6. Section 2.46: The definition of "Critical Slice Amount" should make clear that it is calculated in accordance with, as well as set forth in, Exhibit I.

7. Section 2.50: The definition of "Delivery Limits" should make it clear that BPA must determine Slice Output availability pursuant to the Slice Agreement (as opposed to on an open-ended basis with no standards).

8. Section 2.55: For consistency and clarity, the definition of "Due Date" should be as **"defined"** in the referenced section, not as "described."

9. Section 2.65: The definition of "Federal Operating Decision" remains unreasonably open-ended.

10. Section 2.71: The definition of "Flat Annual Shape" should refer to **"megawatt"** values of energy, not just "values" of energy.

11. Section 2.80: The definition of "Hard Operating Constraint" does not provide meaningful guidance and should be made clearer.

12. Section 2.87: The acronym "ISP" should be removed from the definition of "Initial Slice Percentage" because it is not used.

13. Section 2.91: For consistency and clarity, the definition of "Issue Date" should be as "**defined**" in the referenced section, not as "described."

14. Section 2.100: We do not agree with the current definition of "Monthly Reimbursement Value."

15. Section 2.110: The definition of "Operating Constraints" should be simplified and clarified.

16. Section 2.123: The definition of "Prudent Operating Decision" remains unreasonably open-ended.

17. Section 2.131: The word "actual" in subsection (3) doesn't add anything and should be deleted.

18. Section 2.136: The term "Forecast Tier 1 Load," which is used in the definition of "RP Augmentation" is not defined in the Slice Agreement. At a minimum, a cross-reference to the TRM should be added here.

19. Section 2.137: The definition of "Slice Computer Application" should make it clear that BPA must develop, update, and maintain the application pursuant to the Slice Agreement (as opposed to on an open-ended basis with no standards).

20. Section 2.145: The definition of "Simulator" should be cleaned up.

21. Section 2.153: The definition of "Slice/Block Product" does not make sense and is not consistent with the way either "Slice Product" or "Block Product" is defined. Defining a product as a customer obligation is not logical. This definition also does not mesh up right with the definition of "Slice/Block Power Sales Agreement" in section 2.152.

22. Section 2.157: The definition of "Slice Output Energy" should end with the clause "pursuant to this Agreement."

23. Section 2.158: The definition of "Slice Percentage" should end with the clause "pursuant to this Agreement."

24. Section 2.163: For consistency, the definition of "Slice True-Up Adjustment Charge" should refer to the defined term "Slice Customer," rather than "Slice Product customer."

25. Section 2.164: The definition of "Soft Operating Constraint" does not provide meaningful guidance and should be made clearer.

26. Section 2.173: The definition of "Surplus Firm Power" is factually wrong and should be corrected.

27. Section 2.191: The definition of "Tiered Rate Methodology" refers to establishment in a "section 7(i) hearing." It would make more sense to refer to the defined term "7(i) Process."

28. Section 3.2: The "take or pay" language related to purchase of Slice is wrong. Payment is not tied to the amount of Slice Output Energy. It is tied simply to an obligation to pay a stated percentage of BPA's Tier 1 costs.

29. Section 3.3.1.2: This section needs to be revised to track with the final terms contained in sections 3.4.1 and 3.4.2. As currently written, section 3.3.1.2 contradicts sections 3.4.1 and 3.4.2.

30. Section 3.4.3: This section, including its title, needs to be revised to track with the final terms contained in sections 3.4.1 and 3.4.2. As currently written, section 3.4.3 is inconsistent with sections 3.4.1 and 3.4.2.

31. Section 3.6: This section should not use "its" when referring to Customer-Owned Resources – these Customer-Owned Resources do not belong to the Slice customer.

32. Section 3.6.3: To the extent load is being served by a Consumer Owned Resource, it is not load of the BPA customer, and should not be referred to as "«Customer Name»'s Onsite Consumer Load."

33. Section 5.1: This section should be refined to avoid any implied "double-counting" of system obligations that are already deducted from the Tier 1 System Capability before Operating Constraints (other than those arising from "Designated BPA System Obligations") are factored in.

34. Section 5.2: This section should be refined to avoid any implied "double-counting" of system obligations that are already deducted from the Tier 1 System Capability before Operating Constraints (other than those arising from "Designated BPA System Obligations") are factored in.

35. Section 5.4: Rather than referring to the procedures "described" in Exhibit I, this provision should refer to the procedures "established" or "set forth" in Exhibit I.

36. Section 5.5.1: The term "Northwest Power Act" is defined in section 2.107, so it does not need a "PL" reference here.

37. Section 5.5.4: Because of the way BPA has limited the application of section 20 (the procedure for formal notices) to those sections that specifically reference section 20, this section should specifically require notice in accordance with section 20.

38. Section 5.5.5: Notices should not be limited to only extra-regional and non-preference customers. Notices should also be issued to preference customers that have purchased surplus power.

39. Section 5.5.6: We do not agree with the failure to pay any compensation for the recall of capacity, and we do not agree that the "Monthly Reimbursement Value" is sufficient compensation for recalled energy.

40. Sections 5.6.2.1 and 5.6.2.2: The use of the word "actual" in the title of section 5.6.2.1 and in the text of both provisions adds nothing. The word "actual" should be deleted.

41. Section 5.6.2.6(2): The reference in this section to "95 percent" should be changed to 92.5 percent to match with the test provisions set forth in section 5.6.2.4(2).

42. Section 5.8.2: This section should state explicitly what the default assumption concerning the customer's election will be if the customer fails to give the required notice.

43. Section 5.8.2.4: The term "PS" should be changed to "Power Services."

44. Section 5.9: This language should be fixed so that it does not imply that RHWM Augmentation is a distinct purchase apart from the purchase of the Slice Product.

45. Section 5.12.2.3: The reference in the first sentence should be to the "Slice Product" (defined term). Also, the reference at the end of Section 5.12.2.3(3) should be to "Tier 1 System Resources," not the "Tier 1 System."

46. Section 6.3: This section needs to be clarified because it is NOT intended to apply to the provisions set forth in Section 6.6 (which are meant to be "frozen" at the time the original TRM is adopted, and not to change over time if the TRM changes).

47. Section 8.1: The reference to "Critical Slice Amounts" in subsection (2) is factually wrong. The rates for Slice are not tied to projected system output. They are simply a percentage of BPA's actual Tier 1 costs, without regard to system production.

48. Section 10.1: This language should be refined to track better with the parties' intent.

49. Section 11.2.4: In the final sentence, this section says that the contract amendment will contain the "same terms and conditions as this Agreement." It does not make sense to say that the parties will enter into a new or amended agreement and also say that it will be the same as their current agreement. This language should be refined to make more sense.

50. Section 16.1: This section should be narrowed to refer only to "all products and services provided **under this Agreement** during the preceding month(s)."

51. Section 16.5.1: The final sentence of this section should be revised to say what is intended, which is that the right conferred in the Slice Agreement to dispute a bill does not provide any contractual basis for the customer to dispute the validity of a BPA rate.

52. Section 17.1: The right to be excused from obligations that cannot be performed unless the other party provides necessary information or makes required determinations should be reciprocal, rather than one-sided in BPA's favor.

53. Section 17.7.1(3): This provision should not refer to peak energy amounts, because the new language in sections 3.4.1 and 3.4.2 provides that resource peak amounts will not be calculated or stated in Exhibit A until a future time when a methodology has been adopted.

54. Section 23.6.3: Taking decrements first from Tier 1 purchases was never discussed and is not reasonable. If a party were improperly increasing its Net Requirement on BPA by exporting a resource, it could well take the form of an increase purchase of Tier 2 power if not all of the customer's Net Requirements are met by Tier 1 power. Applying a blanket assumption that a party has improperly increased its Tier 1 purchases is unfounded and unfair.

55. Exhibit A, section 1.2: The language that introduces the table may be appropriate for determining energy amounts, but the table also includes rows (even if left blank at execution) for peak amounts, and this language should NOT apply to the calculation of peak Net Requirements. Rather, the calculation of peak Net Requirements should be governed by section 3.4 of the body of the Slice Agreement.

56. Exhibit A, section 8: This section should include language expressly stating that all other revisions will be by mutual agreement of the parties.

57. Exhibit M, section 3.1.1: This section should include an express cross-reference to section 5.12.2 of the body of the Slice Agreement.

58. Exhibit M, section 3.5.4.1: This section should refer to "correct" values, rather than an obligation to "reasonably reflect the expected values."

59. Exhibit M, section 4.1.1: Because this section is dealing with actual system output, it seems as if it should refer to "RP Augmentation," rather than "RHWM Augmentation."

60. Exhibit N, section 5.1.4: The language in this section should be revised to be more reasonable.

FOSTER PEPPER

November 20, 2008

Bonneville Power Administration

RE: ***Slice/Block Power Sales Agreement Executed by the Bonneville Power Administration and The City of Seattle***

We have rendered a legal opinion dated November 20,, 2008, regarding the above referenced agreement and addressed to The City of Seattle, Washington, which opinion is attached hereto. You may rely on that opinion as though it were addressed to you.

No attorney client relationship has existed or exists between our firm and the Bonneville Power Administration in connection with the Slice/Block Agreement or by virtue of this opinion.

Very truly yours,

FOSTER PEPPER PLLC

By Hugh D. Spitzer

Hugh D. Spitzer

FOSTER PEPPER PLLC

November 20, 2008

The City of Seattle

RE: ***Slice/Block Power Sales Agreement Executed by the Bonneville Power Administration and The City of Seattle***

Ladies and Gentlemen:

We have acted as counsel to The City of Seattle, Washington (the "City") with respect to Contract No. 09PB-13102, a Power Sales Agreement between the Bonneville Power Administration ("Bonneville") and the City (the "Slice/Block Agreement"), executed by the City on November 20, 2008. In this capacity, we have reviewed a copy of the Slice/Block Agreement and a certified copy of Ordinance No. 122805 of the City. We have also served as bond counsel to the City continuously since 1993, and on many other occasions prior to that year. Based upon examination of the Slice/Block Agreement, City Ordinance No. 122805, and such other documents, statutes, ordinances, rules, regulations, resolutions, certificates, records, court opinions, and other information as we have deemed necessary or relevant in rendering this opinion, it is our opinion that:

1. The City is duly authorized, pursuant to RCW 35.22.280(15), 35.92.050 and Ordinance No. 122805, to execute and deliver the Slice/Block Agreement, and assuming due authorization, execution, and delivery by the Bonneville Power Administration, the Slice/Block Agreement constitutes a legal and valid obligation of the City enforceable in accordance with its terms. The foregoing opinion with respect to enforceability is qualified as to:

a) limitations imposed by bankruptcy laws of the United States, insolvency, reorganization, arrangement, moratorium, or other laws relating to or affecting the enforcement of creditors' rights generally;

b) general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law; and

c) the exercise of judicial discretion in appropriate cases.

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2. The execution and delivery by the City of the Slice/Block Agreement, and compliance with the provisions thereof, do not and will not conflict with or constitute a breach of or default under any constitutional provision, law, or administrative regulation or under any judgment, decree, loan agreement, indenture, bond, note, resolution, or other instrument to which the City is a party or to which the City or any of its property or assets is subject.

3. There is no action, suit, proceeding, inquiry, or investigation, at law or in equity, before or by any court, government agency, public board or body, pending (with process properly served on the City), affecting the existence of the City or contesting or affecting the validity or enforceability of the Slice/Block Agreement, nor, to the best of our knowledge, is there any basis for any such action, suit, proceeding, inquiry, or investigation with respect to which it would be reasonable for a court to render an unfavorable decision, ruling or finding that would materially adversely affect the validity, enforceability, or performance by the City of the Slice/Block Agreement.

Reference is made to the Slice/Block Agreement for the definition of capitalized terms not otherwise defined herein.

In rendering the above opinions, we have considered the decision of the Washington Supreme Court in Chemical Bank v. Washington Public Power Supply System, 99 Wn.2d 772, 666 P.2d 329 (1983). It is our opinion that the holding in that case, with respect to the validity of certain participant agreements (the "Participant Agreements") between Washington municipalities and the Washington Public Power Supply System, is inapplicable to the validity of the Slice/Block Agreement for the reasons discussed immediately below.

In relevant part, the Slice/Block Agreement commits the City to the purchase of power from Bonneville for a period commencing on October 1, 2011, and ending on September 30, 2028. The price of power under the Slice/Block Agreement is determined, among other things, by a defined percentage of Bonneville's revenue requirements for the term of that agreement, including Bonneville's costs relating to power production, fish and wildlife, market conditions, and variable water conditions. Under Section 3.2 of the Slice/Block Agreement, the City's payment obligation applies with respect to Firm Requirements Power that Bonneville makes available under the Block Product and the Slice Product, regardless of whether or not the City takes delivery of that available power at that specific point in time. However, under Section 11.2.2 of the Slice/Block Agreement, the City may terminate the Slice/Block Agreement if there is no power available for a two-year period or if Bonneville gives prior notice of its forecast that that will be the case. Further, at times specified in the Slice/Block Agreement, the City may convert all or part of its Slice Product to a Block Product purchase of power or convert to other power options under the circumstances described in the Slice/Block Agreement.

The Chemical Bank opinion acknowledged that at that time, as today, "various statutes clearly provide for Washington PUD's, cities and towns to purchase and sell electricity."

99 Wn.2d at 783, 666 P.2d at 335. In concluding that Washington public utility districts, cities, and towns did not have legal authority to enter into the agreements in that case, the Court emphasized:

> The agreement expressly provides for the possibility that no electricity will be generated and that *participant payments will be due even if the project is not completed.* The unconditional obligation to pay for no electricity is hardly the purchase of electricity. We hold that an agreement to purchase project capability does not qualify as a purchase of electricity.

99 Wn.2d at 784, 666 P.2d at 335 (emphasis added). Accord, Chemical Bank, supra, 99 Wn.2d at 798, 666 P.2d at 342 ("...[T]he participants lacked substantive authority to enter into this type of contract because they constructed an elaborate financing arrangement that required the participants to guarantee bond payments *irrespective of whether the plant was ever completed* ... and to assume the obligations of defaulting participants.") (emphasis added). See also the summary of the Court's conclusions at 99 Wn.2d 798, 666 P.2d at 342, and Chemical Bank v. Washington Public Power Supply System, 102 Wn.2d 874, 892, 691 P.2d 524, 535 (1984).

In contrast, the Slice/Block Agreement does not concern a project or projects yet to be constructed. It concerns a purchase of electricity from existing, operating projects in the Federal Columbia River Power System and other resources. There are no likely circumstances under which all of the federal projects involved would produce no electricity, all at the same time. Furthermore, the City has the right to terminate the Slice/Block Agreement if that highly unlikely event were to occur and continue for a period of two consecutive years or if Bonneville were to give prior notice that such an event is likely to occur, and the City is not obligated to make a monthly payment for power if it does not receive output during an entire calendar month. Consequently, the City's potential liability for the improbable event of no power being produced by the Federal Columbia River Power System at all, is distinctly limited. Because the electricity being purchased under the Slice/Block Agreement is from existing, operating projects, and because the City's obligation to pay if electricity is unavailable, is limited to a discrete, determinable amount that the City has concluded is reasonable and necessary to enable it to gain the advantages of the Slice/Block Agreement, the unprotected risks that the Court perceived in Chemical Bank are not present here. The City does not have the same "dry hole" risk of having to make massive payments for uncompleted projects that the Washington Supreme Court found legally unsupportable in Chemical Bank. In addition, nothing in the Slice/Block Agreement requires the City to assume the obligation of any other utility executing the Slice/Block Agreement, as was the case with the contracts in Chemical Bank.

The distinction between the Slice/Block Agreement and the situation in Chemical Bank is supported by several opinions of the Washington Supreme Court since Chemical Bank.

In City of Tacoma v. Taxpayers of the City of Tacoma, 108 Wn.2d 679, 743 P.2d 793 (1987), the Court discussed its decision in Chemical Bank, noting that, in Chemical Bank, "this court held that municipal utilities did not have authority to enter into guaranteed contracts to purchase the potential output of yet to be constructed nuclear plants." 108 Wn.2d at 697, 743 P.2d at 802. The Court continued: "What the court found objectionable was the 'dry hole' contract provision, which obligated the participating municipal utilities to pay their proportionate shares of the nuclear power costs *whether or not the plants were ever completed, operable, or operating*." Id. (italics in original).

The Court in Tacoma v. Taxpayers, further noted that "[h]aving characterized the 'dry hole' provision as an 'elaborate financing arrangement that required the participants to guarantee bond payments irrespective of whether the plant was ever completed", ... , it is understandable why the court [in Chemical Bank] felt compelled to apply a stricter governmental function approach." 108 Wn.2d at 698, 743 P.2d at 803 (citation omitted). Instead, in the Tacoma case, the Court adopted the more expansive construction of municipal authority typically applied when proprietary activity services are involved. 108 Wn.2d at 694-95, 698-700, 743 P.2d at 801. The Washington Supreme Court has continued to recognize this principle of broad construction in subsequent cases, and as recently as this year. See, e.g., Hite v. Public Utility District No. 2 of Grant County, 112 Wn.2d 456, 460, 772 P.2d 481, 483 (1989); Washington Public Utility Districts Utility System v. PUD No. 1 of Clallam County, 112 Wn.2d 1, 771 P.2d 701, 707 n.2 (1989); Sundquist v. Public Utility District No. 1 of Snohomish County, 140 Wn.2d 403, 410, 997 P.2d 915, 918-19 (2000). The Slice/Block Agreement memorializes a purchase of electricity – part of the City's electric utility service, and electric utility service has typically been held to be proprietary in nature. See, e.g., Hite, supra 112 Wn.2d at 459, 772 P.2d at 483; Washington Public Power Supply System v. General Electric Co., 113 Wn.2d 288, 301, 778 P.2d 1047, 1054, (1989). Thus broad, rather than strict, construction should apply to the analysis of authority.

Based upon the foregoing, which summarizes the analysis we have performed, it is our opinion that the holding in the Chemical Bank case relating to the validity of the Participant Agreements is inapplicable to the Slice/Block Agreement.

As to questions of fact material to the opinions expressed above, we have relied upon representations of the City contained in Ordinance No. 122805, certifications of officials, and other documents furnished to us without undertaking to verify the same by independent investigation, including without limitation the certificate of Arlene Ragozin, Director, Utilities Section, City Attorney's Office of the City, dated this date.

The law covered by the opinions expressed in this letter is limited to the laws of the State of Washington. This opinion does not address the validity and/or enforceability of the Slice/Block Agreement with respect to the City if a court in any State rules it invalid and/or unenforceable with respect to other parties executing the Slice/Block Agreement. This letter

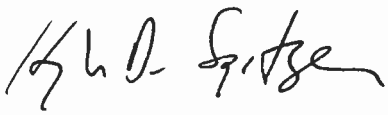
speaks only as of the date hereof, and we assume no obligation to advise you of any changes of law or fact that occur after the date of this letter, even though the changes may affect the legal analysis, a legal conclusion, or information contained herein.

This opinion letter is rendered only to you and is solely for your benefit in connection with the Slice/Block Agreement, and may not be used or relied on for any other purpose or by any other person (other than your legal and professional advisors) without our prior consent.

We bring to your attention the fact that, although it is our opinion that a Washington court reasonably would conclude that the Slice/Block Agreement is valid and enforceable with respect to the City, the foregoing opinions are expressions of our professional judgment on the matters expressly addressed and do not constitute guarantees of result.

Sincerely,

FOSTER PEPPER PLLC

By 
Hugh D. Spitzer