



Department of Energy
Bonneville Power Administration
P.O. Box 3621
Portland, Oregon 97208-3621

POWER SERVICES

June 23, 2009

In reply refer to: PS-6

Contract No. 09PB-12095
SETTLEMENT AGREEMENT

Mr. Dennis Vermillion, Vice President
Avista Corporation
P.O. Box 2595
Spokane, WA 99220

Dear Mr. Vermilion:

This Settlement Agreement ("Agreement") is entered into between the United States of America, Department of Energy, acting by and through the Bonneville Power Administration ("Bonneville" or "BPA"), and Avista Corporation (formerly The Washington Water Power Company ("WWP")), a corporation of the state of Washington. In 1981, Bonneville entered into a Residential Purchase and Sale Agreement ("RPSA") with WWP, Contract No. DE-MS79-81BP90606, in order to implement the Residential Exchange Program ("REP") established in section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act ("Northwest Power Act"), 16 U.S.C. § 839c(c).

Under the REP, BPA purchases power from a Pacific Northwest utility at its average system cost ("ASC") and, in exchange, sells the same amount of power to the utility at BPA's Priority Firm Exchange Rate ("PF Exchange Rate"). In 1981, BPA conducted a consultation proceeding pursuant to section 5(c)(7) of the Northwest Power Act to establish an ASC Methodology, which governs the establishment of exchanging utilities' ASCs. The difference between a utility's ASC and the PF Exchange Rate, multiplied by the utility's residential and small farm load, determines the monetary benefits provided to the utility. Such benefits must be passed through directly to the utility's residential and small farm consumers. The RPSA included a provision under which WWP could elect to have its ASC deemed equal to BPA's PF Exchange Rate. If this occurred, BPA would debit to a separate account the net exchange payment to BPA, if any, that would have been required if the election had not been made.

In 1984, BPA conducted a consultation proceeding pursuant to section 5(c)(7) of the Northwest Power Act to revise the 1981 ASC Methodology. The 1984 ASC Methodology reduced exchanging utilities' ASCs, which reduced REP benefits, made deemer status more likely, and increased existing deemer balances. As a result of BPA's adoption of the 1984 ASC Methodology, WWP developed a deemer balance, to which interest was applied. In 1987, BPA entered into a suspension agreement with WWP, Contract No. DE-MS79-87BP92803, which suspended WWP's participation in the REP. In 1993, WWP provided BPA notice of its termination of its RPSA and BPA responded to such notice. In 1999, WWP became Avista Corporation. Avista has repeatedly disputed the deemer balance.

In 2000, Bonneville and Avista entered into a Residential Exchange Program Settlement Agreement, Contract No. 00PB-12157 ("REP Settlement Agreement"), to resolve disputes arising under the

implementation of the REP. Under the REP Settlement Agreement, BPA and Avista agreed that the settlement would not affect the parties' rights to assert that any deemer balance from 1981-2001 would or would not be carried over to any subsequent RPSA. On May 3, 2007, the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit") held that the REP Settlement Agreements between BPA and its investor-owned utility customers were inconsistent with the Northwest Power Act. BPA then began preparing to once again implement the REP with regional utilities. In 2008, Bonneville and Avista entered into two new Residential Purchase and Sale Agreements: one for FY 2009-2011, Contract No. 08PB-11964 ("Bridge RPSA"), and one for FY 2012-2027, Contract No. 09PB-13201 ("Long-Term RPSA"). These RPSAs continue the deemer mechanism, but afford the exchanging utility additional means to suspend or terminate the Agreement. By executing the Bridge RPSA and the Long-Term RPSA, Avista expressly did not waive any arguments or claims it has made or may make, including any arguments regarding the deemer provision in such contracts. In 2008, Avista filed a petition for review in the Ninth Circuit challenging BPA's Record of Decision adopting the RPSAs, thereby challenging the deemer provisions included in such contracts.

Following discussions between BPA and Avista, both parties desire to resolve any disputes regarding the amount of the deemer balance owed by Avista for the purpose of implementation of the REP. Bonneville and Avista hereinafter are sometimes referred to individually as "Party" and collectively as "Parties".

Accordingly, BPA and Avista agree to the following:

1. EFFECTIVE DATE

This Agreement shall be effective upon execution by the Parties. All obligations incurred hereunder shall be preserved until satisfied.

2. DEFINITIONS

Capitalized terms below shall have the meaning stated below.

- (a) "Balancing Account," shall have the meaning established in the Bridge RPSA.
- (b) "Definitive Benefit Amount" shall have the meaning established in the Residential Exchange Interim Relief and Standstill Agreement, Contract No. 08PB-12438 between the Parties.
- (c) "Lookback Amount" shall have the meaning established in the 2007 Supplemental Wholesale Power Rate Case, Administrator's Final Record of Decision, dated September 22, 2008.

3. ESTABLISHMENT OF BALANCING ACCOUNT (DEEMER) BALANCE

BPA and Avista hereby agree that Avista's deemer balance shall be \$55,000,000.00 (fifty-five million dollars) effective October 1, 2001.

4. IMPLEMENTATION OF DEEMER BALANCE FOR LOOKBACK

- (a) BPA agrees to replace the October 1, 2001, deemer balance assumption BPA used in the WP-07 Supplemental Wholesale Power Rate Proceeding with the deemer balance agreed to by the parties in Section 3 above and recalculate Avista's Definitive Benefit Amount, beginning FY 2009 Balancing Account (deemer) balance, and beginning FY 2009 Lookback Amount in accordance with the 2007 Supplemental Wholesale Power Rate Case, Administrator's Final Record of Decision, dated September 22, 2008 ("WP-07 Supplemental ROD").

- (b) After performing the calculations described in 4(a), BPA shall:
 - (1) Use the revised Definitive Benefit Amount to implement section 9 of the Residential Exchange Interim Relief and Standstill Agreement, Contract No. 08PB-12438, between BPA and Avista; and,
 - (2) Use the revised beginning FY 2009 Balancing Account (deemer) balance, and beginning FY 2009 Lookback Amount to implement the REP for FY 2009 and beyond, consistent with the WP-07 Supplemental ROD and the 2008 Average System Cost Methodology.
- (c) The definition in Section 2(c) and the provisions of this Section 4 are predicated upon BPA's implementation of the Lookback as adopted by the BPA Administrator in the WP-07 Supplemental ROD. The Parties hereby acknowledge that the decisions made in the WP-07 Supplemental ROD are currently being challenged in court. In the event that BPA is required to reconsider any aspect of its WP-07 Supplemental ROD as a result of a final, non-appealable order by a court of competent jurisdiction, the Parties hereby agree to cooperate in good faith to modify the Lookback Amount, if necessary, and implement the provisions of this Section 4 consistent with such order.

5. CHALLENGES TO APPLICATION OF DEEMER BALANCE TO LOOKBACK AND RPSA DEEMER PROVISIONS

- (a) Avista, in consideration of the deemer balance established in Section 3 above and the value provided by other provisions of this Agreement, agrees not to file any claim, petition or other legal action in any court or administrative body that:
 - (1) challenges the manner in which BPA uses utilities' deemer amounts to determine the Lookback Amounts pursuant to the WP-07 Supplemental ROD; or
 - (2) challenges the Balancing Account provisions contained in exchanging utilities' FY 2009-2011 RPSAs, including Contract No. 08PB-11964, and exchanging utilities' FY 2012-2027 RPSAs, including Contract No. 09PB-13201.
- (b) If Avista has already filed petitions for review of any of the foregoing matters, Avista hereby agrees to file for voluntary dismissal of such petitions if issues related to items (1) or (2) of this section are the sole basis for such petitions. If issues related to items (1) or (2) are not the sole basis for the petitions, Avista shall not raise or pursue any arguments related to items (1) or (2) in any litigation occurring pursuant to such petitions. If Avista participates in any litigation regarding items (1) or (2) filed by other parties, Avista shall not raise or pursue any arguments related to items (1) or (2) in such litigation.
- (c) In the event that a person or entity, other than Avista, successfully challenges the Balancing Account provision contained in an exchanging utilities' RPSA, which is substantially similar to the Balancing Account provisions included in Contract Nos. 08PB-11964 and 09PB-13201, and such challenge is reduced to a final non-appealable order issued by a court or administrative agency with jurisdiction over the matter, Avista's Bridge and Long-Term RPSA shall be amended consistent with such order.

6. FULL AND FINAL SETTLEMENT

This Agreement constitutes the full and final settlement of all issues and claims related to Avista's deemer balance. This settlement is in full and complete satisfaction of any obligations owed by either Party to the other in regard to such claims, and each Party releases the other from such claims. Neither Party may pursue any further action against the other related to this matter, whether in dispute resolution, in court, at the Federal Energy Regulatory Commission or elsewhere, other than to enforce this Agreement as permitted by law.

7. NEGOTIATION OF NEW AGREEMENT

Avista agrees to support BPA in defending any challenges to the lawfulness of this Agreement. If a final, non-appealable judicial order is entered in response to a petition for review that holds this Agreement or Bonneville's execution of this Agreement to be void, unenforceable, or unlawful in any material respect, then the Parties shall negotiate in good faith new provisions that shall replace those held to be unlawful, void, or unenforceable with the objective of placing the Parties in the same financial and relational situation as existed under the terms of this Agreement prior to such final, non-appealable order.

8. INABILITY TO NEGOTIATE NEW AGREEMENT

If, acting pursuant to Section 7, the Parties are unable in good faith to negotiate replacement provisions placing the Parties in the same financial and relational situation as existed under the terms of this Agreement prior to such final, non-appealable order within ninety (90) days of the issuance of such order, then this Agreement shall have no further force or effect and the Parties shall be restored to the status quo before this Agreement as if it never existed.

9. EFFECT ON OTHER DISPUTES

Any other disputes that may exist between the Parties are not settled or affected by this Agreement.

10. INTEGRATION

This Agreement represents the entire agreement of the Parties. This Agreement supersedes any agreements and/or representations made by the Parties in all prior discussions, negotiations and agreements, whether oral or written, relating to the subject matter of this Agreement.

11. DRAFTING OF THE AGREEMENT

It is acknowledged that all parties to this Agreement participated in the drafting of the Agreement and that in any action involving the interpretation of this Agreement, the language and terms of the Agreement should not be construed against any party to this Agreement.

12. ADVICE OF COUNSEL

The Parties represent that in executing this Agreement they relied solely upon their own judgment, belief and knowledge, and the advice and recommendations of their own independently selected counsel, concerning the nature, extent, and duration of their rights and claims, and that they have not been influenced to any extent whatsoever in executing the same by any representations or statements covering any matters made by the other Parties hereto other than the statements set forth in this Agreement.

13. WARRANTY OF AUTHORITY

Each signatory to this Agreement warrants that he or she has the authority to execute this Agreement on behalf of the Party for which such execution is made, and to bind that party through such execution.

14. NO ADMISSIONS

This Agreement is for the purposes of settling all claims relating to Avista's deemer balance and the matters set forth in Section 5, and for no other purposes. The Parties understand and agree that nothing contained herein shall be construed as an admission of liability by any party; all such liability being expressly denied.

Avista Corporation

Approved:

By: _____

Name: _____
(Print/Type)

Title: _____

Date: _____

Bonneville Power Administration

Approved:

By: _____

Name: Paul Norman
(Print/Type)

Title: Senior Vice President, Power Services

Date: _____