

Wholesale Market Sales and Purchases

The Department has historically bought and sold energy in wholesale power markets to balance its loads and resources. The amount of wholesale energy purchased or sold has varied with water conditions and with changes in the Department's firm resource base. Prior to 1996, when power available to the Department at critical water levels was roughly equal to its load, the Department typically had surplus power available to sell in the wholesale market when water conditions were above critical levels. With the limitation of its Bonneville purchases in 1996 and the sale of the Centralia Steam Plant in 2000, the Department faced energy deficits at critical water levels, and expected to be a net purchaser of energy in the wholesale market under average water conditions. Acquisition of additional resources beginning in 2001 from Bonneville, the Klamath Falls Cogeneration Project and the Stateline Wind Project, together with a reduction in retail consumption resulting from conservation programs and the effect of rate increases, has substantially changed the relationship between the Department's power resources and retail load. With its current resource portfolio, the Department expects to have surplus power available for sale in the wholesale market through 2011, even under adverse water conditions.

The table below displays the Department's purchases and sales of power in the wholesale market over the period from 1999 through 2003. In 2000 and 2001 a severe regional drought caused the Department to purchase large amounts of power in the wholesale market at extraordinarily high prices. The net cost of the Department's wholesale market transactions was \$109.3 million in 2000 and \$444.9 million in 2001. In 2002 and 2003, with additional power available from the Department's recently acquired resources, substantial energy surpluses were available for sale in the wholesale market. The Department realized net revenue of \$89.6 million in 2002 and \$113.4 million in 2003 from its wholesale market transactions.

**WHOLESALE MARKET SALES AND PURCHASES
(UNAUDITED)**

	1999	2000	2001	2002	2003
Wholesale Market Purchases (MWh) ⁽¹⁾	1,393,718	2,571,228	2,411,210	898,613	1,210,699
Cost of Purchases (\$000s)	\$37,296	\$212,402	\$518,782	\$12,440	\$24,233
Average Cost (\$/MWh)	\$26.76	\$82.61	\$215.15	\$13.84	\$20.02
Wholesale Market Sales (MWh)	2,673,542	2,023,060	468,827	4,647,945	4,262,041
Revenue from Sales (\$000s)	\$51,466	\$103,082	\$73,899	\$102,083	\$137,651
Average Revenue (\$/MWh)	\$19.25	\$50.95	\$157.63	\$21.96	\$32.30
Sales Net of Purchases (MWh)	1,279,824	(548,168)	(1,942,383)	3,749,332	3,051,342
Net Revenue (\$000s)	\$14,170	(\$109,320)	(\$444,883)	\$89,643	\$113,418

(1) In 2000 and 2001, purchases in the wholesale market were at unusually high levels due to poor water conditions. In 2002 and 2003, the net amount of energy available for sale in the wholesale market was considerably higher than in 2000 and 2001, due to improved water conditions and the acquisition of additional firm resources by the Department.

Source: *Seattle City Light, Finance Division*

Risk Management

The Department's exposure to risk is managed by a Risk Management Committee ("RMC") consisting of the Deputy Superintendents for Finance and Administration, Power Management and Generation, the Department's Director of Strategic Planning and the Department's Risk Officer. The RMC is responsible for managing both market risk and credit risk.

Market Risk. The RMC meets weekly to review and adjust the Department's near-term and long-term strategy for marketing surplus energy or, in periods of deficit, for purchasing energy to meet load. The Department executes trades in the wholesale market to meet load during periods of resource deficit, to dispose of energy that is surplus to the needs of the Department's retail customers and to optimize the value of the Department's hydroelectric resources by purchasing wholesale energy in off-peak hours, when prices generally are low, and selling energy in the peak hours, when prices are generally higher. The Department does not engage in speculative trading in the wholesale market.

Credit Risk. The Department's Credit Committee, which reports to the RMC, consists of the Deputy Superintendent for Power Management and the Department's Finance Director, Director of Customer Accounts and Risk Manager. The Credit Committee meets monthly to manage the credit risk associated with the Department's marketing activities. Finance Division staff review the creditworthiness of counterparties with which the Department trades power in the wholesale market and recommends credit limits for each counterparty. Where appropriate, credit enhancements are recommended for counterparties that do not meet standards of creditworthiness adopted by the Credit Committee. Finance and Power Management staff monitor trading activity to ensure that credit limits established by the Credit Committee are not exceeded and provide status reports to the Credit Committee.

Transmission

Department-Owned Transmission. The Department operates 656 miles of transmission facilities. The principal transmission line transmits power from the Skagit Project to the Department's service area. In 1994, the Department signed an agreement with Bonneville for the acquisition of ownership rights to 160 MW of transmission capability over Bonneville's share of the Third AC Intertie, which connects the Northwest region with California and the Southwest. The benefits from this investment include avoidance of Bonneville's transmission charges associated with power sales and exchanges over the Intertie and the ability to enter into long-term firm contracts with out-of-state utilities. The Oregon Department of Revenue has initiated litigation to collect a property tax on the Department's capacity rights in the Third AC Intertie. The potential liability is about \$500,000 per year. Summary judgment motions were argued in the Oregon Tax Court in May 2003. An appeal to the Oregon Supreme Court is likely to follow the Tax Court's disposition of the case, and an appeal to the United States Supreme Court is possible.

Transmission Arrangements with Bonneville. Contracts with Bonneville provide the Department with 1,962 MW of transmission capacity under a point-to-point ("PTP") transmission service agreement for the period from October 1, 2001, through July 31, 2025. The Department's rights under the current PTP contract are expected to be preserved under Grid West. However, the rates that will apply to services provided by Grid West are uncertain, as are the rates likely to be charged by Bonneville if the formation of Grid West is delayed or abandoned. In its financial forecast, the Department has assumed that wheeling costs will increase by 22 percent from 2004 through 2008.

Power supplied to the Department by B.C. Hydro under the High Ross Agreement is transmitted over Bonneville's lines under a second PTP transmission service agreement extending through 2005. The High Ross PTP contract was assigned to B.C. Hydro in 1999. B.C. Hydro in turn reassigned the contract to the British Columbia Power Exchange Corporation ("Powerex"). Under the assignment agreement provisions, Powerex pays Bonneville directly for all costs associated with the PTP contract. The Department expects to renew this PTP contract with Bonneville in 2006 for at least an additional ten-year term, and simultaneously to renew the assignment arrangement with B.C. Hydro for the same term. See "Power Resources—The Department's Resources."

Other Transmission Contracts. The Department also transmits power under contracts with Idaho Power for the transmission of power from the Lucky Peak Project, with Avista for transmission of power from the Grand Coulee Project Hydroelectric Authority; with Puget Sound Energy for transmission of power from the Cedar Falls and South Fork Tolt Projects, and with other utilities.

Additional purchases of transmission on a nonfirm basis may be required in the future in order to accommodate the Department's sales of power in the wholesale market during the spring runoff.

Conservation

The Department has pursued a policy of managing as well as meeting energy demand. As a result of the "Energy 1990" study, prepared in 1976, the City decided to pursue conservation as an alternative to participating in Energy Northwest's Projects Nos. 4 and 5. During the 1980s, single-family residential measures dominated the Department's conservation program. Conservation incentive programs in the commercial, industrial and multifamily sectors were added in the 1990s. Because commercial and industrial measures are more cost-effective, the majority of new energy savings acquired in recent years has come from these sectors, a trend that is projected to continue into the future. Since 1977, the Department has achieved almost 107 average MW of energy savings through conservation.

The 2000 Strategic Resources Plan called for the Department to accelerate the pace of energy savings through conservation. In the spring of 2001, a work plan was developed which increased the targeted level of energy savings to be achieved annually through conservation programs from six average MW to nine average MW per year. To meet this higher target, the work plan called for the Department to continue to operate its core conservation initiatives for all customer groups while adding some new programs and services to address service gaps.

The power sales contract with Bonneville that took effect on October 1, 2001, provides a credit of \$0.50 per MWh against the amounts payable under Bonneville's rate schedules for investments in conservation and renewable resources. In 2003, credits totaling \$2.1 million were applied against the cost of power from Bonneville.

Under agreements with Bonneville in 2002 and 2003, Bonneville will pay the Department \$51.5 million for conservation savings to be achieved over the period from October 1, 2001, through September 30, 2006. As part of these agreements, the Department's purchases of power from Bonneville under the Block product are reduced by the amount of conservation savings purchased by Bonneville. See "Power Resources—Purchased Power Arrangements—Bonneville Power Administration."