

Memorandum of Agreement

Between the State of Washington and Public Utility District of Pend Oreille County

For the Sullivan Lake and Sullivan Creek Water Supply Project

Parties

This Memorandum of Agreement (MOA) is entered into between the Public Utility District of Pend Oreille County (PUD) and the State of Washington (State), by and through the Department of Ecology Office of Columbia River (OCR).

Purpose, Objective and Scope

This MOA outlines the mutual agreement between the Parties concerning a change in operation of Sullivan Lake Dam associated with the PUD's surrender of its existing hydropower license from the Federal Energy Regulatory Commission (FERC), and the associated delivery of water by the PUD to OCR for use consistent with the Columbia River Water Basin Supply Law, RCW 90.90. The foundation of this MOA is based on retiming of 14,000 ac-ft of water deliveries downstream of Sullivan Lake Dam from historic releases during October through December, to a new delivery schedule from June through September.

Background

Sullivan Lake Dam (and associated Mill Pond) was constructed in 1911. The Sullivan Lake Dam was operated for hydroelectric power (4 MW) until 1956. The PUD acquired the dam, property, and water rights in 1959, but power was never generated by the PUD. Instead the lake was operated for recreation and fisheries uses, and indirect power benefits were realized through management of storage releases pursuant to the Pacific Northwest Coordination Agreement and applicable law.

On April 2, 2010, the PUD filed an application with FERC to surrender its license for the Sullivan Lake Hydroelectric Project. This application followed approximately 2 years of facilitated negotiations between state and federal agencies, external stakeholders, the Kalispel Tribe and the public, which resulted in the Sullivan Lake Hydroelectric Project Settlement Agreement (March 26, 2010) ("Settlement Agreement") on future operations of the Sullivan Lake Dam. The Settlement Agreement was filed with the license surrender application to FERC.

Concurrent with these negotiations, OCR and the PUD discussed opportunities that might result from changing the operation of the Sullivan Lake Dam. The Settlement Agreement reserved for the PUD the right to sell or lease 5,000 ac-ft of storage from June 1st to August 31st each year, with priority consideration given to OCR because of the environmental benefits inherent in RCW 90.90. The Settlement Agreement also describes the PUD's release of approximately 9,000 ac-ft of water in September each year, which is also of interest to OCR and is included in this MOA.

Recitals

Whereas the PUD is surrendering its FERC license and agrees to operate Sullivan Lake Dam in the future in a manner that will shift the hydrograph towards earlier summer releases of stored water;

Whereas the PUD has preserved its water rights pursuant to Chapter 90.14 RCW;

Whereas the PUD owns a reservoir water right for Sullivan Lake Dam and Reservoir and owns a vested water right for use of water from Sullivan Creek and the Sullivan Lake Reservoir;

Whereas OCR is aggressively pursuing development to new water supplies that re-time water availability from periods of relative abundance to relative scarcity;

Whereas the PUD has a desire to reduce any adverse economic effect to the public and its rate payers from costs incurred as a result of mitigation measures associated with the Settlement Agreement for the surrender of the FERC license for Sullivan Lake Dam;

Whereas the PUD has agreed to invest in additional recreational opportunities to offset lower lake levels associated with a change in the operation of Sullivan Lake Dam;

Whereas the Legislature created the Columbia River Account in RCW 90.90.010, which OCR uses to invest in water supply strategies that will provide benefits for both instream and out-of-stream uses;

and

Whereas both the PUD and OCR desire a collaborative long-term agreement for the delivery of water from Sullivan Lake Dam to the OCR trust program and financial compensation based thereon;

Now, therefore, the Parties acknowledge and agree to the following:

1. Water Delivered to OCR. The PUD will deliver 14,000 acre-feet annually to OCR at the Sullivan Lake Dam according to the schedule of releases provided in the following table¹. This operation represents a net increase in flows during those months to Sullivan Creek, the Pend Oreille River and the Columbia River compared to historic dam operations, and a shift in the hydrograph towards a more natural condition. All releases under this MOA will be governed by provisions of the Settlement Agreement. Subject to Settlement Agreement temperature constraints, operations shall maximize discharge flows through the cold water pipe and minimize the use of the low-level gates at the dam during fall drawdown. When low level gates are used, releases shall be made from two gates simultaneously.

¹ The following table is based in part on Table 1, Page 8-9, of Appendix A to the March 26, 2010 Settlement Agreement. Table 1 shows total flows available, whereas the following herein reflects increased water availability above 10 cfs historic flow releases in June through September. Late September flows not reflected in Table 1 but shown in the following table are based on model runs using Settlement Agreement criteria for dry, average and wet years.

Period	Dry Year Flow Increase		Avg/Wet Year Flow Increase		Monthly Total	
	cfs	ac-ft	cfs	ac-ft	Dry (ac-ft)	Wet (ac-ft)
June Week 1	40	560	50	700		
June Week 2	40	560	50	700		
June Week 3	40	560	50	700		
June Week 4	40	720	50	900	2400	3000
July Week 1	30	420	30	420		
July Week 2	25	350	25	350		
July Week 3	20	280	20	280		
July Week 4	20	400	20	400	1450	1450
August Week 1	20	280	20	280		
August Week 2	20	280	20	280		
August Week 3	20	280	20	280		
August Week 4	20	400	20	400	1240	1240
September Week 1	20	280	20	280		
September Week 2	170	2380	190	2660		
September Week 3	210	2940	210	2940		
September Week 4	210	3780	210	3780	9380	9660
Total (June-Aug)					5090	5690
Total (June-Sept)					14,470	15,350

2. Implementation Schedule. Before water can be made available to OCR, permitting and construction activities are expected to occur. These include the FERC license surrender process; environmental review under National Environmental Policy Act ("NEPA") conducted by FERC/U.S. Forest Service (USFS); environmental review under Washington's State Environmental Policy Act ("SEPA") conducted by OCR; Clean Water Act Section 401 Water Quality Certification processed by Ecology's SEA Program application and processing of a 30-year special use permit by USFS; construction of the cold-water pipe, screening and gauging, etc. Some delivery of water to OCR can begin after permitting, but before all of the construction activities are completed, provided that provisions of Section 5 (Interim Operations) of the Settlement Agreement are met. A tentative delivery schedule is 2,500 acre-feet (2012), 5,000 acre-feet (2013) and 14,000 acre-feet (2014). Both the PUD and OCR will aggressively pursue completion of the project to meet this schedule. If deliveries of water are delayed despite the best efforts of the PUD and OCR, the compensation discussed in Section 3 will be similarly delayed.

3. Compensation. A goal of the PUD is to offset the cost of the license surrender and change in operation of Sullivan Lake Dam to its rate payers. Projected costs, including construction and O&M (through 30 years), is estimated at \$6.7 million dollars. Additionally, the PUD has agreed to fund additional recreation opportunities to offset impacts associated with lower lake levels. Some on-going costs are expected to be incurred by the PUD after 30 years. However, OCR's funding authority is limited to a capital bond fund and cannot structure compensation through annual payments. Therefore, this funding agreement is intended to compensate for perpetual deliveries of water from the PUD to OCR. To that end, OCR will compensate the PUD a total of \$14 million dollars in three installments proportionate to each year's delivery of water: \$2.5 million in 2012, an additional \$2.5 million in 2013, and the remaining \$9 million in 2014. OCR

will also pay for the cost of performing the SEPA analysis for the project. OCR's funding in excess of the 30-year projected costs is expected to fully compensate the PUD for future O&M or other costs that may be incurred by the PUD not specifically addressed in this agreement. Use of all monies received from OCR by the PUD for the operation of Sullivan Lake Dam will be in accordance with the March 26, 2010 Settlement Agreement (Appendix A, Section 12, Page 9).

4. Use of Water By OCR. Under RCW 90.90, OCR will allocate the 14,000 ac-ft with two-thirds (9,333 acre-feet) for out-of-stream uses and one-third (4,667 acre-feet) for instream uses.
 - a. Out-of Stream Benefit: Both OCR and the PUD have an interest in local benefit for the out-of-stream supply. Use of 9,333 ac-ft of water for out-of-stream permits is limited to Pend Oreille, Stevens, Ferry, Lincoln, Douglas and Okanogan counties.
 - b. Instream Benefit: Both OCR and the PUD have an interest in benefiting instream flows. Use of 4,667 ac-ft for instream flows is intended to be maximized by OCR and protected to the confluence of the Columbia River and the Pacific Ocean. OCR may integrate this quantity of water with other instream trust water holdings to further maximize instream benefit, including cooperative management by the Washington Department of Fish and Wildlife-led "Fish Flow Releases Advisory Group". Greater than 4,667 ac-ft may be used temporarily for instream flow benefit while the 9,333 ac-ft of out-of-stream uses are being permitted. Greater than 4,667 ac-ft may be used for incremental instream flow benefit downstream of Sullivan Lake Dam to the point of diversion or withdrawal.
5. Permitting and Environmental Review. OCR will take a leadership role in state permitting and environmental review for the project. Applying for permits will be the responsibility of the PUD, but OCR will provide technical assistance and coordination activities. OCR will perform the SEPA analysis for the project and coordinate with FERC, and OCR will coordinate the issuance of the Clean Water Act Section 401 Water Quality Certification processed by Ecology's SEA Program, WDFW and other affected agencies, including the PUD. Both OCR and the PUD will attempt to coordinate the SEPA analysis with the NEPA work done by FERC (and possibly additional NEPA work by USFS if required) to streamline the environmental review process.
 - a. Water Rights: New water right permits and decisions will be required for the project. Additionally, some existing PUD rights will no longer be required based on the proposed change in operation of the Sullivan Lake Dam. The following describes the specific permitting actions required:
 - i. New Secondary Use Permit: The PUD will apply for a new secondary use permit for the proposed purposes of use under the change in operation plans. The PUD's application will request authorization for secondary uses of water stored in Sullivan Lake under PUD's reservoir claim embodied in Certificate of Change Vol. 2 Page 817 and Claim 300245. The new secondary use permit application will request a total of 31,209 acre-feet to be used for recreation, instream flow and power generation (indirect via the Pacific Northwest Coordination Agreement). OCR will process the application and issue a secondary use permit if Ecology can make findings that the four statutory criteria for issuing a new water right under RCW 90.03.290 are met. This application will be filed with Ecology within 60

days of executing this MOA.

- ii. Trust Water Application and Conveyance: The PUD will submit a trust water application and conveyance of 14,000 acre-feet of water from the secondary use permit described in Section 5.a.i. above to OCR's trust water program subject to the terms of this MOA. Based on the PUD's interest in enabling local benefit for the out-of-stream supply that will be made available through its conveyance, the PUD shall state in its trust water application and conveyance that the use of 9,333 ac-ft of water for out-of-stream permits shall be limited to Pend Oreille, Stevens, Ferry, Lincoln, Douglas and Okanogan counties. This application and conveyance will be made within 60 days of approval of the secondary use permit, but will not become effective until after perfection of the secondary use permit by the PUD.

In addition, the PUD will submit a trust water application and conveyance to OCR for their interest in Water Right Claim 300244, said claim representing the vested right with a point of diversion at Mill Pond for power generation (250 cfs with a priority date of June 1907). This application and conveyance would be made within 60 days of removal of Mill Pond or the final payment made pursuant to Section 3, whichever is later. This conveyance will be conditioned such that the transfer not affect waters in Sullivan Creek.

- iii. Permit Cancellations: The following water right permits and change decision were the subject of alternate operation strategies considered by the PUD previous to the current license surrender and settlement agreement, and will not be needed for the new project. OCR will cancel the following water right authorizations within 60 days of the PUD receiving a License Surrender Order from FERC:
 1. Reservoir Permit 333: This reservoir permit issued with a priority date of May 13, 1964 for 29,704 acre-feet of storage for power generation. Beginning of construction was due in 1998.
 2. Surface Water Permit S3-26568P: This permit issued with a priority date of June 3, 1980 for 550 cfs (subject to existing and claimed rights) for power generation. Beginning of construction was due in 2008. This cancellation shall not affect Water Right Claim 300244.
 3. Amended Change Decision CS3-CV2P817: This decision issued in 2003 granting a point of diversion change to the Mill Pond site for power generation. Completion of construction is due by 2013.
6. Expectations After 30 Years. It is expected that a USFS special use permit will have a term of 30 years. However, the out-of-stream uses that OCR will manage will be based on perpetual water rights issued to other entities which will be enabled through the water rights that are the subject of this MOA. To that end, there is a need for continuing coordination between the PUD and Ecology in the future. The intent of this agreement is for perpetual coordination and delivery of water by the PUD to OCR. If future permits, applications or licenses are required to continue to deliver water to OCR (such as renewing the special use permit by USFS), then the PUD will, in good faith, make application and endeavor to acquire such permits. Ecology will support the

PUD's efforts to do so. In the event that a permit or license is not granted or is granted in such a way as conflicts with this agreement or the terms of permit or license substantially or materially increase the burden or cost to the PUD, then OCR and the PUD will negotiate modifications to this agreement in good faith with an aim towards preserving the intent of the delivery of 14,000 acre-feet of water according to the terms and conditions agreed upon without imposing additional costs to the PUD.

A substantial or material increase in the burden or cost to the PUD will be triggered if the projected average annual cost of any future permit, application or license (including all projected expenditures such as operation & maintenance, prevention, protection, mitigation and enhancement, capital costs, as well as funding of reserves and similar project expenditure) under which a new 30-year term(s) is being contemplated is more than double of the estimated /actual average annual cost of the initial 30-year term of the special use permit issued by the USFS inclusive of the requirements of the Settlement Agreement and as adjusted upward for inflation. If negotiations are triggered under this section, and if the conditions of a new permit, application or license result in a shifting of the timing of releases from Sullivan Lake, including the 14,000 ac-ft to be contractually delivered to OCR as described in the table in Section 1 of this MOA, towards a more normative hydrograph, such a condition will be considered acceptable in terms of fulfilling the PUD's delivery of water to OCR.

7. Future Deliveries of Water Beyond This Agreement. In the future, the PUD may choose to further change its operations. To the extent that such changes do not affect the water supply delivered to OCR, the PUD shall have the right to do so. However, the PUD and OCR desire a continuing cooperation on water supply development. In the event that such change in operation of supply is of interest to OCR (such as a further shifting of the hydrograph to earlier season releases), the PUD and OCR will negotiate in good faith on further compensation and water delivery opportunities.

General Provisions

- A. **Binding Effect.** This MOA shall bind and inure to the benefit of the Parties and their respective heirs, legal representatives, successors, and assigns.
- B. **Headings.** All headings, captions or subtitles used herein are intended solely for convenience of reference and shall in no way limit or broaden any of the provisions of this agreement.
- C. **Cooperation.** All Parties hereto agree to fully cooperate in all matters related to or arising out of this MOA.
- D. **Entire Agreement.** This MOA, and the Settlement Agreement which is incorporated by reference, contains the entire agreement of the Parties and supersedes and replaces any and all prior or contemporaneous agreements or understandings, written or oral, express or implied, between the Parties concerning the subject matter of this agreement.
- E. **Authority.** Each person signing this MOA in a representative capacity warrants and represents that they have full authority to bind their principal to the provisions of this MOA.

- F. Scrutiny and Interpretation. This MOA has been submitted to the scrutiny of all Parties and their respective legal counsel and shall be given a fair and reasonable interpretation in accordance with the words hereof without consideration or weight being given to its being drafted by or for one of the parties.
- G. Dispute Resolution. Upon alleged breach of this MOA, or other disputes arising hereunder, representatives of the PUD and the State shall meet and confer in good faith to resolve their differences. In the event of any such alleged breach, or any other dispute, or if any term is found or believed by the Parties to be void and unenforceable, the Parties will meet and seek to reach a mutually agreeable modification. The Parties may employ a mutually agreed upon mediator or other facilitator if they believe this may help resolve their dispute.
- H. Enforcement. This MOA is a contractual agreement binding on the Parties and enforceable as may be appropriate in a court of competent jurisdiction under the laws of the State of Washington. Only signatory Parties have a right to seek enforcement of this MOA. No third party is intended to, or shall have, any rights under this MOA.
- I. This MOA may be executed in counterparts, and faxed signatures will be binding.
- J. This MOA will become binding on the Parties at the time every Party has executed this agreement.

Amendment and Severability

The Parties enter into this MOA voluntarily and in good faith. This MOA shall be effective upon the signatures of the officials listed below. This MOA may be amended or supplemented at any time by mutual consent of the parties; however, it shall not be subject to modification except by written agreement signed by all of the Parties. This MOA is severable from any contracts or agreements that are entered into pursuant to this MOA.

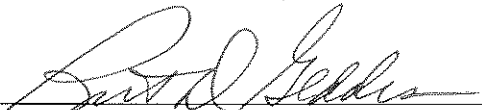
In the event that FERC materially modifies the settlement agreement in its License Surrender Order in a way that specifically and adversely affects the PUD's ability to deliver the contracted water to OCR, the parties shall determine whether an amendment to the MOA is appropriate. The goal of such an amendment would be to restore or maximize the intended delivery of water from the PUD to OCR. A similar amendment may be required if the environmental review results in unforeseen issues or conditions raised that specifically and adversely affects the PUD's ability to deliver water to OCR.

Duration and Termination of Memorandum of Agreement

This MOA is intended to have an indefinite term but shall terminate upon written consent by both parties hereto.

SIGNATURES

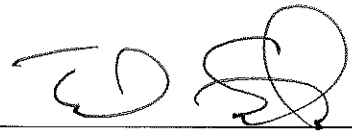
Pend Oreille Public Utility District

By 
Robert D. Geddes, General Manager

9-15-10
Date

As authorized by Resolution of the
Board of Commissioners dated September 15, 2010

State of Washington Department of Ecology

By 
Ted Sturdevant, Director

10-22-10
Date