EVALUATING POWER SUPPLY SOLUTIONS IN UNCERTAIN TIMES

SME
Southern Montana Electric
Generating and Transmission Cooperative, Inc.

2009 ANNUAL REPORT
OARD OF TRUSTEES AND GENERAL MANAGER

President .............................................. Bill FitzGerald, Mid-Yellowstone Electric Cooperative, Inc.
Vice President ........................................ John Prinkki, Beartooth Electric Cooperative, Inc.
Secretary/Treasurer ..................................... Joe Dirkson, Fergus Electric Cooperative, Inc.
Trustee .............................................. Gary Helm, Tongue River Electric Cooperative, Inc.
Trustee .............................................. Dave Kelsey, Yellowstone Valley Electric Cooperative, Inc.
Trustee .............................................. Coleen Balzarini, City of Great Falls
CEO/General Manager .................................. Tim Gregori

FRONT ROW LEFT TO RIGHT:
Dave Kelsey, Gary Helm, Tim Gregori

BACK ROW LEFT TO RIGHT:
John Prinkki, Joe Dirkson, Bill FitzGerald
(Not Pictured: Coleen Balzarini)

STAFF

LEFT TO RIGHT:
Carrie Boysun, Accountant
Troy Dahlgren, Engineer/Power Scheduler
Leisette Hunt, Secretary
# ANNUAL MEETING AGENDA

**Registration, Parish Centre foyer**

**Business Session: Order of Business**

*President Bill Fitzgerald, presiding*

- Call to Order
- Pledge of Allegiance
- Introduction of Guests
- Appointment of a Recording Secretary

- Determination of Quorum and Related Matters
  *for D. Fitzgerald, Secretary*
  - Report on Members Represented by Delegates to Determine Quorum
  - Reading of Notice of Meeting and Proof of Mailing
  - Reading of Minutes of 21 March 2009 Annual Meeting

**President's Report**

*Bill Fitzgerald, President*

**Manager's Report**

*Dan Greaves, Manager*

**Power Supply Alternatives**

16 January 2009 REP Summary and Results

Dick McGinnis, Electrical Consultants Incorporation

Highwood Generating Station - Progress Reports

Project Manager for Permitting and EIS - Jeff Chaffee

Project Principal, Engineering and Design - Kevin Connors

Transmission Interconnection and Wind Project - Dick McGinnis

HGS Finance and Accounting - Sandy Byars

**Lunch**

12:00 noon
**ASSETS**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Office Equipment</td>
<td>$75,547</td>
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<tr>
<td>Automobile</td>
<td>$39,580</td>
</tr>
<tr>
<td>Elementary Equipment</td>
<td>$275,104</td>
</tr>
<tr>
<td>Total Property &amp; Equipment</td>
<td>$390,231</td>
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<tr>
<td>Accumulated Depreciation</td>
<td>$(233,750)</td>
</tr>
<tr>
<td>Total Fixed Assets</td>
<td>$156,481</td>
</tr>
<tr>
<td>Due From Central Montana Electric</td>
<td>$645,165</td>
</tr>
<tr>
<td>Investments in Associated Organizations</td>
<td>$64,722</td>
</tr>
<tr>
<td><strong>Total Other Assets and Investments</strong></td>
<td>$709,887</td>
</tr>
<tr>
<td>Cash - Operations</td>
<td>$831,044</td>
</tr>
<tr>
<td>Accounts Receivable - Members</td>
<td>$4,685,282</td>
</tr>
<tr>
<td>Accounts Receivable - Deposits</td>
<td>$90,017</td>
</tr>
<tr>
<td><strong>Due from SME</strong></td>
<td>$1,062,398</td>
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<tr>
<td>Accounts Receivable - Other</td>
<td>$559,694</td>
</tr>
<tr>
<td>Accrued Interest Receivable</td>
<td>$2,889</td>
</tr>
<tr>
<td>Prepaid Expenses</td>
<td>$24,895</td>
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<tr>
<td>Concessions of Deposit</td>
<td>$365,712</td>
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<tr>
<td>C.F.C. - Commercial Paper</td>
<td>$1,899,715</td>
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<tr>
<td><strong>Total Current Assets</strong></td>
<td>$3,153,351</td>
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<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$5,447,225</td>
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**LIABILITIES & EQUITY**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Memberships</td>
<td>$3,009</td>
</tr>
<tr>
<td>Patronage Capital</td>
<td>$8,580,761</td>
</tr>
<tr>
<td>Capital - Project Development</td>
<td>$13,702,712</td>
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<td><strong>Total Equity</strong></td>
<td>$22,286,233</td>
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<td>Accounts Payable</td>
<td>$6,425,488</td>
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<td>Accrued Compensated Absences</td>
<td>$24,389</td>
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<tr>
<td>Line of Credit - First Interstate Bank</td>
<td>$1,245,343</td>
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<tr>
<td>Member Deposits</td>
<td>$2,537,674</td>
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<tr>
<td><strong>Total Current Liabilities</strong></td>
<td>$10,920,891</td>
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<tr>
<td><strong>TOTAL LIABILITIES &amp; EQUITY</strong></td>
<td>$5,447,225</td>
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### Statements of Revenues & Expenses

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount 1</th>
<th>Amount 2</th>
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<tbody>
<tr>
<td>Electric Power and Energy Revenue</td>
<td>$36,033,314</td>
<td>$30,774,630</td>
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<tr>
<td><strong>Total Revenue</strong></td>
<td><strong>2,255,383</strong></td>
<td><strong>2,317,264</strong></td>
</tr>
<tr>
<td><strong>Total Operating Expense</strong></td>
<td><strong>2,266,315</strong></td>
<td><strong>2,322,092</strong></td>
</tr>
<tr>
<td><strong>Total Net Margin</strong></td>
<td><strong>$1,692,466</strong></td>
<td><strong>$1,706,573</strong></td>
</tr>
</tbody>
</table>

#### Total Operating Expense

- **Operating Income**
  - Payroll: $330,730
  - Salaries and Wages: $42,799
  - Office Supplies and Expenses: $35,408
  - Outside Services - Audit and Accounting: $39,532
  - Outside Services - Marketing and Administration: $41,087
  - Outside Services - Engineering: $581
  - Insurance Expense: $10,021
  - Employer Pension and Benefits: $123,548
  - Fiduciary Fees and Expenses: $53,570
  - Association Dues: $40,707
  - Staff Travel and Other: $51,389
  - Corporate, General, and Administration: $96,673
  - Depreciation and Amortization: $78,760
  - Taxes - Payroll: $22,591
  - Operating Costs Allocated to Preliminary Surveys: $(71,372)

- **Total Operating Expense**: $2,266,315

- **Total Net Margin**: $1,692,466

- **Net Margin**: $1,692,466

- **Supplemental Information**: $1,706,573
Mr. Kaiserski is the Program Manager for the Energy Promotion and Development Division (EPD) in the Montana Department of Commerce. The Division was funded by HB 2 in May of 2007 and EPD is hard at work developing Montana's vast energy resources. EPD's focus at this time is developing electricity transmission projects that can access Montana energy resource areas and move power to load centers in the West.

Prior to taking this new position, Mr. Kaiserski worked as a Senior Economic Development Specialist with Governor Schweitzer's Office of Economic Development where he concentrated on energy development. Mr. Kaiserski has traveled around the region presenting information on energy policy which promotes developing of all of Montana's energy opportunities. This includes emphasis on developing wind, bio-fuels, coal, oil and gas energy sources that eastern Montana has in abundant supply which is one of the keys to national energy independence and revitalizing the economy of eastern Montana.

Mr. Kaiserski grew up in Los Angeles and has a bachelor's degree in earth science from Montana State University in Bozeman. Prior to coming on board with Governor Schweitzer's office in January 2005 he worked for 7 years as the Economic Development Coordinator for the Beartooth RC&D, a regional economic and community development organization that serves a five county region around Billings, Montana. Mr. Kaiserski also worked as a community planner in Montana for over 10 years. Mr. Kaiserski is married to wife Teresa and has four children ranging in ages from 10 to 20.
MINUTES OF THE ANNUAL MEETING OF THE MEMBERSHIP OF SOUTHERN MONTANA ELECTRIC GENERATION AND TRANSMISSION CO-OP., INC.

Pursuant to notice, a meeting of the Membership of Southern Montana Electric Generation and Transmission Cooperative, Inc. was scheduled and held at Grant Thomas' Board members, 3036 Woodside Drive, Billings, Montana 59110, on Friday, March 21, 2006. The representatives of the six member companies were present throughout the meeting. The representatives were: Joe Prindo (Burnside Electric); Gene Brette (City of Great Falls); Joe Hendrickson (Rivertown); Bill Firefield (Mid-Continental); and Dave Kelsey (Yellowstone Valley Electric).

President Bill Firefield called the meeting to order at approximately 9:15 AM, followed by the President of the Board. He welcomed the following guests: Brian Osborne (President, Roeschle Power Administration); Robert Harshman (Western Area Power Administration); Donata Schepke (RUS); Linda Lewis (LCF); Carol Nee (PPL); Susan Lehman (Favorable Law Firm); Russell Malmont; Jim Roeschle (Yellowstone County Commissioner); and Rich Matsumoto (CPA).

President Firefield called on Joe Prindo to introduce the meeting. He then designated Mike McCarter recording secretary for the meeting.

Joe Dallin, Secretary/Treasurer, reported that representatives of all members were present and that they constituted a quorum. He then read the Notice of the Fifty-Fourth Annual Meeting of the Members of Southern Montana Electric Generation and Transmission Cooperative, Inc., and the Preliminary Notice of Notice of Annual Meeting.

John Prindo moved that the members dispose of the reading of the minutes of the March 17, 2007, Fourth Annual Meeting, as set forth in the 2008 Annual Report, and approve the minutes of that meeting. Dave Kelsey seconded the motion. The motion carried by unanimous vote.

President Firefield then gave his report regarding the status of SME. His report included the following points:

- At the close of 2007 SME had good margins and adequate funds.
- SME continues to seek alternatives to funding the HGs.
- SME prepares for the loss of BPA power rates have increased at an average of 5.5% per year since 2004, and rates are still among the lowest in the United States and approximately 46% lower than for Northwest Power Pool members.
- The HGs project will still face challenges, but the key to success is to meet those challenges.

President Firefield then turned the meeting over to General Manager Tim Gregor. Manager Gregor thanked President Firefield and the Board of Trustees for their work the previous year. He reported that despite obstacles in the path of the Higheni Generator Station, SME is on the verge of constructing the first member-owned generation facility in Montana. The project will provide a clean, reliable source of affordable power for SME's members. The project has a larger and longer time frame; the cost is higher than expected. He then talked about the Urquhart family's continuous support of the project.

Manager Gregor then listed the project successes, including the issuance of the Air Quality Permit to the Board of Directors from RUS, issuance of a solid waste disposal permit, execution of agreements for raw water and waste water agreements between SME and the city of Great Falls, execution of a Large Generation Integration Agreement with Northwest Power Pool, completion and execution of a Project Labor Agreement with Montana unions, execution of a Memorandum of Understanding for operating and maintenance reserves, and rezoning of the Salem site for heavy industrial use.

He then gave a power point presentation. Among the points he made during the presentation were the following:

- A simple test for March 17, 2008, showed that the HGs had been operational on that date. It could have supplied all of the energy up to 75% per megawatt.
- The reason for using the HGs to provide power is because the cost of power during peak hours is the most expensive power.
- The institution for constructing the HGs was the same in 2001 when it was conceived.
- SME will provide significant benefits to the city of Great Falls.
- SME has been a good environmental asset.
- SME must soon secure financing for the HGs and resolve some internal problems but its future is not in doubt.

Manager Gregor then called on Jeff Chaffee of Basin Engineering for a report on environmental matters.

Mr. Chaffee reiterated the milestones covered by Manager Gregor and then discussed specific environmental challenges. SME is still facing. He reported that three issues were raised with the Environmental Quality Permit, one by SME. The SME issue concerned the test method for measuring coal combustion. He reported that SME is close to setting that issue and that EPA is expected to approve a new test method. The other two issues were raised by MEPC, which means that a BACT study should be done on carbon dioxide emissions and a specific BACT analysis should be done for PM2.5. He reported that a two-day hearing had been held before the Board of Environmental Review in January and that an extension of times SME will be required to go through more work. He noted that the HGs is a clean project due to Shell's technology and comply favorably with the proposed Future Gen Facility. He then introduced Bob Warkows, another Basin environmental engineer, to report on a carbon capture. Mr. Chaffee noted that SME is far along in its analysis of carbon capture feasibility and technology as anyone.

Mr. Warkows discussed the two major pieces of carbon capture legislation pending in Congress – Lieberman-Warner and Bingaman-Spekter. The former bill proposes a cap and trade system that does not contain a fair allocation for coal. He noted that a speaker at a recent conference he attended predicted that enactment would cost 10,000 to 15,000 jobs in Montana and by 2030 would cost the average family $4,400. He said the Bingaman-Spekter is similar to Lieberman-Warner but with better limits and safeguards. It is receiving more support from industry and labor than Lieberman-Warner.

He went on to report on recent Wyoming legislation and the Montana Governor's Climate Change Advisory Committee. He said that in the previous month Wyoming had enacted carbon legislation regulating power plant emission of carbon dioxide and requiring a carbon analysis for future projects. The Montana Committee had made fifty-five (55) recommendations, forty of which are being considered by the Montana Environmental Quality Council for legislation. He noted that the new legislation is considered "low-hanging fruit" i.e., they are easy to implement.

Barnes introduced the members that the HGs design is well accommodated for carbon dioxide capture technology. He also noted that from a global perspective, the carbon dioxide concentration from HGs will be extremely small. Nonetheless, SME has prepared a draft carbon capture plan targeting 60% carbon dioxide emissions reduction, 50% through capture and sequestration and 10% through carbon offsetting that would bring the HGs in line with the emissions from a natural gas plant. He said that market constraints are important for carbon dioxide for enhanced oil recovery is essential to contain costs. SME-Carbon Capture and Sequestration Task Group is meeting again in 2008 and SME will be submitting an application to the United States Department of Energy for a DOE Clean Energy Coal Innovation Grant.

The meeting was recessed for a short time. When called to order, President Firefield called on Manager Gregor to continue. Manager Gregor introduced Kevin Canavan from Stankey Consulting, the project engineering firm. Mr. Canavan reported on the HGs engineering progress. Among the points he made during his presentation were the following:

- The HGs will be enhanced from the historical landscape.
- A rigidly-arranged form has been created, a unique vertical design, and alignment charts prepared.
- Right-of-way efforts will begin to move forward now that zoning has been approved.
- In conjunction with an analysis of carbon capture technology, Stankey Engineering visited the Al S Sterling Point Power Plant in Oklahoma. The plant uses 95% of carbon dioxide captured. Power plant slides showed that even the capture equipment covered a large area of the plant site.
Finally, he reported that SME’s statements for 2007 are currently being audited by auditor Nick Matlock.

Mr. Vlastakis reported that during the past couple of years he has been unable to complete the SME audit in time for the annual meeting due to Northern Power Energy’s delays in reporting year end energy imbalances. This year further information is needed with respect to the billing year with Central Montana Electric. Resolution of which is pending and which will determine what amount will be looked at as receivable. He acknowledged that SME bylaws require that the audited annual report be presented at the annual meeting but noted that accounting standards preclude his certifying an audit at this time and that he is bound by those standards.

Upon conclusion of the financial report, Gary Ellen moved to accept the current treasurer. Joe Dirksen seconded the motion. The motion was adopted by unanimous vote.

John Trnake then moved to ratify all legal actions taken by SME during the prior year. Joe Dirksen seconded the motion and it was adopted without dissenting vote.

Manager Gregori then introduced Ron Pall, former CEO of First Kentucky Power Cooperative, for the keynote address.

Following the keynote address, Manager Gregori reminded those present that the names of the entities through which SME is seeking financing are confidential.

President Fitch-Gardner noted that the members must still consider the audited financial statements when they become available and that the members should consider amending the articles in light of the difficulties experienced with respect to completing the audit by the date presently set for the annual meeting. He said that he was therefore rescheduling the meeting rather than adjourning, and that the annual meeting will be rescheduled at a later time.

The 2007 Annual Meeting of Southern Montana members was then recessed until further notice.

______________________________
President

______________________________
Treasurer

______________________________
Secretary