

SETTLEMENT AGREEMENT

This Settlement Agreement (“Agreement”) dated November 11, 2010, is by and between East Kentucky Power Cooperative Inc. (“EKPC”), Wendell Berry, Dr. John A. Patterson, M.D., MSPH, and Fr. John Rausch (“Retail Customers”), the Sierra Club, Kentuckians for the Commonwealth, and Kentucky Environmental Foundation (“Environmental Groups”), Gallatin Steel Company (“Gallatin”), and the Kentucky Attorney General (“Attorney General”), collectively the “Parties”.

WHEREAS, EKPC currently holds a Certificate of Public Convenience and Necessity (“CPCN”) authorizing it to construct a 278 MW Circulating Fluidized Bed coal-fired generating facility at the J.K. Smith site located at Trapp, Clark County, Kentucky (“Smith 1 CFB”)¹; and,

WHEREAS, EKPC has obtained a lien accommodation from the United States Department of Agriculture, Rural Utilities Service (“RUS”) to permit EKPC to obtain private financing to construct Smith 1 CFB, and has obtained a combined Title V / Prevention of Significant Deterioration Air Quality Permit from the Kentucky Energy and Environmental Cabinet.² EKPC is working vigorously to obtain all other necessary permits including a Section 404 permit from the U.S. Army Corps of Engineers and a Section 401 Water Quality Certification from the Kentucky Division of Water; and,

¹ The CPCN for construction of Smith 1 CFB was granted by Order of the Kentucky Public Service Commission on August 29, 2006 in Case No. 2005-00053; and, was reaffirmed by subsequent Order of the KPSC on May 11, 2007 in Case No. 2006-00564.

² The Environmental Groups have challenged the issuance of this permit in *Sierra Club, Kentucky Environmental Foundation and Kentuckians for the Commonwealth vs. Energy and Environmental Cabinet, Division for Air Quality, and East Kentucky Power Cooperative, Inc., Energy and Environment Cabinet File No. DAQ-41109-048 (Petition filed May 7, 2010)* and by filing a petition for objection with the United States Environmental Protection Agency.

WHEREAS, Retail Customers and Environmental Groups oppose Smith 1 CFB principally because of their concern regarding the environmental and economic impacts resulting from construction and operation of the plant³; and,

WHEREAS, Gallatin, as a retail customer of Owen Electric Cooperative, Inc., has an interest in the construction of Smith 1 CFB by virtue of being the largest electric consumer on EKPC's system; and,

WHEREAS, the Attorney General is authorized by virtue of KRS 367.150(8) to appear as the advocate representing all of Kentucky's utility consumers, including those retail customers of EKPC's 16 Member Systems; and,

WHEREAS, the Kentucky Public Service Commission ("KPSC") initiated an investigation, pursuant to KRS 278.260, of EKPC's continued need for Smith 1 CFB and summarized as those issues which warranted the investigation: (a) EKPC's current projected need for additional baseload generating capacity; (b) whether or not Smith 1 CFB remains the least costly option available to meet EKPC's need for additional baseload capacity; and (c) the impact on EKPC's financial integrity and its future electric rates from either constructing Smith 1 CFB or pursuing an alternative option if additional baseload capacity is needed.⁴ Constructing Smith 1 CFB or pursuing an alternative option if additional baseload capacity is needed impacts EKPC's financial ability to maintain its on-going operations; and,

³ Retail Customers and Environmental Groups lodged a Complaint against EKPC at the Kentucky Public Service Commission pursuant to KRS 278.260 and 278.280(1) challenging the continued need for Smith 1 CFB and whether construction of the plant was the "least cost" option. This Complaint became Case No. 2009-00426. By Order dated December 22, 2009, the Retail Customers were permitted to maintain their Complaint but the Environmental Groups were dismissed due to lack of standing. Subsequently, the Retail Customers' Complaint was consolidated into Case No. 2010-00238.

⁴ Order, June 22, 2010, pp. 5-6, KPSC Case No. 2010-00238.

WHEREAS, all of the Parties to this Agreement are aware of the long-lasting effect and importance that the decision regarding construction of Smith 1 CFB will have on EKPC, its 16 Member Systems, those Systems' Member-Ratepayers, as well as on Kentucky's economy and environment; and,

WHEREAS, there are many other issues of great importance to EKPC and its Member Systems, which are not included in Case No. 2010-00238, but which must be addressed immediately, including: (a) the need to obtain PSC approval of a Regulatory Asset for EKPC's sunk costs for Smith 1 CFB in the event the plant is not constructed; (b) the viability of alternative sources of baseload capacity for EKPC as its future needs for such capacity dictate; and (c) the numerous administrative and legal challenges which EKPC currently faces from the Retail Customers and/or Environmental Groups related to its existing coal-fired generation units; and,

WHEREAS, the Parties have engaged in good faith discussions and have reached a mutually-agreeable resolution of these issues which they desire be memorialized as follows:

NOW, THEREFORE, in consideration of these discussions and each party's respective positions on these issues, and each party's desire to conclude an amicable resolution of their differences thereby avoiding the expenditure of substantial resources for litigation of the disputes arising from these issues, and other good and valuable consideration flowing between and among them, the Parties to this Settlement Agreement, individually and collectively, do hereby agree as follows:

I. SMITH 1 CFB

Within ten business days following the final execution of this Agreement, EKPC shall:

(1) formally notify the KPSC of its intention to abandon the construction of Smith 1 CFB and to surrender the CPCN granted in Case No. 2005-00053; (2) submit an application for a permit amendment or modification to the Energy and Environment Cabinet requesting that Emission Units 11, 12, 13, 14, 15, 16a, 16b, 17, 18, and 19 be removed from Permit V-05-070 R3; and (3) formally notify the US Army Corps of Engineers that it is withdrawing its application submitted for a Department of the Army (DA) Permit, subject to Section 10 of the Rivers and Harbors Act and Section 404 of the Clean Water Act which was noticed in Public Notice No. LRL-2008-445-mdh.

EKPC shall provide counsel for Environmental Groups and Retail Customers with copies of items (1) – (3) at the same time that EKPC sends the items to the relevant agencies. In addition, EKPC agrees that upon making the filings referenced in I(1), I(2) and I(3) above, that it will not withdraw these submissions and will vigorously pursue the actions requested therein.

II. REGULATORY ASSET

Coincident with EKPC's notice to the KPSC of its intention to abandon the construction of Smith 1 CFB and to surrender the CPCN granted by the KPSC, EKPC shall file an application, pursuant to KPSC's authority to regulate utilities under KRS 278.040 and its authority to establish a system of accounts under KRS 278.220, before the KPSC requesting that a Regulatory Asset be approved allowing EKPC to recover its costs and other expenses reasonably incurred to date for the Smith 1 CFB project. EKPC shall be required to take reasonable action to mitigate and offset such costs and expenses to the extent possible.

Neither the Retail Customers nor the Environmental Groups will object or oppose in any fashion before the KPSC or any court EKPC's Regulatory Asset application. Retail Customers and the Environmental Groups assume that EKPC will make a good faith effort to reasonably

maximize the mitigation and offset of costs and expenses as required above and Retail Customers and Environmental Groups take no position on the information and issues addressed in the following paragraph.

Neither Gallatin nor the Attorney General will object to that portion of EKPC's application that requests establishment of the Regulatory Asset which both believe is necessary to ensure the Company's on-going operations. At the time that the original CPCN for Smith 1 CFB was sought by EKPC⁵ it relied on its 2004 load forecast which showed 2003 retail energy sales and 2024 projected retail energy sales by class in MWh as set forth in Appendix "A," attached.

The construction of Smith 1 CFB was not primarily planned to serve Gallatin's load. The appropriate allocation of cost to Gallatin and the other rate classes is based upon the firm demand of each rate class including Gallatin. Moreover, because of the nature of the proposed Regulatory Asset, the desire to lessen the rate shock to consumers of placing the Regulatory Asset into rates, and the financial ability of EKPC to do so, the Attorney General, Gallatin and EKPC agree that they will fully support before the Kentucky PSC an allocation methodology over the life of the amortization period based upon the firm demand of each rate class including Gallatin Steel as set forth in Appendix "B", attached, and that an amortization period of ten years for recovery of the Regulatory Asset is appropriate. The levelized costs of the Regulatory Asset will be recovered in base rates and recovery will terminate when the cost of the Regulatory Asset is fully recovered. To avoid double recovery, all Smith I costs currently being recovered in existing rates and all Smith I costs proposed to be recovered in future rates will be removed from

⁵ Case No. 2005-00053.

base rates or identified and excluded from recovery of the Regulatory Asset in EKPC's filing for recovery of the Regulatory Asset.

III. PENDING ADMINISTRATIVE AND COURT ACTIONS

The Environmental Groups currently have several state and federal administrative and court actions pending against EKPC listed below which shall be dismissed with prejudice. Within ten business days following the Environmental Groups receipt of all the items included in Section I(1), I(2) and I(3), the Environmental Groups shall file all pleadings and notices necessary to dismiss, with prejudice, with each side to bear its own costs of litigation, the following matters:

Spurlock

- A. **Sierra Club vs. EKPC, Case No. 5:09-CV-144, (E.D. KY) (Complaint filed April 21, 2009).**
- B. **Sierra Club's Notice of Intent to Sue EPA, letter from David C. Bender, McGillivray, Westerberg & Bender LLC, counsel for Sierra Club (March 15, 2010).**
- C. **Sierra Club's Petition Requesting that the Administrator Object to Permit No. V-06-007 Revision 3 from Robert Ukeiley, counsel for Sierra Club (April 6, 2010).**
- D. **Sierra Club's Petition Requesting that the Administrator Object to Permit # V-06-007 Revision 4⁶ from David C. Bender, McGillivray, Westerberg & Bender LLC, counsel for Sierra Club (June 22, 2010).**
- E. **Sierra Club's Notice of Intent to Sue EPA, letter from David C. Bender, McGillivray, Westerberg & Bender LLC, counsel for Sierra Club (September 8, 2010).**

Smith

- A. **Sierra Club, Kentucky Environmental Foundation and Kentuckians for the Commonwealth's Petition Requesting that the Administrator Object to Permit No. V-**

⁶ Petition references Permit # V-06-007 Revision 4. However, Petition actually relates to V-06-007 Revision 3.

05-070 Revision 3 from Robert Ukeiley and Kristin Henry, counsel for the Sierra Club (July 22, 2010).⁷

- B Sierra Club, Kentucky Environmental Foundation and Kentuckians for the Commonwealth vs. Energy and Environmental Cabinet, Division for Air Quality, and East Kentucky Power Cooperative, Inc., Energy and Environment Cabinet File No. DAO-41109-048 (Petition filed May 7, 2010).
- C. Sierra Club and Kentuckians for the Commonwealth vs. U.S. Rural Utilities Service; Thomas J. Vilsack, in his official capacity as Secretary of the U.S. Department of Agriculture; and Jonathan S. Adelstein, in his official capacity as Administrator of the U.S. Rural Utilities Service; Case No. 1:10-CV-01010 HHK, United States District Court for the District of Columbia. However, regardless of any other provision in the agreement, dismissal of Plaintiffs' facial challenge to 7 C.F.R. § 1794.3 shall be without prejudice.

In addition, the Retail Customers and Environmental Groups shall not in the future file any administrative or court action which would have the effect of reviving or reinstating any state or federal, administrative or court proceeding which was previously dismissed or finally adjudged as a result of the operation of this Agreement. If a party believes that this agreement may have been breached, the aggrieved party must provide written notice of any alleged breach and give the party an opportunity to cure. In the event of a breach, remedy is limited to specific performance. Under no circumstances will monetary damages be available for breach.

IV. FUTURE EKPC BASELOAD OR INTERMEDIATE LOAD GENERATING UNITS

Nothing in this Agreement shall in any way affect EKPC's ability in the future to seek approval from the KPSC and other necessary administrative and regulatory agencies to construct either baseload, intermediate-load or peak-load generating units regardless of fuel type as EKPC's capacity needs require except EKPC will not seek KPSC and other necessary

⁷ EPA formally objected to the proposed permit on the issue on May 24, 2010. DAQ issued a revised proposed permit on August 20, 2010 to address EPA's objection. Retail Customers and Environmental Groups agree not to refile the same petition based on the revised proposed permit of August 20, 2010.

administrative and regulatory agency approvals for a coal-fired generating unit within two years of the date this agreement is executed.

V. COLLABORATIVE TO ADDRESS EKPC'S ENERGY DIVERSIFICATION PORTFOLIO

The Parties to this Agreement agree that EKPC will initiate a "Collaborative" among EKPC, each of the Environmental Groups, Gallatin, the Attorney General, each of EKPC's Member Systems, and other organizations or entities representing relevant and appropriate interests. EKPC agrees to chair the Collaborative with one representative from the Environmental Groups acting as vice-chair. The purpose of the Collaborative shall be to evaluate and recommend actions to expand deployment of renewable energy and demand-side management, and to promote collaboration among the Parties in the implementation of those ideas. EKPC shall undertake the appropriate studies (subject to the \$100,000 total referenced below), as agreed upon by the Collaborative, in order to evaluate potential sources of renewable energy for use on EKPC's system along with demand side management options, and determine which would be commercially applicable, financially beneficial and viable for EKPC's customers. EKPC agrees to fund Collaborative reasonable administrative costs up to \$25,000 and, subject to Commission authorization up to a total of \$100,000, on studies of available wind resources at 100 meters and above in Kentucky or other sources of viable renewable power not including landfill gas. EKPC agrees to draft a charter for the Collaborative consistent with applicable KPSC regulation and policy. The Collaborative shall convene no later than 60 days after this agreement takes effect, and shall meet at least quarterly for 2 years, at which time it may be renewed by agreement of the Parties. The Collaborative will operate by consensus. Meetings of the Collaborative shall be open to the public

VI. PARTIES TO BE BOUND

All of the Parties to this Agreement shall be bound by its terms and conditions. In addition, each individual organization comprising the Environmental Groups shall not provide funding to any individual, whether or not such individual is a member of that organization, for the bringing of any administrative or court action which would revive or reinstitute any state or federal administrative or court proceeding which was previously dismissed or finally adjudged as a result of the operation of this Agreement.

VII. CHOICE OF LAW AND VENUE

The laws of the Commonwealth of Kentucky shall govern the execution, interpretation and operation of this Agreement. Any subsequent action that may be necessary to settle any dispute arising under this Agreement or to enforce any of its provisions, including any breach thereof, shall be initiated in and processed under the laws and courts of the Commonwealth of Kentucky. In such event, the Parties further agree that the appropriate venue for addressing any such issue which might arise shall be Franklin County, Kentucky.

VIII. CONFIDENTIALITY

The Parties to this Agreement affirm that this document is the product of settlement discussions and negotiations. All data, analyses, documents (but not including the final version of this Agreement) or other materials of any kind (verbal or written) are confidential pursuant to the terms and conditions of the Confidentiality Agreement executed by the Parties.

IX. SEVERABILITY

If any provision of this Agreement or its application will be invalid, illegal or unenforceable in any respect except Section I, the validity, legality and enforceability of all other applications of that provision, and of all other provisions and applications hereof, will not in any way be affected or impaired. If any part of Section I or its application is invalid, illegal or

unenforceable in any respect, then the obligations of all Parties under Section III are void. If any court shall determine that any provision of this Agreement is in any way unenforceable except Section I, the remainder of the Agreement shall remain in full force and effect. If the KPSC fails to fully approve any provision of this Agreement which relates to rates or ratemaking, then neither EKPC, Gallatin, nor the Attorney General will be bound by this Agreement except Section I.

Executed this _____ day of _____, 2010.

EAST KENTUCKY POWER COOPERATIVE, INC.

By: _____

Title: _____

WENDELL BERRY

JOHN A. PATTERSON, M.D., MSPH

FR. JOHN RAUSCH

THE SIERRA CLUB

By: _____

Title: _____

KENTUCKIANS FOR THE COMMONWEALTH

By: _____

Title: _____

KENTUCKY ENVIRONMENTAL FOUNDATION

By: _____

Title: _____

GALLATIN STEEL COMPANY

By: _____

Title: _____

KENTUCKY ATTORNEY GENERAL

By: _____

Title: _____

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APPENDIX “A”

YEAR	RESIDENTIAL	SEASONAL	SMALL COMM'L	PUBLIC BLDGS.	LARGE COMM'L	GALLATIN
2003	6,156,774	15,487	1,581,188	42,689	1,906,861	1,007,676
2024	13,194,533	30,814	3,314,701	71,684	4,740,172	959,015
PERCENT INCREASE 2003-2024	114.3%	99%	109.6%	68%	148.6%	(4.85%)

APPENDIX “B”

Firm Demand by Rate Class					
			Firm Demand (MW)		% of Total Firm Demand
Rate E					
Option 1 (Owen)			2,305		8.32%
Option 2			22,170		79.99%
Rate B					
Minimum			1,349		4.87%
Excess			167		0.60%
Rate C			502		1.81%
Rate G			552		1.99%
Large Special Contract					
Firm Demand			180		0.65%
Steam Service (equivalent MW)			492		1.78%
			27,717		100.00%
*Firm demand was based upon a modified version of the 2008 load forecast, consistent with the demand levels used in Case No. 2010-00167.					