

# **EXHIBIT 1**

**PROPOSED NOTE**

# **EXHIBIT 1**

SECURED PROMISSORY NOTE

\$1,060,340.00

dated as of \_\_\_\_\_

EMPIRE ELECTRIC ASSOCIATION, INC., a Colorado corporation (the "Borrower"), for value received, hereby promises to pay, without setoff, deduction, recoupment or counterclaim, to the order of NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION (the "Payee"), at its office in Herndon, Virginia or such other location as the Payee may designate to the Borrower, in lawful money of the United States, the principal sum of ONE MILLION SIXTY THOUSAND THREE HUNDRED FORTY AND NO/100 DOLLARS (\$1,060,340.00), or such lesser sum of the aggregate unpaid principal amount of all advances made by the Payee pursuant to that certain Loan Agreement dated as of even date herewith between the Borrower and the Payee, as it may be amended from time to time (herein called the "Loan Agreement"), and to pay interest on all amounts remaining unpaid hereunder from the date of each advance in like money, at said office, at the rate and in amounts and payable on the dates provided in the Loan Agreement together with any other amount payable under the Loan Agreement. If not sooner paid, any balance of the principal amount and interest accrued thereon shall be due and payable nine (9) years from the date of the Loan Agreement (such date herein called the "Maturity Date") provided, however, that if such date is not a Payment Date (as defined in the Loan Agreement), then the Maturity Date shall be the Payment Date immediately preceding such date.

This Note is secured under a Restated Mortgage and Security Agreement, dated as of August 1, 2007, among the Borrower, the Payee and the United States of America, as it may have been or shall be supplemented, amended, consolidated or restated from time to time ("Mortgage"). This Note is one of the Notes referred to in, and has been executed and delivered pursuant to, the Loan Agreement.

The principal hereof and interest accrued thereon and any other amount due under the Loan Agreement may be declared to be forthwith due and payable in the manner, upon the conditions, and with the effect provided in the Mortgage or the Loan Agreement.

The Borrower waives demand, presentment for payment, notice of dishonor, protest, notice of protest, and notice of non-payment of this Note.

IN WITNESS WHEREOF the Borrower has caused this Note to be signed in its corporate name and its corporate seal to be hereunto affixed and to be attested by its duly authorized officers, all as of the day and year first above written.

EMPIRE ELECTRIC ASSOCIATION, INC.

(SEAL)

By: \_\_\_\_\_

Title: \_\_\_\_\_

Attest: \_\_\_\_\_  
Secretary

Loan No. CO033-A-9018

# **EXHIBIT 2**

## **LOAN AGREEMENT**

# **EXHIBIT 2**

## LOAN AGREEMENT

**LOAN AGREEMENT** (this "Agreement") dated as of \_\_\_\_\_, between EMPIRE ELECTRIC ASSOCIATION, INC. ("Borrower"), a corporation organized and existing under the laws of the State of Colorado and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION ("CFC"), a cooperative association organized and existing under the laws of the District of Columbia.

### RECITALS

**WHEREAS**, the Borrower has applied to CFC for a loan or a series of loans for the purpose of refinancing certain of its existing indebtedness, as more fully described on Schedule 1 hereto, and CFC is willing to make such a loan to the Borrower on the terms and conditions stated herein; and

**WHEREAS**, the Borrower has agreed to execute one or more secured promissory notes to evidence an indebtedness in the aggregate principal amount of the CFC Commitment (as hereinafter defined).

**NOW, THEREFORE**, for and in consideration of the premises and the mutual covenants hereinafter contained, the parties hereto agree and bind themselves as follows:

### ARTICLE I

#### DEFINITIONS

**Section 1.01** For purposes of this Agreement, the following capitalized terms shall have the following meanings (such definitions to be equally applicable to the singular and the plural form thereof). Capitalized terms that are not defined herein shall have the meanings as set forth in the Mortgage.

**"Accounting Requirements"** shall mean any system of accounts prescribed by a federal regulatory authority having jurisdiction over the Borrower (including but not limited to that prescribed by the financial and statistical report required by RUS, commonly known as the "RUS Form 7"), or in the absence thereof, the requirements of GAAP applicable to businesses similar to that of the Borrower.

**"Advance"** shall mean each advance of funds by CFC to the Borrower pursuant to the terms and conditions of this Agreement.

**"Amortization Basis Date"** shall mean the first calendar day of the month following the end of the Billing Cycle in which the Advance occurs, provided, however, that if the Advance is made on the first day of a Billing Cycle, and such day is a Business Day, then the Amortization Basis Date shall be the date of the Advance.

**"Average DSC Ratio"** shall mean the average of the Borrower's two highest annual DSC Ratios during the most recent three calendar years.

**"Billing Cycle"** shall mean any 3-month period ending on, and including, a Payment Date.

**“Business Day”** shall mean any day that both CFC and the depository institution CFC utilizes for funds transfers hereunder are open for business.

**“CFC Commitment”** shall have the meaning as defined in Schedule 1.

**“CFC Fixed Rate”** shall mean (i) such fixed rate as is then available for loans similarly classified pursuant to CFC's policies and procedures then in effect, or (ii) such other fixed rate as may be agreed to by the parties and reflected on the written requisition for funds in the form attached as Exhibit A hereto.

**“CFC Fixed Rate Term”** shall mean the specific period of time that a CFC Fixed Rate is in effect for an Advance.

**“CFC Variable Rate”** shall mean (i) the rate established by CFC for variable interest rate long-term loans similarly classified pursuant to the long-term loan programs established by CFC from time to time, or (ii) such other variable rate as may be agreed to by the parties on the written requisition for funds in the form attached as Exhibit A hereto.

**“Capital Certificate”** shall mean a certificate, or book entry form of account, evidencing the Borrower's purchase of subordinated debt instruments issued by CFC from time to time. Such instruments may be denoted by CFC as “Loan Capital Term Certificates”, “Member Capital Securities”, “Subordinated Term Certificates”, or other like designations.

**“CREB Provisions”** shall mean the specific covenants relating to funds requisition, tax status of the CREBs and completion and termination certificates contained in any loan agreements related to a clean renewable energy project of the Borrower funded by proceeds of one or more series of clean renewable energy bonds issued by CFC.

**“Conversion Request”** shall mean a written request to CFC from any duly authorized officer or other employee of the Borrower requesting an interest rate conversion available pursuant to the terms of this Agreement.

**“Debt Service Coverage (“DSC”) Ratio”** shall mean the ratio determined as follows: for any calendar year add (i) Operating Margins, (ii) Non-Operating Margins--Interest, (iii) Interest Expense, (iv) Depreciation and Amortization Expense, and (v) cash received in respect of generation and transmission and other capital credits, and divide the sum so obtained by the sum of all payments of Principal and Interest Expense required to be made during such calendar year; provided, however, that in the event that any amount of Long-Term Debt has been refinanced during such year, the payments of Principal and Interest Expense required to be made during such year on account of such refinanced amount of Long-Term Debt shall be based (in lieu of actual payments required to be made on such refinanced amount of Long-Term Debt) upon the larger of (i) an annualization of the payments required to be made with respect to the refinancing debt during the portion of such year such refinancing debt is outstanding or (ii) the payment of Principal and Interest Expense required to be made during the following year on account of such refinancing debt.

**“Default Rate”** shall mean a rate per annum equal to the interest rate in effect for an Advance plus two hundred basis points.

**“Depreciation and Amortization Expense”** shall mean an amount constituting the depreciation and amortization of the Borrower computed pursuant to Accounting Requirements.

**“Distributions”** shall mean, with respect to the Borrower, any dividend, patronage refund, patronage capital retirement or cash distribution to its members, or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower). The term “Distribution” shall *not* include (a) a distribution by the Borrower to the estate of a deceased patron, (b) repayment by the Borrower of a membership fee upon termination of a membership, or (c) any rebate to a patron resulting from a cost abatement received by the Borrower, such as a reduction of wholesale power cost previously incurred.

**“Draw Period”** Draw Period shall mean the period of beginning on the date hereof and ending on the date that is one year thereafter.

**“Environmental Laws”** shall mean all laws, rules and regulations promulgated by any Governmental Authority, with which Borrower is required to comply, regarding the use, treatment, discharge, storage, management, handling, manufacture, generation, processing, recycling, distribution, transport, release of or exposure to any Hazardous Material.

**“Equity”** shall mean the aggregate of the Borrower's equities and margins computed pursuant to Accounting Requirements.

**“Event of Default”** shall have the meaning as described in Article VI hereof.

**“GAAP”** shall mean generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board and the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board.

**“Governmental Authority”** shall mean the government of the United States of America, any other nation or government, any state or other political subdivision thereof, whether state or local, and any agency, authority, instrumentality, regulatory body, court or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative powers or functions of or pertaining to government.

**“Hazardous Material”** shall mean any (a) petroleum or petroleum products, radioactive materials, asbestos-containing materials, polychlorinated biphenyls, lead and radon gas, and (b) any other substance designated as hazardous or toxic or as a pollutant or contaminant under any Environmental Law.

**“Interest Expense”** shall mean an amount constituting the interest expense with respect to Long-Term Debt of the Borrower computed pursuant to Accounting Requirements. In computing Interest Expense, there shall be added, to the extent not otherwise included, an amount equal to 33-1/3% of the excess of Restricted Rentals paid by the Borrower over 2% of the Borrower's Equity.

**“Interest Rate Reset Date”** shall mean, with respect to any Advance, the first day following the expiration of the CFC Fixed Rate Term for such Advance.

**“LCTC Purchase Provisions”** shall mean the specific conditions and covenants in any Prior Loan Document requiring the Borrower to purchase subordinated debt instruments issued by CFC that may be referred to in Prior Loan Documents as “LCTCs”, “Loan Capital Term Certificates”, “Capital Certificates”, “Equity Certificates”, “Subordinated Term Certificates” or instruments with other like designations.

**“Lien”** shall mean any statutory or common law consensual or non-consensual mortgage, pledge, security interest, encumbrance, lien, right of set off, claim or charge of any kind, including, without limitation, any conditional sale or other title retention transaction, any lease transaction in the nature thereof and any secured transaction under the Uniform Commercial Code.

**“Loan Documents”** shall mean this Agreement, the Note, the Mortgage and all other documents or instruments executed, delivered or executed and delivered by the Borrower and evidencing, securing, governing or otherwise pertaining to the loan made by CFC to the Borrower pursuant to this Agreement.

**“Long-Term Debt”** shall mean an amount constituting the long-term debt of the Borrower computed pursuant to Accounting Requirements.

**“Make-Whole Premium”** shall mean, with respect to any principal sum of a CFC Fixed Rate Advance paid prior to the expiration of the CFC Fixed Rate Term applicable thereto (the “Prepaid Principal Amount”), an amount calculated as set forth below. The Make-Whole Premium represents CFC’s reinvestment loss resulting from making a fixed rate loan.

(1) Compute the amount of interest (“Loan Interest”) that would have been due on the Prepaid Principal Amount at the applicable CFC Fixed Rate for the period from the prepayment date through the end of the CFC Fixed Rate Term (such period is hereinafter referred to as the “Remaining Term”), calculated on the basis of a 30-day month/360-day year, adjusted to include any amortization of principal in accordance with the amortization schedule that would have been in effect for the Prepaid Principal Amount.

(2) Compute the amount of interest (“Investment Interest”) that would be earned on the Prepaid Principal Amount (adjusted to include any applicable amortization) if invested in a United States government security with a term equivalent to the Remaining Term, calculated on the basis of a 30-day month/360-day year. The yield used to determine the amount of Investment Interest shall be based upon United States government security yields dated no more than two Business Days prior to the prepayment date in Federal Reserve statistical release H.15 (519), under the caption “U.S. Government Securities/Treasury Constant Maturities”. If there is no such United States government security under said caption with a term equivalent to the Remaining Term, then the yield shall be determined by interpolating between the terms of whole years nearest to the Remaining Term.

(3) Subtract the amount of Investment Interest from the amount of Loan Interest. If the difference is zero or less, then the Make-Whole Premium is zero. If the difference is greater than zero, then the Make-Whole premium is a sum equal to the present value of the difference, applying as the present value discount a rate equal to the yield utilized to determine Investment Interest.

**“Maturity Date”** with respect to each Note shall have the meaning ascribed to it therein.

**"Mortgage"** shall have the meaning as described in Schedule 1 hereto.

**"Mortgagee"** shall mean each of CFC, RUS, and each other lender which shall hereafter become a mortgagee under the terms of the Mortgage.

**"Mortgaged Property"** shall have the meaning ascribed to it in the Mortgage.

**"Non-Operating Margins--Interest"** shall mean the amount representing the interest component of non-operating margins of the Borrower computed pursuant to Accounting Requirements.

**"Note" or "Notes"** shall mean each secured promissory notes, payable to the order of CFC, executed by the Borrower, dated as of even date herewith, pursuant to this Agreement as identified on Schedule 1 hereto, and shall include all substitute, amended or replacement promissory notes.

**"Obligations"** shall mean any and all liabilities, obligations or indebtedness owing by the Borrower to CFC, of any kind or description, irrespective of whether for the payment of money, whether direct or indirect, absolute or contingent, due or to become due, now existing or hereafter arising.

**"Operating Margins"** shall mean the amount of patronage capital and operating margins of the Borrower computed pursuant to Accounting Requirements.

**"Payment Date"** shall mean the last day of each of the months referred to in Schedule 1.

**"Permitted Encumbrances"** shall have the meaning ascribed to it in the Mortgage.

**"Person"** shall mean natural persons, cooperatives, corporations, limited liability companies, limited partnerships, general partnerships, limited liability partnerships, joint ventures, associations, companies, trusts or other organizations, irrespective of whether they are legal entities, and Governmental Authorities.

**"Principal"** shall mean the amount of principal billed on account of Long-Term Debt of the Borrower computed pursuant to Accounting Requirements.

**"Prior Loan Documents"** shall mean, collectively, all long term loan agreements entered into prior to the date hereof by and between CFC and the Borrower, and all promissory notes delivered pursuant thereto secured under the Mortgage.

**"Restricted Rentals"** shall mean all rentals required to be paid under finance leases and charged to income, exclusive of any amounts paid under any such lease (whether or not designated therein as rental or additional rental) for maintenance or repairs, insurance, taxes, assessments, water rates or similar charges. For the purpose of this definition the term "finance lease" shall mean any lease having a rental term (including the term for which such lease may be renewed or extended at the option of the lessee) in excess of three (3) years and covering property having an initial cost in excess of \$250,000 other than automobiles, trucks, trailers, other vehicles (including without limitation aircraft and ships), office, garage and warehouse space and office equipment (including without limitation computers).



**“RUS”** shall mean the Rural Utilities Service, an agency of the United States Department of Agriculture, or if at any time after the execution of this Agreement RUS is not existing and performing the duties of administering a program of rural electrification as currently assigned to it, then the entity performing such duties at such time.

**“Subsidiary”** as to any Person, shall mean a corporation, partnership, limited partnership, limited liability company or other entity of which shares of stock or other ownership interests having ordinary voting power (other than stock or such other ownership interests having such power only by reason of the happening of a contingency) to elect a majority of the board of directors or other managers of such entity are at the time owned, or the management of which is otherwise controlled, directly or indirectly through one or more intermediaries, or both, by such Person. Unless otherwise qualified, all references to a “Subsidiary” or to “Subsidiaries” in this Agreement shall refer to a Subsidiary or Subsidiaries of the Borrower.

**“Total Assets”** shall mean an amount constituting the total assets of the Borrower computed pursuant to Accounting Requirements.

**“Total Utility Plant”** shall mean the amount constituting the total utility plant of the Borrower computed pursuant to Accounting Requirements.

## ARTICLE II

### REPRESENTATIONS AND WARRANTIES

**Section 2.01** The Borrower represents and warrants to CFC that as of the date of this Agreement:

**A. Good Standing.** The Borrower is duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation or organization, is duly qualified to do business and is in good standing in those states in which it is required to be qualified to conduct its business. The Borrower is a member in good standing of CFC.

**B. Subsidiaries and Ownership.** Schedule 1 hereto sets forth a complete and accurate list of the Subsidiaries of the Borrower showing the percentage of the Borrower's ownership of the outstanding stock, membership interests or partnership interests, as applicable, of each Subsidiary.

**C. Authority; Validity.** The Borrower has the power and authority to enter into this Agreement, the Note and the Mortgage; to make the borrowing hereunder; to execute and deliver all documents and instruments required hereunder and to incur and perform the obligations provided for herein, in the Note and in the Mortgage, all of which have been duly authorized by all necessary and proper action; and no consent or approval of any Person, including, as applicable and without limitation, members of the Borrower, which has not been obtained is required as a condition to the validity or enforceability hereof or thereof.

Each of this Agreement, the Note and the Mortgage is, and when fully executed and delivered will be, legal, valid and binding upon the Borrower and enforceable against the Borrower in accordance with its terms, subject to applicable bankruptcy, insolvency, reorganization, moratorium or other laws affecting creditors' rights generally and subject to general principles of equity.

**D. No Conflicting Agreements.** The execution and delivery of the Loan Documents and performance by the Borrower of the obligations thereunder, and the transactions contemplated hereby or thereby, will not: (i) violate any provision of law, any order, rule or regulation of any court or other agency of government, any award of any arbitrator, the articles of incorporation or by-laws of the Borrower, or any indenture, contract, agreement, mortgage, deed of trust or other instrument to which the Borrower is a party or by which it or any of its property is bound; or (ii) be in conflict with, result in a breach of or constitute (with due notice and/or lapse of time) a default under, any such award, indenture, contract, agreement, mortgage, deed of trust or other instrument, or result in the creation or imposition of any Lien (other than contemplated hereby) upon any of the property or assets of the Borrower.

The Borrower is not in default of any of its obligations to RUS or, in any material respect, under any agreement or instrument to which it is a party or by which it is bound and no event or condition exists which constitutes a default, or with the giving of notice or lapse of time, or both, would constitute a default under any such agreement or instrument.

**E. Taxes.** The Borrower, and each of its Subsidiaries, has filed or caused to be filed all federal, state and local tax returns which are required to be filed and has paid or caused to be paid all federal, state and local taxes, assessments, and governmental charges and levies thereon, including interest and penalties to the extent that such taxes, assessments, and governmental charges and levies have become due, except for such taxes, assessments, and governmental charges and levies which the Borrower or any Subsidiary is contesting in good faith by appropriate proceedings for which adequate reserves have been set aside.

**F. Licenses and Permits.** The Borrower has duly obtained and now holds all licenses, permits, certifications, approvals and the like necessary to own and operate its property and business that are required by Governmental Authorities and each remains valid and in full force and effect.

**G. Litigation.** There are no outstanding judgments, suits, claims, actions or proceedings pending or, to the knowledge of the Borrower, threatened against or affecting the Borrower, its Subsidiaries or any of their respective properties which, if adversely determined, either individually or collectively, would have a material adverse effect upon the business, operations, prospects, assets, liabilities or financial condition of the Borrower or its Subsidiaries. The Borrower and its Subsidiaries are not, to the Borrower's knowledge, in default or violation with respect to any judgment, order, writ, injunction, decree, rule or regulation of any Governmental Authority which would have a material adverse effect upon the business, operations, prospects, assets, liabilities or financial condition of the Borrower or its Subsidiaries.

**H. Financial Statements.** The balance sheet of the Borrower as at the date identified in Schedule 1 hereto, the statement of operations of the Borrower for the period ending on said date, and the interim financial statements of the Borrower, all heretofore furnished to CFC, are complete and correct. Said balance sheet fairly presents the financial condition of the Borrower as at said date and said statement of operations fairly reflects its operations for the period ending on said date. The Borrower has no contingent obligations or extraordinary forward or long-term commitments except as specifically stated in said balance sheet or herein. There has been no material adverse change in the financial condition or operations of the Borrower from that set forth in said financial statements except changes disclosed in writing to CFC prior to the date hereof.

**I. Borrower's Legal Status.** Schedule 1 hereto accurately sets forth: (i) the Borrower's exact legal name, (ii) the Borrower's organizational type and jurisdiction of organization, (iii) the Borrower's organizational identification number or accurate statement that the Borrower has none, and (iv) the Borrower's place of business or, if more than one, its chief executive office as well as the Borrower's mailing address if different.

**J. Required Approvals.** No license, consent or approval of any Governmental Authority is required to enable the Borrower to enter into this Agreement, the Note and the Mortgage, or to perform any of its Obligations provided for in such documents, including without limitation (and if applicable), that of any state public utilities commission and any state public service commission, except as disclosed in Schedule 1 hereto, all of which the Borrower has obtained prior to the date hereof.

**K. Compliance With Laws.** The Borrower and each Subsidiary is in compliance, in all material respects, with all applicable requirements of law and all applicable rules and regulations of each Governmental Authority.

**L. Disclosure.** To the Borrower's knowledge, information and belief, neither this Agreement nor any document, certificate or financial statement furnished to CFC by or on behalf of the Borrower in connection herewith (all such documents, certificates and financial statements, taken as a whole) contains any untrue statement of a material fact or omits to state any material fact necessary in order to make the statements contained herein and therein not misleading.

**M. No Other Liens.** As to property which is presently included in the description of Mortgaged Property, the Borrower has not, without the prior written approval of CFC, executed or authenticated any security agreement or mortgage, or filed or authorized any financing statement to be filed with respect to assets owned by it, other than security agreements, mortgages and financing statements in favor of any of the Mortgagees, except as disclosed in writing to CFC prior to the date hereof or relating to Permitted Encumbrances.

**N. Environmental Matters.** Except as to matters which individually or in the aggregate would not have a material adverse effect upon the business or financial condition of the Borrower or its Subsidiaries, (i) Borrower is in compliance with all Environmental Laws (including, but not limited to, having any required permits and licenses), (ii) there have been no releases (other than releases remediated in compliance with Environmental Laws) from any underground or aboveground storage tanks (or piping associated therewith) that are or were present at the Mortgaged Property, (iii) Borrower has not received written notice or claim of any violation of any Environmental Law, (iv) there is no pending investigation of Borrower in regard to any Environmental Law, and (v) to the best of Borrower's knowledge, there has not been any release or contamination (other than releases or contamination remediated in compliance with Environmental Laws) resulting from the presence of Hazardous Materials on property owned, leased or operated by the Borrower.

## ARTICLE III

### LOAN

**Section 3.01 Advances.** CFC agrees to make one or more Advances for the purpose of refinancing certain of Borrower's existing indebtedness to any Mortgagee, as more fully described on Schedule 1 hereto, in an aggregate principal amount not to exceed the CFC Commitment, *provided, however,* that Borrower shall not request, and CFC shall have no obligation to advance, an amount greater than 105% of the outstanding principal balance of the indebtedness that is being refinanced. The obligation of the Borrower to repay Advances shall be evidenced by the Note. The Borrower shall give CFC written notice of the date on which each Advance is to be made. Advances shall be remitted by CFC directly to the Mortgagee whose indebtedness the Borrower is refinancing. Borrower shall provide CFC with wiring instructions and/or such other information as is necessary to remit funds pursuant hereto.

At the end of the Draw Period, CFC shall have no further obligation to make Advances. The obligation of the Borrower to repay the Advances shall be evidenced by one or more Notes.

**Section 3.02 Interest Rate and Payment.** Notes shall be payable and bear interest as follows:

**A. Payments; Maturity; Amortization.**

(i) Each Note shall have a Maturity Date as set forth therein, *provided, however,* that if such date is not a Payment Date, then the Maturity Date shall be the Payment Date immediately preceding such date.

(ii) The principal amount of each Advance shall amortize over a period not to exceed nine (9) years from the date of such Advance according to the amortization method set forth in Schedule 1 hereto, *provided, however,* that such period shall not extend beyond the Maturity Date.

For each Advance, the Borrower shall promptly pay interest in the amount invoiced on each Payment Date until the first Payment Date of the Billing Cycle in which the Amortization Basis Date occurs. On such Payment Date, and on each Payment Date thereafter, the Borrower shall promptly pay interest and principal in the amounts invoiced. If not sooner paid, any amount due on account of the unpaid principal, interest accrued thereon and fees, if any, shall be due and payable on the Maturity Date. The amortization method for each Advance shall be as stated on Schedule 1 or, if not so stated, then as stated on the written requisition for such Advance submitted by the Borrower to CFC pursuant to the terms hereof.

(iii) CFC will invoice the Borrower at least ten (10) days before each Payment Date, *provided, however,* that CFC's failure to send an invoice shall not constitute a waiver by CFC or be deemed to relieve the Borrower of its obligation to make payments as and when due as provided for herein.

(iv) No provision of this Agreement or of any Note shall require the payment, or permit the collection, of interest in excess of the highest rate permitted by applicable law.

(v) Notwithstanding anything to contrary contained herein, the weighted average life of a Note shall not be greater than the weighted average remaining life of the notes being refinanced with the proceeds of such Note.

**B. Application of Payments.** Each payment shall be applied to the Obligations, first to any fees, costs, expenses or charges other than interest or principal, second to interest accrued, and the balance to principal.

**C. Selection of Interest Rate and Interest Rate Computation.** Prior to each Advance on a Note, the Borrower must select in writing either a CFC Fixed Rate or the CFC Variable Rate, as follows:

(i) CFC Fixed Rate. If the Borrower selects a CFC Fixed Rate for an Advance, then such rate shall be in effect for the CFC Fixed Rate Term selected by the Borrower. CFC shall provide the Borrower with at least sixty (60) days prior written or electronic notice of the Interest Rate Reset Date for such Advance. The Borrower may then select any available interest rate option for such Advance pursuant to CFC's policies of general application. The Advance shall bear interest according to the interest rate option so selected beginning on the Interest Rate Reset Date. If the Borrower does not select an interest rate in writing prior to the Interest Rate Reset Date, then beginning on the Interest Rate Reset Date the Advance shall bear interest at, the CFC Variable Rate. CFC agrees that its long-term loan policies will include a fixed interest rate option until the Maturity Date. For any Advance, the Borrower may not select a CFC Fixed Rate with a CFC Fixed Rate Term that extends beyond the Maturity Date. Interest on Advances bearing interest at a CFC Fixed Rate shall be computed for the actual number of days elapsed on the basis of a year of 365 days, until the first day of the Billing Cycle in which the Amortization Basis Date occurs; interest shall then be computed on the basis of a 30-day month and 360-day year.

(ii) CFC Variable Rate. If the Borrower selects the CFC Variable Rate for an Advance, then such CFC Variable Rate shall apply until the Maturity Date, unless the Borrower elects to convert to a CFC Fixed Rate pursuant to the terms hereof. Interest on Advances bearing interest at the CFC Variable Rate shall be computed for the actual number of days elapsed on the basis of a year of 365 days.

**Section 3.03 Conversion of Interest Rates.** The Borrower may at any time exercise any or all of the following interest rate conversion options by submitting a Conversion Request. The effective date of the interest rate conversion shall be determined by CFC pursuant to its policies of general application.

**A. CFC Variable Rate to a CFC Fixed Rate.** The Borrower may convert the interest rate on an outstanding Advance from the CFC Variable Rate to a CFC Fixed Rate without a fee. Upon such conversion, the new interest rate shall be the CFC Fixed Rate in effect on the date of the Conversion Request for the CFC Fixed Rate Term selected by the Borrower.

**B. CFC Fixed Rate to CFC Variable Rate.** The Borrower may convert the interest rate on an outstanding Advance from a CFC Fixed Rate to the CFC Variable Rate, provided that the Borrower promptly pays the invoiced amount for any applicable conversion fee calculated pursuant to CFC's long-term loan policies as established from time to time for similarly classified long-term loans. Upon such conversion, the new interest rate shall be the CFC Variable Rate in effect on the date of the Conversion Request.

**C. A CFC Fixed Rate to Another CFC Fixed Rate.** The Borrower may convert the interest rate on an outstanding Advance from a CFC Fixed Rate to a different CFC Fixed Rate by selecting a different CFC Fixed Rate Term, provided that the Borrower promptly pays the invoiced amount for any applicable conversion fee calculated pursuant to CFC's long-term loan policies as established from time to time for similarly classified long-term loans. Upon such conversion, the new interest rate shall be the CFC Fixed Rate in effect on the date of the Conversion Request for the new CFC Fixed Rate Term selected by the Borrower.

**Section 3.04 Optional Prepayment.** The Borrower may at any time, on not less than thirty (30) days prior written notice to CFC, prepay any Advance, in whole or in part. In the event the Borrower prepays all or any part of an Advance (regardless of the source of such prepayment and whether voluntary, by acceleration or otherwise), the Borrower shall pay any prepayment fee or Make-Whole Premium as CFC may prescribe pursuant to the terms of this Section 3.04. All prepayments shall be accompanied by payment of accrued and unpaid interest on the amount of and to the date of the repayment. All prepayments shall be applied first to fees, second to the payment of accrued and unpaid interest, and then to the unpaid balance of the principal amount of the applicable Advance. If the Advance bears interest at the CFC Variable Rate, the Borrower may prepay the Advance or any portion thereof, as the case may be, at any time subject to the terms hereof and said prepayment fee shall be in an amount equal to thirty three (33) basis points times the amount being prepaid. If the Advance bears interest at a CFC Fixed Rate, the Borrower may (a) prepay the Advance on the day before an Interest Rate Reset Date provided that the Borrower shall pay a prepayment fee in an amount equal to thirty three (33) basis points times the amount being prepaid or (b) any such other date provided that the Borrower shall pay a prepayment fee in an amount equal to thirty three (33) basis points times the amount being prepaid plus any applicable Make-Whole Premium.

**Section 3.05 Mandatory Prepayment.** If there is a change in the Borrower's corporate structure (including without limitation by merger, consolidation, conversion or acquisition), then upon the effective date of such change, (a) the Borrower shall no longer have the ability to request, and CFC shall have no obligation to make, Advances hereunder and (b) the Borrower shall prepay the outstanding principal balance of all Obligations, together with any accrued but unpaid interest thereon, any unpaid costs or expenses provided for herein, and a prepayment premium as set forth in any agreement between the Borrower and CFC with respect to any such Obligation or, if not specified therein, as prescribed by CFC pursuant to its policies of general application in effect from time to time.

Notwithstanding the foregoing, if after giving effect to such change in Borrower's corporate structure, Borrower, or its successor in interest, is engaged in the furnishing of electric utility services to its members and patrons for their use as ultimate consumers and is organized as a cooperative, nonprofit corporation, public utility district, municipality, or other public governmental body, Borrower shall retain the ability to request, and CFC shall retain the obligation to make, Advances hereunder and no prepayment shall be required under this Section 3.05.

**Section 3.06 Default Rate.** If Borrower defaults on its obligation to make a payment due hereunder by the applicable Payment Date, and such default continues for thirty days thereafter, then beginning on the thirty-first day after the Payment Date and for so long as such default continues, Advances shall bear interest at the Default Rate.

## ARTICLE IV

## CONDITIONS OF LENDING

**Section 4.01** The obligation of CFC to make any Advance hereunder is subject to satisfaction of the following conditions in form and substance satisfactory to CFC:

**A. Legal Matters.** All legal matters incident to the consummation of the transactions hereby contemplated shall be satisfactory to counsel for CFC.

**B. Documents.** CFC shall have been furnished with (i) the executed Loan Documents, (ii) certified copies of all such organizational documents and proceedings of the Borrower authorizing the transactions hereby contemplated as CFC shall require, (iii) an opinion of counsel for the Borrower addressing such legal matters as CFC shall reasonably require, and (iv) all other such documents as CFC may reasonably request.

**C. Government Approvals.** The Borrower shall have furnished to CFC true and correct copies of all certificates, authorizations, consents, permits and licenses from Governmental Authorities (including RUS) necessary for the execution or delivery of the Loan Documents or performance by the Borrower of the obligations thereunder.

**D. Representations and Warranties.** The representations and warranties contained in Article II shall be true on the date of the making of each Advance hereunder with the same effect as though such representations and warranties had been made on such date; no Event of Default and no event which, with the lapse of time or the notice and lapse of time would become such an Event of Default, shall have occurred and be continuing or will have occurred after giving effect to each Advance on the books of the Borrower; there shall have occurred no material adverse change in the business or condition, financial or otherwise, of the Borrower; and nothing shall have occurred which in the opinion of CFC materially and adversely affects the Borrower's ability to perform its obligations hereunder.

**E. Mortgage Recordation.** The Mortgage (and any amendments, supplements or restatements as CFC may require from time to time) shall have been duly filed, recorded or indexed in all jurisdictions necessary (and in any other jurisdiction that CFC shall have reasonably requested) to provide CFC a lien, subject to Permitted Encumbrances, on all of the Borrower's real property, all in accordance with applicable law, and the Borrower shall have paid all applicable taxes, recording and filing fees and caused satisfactory evidence thereof to be furnished to CFC.

**F. UCC Filings.** Uniform Commercial Code financing statements (and any continuation statements and other amendments thereto that CFC shall require from time to time) shall have been duly filed, recorded or indexed in all jurisdictions necessary (and in any other jurisdiction that CFC shall have reasonably requested) to provide CFC a perfected security interest, subject to Permitted Encumbrances, in the Mortgaged Property which may be perfected by the filing of a financing statement, all in accordance with applicable law, and the Borrower shall have paid all applicable taxes, recording and filing fees and caused satisfactory evidence thereof to be furnished to CFC.

**G. Notification of Refinancing.** On or before the first Advance, Borrower shall have notified each Mortgagee of the refunding or refinancing contemplated herein, as required by Section 2.02 of the Mortgage, with such notice to be in form and substance satisfactory to CFC.

**H. Requisitions.** The Borrower will requisition each Advance by submitting its written requisition to CFC, in form and substance satisfactory to CFC. Requisitions for Advances shall be made only for the purposes set forth in Schedule 1 hereto.

**I. Other Information.** The Borrower shall have furnished such other information as CFC may reasonably require, including but not limited to (i) information regarding the specific purpose for an Advance and the use thereof, (ii) feasibility studies, cash flow projections, financial analyses and pro forma financial statements sufficient to demonstrate to CFC's reasonable satisfaction that after giving effect to the Advance requested, the Borrower shall continue to achieve the DSC ratio set forth in Section 5.01.A. herein, to meet all of its debt service obligations, and otherwise to perform and to comply with all other covenants and conditions set forth in this Agreement, and (iii) any other information as CFC may reasonably request. CFC's obligation to make any Advance hereunder is conditioned upon prior receipt and approval of the Borrower's written requisition and other information and documentation, if any, as CFC may have requested pursuant to this paragraph.

**J. Special Conditions.** CFC shall be fully satisfied that the Borrower has complied with all special conditions identified in Schedule 1 hereto.

## ARTICLE V

### COVENANTS

**Section 5.01 Affirmative Covenants.** The Borrower covenants and agrees with CFC that until payment in full of all Notes and performance of all obligations of the Borrower hereunder:

**A. Financial Ratios; Design of Rates.** The Borrower shall achieve an Average DSC Ratio of not less than 1.35. The Borrower shall not decrease its rates for electric service if it has failed to achieve a DSC Ratio of 1.35 for the calendar year prior to such reduction subject only to an order from a Governmental Authority properly exercising jurisdiction over the Borrower.

**B. Loan Proceeds.** The Borrower shall use the proceeds of this loan solely for the purposes identified on Schedule 1 hereto.

**C. Notice.** The Borrower shall promptly notify CFC in writing of:

- (i) any material adverse change in the business, operations, prospects, assets, liabilities or financial condition of the Borrower;
- (ii) the institution or threat of any litigation or administrative proceeding of any nature involving the Borrower which could materially affect the business, operations, prospects, assets, liabilities or financial condition of the Borrower; and
- (iii) the occurrence of an Event of Default hereunder, or any event that, with the giving of notice or lapse of time, or both, would constitute an Event of Default.

**D. Default Notices.** Upon receipt of any notices with respect to a default by the Borrower under the terms of any evidence of any indebtedness with parties other than CFC or



of any loan agreement, mortgage or other agreement relating thereto, the Borrower shall deliver copies of such notice to CFC.

**E. Annual Certificate.** Within one hundred twenty (120) days after the close of each calendar year, commencing with the year in which the initial Advance hereunder shall have been made, the Borrower will deliver to CFC a written statement, in form and substance satisfactory to CFC, either (a) signed by the Borrower's General Manager or Chief Executive Officer, or (b) submitted electronically through means made available to the Borrower by CFC, stating that during such year, and that to the best of said person's knowledge, the Borrower has fulfilled all of its obligations under this Agreement, the Note, and the Mortgage throughout such year or, if there has been a default in the fulfillment of any such obligations, specifying each such default known to said person and the nature and status thereof. The Borrower shall also deliver to CFC such other information as CFC may reasonably request from time to time.

**F. Reserved.**

**G. Financial Books; Financial Reports; Right of Inspection.** The Borrower will at all times keep, and safely preserve, proper books, records and accounts in which full and true entries will be made of all of the dealings, business and affairs of the Borrower, in accordance with Accounting Requirements. When requested by CFC, the Borrower will prepare and furnish CFC from time to time, periodic financial and statistical reports on its condition and operations. All of such reports shall be in such form and include such information as may be specified by CFC. Within one hundred twenty (120) days of the end of each calendar year during the term hereof, the Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such calendar year, in form and substance satisfactory to CFC. In addition, within one hundred twenty (120) days of the end of each the Borrower's fiscal years during the term hereof, the Borrower shall furnish to CFC a full and complete consolidated and consolidating report of its financial condition and statement of its operations as of the end of such fiscal year, audited and certified by independent certified public accountants nationally recognized or otherwise satisfactory to CFC and accompanied by a report of such audit in form and substance satisfactory to CFC, including without limitation a consolidated and consolidating balance sheet and the related consolidated and consolidating statements of income and cash flow. CFC, through its representatives, shall at all times during reasonable business hours and upon prior notice have access to, and the right to inspect and make copies of, any or all books, records and accounts, and any or all invoices, contracts, leases, payrolls, canceled checks, statements and other documents and papers of every kind belonging to or in the possession of the Borrower or in anyway pertaining to its property or business.

**H. Notice of Additional Secured Debt.** The Borrower will notify CFC promptly in writing if it incurs any additional secured indebtedness other than indebtedness to CFC.

**I. Funds Requisition.** The Borrower agrees (i) that CFC may rely conclusively upon the interest rate option, interest rate term and other written instructions submitted to CFC in the Borrower's written request for an Advance hereunder, (ii) that such instructions shall constitute a covenant under this Agreement to repay the Advance in accordance with such instructions, the applicable Note, the Mortgage and this Agreement, and (iii) to request Advances only for the purposes set forth in Schedule 1 hereto.

**J. Compliance With Laws.** The Borrower and each Subsidiary shall remain in compliance, in all material respects, with all applicable requirements of law and applicable rules and regulations of each Governmental Authority.

**K. Taxes.** The Borrower shall pay, or cause to be paid all taxes, assessments or governmental charges lawfully levied or imposed on or against it and its properties prior to the time they become delinquent, except for any taxes, assessments or charges that are being contested in good faith and with respect to which adequate reserves as determined in good faith by the Borrower have been established and are being maintained.

**L. Further Assurances.** The Borrower shall execute any and all further documents, financing statements, agreements and instruments, and take all such further actions (including the filing and recording of financing statements, fixture filings, mortgages, deeds of trust and other documents), which may be required under any applicable law, or which CFC may reasonably request, to effectuate the transactions contemplated by the Loan Documents or to grant, preserve, protect or perfect the Liens created or intended to be created thereby. The Borrower also agrees to provide to CFC, from time to time upon request, evidence reasonably satisfactory to CFC as to the perfection and priority of the Liens created or intended to be created by the Loan Documents.

**M. Environmental Covenants.** Borrower shall:

- (i) at its own cost, comply in all material respects with all applicable Environmental Laws, including, but not limited to, any required remediation; and
- (ii) if it receives any written communication alleging Borrower's violation of any Environmental Law, provide CFC with a copy thereof within ten (10) Business Days after receipt, and promptly take appropriate action to remedy, cure, defend, or otherwise affirmatively respond to the matter.

**N. Limitations on Loans, Investments and Other Obligations.** The aggregate amount of all purchases, investments, loans, guarantees, commitments and other obligations described in Section 5.02.D(i) of this Agreement shall at all times be less than fifteen percent (15%) of Total Utility Plant or fifty percent (50%) of Equity, whichever is greater.

**O. Special Covenants.** The Borrower agrees that it will comply with any special covenants identified in Schedule 1 hereto.

**Section 5.02 Negative Covenants.** The Borrower covenants and agrees with CFC that until payment in full of the Note and performance of all obligations of the Borrower hereunder, the Borrower will not, directly or indirectly, without CFC's prior written consent:

**A. Limitations on Mergers.** Consolidate with, merge, or sell all or substantially all of its business or assets, or enter into an agreement for such consolidation, merger or sale, to another entity or person unless such action is either approved, as is evidenced by the prior written consent of CFC, or the purchaser, successor or resulting corporation is or becomes a member in good standing of CFC and assumes the due and punctual payment of the Note and the due and punctual performance of the covenants contained in the Mortgage and this Agreement.

**B. Limitations on Sale, Lease or Transfer of Capital Assets; Application of Proceeds.** Sell, lease or transfer (or enter into an agreement to sell, lease or transfer) any capital asset, except in accordance with this Section 5.02.B. If no Event of Default (and no event which with notice or lapse of time and notice would become an Event of Default) shall have

occurred and be continuing, the Borrower may, without the prior written consent of CFC, sell, lease or transfer (or enter into an agreement to sell, lease or transfer) any capital asset in exchange for fair market value consideration paid to the Borrower if the value of such capital asset is less than five percent (5%) of Total Utility Plant and the aggregate value of capital assets sold, leased or transferred in any 12-month period is less than ten percent (10%) of Total Utility Plant. Subject to the terms of the Mortgage, if the Borrower does sell, lease or transfer any capital assets, then the proceeds thereof (less ordinary and reasonable expenses incident to such transaction) shall immediately (i) be applied as a prepayment of the Note, to such installments as may be designated by CFC at the time of any such prepayment; (ii) in the case of dispositions of equipment, material or scrap, applied to the purchase of other property useful in the Borrower's business, although not necessarily of the same kind as the property disposed of, which shall forthwith become subject to the lien of the Mortgage; or (iii) applied to the acquisition or construction of other property or in reimbursement of the costs of such property.

**C. Limitation on Dividends, Patronage Refunds and Other Distributions.**

(i) Make any Distribution if an Event of Default under this Agreement has occurred and is continuing; or

(ii) Make a Distribution in any calendar year in an amount greater than thirty percent (30%) of the Borrower's total margins for the preceding calendar year, unless, after giving effect to the Distribution, the total Equity of the Borrower will be at least twenty percent (20%) of its Total Assets.

**D. Limitations on Loans, Investments and Other Obligations.**

(i) (a) Purchase, or make any commitment to purchase, any stock, bonds, notes, debentures, or other securities or obligations of or beneficial interests in, (b) make, or enter into a commitment to make, any other investment, monetary or otherwise, in, (c) make, or enter into a commitment to make, any loan to, or (d) guarantee, assume, or otherwise become liable for, or enter into a commitment to guarantee, assume, or otherwise become liable for, any obligation of any Person if, after giving effect to such purchase, investment, loan, guarantee or commitment, the aggregate amount thereof would exceed the greater of fifteen percent (15%) of Total Utility Plant or fifty percent (50%) of Equity.

(ii) The following shall not be included in the limitation of purchases, investments, loans and guarantees in (i) above: (a) bonds, notes, debentures, stock, or other securities or obligations issued by or guaranteed by the United States or any agency or instrumentality thereof; (b) bonds, notes, debentures, stock, commercial paper, subordinated capital certificates, or any other security or obligation issued by CFC or by institutions whose senior unsecured debt obligations are rated by at least two nationally recognized rating organizations in either of their two highest categories; (c) investments incidental to loans made by CFC; (d) any deposit that is fully insured by the United States; (e) loans and grants made by any Governmental Authority to the Borrower under any rural economic development program, but only to the extent that such loans and grants are non-recourse to the Borrower; and (f) unretired patronage capital allocated to the Borrower by CFC, a cooperative from which the Borrower purchases electric power, or a statewide cooperative association of which Borrower is a member.

(iii) In no event may the Borrower take any action pursuant to subsection (i) if an Event of Default under this Agreement has occurred and is continuing,

**E. Organizational Change.** Change its type of organization or other legal structure, except as permitted by Section 5.02.A. hereof, in which case the Borrower shall provide at least 30 days prior written notice to CFC together with all documentation reflecting such change as CFC may reasonably require.

**F. Notice of Change in Borrower Information.** Change its (i) state of incorporation, (ii) legal name, (iii) mailing address, or (iv) organizational identification number, if it has one, unless the Borrower provides written notice to CFC at least thirty (30) days prior to the effective date of any such change together with all documentation reflecting any such change as CFC may reasonably require.

## ARTICLE VI

### EVENTS OF DEFAULT

**Section 6.01** The following shall be "Events of Default" under this Agreement:

**A. Representations and Warranties.** Any representation or warranty made by the Borrower herein, or in any of the other Loan Documents, or in any certificate or financial statement furnished to CFC hereunder or under any of the other Loan Documents shall prove to be false or misleading in any material respect.

**B. Payment.** The Borrower shall fail to pay (whether upon stated maturity, by acceleration, or otherwise) any principal, interest, premium (if any) or other amount payable under the Note and the Loan Documents within five (5) Business Days after the due date thereof.

**C. Other Covenants.**

**(i) No Grace Period.** Failure of the Borrower to observe or perform any covenant or agreement contained in Sections 5.01.A, 5.01.B, 5.01.D, 5.01.E, 5.01.G, 5.01.I, 5.01.N, 5.02 of this Agreement.

**(ii) Thirty Day Grace Period.** Failure of the Borrower to observe or perform any other covenant or agreement contained in this Agreement or any of the other Loan Documents, which shall remain unremedied for thirty (30) calendar days after written notice thereof shall have been given to the Borrower by CFC.

**D. Legal Existence, Permits and Licenses.** The Borrower shall forfeit or otherwise be deprived of (i) its authority to conduct business in the jurisdiction in which it is organized or in any other jurisdiction where such authority is required in order for the Borrower to conduct its business in such jurisdiction or (ii) permits, easements, consents or licenses required to carry on any material portion of its business.

**E. Other CFC Obligations.** The Borrower shall be in breach or default of any Obligation, which breach or default continues uncured beyond the expiration of any applicable grace period.

**F. Other Obligations.** The Borrower shall (i) fail to make any payment of any principal, premium or any other amount due or interest on any indebtedness with parties other

than CFC which shall remain unpaid beyond the expiration of any applicable grace period, or (ii) be in breach or default with respect to any other term of any evidence of any other indebtedness with parties other than CFC or of any loan agreement, mortgage or other agreement relating thereto which breach or default continues uncured beyond the expiration of any applicable grace period, if the effect of such failure, default or breach is to cause the holder or holders of that indebtedness to cause that indebtedness to become or be declared due prior to its stated maturity (upon the giving or receiving of notice, lapse of time, both or otherwise).

**G. Involuntary Bankruptcy.** An involuntary case or other proceeding shall be commenced against the Borrower seeking liquidation, reorganization or other relief with respect to it or its debts under bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property and such involuntary case or other proceeding shall continue without dismissal or stay for a period of sixty (60) consecutive days; or an order for relief shall be entered against the Borrower under the federal bankruptcy laws or applicable state law as now or hereafter in effect.

**H. Insolvency.** The Borrower shall commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, or shall consent to any such relief or to the appointment of or taking possession by any such official in an involuntary case or proceeding commenced against it, or shall make a general assignment for the benefit of creditors, or shall admit in writing its inability to, or be generally unable to, pay its debts as they become due, or shall take any action to authorize any of the foregoing.

**I. Dissolution or Liquidation.** Other than as provided in subsection H. above, the dissolution or liquidation of the Borrower, or failure by the Borrower promptly to forestall or remove any execution, garnishment or attachment of such consequence as will impair its ability to continue its business or fulfill its obligations and such execution, garnishment or attachment shall not be vacated within sixty (60) days. The term "dissolution or liquidation of the Borrower", as used in this subsection, shall not be construed to include the cessation of the corporate existence of the Borrower resulting either from a merger or consolidation of the Borrower into or with another corporation following a transfer of all or substantially all its assets as an entirety, under the conditions set forth in Section 5.02.A.

**J. Material Adverse Change.** Any material adverse change in the business or condition, financial or otherwise, of the Borrower.

**K. Monetary Judgment.** The Borrower shall suffer any money judgment not covered by insurance, writ or warrant of attachment or similar process involving an amount in excess of \$100,000 and shall not discharge, vacate, bond or stay the same within a period of sixty (60) days.

**L. Nonmonetary Judgment.** One or more nonmonetary judgments or orders (including, without limitation, injunctions, writs or warrants of attachment, garnishment, execution, distraint, replevin or similar process) shall be rendered against the Borrower that, either individually or in the aggregate, could reasonably be expected to have a material adverse effect upon the business, operations, prospects, assets, liabilities or financial condition of the Borrower.

## ARTICLE VII

### REMEDIES

**Section 7.01** If any of the Events of Default listed in Section 6 hereof shall occur after the date of this Agreement and shall not have been remedied within the applicable grace periods specified therein, then CFC may:

- (i) Cease making Advances hereunder;
- (ii) Declare all unpaid principal outstanding on the Note, all accrued and unpaid interest thereon, and all other Obligations to be immediately due and payable and the same shall thereupon become immediately due and payable without presentment, demand, protest or notice of any kind, all of which are hereby expressly waived;
- (iii) Exercise rights of setoff or recoupment and apply any and all amounts held, or hereafter held, by CFC or owed to the Borrower or for the credit or account of the Borrower against any and all of the Obligations of the Borrower now or hereafter existing hereunder or under the Note, including, but not limited to, patronage capital allocations and retirements, money due to Borrower from equity certificates purchased from CFC, and any membership or other fees that would otherwise be returned to Borrower. The rights of CFC under this section are in addition to any other rights and remedies (including other rights of setoff or recoupment) which CFC may have. The Borrower waives all rights of setoff, deduction, recoupment or counterclaim;
- (iv) Pursue all rights and remedies available to CFC that are contemplated by the Mortgage and the other Loan Documents in the manner, upon the conditions, and with the effect provided in the Mortgage and the other Loan Documents, including, but not limited to, a suit for specific performance, injunctive relief or damages;
- (v) Pursue any other rights and remedies available to CFC at law or in equity.

Nothing herein shall limit the right of CFC to pursue all rights and remedies available to a creditor following the occurrence of an Event of Default. Each right, power and remedy of CFC shall be cumulative and concurrent, and recourse to one or more rights or remedies shall not constitute a waiver of any other right, power or remedy.

## ARTICLE VIII

### MISCELLANEOUS

**Section 8.01 Notices.** All notices, requests and other communications provided for herein including, without limitation, any modifications of, or waivers, requests or consents under, this Agreement shall be given or made in writing (including, without limitation, by telecopy) and delivered to the intended recipient at the "Address for Notices" specified below; or, as to any party, at such other address as shall be designated by such party in a notice to each other party. All such communications shall be deemed to have been duly given (i) when personally

delivered including, without limitation, by overnight mail or courier service, (ii) in the case of notice by United States mail, certified or registered, postage prepaid, return receipt requested, upon receipt thereof, or (iii) in the case of notice by telecopy, upon transmission thereof, provided such transmission is promptly confirmed by either of the methods set forth in clauses (i) or (ii) above in each case given or addressed as provided for herein. The Address for Notices of each of the respective parties is as follows:

National Rural Utilities Cooperative Finance Corporation  
 2201 Cooperative Way  
 Herndon, Virginia 20171-3025  
 Attention: Senior Vice President – Member Services  
 Fax # 703-709-6776

The Borrower:

The address set forth in  
 Schedule 1 hereto

**Section 8.02 Expenses.** Borrower shall reimburse CFC for any reasonable costs and out-of-pocket expenses paid or incurred by CFC (including, without limitation, reasonable fees and expenses of outside attorneys, paralegals and consultants) for all actions CFC takes, (a) to enforce the payment of any Obligation, to effect collection of any Mortgaged Property, or in preparation for such enforcement or collection, (b) to institute, maintain, preserve, enforce and foreclose on CFC's security interest in or Lien on any of the Mortgaged Property, whether through judicial proceedings or otherwise, (c) to restructure any of the Obligations, (d) to review, approve or grant any consents or waivers hereunder, (e) to prepare, negotiate, execute, deliver, review, amend or modify this Agreement, and (f) to prepare, negotiate, execute, deliver, review, amend or modify any other agreements, documents and instruments deemed necessary or appropriate by CFC in connection with any of the foregoing.

The amount of all such expenses identified in this Section 8.02 shall be secured by the Mortgage and shall be payable upon demand, and if not paid, shall accrue interest at the then prevailing CFC Variable Rate plus two hundred basis points.

**Section 8.03 Late Payments.** If payment of any amount due hereunder is not received at CFC's office in Herndon, Virginia, or such other location as CFC may designate to the Borrower within five (5) Business Days after the due date thereof, the Borrower will pay to CFC, in addition to all other amounts due under the terms of the Loan Documents, any late-payment charge as may be fixed by CFC from time to time pursuant to its policies of general application as in effect from time to time.

**Section 8.04. Non-Business Day Payments.** If any payment to be made by the Borrower hereunder shall become due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and such extension of time shall be included in computing any interest in respect of such payment.

**Section 8.05 Filing Fees.** To the extent permitted by law, the Borrower agrees to pay all expenses of CFC (including the reasonable fees and expenses of its counsel) in connection with the filing, registration, recordation or perfection of the Mortgage and any other security instruments as may be required by CFC in connection with this Agreement, including, without limitation, all documentary stamps, recordation and transfer taxes and other costs and taxes

incident to execution, filing, registration or recordation of any document or instrument in connection herewith. The Borrower agrees to save harmless and indemnify CFC from and against any liability resulting from the failure to pay any required documentary stamps, recordation and transfer taxes, recording costs, or any other expenses incurred by CFC in connection with this Agreement. The provisions of this subsection shall survive the execution and delivery of this Agreement and the payment of all other amounts due under the Loan Documents.

**Section 8.06 Waiver; Modification.** No failure on the part of CFC to exercise, and no delay in exercising, any right or power hereunder or under the other Loan Documents shall operate as a waiver thereof, nor shall any single or partial exercise by CFC of any right hereunder, or any abandonment or discontinuance of steps to enforce such right or power, preclude any other or further exercise thereof or the exercise of any other right or power. No modification or waiver of any provision of this Agreement, the Note or the other Loan Documents and no consent to any departure by the Borrower therefrom shall in any event be effective unless the same shall be in writing by the party granting such modification, waiver or consent, and then such modification, waiver or consent shall be effective only in the specific instance and for the purpose for which given.

**SECTION 8.07 GOVERNING LAW; SUBMISSION TO JURISDICTION; WAIVER OF JURY TRIAL.**

(A) THE PERFORMANCE AND CONSTRUCTION OF THIS AGREEMENT AND THE NOTE SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE COMMONWEALTH OF VIRGINIA.

(B) THE BORROWER HEREBY SUBMITS TO THE NON-EXCLUSIVE JURISDICTION OF THE UNITED STATES COURTS LOCATED IN VIRGINIA AND OF ANY STATE COURT SO LOCATED FOR PURPOSES OF ALL LEGAL PROCEEDINGS ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. THE BORROWER IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY OBJECTIONS THAT IT MAY NOW OR HEREAFTER HAVE TO THE ESTABLISHING OF THE VENUE OF ANY SUCH PROCEEDINGS BROUGHT IN SUCH A COURT AND ANY CLAIM THAT ANY SUCH PROCEEDING HAS BEEN BROUGHT IN AN INCONVENIENT FORUM.

(C) THE BORROWER AND CFC EACH HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

**SECTION 8.08 INDEMNIFICATION.** THE BORROWER HEREBY INDEMNIFIES AND AGREES TO HOLD HARMLESS, AND DEFEND CFC AND ITS MEMBERS, DIRECTORS, OFFICERS, EMPLOYEES, AGENTS, ATTORNEYS AND REPRESENTATIVES (EACH AN "INDEMNITEE") FOR, FROM, AND AGAINST ALL CLAIMS, DAMAGES, LOSSES, LIABILITIES, COSTS, AND EXPENSES (INCLUDING, WITHOUT LIMITATION, COSTS AND EXPENSES OF LITIGATION AND REASONABLE ATTORNEYS' FEES) ARISING FROM ANY CLAIM OR DEMAND IN RESPECT OF THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS, THE MORTGAGED PROPERTY, OR THE TRANSACTIONS DESCRIBED IN THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS AND ARISING AT ANY TIME, WHETHER BEFORE OR AFTER PAYMENT AND PERFORMANCE OF ALL OBLIGATIONS



UNDER THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS IN FULL, EXCEPTING ANY SUCH MATTERS ARISING SOLELY FROM THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF CFC OR ANY INDEMNITEE. NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED IN SECTION 8.10 HEREOF, THE OBLIGATIONS IMPOSED UPON THE BORROWER BY THIS SECTION SHALL SURVIVE THE REPAYMENT OF THE NOTE, THE TERMINATION OF THIS AGREEMENT AND THE TERMINATION OR RELEASE OF THE LIEN OF THE MORTGAGE.

**Section 8.09 Complete Agreement.** This Agreement, together with the schedules to this Agreement, the Note and the other Loan Documents, and the other agreements and matters referred to herein or by their terms referring hereto, is intended by the parties as a final expression of their agreement and is intended as a complete statement of the terms and conditions of their agreement. In the event of any conflict in the terms and provisions of this Agreement and any other Loan Documents, the terms and provisions of this Agreement shall control.

**Section 8.10 Survival; Successors and Assigns.** All covenants, agreements, representations and warranties of the Borrower which are contained in this Agreement shall survive the execution and delivery to CFC of the Loan Documents and the making of the Loan hereunder and shall continue in full force and effect until all of the obligations under the Loan Documents have been paid in full. All covenants, agreements, representations and warranties of the Borrower which are contained in this Agreement shall inure to the benefit of the successors and assigns of CFC. The Borrower shall not have the right to assign its rights or obligations under this Agreement without the prior written consent of CFC, except as provided in Section 5.02.A hereof.

**Section 8.11 Use of Terms.** The use of the singular herein shall also refer to the plural, and vice versa.

**Section 8.12 Headings.** The headings and sub-headings contained in this Agreement are intended to be used for convenience only and do not constitute part of this Agreement.

**Section 8.13 Severability.** If any term, provision or condition, or any part thereof, of this Agreement, the Note or the other Loan Documents shall for any reason be found or held invalid or unenforceable by any governmental agency or court of competent jurisdiction, such invalidity or unenforceability shall not affect the remainder of such term, provision or condition nor any other term, provision or condition, and this Agreement, the Note and the other Loan Documents shall survive and be construed as if such invalid or unenforceable term, provision or condition had not been contained therein.

**Section 8.14. Prior Loan Documents.** It is understood and agreed that the covenants set forth in this Agreement under the Article entitled "COVENANTS" shall restate and supersede all of the covenants set forth in the corresponding Article or Articles of each Prior Loan Document dealing with covenants, regardless of the specific title or titles thereof, *except for* (a) the LCTC Purchase Provisions, (b) the CREB Provisions, and (c) any special covenant or other specific term set forth on Schedule 1 to any Prior Loan Document, unless otherwise explicitly agreed to in writing by CFC, or superseded by explicit reference thereto in this Agreement. For purposes of the foregoing, this Section 8.14 shall be deemed to amend all Prior Loan Documents, and notwithstanding termination of this Agreement for any reason, this Section 8.14 shall nevertheless survive and shall continue to amend each Prior Loan Document for as long

as the respective Prior Loan Document is in effect, but only with respect to the matters set forth in this Section 8.14.

**Section 8.15 Binding Effect.** This Agreement shall become effective when it shall have been executed by both the Borrower and CFC and thereafter shall be binding upon and inure to the benefit of the Borrower and CFC and their respective successors and assigns.

**Section 8.16 Counterparts.** This Agreement may be executed in one or more counterparts, each of which will be deemed an original and all of which together will constitute one and the same document. Signature pages may be detached from the counterparts and attached to a single copy of this Agreement to physically form one document.

**Section 8.17 Rescission of Excess Commitment.** Any amount of the CFC Commitment not required for the purpose set forth in Schedule 1 shall be rescinded by CFC and the CFC Commitment shall automatically be reduced by such amount without fee.

**Section 8.18 Schedule 1.** Schedule 1 attached hereto is an integral part of this Agreement.

**IN WITNESS WHEREOF**, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

EMPIRE ELECTRIC ASSOCIATION, INC.

(SEAL)

By: \_\_\_\_\_

Title: \_\_\_\_\_

Attest: \_\_\_\_\_  
Secretary

NATIONAL RURAL UTILITIES  
COOPERATIVE FINANCE CORPORATION

(SEAL)

By: \_\_\_\_\_  
Assistant Secretary-Treasurer

Attest: \_\_\_\_\_  
Assistant Secretary-Treasurer

## SCHEDULE 1

1. The purpose of this loan is to refinance up to 105% of the outstanding principal balance of certain indebtedness of the Borrower to RUS.
2. The aggregate CFC Commitment is \$1,060,340.00. Within this aggregate amount, the Borrower may, at its discretion, execute one or more Notes, each Note representing a separate loan with CFC and containing a face amount and Maturity Date in accordance with the terms, conditions and provisions of this Agreement.
3. The Mortgage shall mean the Restated Mortgage and Security Agreement, dated as of August 1, 2007, among the Borrower, CFC and RUS, as it may have been supplemented, amended, consolidated, or restated from time to time.
4. The Notes executed pursuant hereto and the amortization method for such Notes are as follows:

LOAN NUMBER	AMOUNT	AMORTIZATION METHOD
CO033-A-9018	\$1,060,340.00	Level Debt Service

5. The Payment Date months are January, April, July and October.
6. The Subsidiaries of the Borrower referred to in Section 2.01.B. are:  

<u>Name of Subsidiary</u>	<u>% of Borrower's ownership</u>
N/A	
7. The date of the Borrower's balance sheet referred to in Section 2.01.H is December 31, 2009.
8. The Borrower's exact legal name is: Empire Electric Association, Inc.
9. The Borrower's organizational type is: Corporation
10. The Borrower is organized under the laws of the state of: Colorado
11. The Borrower's organizational identification number is: 19871104688
12. The place of business or, if more than one, the chief executive office of the Borrower referred to in Section 2.01.I is 801 North Broadway, Cortez, Colorado 81321-0676.
13. The Governmental Authority referred to in Section 2.01.J. is: N/A
14. The special conditions referred to in Section 4.01.J are: None
15. The special covenants referred to in Section 5.01.O are as follows: None
16. The address for notices to the Borrower referred to in Section 8.01 is P O Drawer K,

Cortez, Colorado 81321-0676, Attention: General Manager, Fax: (970) 564-4401.



**Loan Funds Requisition Statement  
Refinance of RUS 5% Loans**

Borrower Name: \_\_\_\_\_  
Date of Advance: \_\_\_\_\_

Co-op ID: \_\_\_\_\_

Amount requested to prepay the following RUS loans:

Loan Designation and Account No.	Principal to be Paid	Interest to be Paid	Total Payment
Total amount to be wired directly to RUS by CFC for Borrower			

**Officer's Certification**

I hereby certify that as of the date below: (1) I am duly authorized to make this certification and to request funds on behalf of the Borrower (each such request, an "Advance") in accordance with the loan agreement governing the Advance (the "Loan Agreement"); (2) no Event of Default (as defined in the Loan Agreement) has occurred and is continuing; (3) I know of no other event that has occurred which, with the lapse of time and/or notification to CFC of such event, or after giving effect to the Advance, would become such an Event of Default; (4) all of the representations and warranties made in the Loan Agreement are true; (5) the Borrower has satisfied each other condition to the Advance as set forth in the Loan Agreement; and (6) the proceeds of the Advance will be used only for the purposes permitted by the Loan Agreement. I hereby authorize CFC to make Advances on the following terms, and hereby agree that such terms shall be binding upon Borrower under the provisions of the Loan Agreement:

Facility No.	Advance No.	Advance Amount	Advance Term (Years)	Loan Maturity	Amortization Type	Interest Rate	Rate Term	Rate Maturity	Principal Deferral (Years)	1st Prin Pymt Date
<b>Total</b>										

Certified By: \_\_\_\_\_ Date: \_\_\_\_\_  
Signature \_\_\_\_\_  
Print Name \_\_\_\_\_  
Title \_\_\_\_\_

Please fax to CFC at 703.709.6776 ATTN: \_\_\_\_\_ (AVP)

# **EXHIBIT 3**

## **COMPARISON OF CASH FLOWS AND SUMMARY**

# **EXHIBIT 3**





Empire Electric Assn.  
Summary Comparison of Cash Flows  
Portfolio: 1

	Principal Payments	Interest Payments	Total Discounts	Patronage Retirement	LCTC Payments	LCTC Return	Total Cash Flow
RUS	(\$1,009,845)	(\$245,367)	\$0	\$0	\$0	\$0	(\$1,255,212)
CFC	(\$1,009,845)	(\$192,781)	\$0	\$17,156	\$0	\$0	(\$1,175,470)
RUS-CFC	\$0	(\$52,686)	\$0	(\$17,156)	\$0	\$0	(\$75,742)



Powerful  
Financial  
Solutions

*CFC's credit services provide its members with the financial tools they need to compete in an increasingly complex industry.*

Prepared exclusively for: Empire Electric Assn.

Scenario: 1

### Overall Summary

Effective Interest Rate (after discounts, patronage capital):	3.69%
Effective Interest Rate (before discounts, patronage capital):	3.94%
Value of savings from discounts, patronage capital:	(0.25%)

### Debt Summary

Current total LT debt outstanding: \$	8,867,016
New proposed loan amount: \$	1,009,845
Potential total LT debt outstanding: \$	9,876,861

### Equity Summary

Current total equity at CFC: \$	1,368,343
Potential CFC debt to equity ratio:	7.22
Additional equity required as LCTCs: \$	-
Portion of new loan used to purchase LCTCs: \$	-

This information is confidential and is not to be disclosed to third parties without prior CFC consent. This presentation reflects CFC's programs and policies in effect at the time this presentation was created and will remain valid through 10/20/2010. The interest rates used in this presentation were CFC's interest rates in effect on 7/22/2010 and are effective for that date only. No future representation of interest rates is implied.



**Empire Electric Assn.**  
**Detailed Comparison of Cash Flows**  
**Portfolio: 1**

Year	RUS events		CFC events				Comparison	
	RUS Payments	RUS	CFC Payments	CFC Patronage	LTC's Payments	LTC's Return	CFC Net Cash Flows	RUS - CFC Net Cash Flows
4/30/2011	(\$116,689)		(\$101,390)	-	-	-	(\$101,390)	(\$15,298)
4/30/2012	(\$140,027)		(\$139,555)	\$1,205	-	-	(\$138,350)	(\$1,677)
4/30/2013	(\$140,027)		(\$139,278)	\$1,536	-	-	(\$137,741)	(\$2,285)
4/30/2014	(\$140,027)		(\$139,940)	\$1,418	-	-	(\$138,522)	(\$1,504)
4/30/2015	(\$140,027)		(\$140,228)	\$1,261	-	-	(\$138,967)	(\$1,060)
4/30/2016	(\$140,027)		(\$140,225)	\$1,083	-	-	(\$139,142)	(\$885)
4/30/2017	(\$140,027)		(\$139,829)	\$877	-	-	(\$138,952)	(\$1,075)
4/30/2018	(\$140,027)		(\$140,184)	\$647	-	-	(\$139,537)	(\$490)
4/30/2019	(\$140,027)		(\$92,770)	\$396	-	-	(\$92,374)	(\$47,653)
4/30/2020	(\$18,311)		(\$19,229)	\$146	-	-	(\$19,083)	\$772
4/30/2021	-		-	\$10	-	-	\$10	(\$10)
4/30/2022	-		-	-	-	-	-	-
4/30/2023	-		-	-	-	-	-	-
4/30/2024	-		-	-	-	-	-	-
4/30/2025	-		-	-	-	-	-	-
4/30/2026	-		-	-	-	-	-	-
4/30/2027	-		-	-	-	-	-	-
4/30/2028	-		-	-	-	-	-	-
4/30/2029	-		-	-	-	-	-	-
4/30/2030	-		-	-	-	-	-	-
4/30/2031	-		-	-	-	-	-	-
4/30/2032	-		-	-	-	-	-	-
4/30/2033	-		-	-	-	-	-	-
4/30/2034	-		-	-	-	-	-	-
4/30/2035	-		-	-	-	-	-	-
4/30/2036	-		-	-	-	-	-	-
4/30/2037	-		-	\$1,205	-	-	\$1,205	(\$1,205)
4/30/2038	-		-	\$1,536	-	-	\$1,536	(\$1,536)
4/30/2039	-		-	\$1,418	-	-	\$1,418	(\$1,418)
4/30/2040	-		-	\$1,261	-	-	\$1,261	(\$1,261)
4/30/2041	-		-	\$1,083	-	-	\$1,083	(\$1,083)
4/30/2042	-		-	\$877	-	-	\$877	(\$877)
4/30/2043	-		-	\$647	-	-	\$647	(\$647)
4/30/2044	-		-	\$396	-	-	\$396	(\$396)



**Empire Electric Assn.  
Detailed Comparison of Cash Flows  
Portfolio: 1**

Year	RUS events		CFC events				LTC's Return	CFC Net Cash Flows	Comparison RUS - CFC Net Cash Flows
	RUS Payments	CFC Payments	CFC Patronage	LTC's Payments	LTC's Return	CFC Net Cash Flows			
4/30/2045	-	-	\$146	-	-	-	\$146	(\$146)	
4/30/2046	-	-	\$10	-	-	-	\$10	(\$10)	
4/30/2047	-	-	-	-	-	-	-	-	
4/30/2048	-	-	-	-	-	-	-	-	
4/30/2049	-	-	-	-	-	-	-	-	
4/30/2050	-	-	-	-	-	-	-	-	
4/30/2051	-	-	-	-	-	-	-	-	
4/30/2052	-	-	-	-	-	-	-	-	
4/30/2053	-	-	-	-	-	-	-	-	
4/30/2054	-	-	-	-	-	-	-	-	
4/30/2055	-	-	-	-	-	-	-	-	
4/30/2056	-	-	-	-	-	-	-	-	
4/30/2057	-	-	-	-	-	-	-	-	
4/30/2058	-	-	-	-	-	-	-	-	
4/30/2059	-	-	-	-	-	-	-	-	
4/30/2060	-	-	-	-	-	-	-	-	
<b>Sum of Cash Flows</b>									
Year 5	(\$676,795)	(\$660,391)	\$5,420	\$0	\$0	\$0	(\$654,970)	(\$21,825)	
Year 10	(\$1,255,212)	(\$1,192,626)	\$8,568	\$0	\$0	\$0	(\$1,184,058)	(\$71,154)	
Year 15	(\$1,255,212)	(\$1,192,626)	\$8,578	\$0	\$0	\$0	(\$1,184,048)	(\$71,164)	
Year 20	(\$1,255,212)	(\$1,192,626)	\$8,578	\$0	\$0	\$0	(\$1,184,048)	(\$71,164)	
Year 30	(\$1,255,212)	(\$1,192,626)	\$13,998	\$0	\$0	\$0	(\$1,178,628)	(\$76,584)	
All years	(\$1,255,212)	(\$1,192,626)	\$17,156	\$0	\$0	\$0	(\$1,175,470)	(\$79,742)	



**Empire Electric Assn.**  
**CFC Loan Scenario**  
**Portfolio: 1**

Count	Variable or Fixed	Interest Rate	Amort. Type	Advance Date	Amortization Start Date	Interest Rate Term	Loan Term In Months	Months to defer	Balloon Date	Final Payment Date	Loan Amount	LCITC's required?	Loans w/ Volume	Loans w/ Performance	Loans w/ Collateral	Loans w/ Equity
1	F	2.200%	LD	8/9/2010	11/1/2010	1	12	0		7/31/2011	\$113,742	No	\$0	N	N	N
2	F	2.450%	LD	8/9/2010	8/1/2011	2	24	9		7/31/2012	\$91,908	No	\$0	N	N	N
3	F	2.900%	LD	8/9/2010	8/1/2012	3	36	21		7/31/2013	\$114,946	No	\$0	N	N	N
4	F	3.300%	LD	8/9/2010	8/1/2013	4	48	33		7/31/2014	\$112,508	No	\$0	N	N	N
5	F	3.650%	LD	8/9/2010	8/1/2014	5	60	45		7/31/2015	\$118,806	No	\$0	N	N	N
6	F	3.950%	LD	8/9/2010	8/1/2015	6	72	57		7/31/2016	\$122,540	No	\$0	N	N	N
7	F	4.150%	LD	8/9/2010	8/1/2016	7	84	69		7/31/2017	\$127,279	No	\$0	N	N	N
8	F	4.350%	LD	8/9/2010	8/1/2017	8	96	81		7/31/2018	\$133,314	No	\$0	N	N	N
9	F	4.500%	LD	8/9/2010	8/1/2018	9	108	93		7/31/2019	\$74,802	No	\$0	N	N	N

# **EXHIBIT 4**

**INDEPENDENT AUDIT**

**EXHIBIT 4**

**EMPIRE ELECTRIC ASSOCIATION, INC.**

**INDEPENDENT AUDITOR'S REPORT  
AND  
FINANCIAL STATEMENTS**

*December 31, 2009 and 2008*

# EMPIRE ELECTRIC ASSOCIATION, INC.

## TABLE OF CONTENTS

	<i>Page</i>
Board of Directors and General Manager	1
Independent Auditor's Report	2
Comparative Balance Sheets	3
Statements of Revenue and Patronage Capital	4
Statements of Cash Flows	5
Notes to Financial Statements	7
Independent Auditor's Report on Compliance and on Internal Control	14
Management Letter	16



**EMPIRE ELECTRIC ASSOCIATION, INC.**

**BOARD OF DIRECTORS AND GENERAL MANAGER**

NAME	TITLE	ADDRESS
William C. Bauer	President	Cortez, Colorado
David Sitton	Vice-President	Cortez, Colorado
Jim Lawrence	Secretary-Treasurer	Cortez, Colorado
Sue McWilliams		Dolores, Colorado
Jerry Fetterman		Yellow Jacket, Colorado
John Porter		Cortez, Colorado
William Mollenkopf		Dolores, Colorado
Neal E. Stephens	General Manager	Cortez, Colorado

# SCHMIDT & COMPANY LLC

*Devoted to Audits of Rural Utility Industries  
45 Years of Utility Accounting Experience*

Board of Directors  
Empire Electric Association, Inc.  
Cortez, Colorado

## INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying balance sheets of Empire Electric Association, Inc. as of December 31, 2009 and 2008, and the related statements of revenue and patronage capital and cash flows for the years then ended. These financial statements are the responsibility of Empire Electric Association, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the valuation of the subsidiary companies and the assets underlying those valuations is a significant estimate. Adverse changes in the ultimate value of those subsidiaries and assets could result in future additional charges to income and a reduction of the value of those assets on the balance sheet.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Empire Electric Association, Inc. as of December 31, 2009 and 2008, and the results of operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 20, 2010 on our consideration of Empire Electric Association, Inc.'s internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.



SCHMIDT & COMPANY, LLC  
April 20, 2010

# EMPIRE ELECTRIC ASSOCIATION, INC.

## COMPARATIVE BALANCE SHEETS - DECEMBER 31

	<u>2009</u>	<u>2008</u>
<b>ASSETS (Notes 1 &amp; 2)</b>		
<b>UTILITY PLANT (Note 3)</b>		
Electric plant	\$ 67,874,779.66	\$ 62,784,408.07
Depreciation	23,484,728.81	22,729,809.28
Depreciated Value	<u>44,390,050.85</u>	<u>40,054,598.79</u>
<b>INVESTMENTS (Note 4)</b>	<u>35,403,968.83</u>	<u>31,429,817.00</u>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	2,984,541.72	2,300,649.89
Held-to-maturity securities (Note 5)	100,000.00	100,000.00
Receivables (Less provision for uncollectible accounts of \$90,975.64 in current period and \$44,302.29 in prior period)	4,399,105.11	3,436,787.71
Materials	535,875.03	536,183.82
Prepayments	81,348.20	78,037.02
Total	<u>8,100,870.06</u>	<u>6,451,658.44</u>
<b>DEFERRED DEBITS (Note 6)</b>	<u>183,901.09</u>	<u>48,304.05</u>
<b>TOTAL ASSETS</b>	<u>\$ 88,078,790.83</u>	<u>\$ 77,984,378.28</u>
<b>LIABILITIES AND CAPITAL</b>		
	<u>2009</u>	<u>2008</u>
<b>CAPITAL EQUITIES (Note 7)</b>		
Patronage capital	\$ 47,682,400.52	\$ 42,225,015.55
Other equities	473,576.35	505,865.51
Total	<u>48,155,976.87</u>	<u>42,730,881.06</u>
<b>LONG-TERM LIABILITIES (Note 8)</b>	<u>29,965,289.77</u>	<u>25,918,652.88</u>
<b>OTHER LONG-TERM OBLIGATIONS (Note 10)</b>	<u>2,327,361.26</u>	<u>2,331,527.74</u>
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt	1,182,000.00	899,400.00
Accounts payable	3,864,603.62	3,576,698.66
Accrued expenses	963,892.39	930,180.78
Accrued taxes	571,096.70	560,448.45
Customer deposits	483,466.90	412,745.87
Total	<u>7,065,059.61</u>	<u>6,379,473.76</u>
<b>DEFERRED CREDITS (Note 11)</b>	<u>565,103.32</u>	<u>623,842.84</u>
<b>COMMITMENTS/RELATED PARTY TRANSACTIONS (Note 13)</b>		
<b>TOTAL LIABILITIES AND CAPITAL</b>	<u>\$ 88,078,790.83</u>	<u>\$ 77,984,378.28</u>

*The accompanying notes are an integral part of these statements.*

# EMPIRE ELECTRIC ASSOCIATION, INC.

## STATEMENTS OF REVENUE AND PATRONAGE CAPITAL FOR THE YEARS ENDED - DECEMBER 31

	<u>2009</u>	<u>2008</u>
<b>OPERATING REVENUE</b>		
Electric energy revenue	\$ 50,104,597.17	\$ 46,472,016.07
Miscellaneous electric revenue	376,290.87	406,627.56
Total Operating Revenue	<u>50,480,888.04</u>	<u>46,878,643.63</u>
<b>OPERATING REVENUE DEDUCTIONS</b>		
Cost of power purchased	37,752,672.38	34,557,881.95
Operating expenses - transmission	565,405.31	646,057.99
Operating expenses - distribution	2,149,306.76	2,081,894.10
Maintenance of distribution plant	1,322,033.31	1,382,333.59
Accounting and collection expenses	1,176,408.54	1,087,856.72
Other customer expenses	470,091.91	389,771.97
Administrative and general	2,204,890.98	2,295,567.67
Depreciation	1,719,016.14	1,645,358.88
Total Operating Revenue Deductions	<u>47,359,825.33</u>	<u>44,086,722.87</u>
Electric Operating Margin	3,121,062.71	2,791,920.76
Less: Interest on long-term debt	1,599,792.01	1,530,882.85
Operating margin before capital credits	<u>1,521,270.70</u>	<u>1,261,037.91</u>
G & T and other capital credits	4,509,853.17	4,326,009.08
Operating Margin	<u>6,031,123.87</u>	<u>5,587,046.99</u>
Interest revenue	163,017.85	221,159.89
Other revenue	(32,806.04)	(24,156.52)
Nonoperating Margin	<u>130,211.81</u>	<u>197,003.37</u>
<b>NET MARGIN</b>	6,161,335.68	5,784,050.36
Patronage Capital - Beginning of Year	42,719,626.68	37,018,502.87
Subtotal	<u>48,880,962.36</u>	<u>42,802,553.23</u>
Retirement of capital credits	(735,502.27)	(82,926.55)
<b>PATRONAGE CAPITAL - END OF YEAR (Note 7)</b>	<u>\$ 48,145,460.09</u>	<u>\$ 42,719,626.68</u>

*The accompanying notes are an integral part of these statements.*

# EMPIRE ELECTRIC ASSOCIATION, INC.

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED - DECEMBER 31

	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net margin	\$ 6,161,335.68	\$ 5,784,050.36
Adjustments to reconcile net margin to net cash provided by operating activities:		
Depreciation	1,719,016.14	1,645,358.88
Depreciation charged to clearing	127,174.08	108,519.57
Interest earned on cushion of credit	(30,197.79)	(61,103.95)
Postretirement benefits accrued	4,708.66	(24,285.76)
Patronage capital credits assigned by associated organizations	(4,509,853.17)	(4,326,009.08)
Decrease (Increase) In:		
Receivables (net)	(958,750.26)	(730,407.17)
Prepaid expenses	(3,311.18)	(3,491.04)
Interest receivable	(3,567.14)	667.18
Deferred debits	(135,597.04)	(47,741.05)
Increase (Decrease) In:		
Accounts payable	287,904.96	525,220.05
Accrued liabilities	44,359.86	274,532.48
Customer deposits	70,721.03	54,273.91
Deferred credits	(58,739.52)	96,092.76
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>2,715,204.31</b>	<b>3,295,677.14</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Investment in plant (net)	(6,181,642.28)	(5,650,357.16)
Decrease (Increase) in materials inventory	308.79	(319.27)
Decrease (Increase) in other investments	(81,484.88)	206,221.67
Payments received from associated organizations	717,402.82	736,921.07
<b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	<b>(5,545,415.55)</b>	<b>(4,707,533.69)</b>

*The accompanying notes are an integral part of these statements.*

**EMPIRE ELECTRIC ASSOCIATION, INC.**

**STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED - DECEMBER 31**

	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Long-term borrowing	5,000,000.00	3,980,000.00
Principal payments on long-term debt	(1,203,313.58)	(1,113,589.11)
Cushion of credit applied	562,748.26	317,296.16
Paid into cushion of credit	-	(1,000,000.00)
Postretirement benefits payments	(109,091.74)	(145,049.75)
Increase (Decrease) in other capital	(737.60)	(4,453.02)
Capital refunds to members	(735,502.27)	(82,926.55)
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<u>3,514,103.07</u>	<u>1,951,277.73</u>
 <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	 683,891.83	 539,421.18
 <b>CASH AND CASH EQUIVALENTS BEGINNING OF YEAR</b>	 2,300,649.89	 1,761,228.71
<b>END OF YEAR</b>	<u>\$ 2,984,541.72</u>	<u>\$ 2,300,649.89</u>
 <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the year for interest	\$ 1,608,994.48	\$ 1,544,968.00
Cash paid during the year for income taxes	\$ -	\$ -

*The accompanying notes are an integral part of these statements.*

# **EMPIRE ELECTRIC ASSOCIATION, INC.**

## **NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008**

### **(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

#### **UTILITY PLANT**

The Association employs the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission and the work order procedures suggested by the Rural Development Utilities Programs (RUS).

#### **INVESTMENTS**

Investments are generally included in the financial statements at cost. Equities in other organizations are included at face value of related certificates.

#### **CASH AND CASH EQUIVALENTS**

For purposes of the statement of cash flows, the Association considers all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents.

#### **ACCOUNTS RECEIVABLE**

Provision is made for accounts deemed uncollectible.

#### **CONCENTRATION OF CREDIT RISK**

Empire Electric Association, Inc. is an electric distribution system. The Association grants credit to customers, substantially all are local residents.

#### **ACCOUNTING ESTIMATES**

The presentation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the valuation of the Association's investment in subsidiary companies and the value of the assets owned by the subsidiaries. Changes in the value of subsidiary assets may affect the Association's future earnings.

#### **MATERIALS AND SUPPLIES**

Materials and supplies are included in the financial statements at average cost. Usable material from plant retirements is returned to inventory at current average cost. A physical inventory is taken at least once each year.

#### **DEFERRED DEBITS**

Amortization of deferred charges is authorized by the Board of Directors, subject to approval by RUS.

## ELECTRIC ENERGY SALES

The Association recognizes sales of electricity on a turn-around billing procedure, and the procedure followed records part of sales following the month of use of the electricity by the customer. The Association does not record unbilled revenue as of the audit date. The estimated unbilled revenue amounted to approximately \$1,847,079 and \$1,716,074 in 2009 and 2008, respectively.

## INCOME TAX STATUS

The Association has been granted exemption from federal income tax under Section 501(c)(12) of the Internal Revenue Code. Net margins are allocated to patrons.

The Cooperative evaluates the components of the annual test for maintenance of its tax-exempt status under section 501(c)(12) of the Internal Revenue Code of 1986, as amended. This process includes an analysis of whether the position the Cooperative takes with regard to a particular item of income would meet the definition of an uncertain tax position under Financial Accounting Interpretation No. 48, Accounting for Uncertainty in Income Taxes.

### (2) ASSETS PLEDGED:

Substantially all assets are pledged as security for long-term debt to the RUS and the National Rural Utilities Cooperative Finance Corporation (CFC).

### (3) ELECTRIC PLANT AND DEPRECIATION PROCEDURES:

Listed below are the major classes of the electric plant as of December 31:

	<u>2009</u>	<u>2008</u>
Intangible plant	\$ 439,485.92	\$ 439,485.92
Production plant	77,139.22	77,139.22
Transmission plant	3,528,213.45	3,426,877.15
Distribution plant	45,817,953.57	43,907,825.57
General plant	<u>10,218,080.30</u>	<u>9,894,710.67</u>
Electric plant in service	60,080,872.46	57,746,038.53
Construction work in progress	<u>7,793,907.20</u>	<u>5,038,369.54</u>
Total	<u><u>\$67,874,779.66</u></u>	<u><u>\$62,784,408.07</u></u>

Provision has been made for depreciation of transmission plant and distribution plant on a straight-line composite rate of 2.75% and 2.85%, respectively. Intangible plant is depreciated at 2.75%. General plant depreciation rates have been applied on a straight-line unit method basis at rates which will depreciate the assets over their estimated useful lives.



#### (4) INVESTMENTS AND OTHER PROPERTY:

At December 31, investments and other property included:

	<u>2009</u>	<u>2008</u>
Equities in other organizations	\$ 34,970,789.91	\$ 30,996,854.68
Certificate of deposit	-	100,000.00
Deferred compensation	414,378.92	314,162.32
Water taps	12,800.00	12,800.00
Non-utility property	6,000.00	6,000.00
Total	<u>\$ 35,403,968.83</u>	<u>\$ 31,429,817.00</u>

Equities and investments in other organizations were as follows:

	<u>2009</u>	<u>2008</u>
National Rural Utilities Cooperative Finance Corporation Herndon, Virginia		
Membership	\$ 1,000.00	\$ 1,000.00
Capital term certificates	876,689.95	884,033.39
Member capital securities	250,000.00	-
Capital credits	242,663.70	216,390.69
PathNet Fiber Network		
Capital contribution	2,645,676.49	2,706,848.17
FastTrack Communications, Inc.		
Investments	842,175.00	842,175.00
Federated Rural Electric Insurance Exchange Lenexa, Kansas		
Capital credits	154,492.00	145,354.00
Tri-State G & T Association, Inc. Denver, Colorado		
Capital credits	29,604,887.38	25,989,918.00
Western United Electric Supply Corporation Denver, Colorado		
Capital credits	352,990.56	211,020.60
Other organizations	214.83	114.83
Total	<u>\$ 34,970,789.91</u>	<u>\$ 30,996,854.68</u>

**(5) HELD-TO-MATURITY SECURITIES:**

Held-to-maturity securities (stated at cost which approximates market), at December 31, 2009 consisted of a certificate of deposit earning 1.83% maturing April 2, 2010.

**(6) DEFERRED DEBITS:**

At December 31, deferred debits were as follows:

	<u>2009</u>	<u>2008</u>
Long-term work plan	\$ 39,153.73	\$ 48,304.05
Miscellaneous	144,747.36	-
Total	<u>\$ 183,901.09</u>	<u>\$ 48,304.05</u>

**(7) PATRONAGE CAPITAL:**

At December 31, patronage capital consisted of:

	<u>2009</u>	<u>2008</u>
Assignable	\$ 6,161,335.68	\$ 5,784,050.36
Assigned to date	57,393,691.27	51,609,640.91
Subtotal	<u>63,555,026.95</u>	<u>57,393,691.27</u>
Less: Retirements to date	15,409,566.86	14,674,064.59
Subtotal	<u>48,145,460.09</u>	<u>42,719,626.68</u>
Less: Capital gain	463,059.57	494,611.13
Total	<u>\$ 47,682,400.52</u>	<u>\$ 42,225,015.55</u>

Other equities at December 31, included:

	<u>2009</u>	<u>2008</u>
Donated capital	\$ 10,516.78	\$ 11,254.38
Capital credits - gain	463,059.57	494,611.13
Total	<u>\$ 473,576.35</u>	<u>\$ 505,865.51</u>

Under the provisions of the mortgage agreement, until the equities and margins equal or exceed thirty percent of the total assets of the Association, the return to patrons of capital contributed by them is limited generally to twenty-five percent of the patronage capital or margins received by the Association in the prior calendar year. During the year ended December 31, 2009, total refunds of capital to patrons amounted to approximately \$735,502.27. The equities and margins of the Association represent 54.70% of the total assets at balance sheet date.

**(8) LONG-TERM LIABILITIES:**

Substantially all assets of the Association are mortgaged to the United States. Lien accommodations have been executed with CFC. Long-term debt is represented by mortgage notes payable to the United States of America, RUS, the Federal Financing Bank (FFB) and CFC. Following is a summary of outstanding long-term debt as of December 31:

	<u>2009</u>	<u>2008</u>
RUS, 2.99% to 5.50% notes maturing through 2042	\$ 13,866,871.44	\$ 9,103,076.50
RUS, Cushion of credit	(588,038.11)	(1,120,588.58)
FFB, 4.645% to 6.331% notes maturing through 2034	8,456,333.36	8,623,211.58
CFC, 4.65% to 7.00% notes maturing through 2030	9,412,123.08	10,212,353.38
Subtotal	<u>31,147,289.77</u>	<u>26,818,052.88</u>
Less: Current maturities	1,182,000.00	899,400.00
Total	<u><u>\$ 29,965,289.77</u></u>	<u><u>\$ 25,918,652.88</u></u>

There were unadvanced loan funds in the amount of \$700,000 available to the Association on loan commitments with RUS as of the audit date.

Principal and interest installments on the above notes due during the next year amount to approximately \$2,600,000. Advance payments of \$588,038.11 may be applied against RUS debt service. As of December 31, 2009, annual maturities of long-term debt outstanding for the next five years are as follows:

<u>Year Ending</u> <u>December 31</u>	<u>RUS</u> <u>Principal</u> <u>Payment</u>	<u>CFC</u> <u>Principal</u> <u>Payment</u>	<u>FFB</u> <u>Principal</u> <u>Payment</u>	<u>Total</u> <u>Principal</u> <u>Payment</u>
2010	183,700	825,900	172,400	1,182,000
2011	191,300	866,500	185,900	1,243,700
2012	199,100	872,600	199,600	1,271,300
2013	207,300	887,600	207,000	1,301,900
2014	215,900	981,700	218,500	1,416,100

**(9) LINE OF CREDIT:**

The Association has a \$7,900,000 line of credit available with CFC. As of the audit date no funds were borrowed on the line of credit.

**(10) OTHER LONG-TERM OBLIGATIONS:**

At December 31, other long-term obligations consisted of the following:

	<u>2009</u>	<u>2008</u>
Accumulated postretirement benefits obligation	\$ 1,917,372.38	\$ 2,017,365.42
Deferred compensation	409,988.88	314,162.32
Total	<u>\$ 2,327,361.26</u>	<u>\$ 2,331,527.74</u>

The Association provides certain health care benefits for retired employees. The benefits cover employees and directors retiring at age 65. Early retirements must be approved by petition to the Board. Retirees with less than 12 years of service may remain in the plan subject to approval by petition to the Board, but receive no Association contribution. Disabled employees may remain in the medical plan but contribute 75 percent of the premium. The Association pays 25 percent of the medical insurance premiums for retirees and eligible dependents during the lifetime of the retiree. The Association has elected to pay as you go and not fund this benefit.

The postretirement benefit plan of the Association is subject to the recognition and disclosure provisions of FASB No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Association implemented the requirements of FASB No. 158 during the 2008 fiscal year.

The accumulated benefit obligation and the net periodic postretirement benefit costs for the years ended December 31, were comprised of:

	<u>2009</u>	<u>2008</u>
Benefit obligation - December 31	\$ 1,917,372.38	\$ 2,017,365.42
Fair value of plan assets	-	-
Postretirement benefit obligation	<u>\$ (1,917,372.38)</u>	<u>\$ (2,017,365.42)</u>
Accrued benefit cost recorded in the balance sheet	<u>\$ 1,917,372.38</u>	<u>\$ 2,017,365.42</u>
Discount rate	6.20%	7.00%
Benefit costs	\$ 49,315.50	\$ 47,403.71
Benefits paid	\$ 38,123.87	\$ 160,665.40

**(11) DEFERRED CREDITS:**

At December 31, deferred credits were as follows:

	<u>2009</u>	<u>2008</u>
Customers' advances for construction	\$ 163,353.23	\$ 163,069.78
Deferred property tax - KM	252,153.35	252,153.35
Customers' prepayments	86,436.20	147,467.67
Deferred revenue - Pathnet	54,586.97	56,649.56
Miscellaneous	8,573.57	4,502.48
Total	<u>\$ 565,103.32</u>	<u>\$ 623,842.84</u>

**(12) PENSION PLAN:**

The Association has a contributory 401(k) plan in lieu of a pension plan for its employees. Total 401(k) costs for the years ended December 31, 2009 and 2008 amounted to approximately \$459,000 and \$442,000, respectively.

**(13) COMMITMENTS AND RELATED PARTY TRANSACTIONS:**

Under its wholesale power agreement, the Association is committed to purchase its electric power and energy requirements from Tri-State. The rates paid for such purchases are subject to review by the Federal Energy Regulatory Commission. Following is a summary of transactions and balances with the affiliate for the years ended December 31:

	<u>2009</u>	<u>2008</u>
Cost of power purchased from Tri-State	\$ 37,752,672	\$ 34,557,882
Due to Tri-State (included in the accompanying balance sheets)	3,492,862	3,310,498
Capital allocated by Tri-State	4,273,700	4,228,465
Capital refunded by Tri-State	658,631	646,500
Accumulated capital allocated by Tri-State	29,604,887	25,989,818

# SCHMIDT & COMPANY LLC

*Devoted to Audits of Rural Utility Industries  
45 Years of Utility Accounting Experience*

Board of Directors  
Empire Electric Association, Inc.  
Cortez, Colorado

## **INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

We have audited the financial statements of Empire Electric Association, Inc. as of and for the years ended December 31, 2009 and 2008, and have issued our report thereon dated April 20, 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **COMPLIANCE**

As part of obtaining reasonable assurance about whether Empire Electric Association, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered Empire Electric Association, Inc. internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Empire Electric Association, Inc. internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Empire Electric Association, Inc. internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Empire Electric Association, Inc. ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Empire Electric Association, Inc. financial statements that is more than inconsequential will not be prevented or detected by Empire Electric Association, Inc. internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Empire Electric Association, Inc. internal control. Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended for the information of the Board of Directors, management, the RUS, and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

*Schmidt & Company, LLC*

SCHMIDT & COMPANY, LLC

April 20, 2010

# SCHMIDT & COMPANY LLC

*Devoted to Audits of Rural Utility Industries  
45 Years of Utility Accounting Experience*

Board of Directors  
Empire Electric Association, Inc.  
Cortez, Colorado

We have audited the financial statements of Empire Electric Association, Inc. for the year ended December 31, 2009, and have issued our report thereon dated April 20, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR part 1773, Policy on Audits of Rural Development Utilities Programs (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Empire Electric Association, Inc. for the year ended December 31, 2009, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses.

Section 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR 1773.33 (e)(1), related party transactions, depreciation rates, and a schedule of deferred debits and deferred credits, and a schedule of investments, upon which we express an opinion. In addition, our audit of the financial statements also included the procedures specified in 7 CFR 1773.38-.45. Our objective was not to provide an opinion on these specific aspects of the internal control over



financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports other than our independent auditor's report and our independent auditor's report on compliance and on internal control over financial reporting, all dated April 20, 2010 or summary of recommendations related to our audit have been furnished to management.

Our comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR 1773.33 are presented below.

#### **COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING**

We noted no matters regarding Empire Electric Association, Inc.'s internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records;
- The process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement and maintenance or other expense accounts; and
- The materials control.

#### **COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS**

We have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations and contracts. The procedures we performed are summarized as follows:

Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property or for the use of mortgaged property by others for the year ended December 31, 2009:

We noted no new contracts during the audit period.

Procedure performed with respect to the requirement to submit RUS Form 7 to the RUS:

- Agreed amounts reported in Form 7 to Empire Electric Association, Inc.'s records.

The results of our tests indicate that, with respect to the items tested, Empire Electric Association, Inc. complied, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has obtained written approval of the RUS to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others as defined in §1773.33 (e)(1)(i); and

- The borrower has submitted its Form 7 to the RUS and the Form 7, Financial and Statistical Report, as of December 31, 2009, represented by the borrower as having been submitted to RUS is in agreement with Empire Electric Association, Inc.'s audited records in all material respects, and appears reasonable based upon the audit procedures performed.

**COMMENTS ON OTHER ADDITIONAL MATTERS**

In connection with our audit of the financial statements of Empire Electric Association, Inc., nothing came to our attention that caused us to believe that Empire Electric Association, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at 7 CFR 1773.33 (c)(1);
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33 (c)(2);
- The retirement of plant addressed at 7 CFR 1773.33 (c)(3) and (4);
- Approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR 1773.33 (c)(5);
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 2009, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33 (f);
- The depreciation rates addressed at 7 CFR 1773.33 (g);
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR 1773.33 (h), the detailed schedule of investments required by 7 CFR 1773.33 (i), and provided below, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

**DEFERRED DEBITS**

At December 31, deferred items were as follows:

	<u>2009</u>
Long-term work plan	\$ 39,153.73
Miscellaneous	<u>144,747.36</u>
Total	<u><u>\$ 183,901.09</u></u>

## DEFERRED CREDITS

At December 31, deferred credits were as follows:

	<u>2009</u>
Customers' advances for construction	\$ 163,353.23
Deferred property tax - SWEPI	252,153.35
Customers' prepayments	86,436.20
Deferred revenue - Pathnet	54,586.97
Miscellaneous	8,573.57
Total	<u><u>\$ 565,103.32</u></u>

## INVESTMENT IN AFFILIATED COMPANIES

	<u>PathNet</u>	<u>Fast Track Communications</u>
Original investment	\$ 2,780,558.54	\$ 2,136,102.98
Investment advances through the year ending March 31, 2003	278,025.79	-
Book value of investment March 31, 2003	<u>3,058,584.33</u>	<u>2,136,102.98</u>
Amortization of investment during the year ending March 31, 2004	<u>(61,170.68)</u>	<u>-</u>
Book value of investments March 31, 2004	<u>2,997,413.65</u>	<u>2,136,102.98</u>
Amortization of investment during the year ending March 31, 2005	<u>(61,171.68)</u>	<u>-</u>
Book value of investments March 31, 2005	<u>2,936,241.97</u>	<u>2,136,102.98</u>
Amortization of investment during the year ending March 31, 2006	<u>(61,171.68)</u>	<u>(1,249,602.98)</u>
Book value of investments March 31, 2006	<u>2,875,070.29</u>	<u>886,500.00</u>
Amortization of investment for nine months ending December 31, 2006	<u>(45,878.76)</u>	<u>(44,325.00)</u>
Book value of investments December 31, 2006	<u>2,829,191.53</u>	<u>842,175.00</u>
Amortization of investment during the year ending December 31, 2007	<u>(61,171.68)</u>	<u>-</u>
Book value of investments December 31, 2007	<u>2,768,019.85</u>	<u>842,175.00</u>
Amortization of investment during the year ending December 31, 2008	<u>(61,171.68)</u>	<u>-</u>
Book value of investments December 31, 2008	<u>2,706,848.17</u>	<u>842,175.00</u>
Amortization of investment during the year ending December 31, 2009	<u>(61,171.68)</u>	<u>-</u>
Book value of investments December 31, 2009	<u><u>\$ 2,645,676.49</u></u>	<u><u>\$ 842,175.00</u></u>

PathNet is a joint venture with Tri-State G & T, the Project Manager and four cooperatives in Southwestern Colorado. The joint venture operates a carrier quality, long haul, fiber optic telecommunication system between Albuquerque, New Mexico and Grand Junction, Colorado. The Association owns 6.25% of PathNet. This investment is accounted for on the cost basis. The Association is convinced the investment is not at risk in terms of a loss of the investment.

FastTrack Communications is a Colorado based telecommunications company doing business in Colorado, New Mexico, and Utah. Under terms of the bylaws of FastTrack, the Association has a 23.75% ownership interest and one seat on the Board of Directors. This investment is accounted for on the cost basis.

This report is intended solely for the information and use of the Board of Directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*Schmidt & Company, LLC*

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April 20, 2010