

Great River Energy

Consolidated Financial Statements as of
December 31, 2008 and 2007, and for the Years
Ended December 31, 2008, 2007, and 2006,
and Independent Auditors' Report

GREAT RIVER ENERGY

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Great River Energy
Maple Grove, MN

We have audited the accompanying consolidated balance sheets of Great River Energy (GRE) as of December 31, 2008 and 2007, and the related consolidated statements of revenues, expenses and members' patronage capital and cash flows for each of the three years in the period ended December 31, 2008. These consolidated financial statements are the responsibility of GRE's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of GRE's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of GRE as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 6, 2009

GREAT RIVER ENERGY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2008 AND 2007 (In thousands)

	2008	2007
ASSETS		
UTILITY PLANT:		
Electric plant	\$ 2,844,739	\$ 2,576,657
Coal mine plant	260,834	249,099
Construction work in progress	475,518	279,136
Less accumulated depreciation and amortization	<u>(1,499,769)</u>	<u>(1,416,830)</u>
Utility plant — net	<u>2,081,322</u>	<u>1,688,062</u>
OTHER ASSETS AND INVESTMENTS:		
Funds reserved for debt service	15,085	17,595
Restricted investments — deferred compensation	7,518	10,633
Restricted investments — lease deposit		7,302
Restricted investments — lease termination		29,031
Other investments — principally CFC	20,197	21,368
Equity investment in Blue Flint Ethanol	7,357	9,127
Equity investment in Great American Energy	4,835	
Deferred charges	163,648	67,143
Other long-term assets	16,849	10,102
Other long-term receivables:		
Members	10,343	12,060
Others — net of allowance for doubtful accounts of \$107 and \$107	<u>9,207</u>	<u>2,844</u>
Total other assets and investments	<u>255,039</u>	<u>187,205</u>
CURRENT ASSETS:		
Cash and cash equivalents	233,887	244,694
Accounts receivable from nonaffiliated parties	20,330	12,826
Accounts receivable from members	127,040	93,074
Fuel inventory	17,468	17,919
Materials and supplies inventory	52,245	50,647
Prepays	1,933	2,730
Deferred income tax benefit	<u>12,335</u>	<u>11,130</u>
Total current assets	<u>465,238</u>	<u>433,020</u>
TOTAL	<u>\$ 2,801,599</u>	<u>\$ 2,308,287</u>

(Continued)

GREAT RIVER ENERGY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2008 AND 2007 (In thousands)

	2008	2007
LIABILITIES AND CAPITAL		
MEMBERS' PATRONAGE CAPITAL	\$ 309,222	\$ 278,799
DEFERRED GAIN ON REFINANCING	<u> </u>	<u>6,510</u>
OTHER NONCURRENT LIABILITIES	<u>83,889</u>	<u>51,100</u>
LONG-TERM OBLIGATIONS — Less current portion	<u>1,987,513</u>	<u>1,607,587</u>
LEASE TERMINATION OBLIGATION	<u> </u>	<u>29,031</u>
DEFERRED COMPENSATION	<u>7,518</u>	<u>10,633</u>
DEFERRED INCOME TAXES	<u>12,312</u>	<u>9,946</u>
CONTINGENCIES (Notes 3, 4, and 8)		
CURRENT LIABILITIES:		
Current portion of long-term obligations	78,122	82,039
Notes payable to members	15,012	18,632
Obligations under lines of credit	60,709	60,709
Accounts payable	90,903	74,582
Property and other taxes	14,656	13,373
Other accrued expenses	19,042	21,975
Accrued interest payable	53,554	43,371
Derivative instruments	<u>69,147</u>	<u> </u>
Total current liabilities	<u>401,145</u>	<u>314,681</u>
TOTAL	<u>\$2,801,599</u>	<u>\$2,308,287</u>

See notes to consolidated financial statements.

(Concluded)

GREAT RIVER ENERGY

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES, AND MEMBERS' PATRONAGE CAPITAL FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006 (In thousands)

	2008	2007	2006
ELECTRIC REVENUE	\$804,827	\$752,219	\$686,095
OTHER OPERATING REVENUE	<u>25,095</u>	<u>23,565</u>	<u>23,936</u>
Total operating revenue	<u>829,922</u>	<u>775,784</u>	<u>710,031</u>
OPERATING EXPENSES:			
Purchased power	240,428	198,640	181,020
Fuel	173,528	196,548	169,287
Generation operation and maintenance	93,015	87,464	84,512
Transmission operation and maintenance	49,936	46,588	44,810
Business support services	66,475	60,363	47,621
Dispatch services			4,200
Depreciation and amortization	88,199	86,123	83,460
Property and other taxes	<u>19,804</u>	<u>18,887</u>	<u>18,326</u>
Total operating expenses	<u>731,385</u>	<u>694,613</u>	<u>633,236</u>
OPERATING MARGIN	98,537	81,171	76,795
OTHER INCOME (EXPENSE):			
Other income — net	13,799	23,858	43,483
Interest income	8,628	13,375	6,364
Interest expense — net of amounts capitalized	<u>(91,128)</u>	<u>(82,358)</u>	<u>(69,451)</u>
NET UTILITY MARGIN	<u>29,836</u>	<u>36,046</u>	<u>57,191</u>
NONUTILITY OPERATIONS:			
Gross margin on trading			5,096
General, administrative, and operating			(7,500)
Depreciation			(268)
Other income — net			2,117
Gain (loss) from joint ventures	<u>1,246</u>	<u>487</u>	<u>(673)</u>
NET NONUTILITY MARGIN (LOSS)	<u>1,246</u>	<u>487</u>	<u>(1,228)</u>
NET MARGIN	31,082	36,533	55,963
OTHER COMPREHENSIVE INCOME:			
Additional minimum pension obligation		3,049	821
Interest rate swap valuation — joint venture	<u>(659)</u>	<u>(572)</u>	<u>(488)</u>
COMPREHENSIVE INCOME	30,423	39,010	56,296
MEMBERS' PATRONAGE CAPITAL — Beginning of year	278,799	234,803	178,507
CUMULATIVE EFFECT OF ADOPTING FASB STATEMENT NO. 158		<u>4,986</u>	
MEMBERS' PATRONAGE CAPITAL — End of year	<u>\$309,222</u>	<u>\$278,799</u>	<u>\$234,803</u>

See notes to consolidated financial statements.

GREAT RIVER ENERGY

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006 (In thousands)

	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net margin	\$ 31,082	\$ 36,533	\$ 55,963
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation and amortization:			
Charged to operating expenses	88,199	86,123	83,728
Charged to fuel expense and other accounts	9,641	10,291	9,763
Amortization of deferred credits	(510)	(6,543)	(6,542)
Gain from lease termination	(2,979)		
Loss (gain) from equity investment in joint ventures	1,123	(540)	673
Changes in working capital (excluding cash, investments, and borrowings):			
Accounts receivable	(46,116)	3,860	16,124
Inventory and other assets	(9,680)	(6,144)	(926)
Accounts payable, taxes, and other accrued expenses	(29,758)	(22,198)	(9,003)
Accrued interest	10,645	27,871	(839)
Noncurrent liabilities	5,514	2,006	(4,658)
Net cash provided by operating activities	<u>57,161</u>	<u>131,259</u>	<u>144,283</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Electric utility plant additions	(436,155)	(276,151)	(153,812)
Proceeds from sale of property	359	398	71
Investment in joint ventures	(4,300)	(1,563)	(9,359)
Purchases of investments	(727)	(25,623)	(43,799)
Proceeds from maturity of investments	49,162	104,783	5,299
Net cash used in investing activities	<u>(391,661)</u>	<u>(198,156)</u>	<u>(201,600)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term obligations	800,376	1,539,297	312,732
Costs of new debt issuance	(8,283)	(17,728)	(1,550)
Notes (paid) received from members	(3,620)	8,025	(1,336)
Repayments of long-term obligations	(424,580)	(1,358,604)	(66,476)
Lease termination obligation	(40,200)		
Net borrowings (repayments) under lines of credit		60,709	(133,905)
Net cash provided by financing activities	<u>323,693</u>	<u>231,699</u>	<u>109,465</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(10,807)	164,802	52,148
CASH AND CASH EQUIVALENTS — Beginning of year	<u>244,694</u>	<u>79,892</u>	<u>27,744</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 233,887</u>	<u>\$ 244,694</u>	<u>\$ 79,892</u>

See notes to consolidated financial statements.

GREAT RIVER ENERGY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2008 AND 2007, AND FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — Great River Energy (GRE) is a Minnesota electric generation and transmission cooperative corporation providing wholesale electric service to member distribution cooperatives engaged in the retail sale of electricity to member consumers in Minnesota and a small section of Wisconsin. This service is provided in accordance with the terms of the power purchase and transmission service contracts between GRE and the members. These contracts have expiration dates of December 31, 2045, and December 31, 2035, respectively. GRE was formed on January 1, 1999, when Cooperative Power (CP) of Eden Prairie, MN, and United Power Association (UPA) of Elk River, MN, consolidated their operations. The consolidation was accounted for as a pooling of interests. CP and UPA remained as legal entities until May 1, 2006, when the merger of the three entities was completed.

Basis of Accounting — The consolidated financial statements are prepared on the accrual basis of accounting and include the accounts of GRE and its variable interest entity, The Falkirk Mining Company (“Falkirk”) for all years presented. In 2006, the accounts of Split Rock Energy, LLC (“Split Rock”) were also included. All significant intercompany balances and transactions have been eliminated in consolidation.

Split Rock Energy, LLC — Split Rock provided core energy services to GRE that included marketing excess energy which GRE had available for sale and purchasing energy to cover GRE’s load. Split Rock provided these services as an agent for GRE. Split Rock also had contracts related to its proprietary trading operations dealing in both physical and financial transactions with various counterparties and power pools. Effective November 10, 2006, the Split Rock Board of Governors decided to cease trading operations. The core energy services provided by Split Rock were integrated into GRE’s operations. Energy trading activities were recorded as nonutility operations in the consolidated statements of revenues, expenses, and members’ patronage capital. Most of the costs associated with closing the operations of Split Rock were related to severance and retention agreements, which totaled \$2 million of which \$0.2 million was paid during 2006. This amount is recorded in nonutility operations as general, administrative, and operating. An additional \$1 million of severance and retention costs was recognized over the required service periods during 2007. In addition, included in gross margin on trading for 2006 is a \$1.2 million charge related to the cost of existing transmission positions that had been purchased in 2006, but were not utilized.

The Falkirk Mining Company — GRE has an agreement with Falkirk for the development and operation of a lignite coal mine. Falkirk is the coal supplier for the Coal Creek Station (CCS), GRE’s steam-generating facility located near Underwood, ND. GRE is required to provide financing for all costs associated with the mine development and operation. In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 46, *Consolidation of Variable Interest Entities (revised December 2003, FIN 46(R))*, which established new standards for consolidation of the financial statements of entities that are controlled by variable interests rather than by voting interests. In 2005, GRE adopted FIN 46(R), and determined that Falkirk qualifies as a variable interest entity for which GRE is the primary beneficiary. FIN 46(R) requires GRE to consolidate its financial statements with Falkirk. The coal purchase price includes all costs incurred by Falkirk for development and operation of the mine, including Falkirk’s net income of \$10.5 million in 2008 and 2007, and

\$10.2 million in 2006, which is part of the contract cost of coal purchased under the coal sales agreement. Accordingly, the net effect of consolidating the income statement of Falkirk had no impact on GRE's margin for the years ended December 31, 2008, 2007, and 2006.

Falkirk is a wholly owned subsidiary of the North American Coal Corporation, which is a wholly owned subsidiary of NACCO Industries, Inc. Falkirk is principally engaged in lignite mining through the operation of a surface mine in North Dakota.

Regulatory Accounting — GRE operations follow the provisions of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, and the consolidated financial statements report the effects of FASB Statement No. 71.

GRE had regulatory assets of \$139.3 million and \$46.1 million and regulatory liabilities of \$3.6 million and \$10.6 million as of December 31, 2008 and 2007, respectively. Regulatory assets and liabilities are recorded as deferred charges, other noncurrent liabilities, and deferred gain on refinancing in the consolidated balance sheets. As of December 31, 2008, GRE's regulatory assets and liabilities are being reflected in rates charged to customers. If all or a separable portion of GRE's operations no longer become subject to the provisions of FASB Statement No. 71, a write-off of related regulatory assets and liabilities would be required, unless some form of transition recovery (refund) continues through rates established and collected for GRE's remaining regulated operations. In addition, GRE would be required to determine any impairment to the carrying costs of deregulated plant and inventory assets.

Cash and Cash Equivalents — Cash equivalents include all highly liquid investments with original maturities of three months or less (e.g., money market funds). Certain cash and cash equivalents are classified as investments when they relate to trust funds held for long-term purposes.

Inventories — Inventories are stated at lower of average cost or market. Emission allowances are also accounted for as inventory and recorded at lower of cost or market. The U.S. Environmental Protection Agency has requirements limiting the amount of sulfur dioxide which can be emitted from GRE-owned power plants. Under these requirements, GRE was allotted one emission allowance per ton of sulfur dioxide emissions based upon historic emission levels. As of December 31, 2008, GRE had approximately seventeen thousand allowances available for sale, which are recorded at a cost of \$0 (see Note 1 — Other Income — Net).

Utility Plant — Utility plant is stated at original cost, which includes materials, contract and direct labor, overhead, allowance for funds used for construction, and interest during construction. Interest charged to construction on borrowed funds and allowance for funds used for construction (other than borrowed funds) are included as a component of utility plant cost and credited to interest expense and interest income, respectively. The rates applied reflect the actual rates for borrowed funds and the prevailing short-term investment rates for other than borrowed funds. Included in accumulated depreciation are nonlegal or noncontractual costs of removal components in the amount of \$19.8 million and \$17.9 million for 2008 and 2007, respectively. At December 31, 2008, 2007, and 2006, there are accounts payable related to property additions of \$44.2 million, \$26.1 million, and \$9.2 million, respectively.

Depreciation and Amortization — Depreciation for financial reporting purposes is provided based upon the straight-line method at rates designed to amortize the original costs of properties over their estimated service lives. The effective depreciation rate was 3.0% for 2008 and 3.1% for other years presented. The range of useful lives for utility plant is 3 to 50 years. Coal mine equipment is amortized on a straight-line method over the estimated useful lives. Amortization of coal lands and leaseholds is calculated on the units-of-production method based upon estimated recoverable tonnages and is included in fuel expense in the consolidated statements of revenues, expenses, and members' patronage capital.

Recoverability of Long-Lived Assets — GRE reviews its long-lived assets whenever events or changes in circumstances indicate the carrying value of the assets may not be recoverable. GRE determines potential impairment by comparing the carrying value of the asset with the net cash flows expected to be provided by the operating activities of the business or related products. Should the sum of the expected cash flows be less than the carrying values, GRE would determine whether an impairment loss should be recognized. No impairment losses have been identified in the consolidated financial statements.

Income Taxes — GRE accounts for income taxes using the liability method. Under this method, deferred income taxes are recognized for temporary differences between the tax and financial reporting bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

Accounting for Energy Trading — Emerging Issues Task Force (EITF) Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*, requires that all gains and losses related to energy trading activities be shown net in the statements of income. Accordingly, the consolidated financial statements report 2006 gross margins on trading of \$5.1 million, net of power trading purchases of \$596.7 million.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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. The significant estimates in the consolidated financial statements relate to actuarially determined benefit costs, compensation and benefit accruals, asset retirement obligation liabilities, accrued property and other taxes, and contingencies and other reserves. Actual results could differ from those estimates.

Revenue Recognition — Electric revenue is recognized when energy is delivered to GRE's members or to other nonmember organizations. The GRE rate schedule includes a power cost adjustment that allows for increases or decreases in member power billings based upon actual power costs compared to plan. For 2008 and 2007, the power cost adjustments were charges to our members of \$48.9 million and \$0.7 million, respectively, and for 2006, the power cost adjustment was a credit of \$17.1 million. The 2008 and 2007 charges are recorded as an increase in electric revenue and the credit for 2006 is recorded as a reduction to electric revenue in the consolidated statements of revenues, expenses, and members' patronage capital.

Other Operating Revenue — Other operating revenue includes revenue received from a joint venture with Resource Recovery Technologies, LLC related to the processing plant that transforms municipal solid waste into refuse-derived fuel and the burning of that fuel at the Elk River Station, and revenues received from other utilities related to providing transmission service under various integrated transmission agreements. Other operating revenue is recorded as services are provided.

Other Income — Net — Other income is reported net of expenses and includes income from the sale of emission allowances (see Note 1 — Inventories) and other nonoperating income. Through operational changes, GRE is emitting less sulfur dioxide than in the past, resulting in excess emission allowances which can be sold in the open market. GRE sold \$7.8 million, \$13.0 million, and \$30.9 million of allowances in 2008, 2007, and 2006, respectively. The GRE Board of Directors approved the recording of a regulatory liability for \$12.0 million in 2005 related to emission allowance sales, which was amortized evenly into operations during 2007 and 2006. The other nonoperating income consists of income from providing engineering services to members and others, patronage capital credits from associated organizations, amortization of gains from leasing transactions (see Note 3), gain from termination of a leasing transaction (see Note 3), and income from a termination clause contained in a power sales contract with a nonmember. The amount of income from these items was \$6.0 million, \$4.9 million, and \$6.6 million in 2008, 2007, and 2006, respectively.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Effective January 1, 2008, GRE adopted the provisions of FASB Statement No. 157, *Fair Value Measurements*, with respect to fair value measurements of financial assets and liabilities. Under FASB Statement No. 157, fair value is the price to sell an asset or transfer a liability between market participants as of the measurement date. Fair value measurements assume the asset or liability is exchanged in an orderly manner; the exchange is in the principal market for that asset or liability (or the most advantageous market when no principal market exists); and the market participants are independent, knowledgeable, able, and willing to transact an exchange. FASB Statement No. 157 also clarifies that the reporting entity's nonperformance risk (credit risk) should be considered in valuing liabilities.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133*, which requires enhanced disclosures about an entity's derivative and hedging activities, including how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FASB Statement No. 161 was effective on January 1, 2009. GRE does not expect that the adoption of FASB Statement No. 161 will have a material impact on our consolidated financial statements.

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In December 2008, the FASB issued FASB Staff Position No. FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, which defers the effective date of FIN No. 48 for entities that do not meet the definition of a public enterprise in accordance with FASB Statement No. 109. As a result, GRE has elected to defer adopting FIN No. 48 until fiscal year 2009. GRE has a policy of annually evaluating current tax positions to determine if any are uncertain.

3. LEASING TRANSACTIONS

1996 Sale/Leaseback — On December 30, 1996, GRE entered into a 60-year sale/leaseback transaction involving a portion of its interest in CCS. On December 10, 2008, a termination agreement was executed with all parties, ending the lease.

At the inception of the sale/leaseback transaction, a portion of the plant was sold for \$100 million, of which \$3 million was used to pay transaction costs, a \$12.7 million gain was realized by GRE and the proceeds used to fund utility plant expenditures, \$55.3 million was invested in a finance obligation deposit, and \$6.1 million was invested as a debt deposit. The interest on these investments was used to pay rent under the lease. The remaining \$22.9 million funded an equity deposit used to purchase securities of which \$9.3 million was invested short term with maturities to match scheduled basic rent payments that have been made, and \$13.6 million was invested in high-grade investments with a 23-year maturity. This investment was to accrete in value to allow GRE to fully fund a fixed-price purchase option at the end of the lease term.

GRE's \$12.7 million gain was deferred and recognized ratably over the initial 23-year lease period. The remaining deferred amount as of December 31, 2007, was \$6.5 million. An additional \$.5 million was recognized in 2008 prior to the termination date and \$6.0 million was subsequently recognized at the termination date.

The initial finance obligation and corresponding investment of \$55.3 million were not presented in the consolidated balance sheets as the sale/leaseback agreements provided for the owner participant to pursue the obligor on the investment (which was pledged to the owner participant) before pursuing GRE, permitting the related investment and debt to be netted for financial reporting purposes. The outstanding balance of the finance obligation was \$63.6 million as of December 31, 2007.

As of December 31, 2007, the debt deposit investment (see Note 6) and the related obligation (see Note 4) were recorded in the consolidated balance sheets at \$7.3 million because GRE remained primarily liable for the obligation. The investment was liquidated on December 10, 2008, to satisfy the obligation at lease termination, resulting in an immaterial effect on the recorded gain.

As of December 31, 2007, the equity deposit investment was recorded in restricted investments – lease termination, and the obligation was recorded in lease termination obligation on the consolidated balance sheets, both in the amount of \$29.0 million. The investment was liquidated following the lease termination at a market value of \$37.4 million and the proceeds substantially offset GRE's \$40.2 million termination obligation payment to the owner participant.

The termination resulted in a gain of \$3.0 million in 2008, which is recorded in other income – net in the consolidated statements of revenues, expenses, and members' patronage capital. The following is an analysis of the gain (in millions):

Lease termination obligation payment	\$ (40.2)
Proceeds from equity deposit investment liquidation	37.4
Recognition of unamortized deferred gain	6.0
Legal costs	<u>(0.2)</u>
Recognized gain at termination	<u>\$ 3.0</u>

The sale/leaseback transaction was accounted for as a financing, wherein the property remained in the consolidated books and continued to be depreciated as described in Note 1. Legal title and mortgage obligations were held by GRE over the lease term.

Operating Leases — GRE is the lessee on various operating leases used for equipment used in its operations. These transactions are governed by the terms of various master lease agreements. The lease term of each leased item is determined at the time it is added to its respective master lease, and terms currently range from 24 to 84 months. Rent expense was \$2.0 million in 2008, \$2.1 million in 2007, and \$1.7 million in 2006. As of December 31, 2008, the following is the schedule of future minimum lease payments (in thousands):

Years Ending December 31	
2009	\$ 1,471
2010	1,308
2011	1,152
2012	1,084
2013	412
Thereafter	<u>17</u>
	<u>\$ 5,444</u>

Capital Leases — GRE is the lessee of a dragline used in the Falkirk coal mining operations (see Note 1). The original lease agreement was due to expire in 2005. GRE amended this lease in 2001 to extend the term to 2015, at which time GRE will purchase the asset for \$1. The gross amount of this lease was \$48.3 million at December 31, 2008 and 2007. The accumulated amortization of this lease was \$41.3 million and \$40.2 million as of December 31, 2008 and 2007, respectively. GRE has the right of first refusal, should a disposition of property occur. The principal and interest payments were \$1.6 million for 2008 and 2007.

Falkirk has also leased certain equipment that is used in mining operations. The gross amount of these leases was \$73.7 million and \$66.7 million and the accumulated amortization was \$21.8 million and \$14.9 million, respectively, as of December 31, 2008 and 2007. These amounts are recorded in coal mine plant and accumulated depreciation and amortization in the consolidated balance sheets. The schedule of future minimum lease payments for both GRE and Falkirk leases as of December 31, 2008, is as follows (in thousands):

Years Ending December 31	Falkirk	GRE
2009	\$ 10,777	\$ 2,400
2010	8,869	1,600
2011	8,825	1,600
2012	7,068	1,600
2013	7,318	1,600
Thereafter	<u>23,459</u>	<u>2,400</u>
Total minimum lease payments	66,316	11,200
Amounts representing interest	<u>(12,001)</u>	<u>(2,266)</u>
Present value of minimum lease payments	54,315	8,934
Current maturities	<u>(8,300)</u>	<u>(1,600)</u>
Long-term capital lease obligations	<u>\$ 46,015</u>	<u>\$ 7,334</u>

4. LONG-TERM OBLIGATIONS

The consolidated long-term obligations as of December 31, 2008 and 2007, are as follows (in thousands):

	2008	2007
First Mortgage Bonds, Series 2007A, 5.829%, due 2008–2017	\$ 489,700	\$ 560,900
First Mortgage Bonds, Series 2007A, 6.254%, due 2018–2038	739,100	739,100
First Mortgage Bonds, Series 2008A, 7.233%, due 2009–2038	400,000	
First Mortgage Bonds, Series 2008B, 3.0999%, due 2009–2023	25,000	
Syndicated Credit Facility, National Rural Utilities Cooperative Finance Corp, 1.03% to 4.73% at December 31, 2008, due 2011	315,000	285,000
National Rural Utilities Cooperative Finance Corporation, 5.40% to 7.00%, due 2010	34,847	34,847
Anoka County, MN, National Rural Utilities Cooperative Finance Corporation Solid Waste Disposal Revenue Bonds, 6.95%		2,650
Capitalized lease obligations, mining equipment, 1979 lease, 6.3% imputed interest	8,934	9,921
AMBAC Indemnity Corporation, 7.35%		7,325
Department of Energy, 0.00% due 2009–2028, imputed interest at various rates	7,764	5,177
Capitalized lease obligations, Falkirk Mine, 6.00% to 7.50% imputed interest	54,315	53,546
Other — at various rates and maturities	7,100	3,536
Less unamortized bond discount	<u>(16,125)</u>	<u>(12,376)</u>
	2,065,635	1,689,626
Current maturities	<u>(78,122)</u>	<u>(82,039)</u>
Net long-term debt	<u>\$1,987,513</u>	<u>\$1,607,587</u>

On July 2, 2007, GRE issued the 2007A bonds in the amount of \$1.3 billion. The proceeds from the bonds were used to retire Federal Financing Bank, Rural Utilities Service (RUS), and a portion of the National Rural Utilities Cooperative Finance Corporation (CFC) debt, pay the offering expenses associated with the issuance of the bonds, and for other general purposes. All of the obligations under the RUS mortgage have been satisfied and its lien is discharged. In connection with the issuance of the 2007A bonds and satisfaction of debt under the RUS mortgage, GRE entered into an Indenture of Mortgage, Security Agreement, and Financing Statement (Indenture), which requires GRE to establish and collect rates reasonably expected to yield a specified margins-for-interest level. Substantially all of the tangible assets of GRE and the power purchase and transmission service contracts with the members (see Note 1) are pledged as security under the Indenture.

GRE has a \$600 million unsecured five-year revolving credit facility for which CFC is the administrative agent. This facility expires on December 1, 2011. At December 31, 2008 and 2007, the outstanding balance of this facility was \$315 million and \$285 million, respectively. These amounts are recorded in long-term obligations in the consolidated balance sheets. GRE also has an unsecured line of credit facility with CoBank ACB (CoBank) for \$100 million. This facility is renewable annually as to terms and conditions, and the principal balance must be paid in full within one business day of expiration unless unilaterally extended by CoBank. This facility expires on October 31, 2009, and we plan to renew. Borrowings from the facility were \$60.7 million as of December 31, 2008 and 2007, respectively, which are recorded in obligations under lines of credit in the consolidated balance sheets.

As of December 31, 2008, GRE has guaranteed \$1.8 million of rural development loans that various member systems have secured from RUS. The guaranteed loans are collateralized in the form of land, buildings, or equipment. No liability has been recorded in the consolidated financial statements related to these guarantees as of December 31, 2008 and 2007.

As of December 31, 2008, future maturities on long-term obligations are as follows (in thousands):

**Years Ending
December 31**

2009	\$ 78,122
2010	112,350
2011	390,909
2012	76,431
2013	70,641
Thereafter	<u>1,337,182</u>
	<u>\$ 2,065,635</u>

Cash payments for interest were \$101.4 million, \$63.9 million, and \$76.2 million in 2008, 2007, and 2006, respectively. Interest on borrowed funds in the amount of \$18.8 million, \$9.1 million, and \$5.1 million was capitalized in 2008, 2007, and 2006, respectively (see Note 1) and are included in the cash payments noted above.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB Statement No. 157 establishes a framework for measuring fair value by creating a hierarchy for observable independent market inputs and unobservable market assumptions and expands disclosures about fair value measurements. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

A description of the inputs used in the valuation of assets and liabilities are as follows:

Level 1 — Inputs represent unadjusted quoted prices for identical assets or liabilities exchanged in active markets.

Level 2 — Inputs include directly or indirectly observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities exchanged in active or inactive markets; quoted prices for identical assets or liabilities exchanged in inactive markets; other inputs that are considered in fair value determinations of the assets or liabilities.

Level 3 — Inputs include unobservable inputs used in the measurement of assets and liabilities. Management is required to use its own assumptions regarding unobservable inputs because there is little, if any, market activity in the assets or liabilities or related observable inputs that can be corroborated at the measurement date.

As of December 31, 2008, GRE has money market accounts and commercial paper, included in cash and cash equivalents, valued at a fair value of \$233.8 million using quoted prices in active markets for identical assets as the fair value measurement (Level 1).

As of December 31, 2008, GRE has recorded derivative instruments at a fair value of \$69.1 million using significant other observable inputs as the fair value measurement (Level 2). These derivatives relate to interest rate swap contracts. The fair value is determined by comparing the difference between

the net present value of the cash flows for the swaps at their initial fixed rate and the current market fixed rate. The initial fixed rate is quoted in the swap agreement and the current market fixed rate is corroborated by observable market data.

6. INVESTMENTS

GRE's investments are classified as held to maturity and reported at amortized cost using the specific identification method. As of December 31, 2008 and 2007, the amount of investments at amortized cost and fair market value were as follows (in thousands):

	Amortized Cost	Gross		Fair Value
		Unrealized Gains	Unrealized Losses	
2008				
Long-term investments — held-to-maturity securities:				
Federated treasury fund	\$ 15,085	\$ -	\$ -	\$ 15,085
CFC term certificates	20,197			20,197
Investments for deferred compensation	<u>7,518</u>	<u> </u>	<u> </u>	<u>7,518</u>
	<u>\$ 42,800</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 42,800</u>
2007				
Long-term investments — held-to-maturity securities:				
Treasury bonds and notes	\$ 43,895	\$ 9,046	\$ -	\$ 52,941
CFC term certificates	21,368			21,368
Investments for deferred compensation	10,633			10,633
Municipal bonds	2,713			2,713
Guaranteed investment contracts	7,302			7,302
Commercial paper	<u>18</u>	<u> </u>	<u> </u>	<u>18</u>
	<u>\$ 85,929</u>	<u>\$ 9,046</u>	<u>\$ -</u>	<u>\$ 94,975</u>

Reported as:

	2008	2007
Funds reserved for debt service	\$ 15,085	\$ 17,595
Restricted investments — deferred compensation	7,518	10,633
Restricted investments — lease deposit		7,302
Restricted investments — lease termination		29,031
Other investments — principally CFC	<u>20,197</u>	<u>21,368</u>
	<u>\$ 42,800</u>	<u>\$ 85,929</u>

As of December 31, 2008, investment maturities at amortized cost are as follows (in thousands):

One to five years	\$ 19,442
Greater than ten years	<u>23,358</u>
	<u>\$ 42,800</u>

Interest income received on all investments was \$8.6 million, \$13.4 million, and \$6.4 million in 2008, 2007, and 2006, respectively. This income is recorded in interest income in the consolidated statements of revenues, expenses, and members' patronage capital.

7. INCOME TAXES

GRE is a taxable cooperative and is allowed a deduction for margins allocated to members.

GRE had no regular federal income tax expense during 2008 and 2007 due to a net loss position. This net loss position was the result of the allocation of margins to members, depreciation deductions, and the deduction of certain costs for income tax reporting purposes, which were deferred for financial reporting purposes.

The consolidated deferred income taxes as of December 31, 2008 and 2007, were as follows (in thousands):

	2008	2007
Current deferred income tax assets — net	<u>\$ 12,335</u>	<u>\$ 11,130</u>
Noncurrent income tax asset — net:		
Long-term deferred tax asset	\$ 14,393	\$ 9,118
Long-term deferred tax liability	<u>(11,714)</u>	<u>(6,971)</u>
Total deferred tax asset	<u>\$ 2,679</u>	<u>\$ 2,147</u>
Noncurrent income tax liability — net:		
Long-term deferred tax liabilities	\$ 110,385	\$ 89,476
Long-term deferred tax assets	<u>(98,073)</u>	<u>(79,530)</u>
Total deferred income tax liability	<u>\$ 12,312</u>	<u>\$ 9,946</u>

The noncurrent income tax asset — net is recorded in deferred charges in the consolidated balance sheets.

These deferred taxes result from differences in the recognition of accounting transactions for tax and financial reporting purposes. The primary temporary differences relate to depreciation, the sale and leaseback transaction, deferred charges, retirement benefits, and certain financial reserves not deductible for tax purposes until paid.

As of December 31, 2008, GRE had a federal net operating loss (NOL) of \$193.6 million that can be used to offset taxable income in the carryforward period. These NOLs expire in varying amounts from 2024 through 2028. GRE has a tax credit carryforward of \$4.8 million and a prepaid alternative minimum tax (AMT) credit of \$0.6 million. The AMT credit has no expiration.

8. PENDING LITIGATION, CONTINGENCIES, AND COMMITMENTS

Midwest Independent System Operator (MISO) — The MISO market began on April 1, 2005. Due to the nature of this market, various disputes and resettlements have taken place and some are still in process. It is the opinion of management that the resolution of the various open MISO disputes and resettlements will not have a material effect on the consolidated financial position, results of operations, or cash flows.

Litigation — GRE is involved in various legal actions arising in the normal course of business. It is the opinion of management that the resolution of such actions will not have a material adverse effect on the consolidated financial position, results of operations, or cash flows.

Future Commitments — GRE is committed to the following estimated expenditures under the various purchased power and fuel contracts discussed below (in millions):

	2009	2010	2011	2012	2013	Thereafter	Total
Dairyland Power Cooperative	\$ 64.3	\$ 74.9	\$ 74.1	\$ 67.8	\$ 68.3	\$2,192.8	\$2,542.2
Minnesota Power	19.9	6.6					26.5
Wind Energy Purchases	40.0	40.1	40.1	40.5	40.5	504.5	705.7
Fuel Contracts	<u>12.5</u>	<u>21.1</u>	<u>22.0</u>	<u> </u>	<u> </u>	<u> </u>	<u>55.6</u>
	<u>\$136.7</u>	<u>\$142.7</u>	<u>\$136.2</u>	<u>\$108.3</u>	<u>\$108.8</u>	<u>\$2,697.3</u>	<u>\$3,330.0</u>

Purchased Power Contracts — GRE has a power agreement with Dairyland Power Cooperative (DPC) to share costs and benefits of a 350-megawatt generating unit (Genoa 3) located near Genoa, WI. This agreement remains in effect until the retirement of the unit from service or until the payment in full of all obligations arising from the construction of the unit, whichever is later. Under the agreement, the capacity costs are shared equally by GRE and DPC, and GRE is required to pay additional amounts for the actual energy purchased. GRE's expenses for capacity and energy charges under the agreement were \$47.6 million for 2008, \$39.3 million for 2007, and \$35.2 million for 2006. The estimated future expenditures for this agreement in the table above include amounts through 2038, which is the end of GRE's current planning cycle.

GRE has a long-term power agreement with Minnesota Power for the purchase of 175 megawatts of capacity and associated energy. The contract has a five-year term which ends in 2010. The capacity charge is fixed for the term of the agreement, while energy charges are subject to escalation based upon coal and natural gas prices. GRE's expenses for capacity and energy under the agreement were \$45.5 million for 2008 and \$46.3 million for 2007 and 2006.

GRE has long-term power agreements for the purchase of 317 megawatts of wind energy from various power suppliers. The agreements have terms that began in 2005 and extend to 2028, with various extension options. GRE is obligated to purchase the energy generated from these facilities at fixed prices for the term of the agreements. GRE's expenses for energy purchased under these agreements were \$28.3 million for 2008, \$10.8 million for 2007, and \$9.9 million for 2006.

Fuel Contracts — GRE has a coal purchase agreement with Rio Tinto Energy for coal for the Stanton generating station in North Dakota. GRE also has an agreement with The Burlington Northern Santa Fe Railroad for the delivery of this coal. These agreements end in 2011. GRE's expenses under these agreements were \$18.5 million in 2008, \$15.7 million in 2007, and \$15.2 million for 2006.

9. DEFERRED CHARGES

The amount of deferred charges recorded by GRE as of December 31, 2008 and 2007, is as follows (in thousands):

	2008	2007
Regulatory assets:		
Premiums on refinanced long-term debt	\$ 16,898	\$18,042
Canceled power supply projects	8,074	13,038
Asset retirement obligation	2,785	3,713
Postretirement benefit plans	36,340	11,320
Interest rate hedges	73,877	
Other	<u>1,356</u>	<u> </u>
	139,330	46,113
Other deferred charges	<u>24,318</u>	<u>21,030</u>
Total deferred charges	<u>\$163,648</u>	<u>\$67,143</u>

The regulatory assets are recorded as per the requirements of FASB Statement No. 71 and have all been approved by the board of directors.

Premiums on Refinanced Long-Term Debt — GRE has refinanced various issues of long-term debt, which resulted in the payment of premiums. This amount will be fully amortized by 2038, the maturity date of the 2007A bonds.

Canceled Power Supply Projects — GRE incurred \$14.7 million of charges related to a power supply project, which was canceled in 2003. This amount was amortized over a period of five years, which ended December 31, 2008. GRE also incurred \$10.1 million of costs related to a power supply project, which was canceled in 2007. This amount is being amortized over a period of five years beginning in 2008.

Asset Retirement Obligation — In 2006, GRE deferred \$4.6 million of costs related to an asset retirement obligation. This amount is being amortized over a period of five years beginning in 2007.

Postretirement Benefit Plans — GRE has defined benefit pension plans and a postretirement medical plan for certain employees. GRE is recording a regulatory asset related to items that are normally reported as accumulated other comprehensive income for these plans. This amount will be adjusted each year as a result of the remeasurement of the obligations related to these plans.

Interest Rate Hedges — GRE purchased an interest rate hedge related to the 2008A bonds (see Note 4). The settlement of the hedge resulted in a payment to the hedge counterparty in the amount of \$4.8 million. GRE also purchased interest rate hedges, which have not been settled as of December 31, 2008. These hedges have been recorded as derivative instruments at a fair value liability of \$69.1 million in the consolidated balance sheets. These hedges are related to future debt issues. Settled hedges are amortized over the life of the related debt.

Other Deferred Charges — Other deferred charges primarily relate to unamortized debt issuance costs, deferred income taxes and deferred mining costs.

10. EMPLOYEE BENEFIT PLANS

Pension Plans — GRE has a defined benefit plan that covers certain employees who chose to remain in a defined benefit plan, a nonqualified supplemental defined benefit plan, and a defined contribution plan for the other employees. GRE's defined benefit plan recognized a curtailment during 2008 due to the freezing of benefits for certain highly compensated participants. Falkirk has a defined benefit plan that covers employees hired before December 31, 1999, and a defined contribution plan for the other employees. Changes in benefit obligations and plan assets for all defined benefit plans for the years ended December 31, 2008 and 2007, and the amounts recognized in the consolidated balance sheets as of December 31, 2008 and 2007, were as follows (in thousands):

	2008		2007	
	Falkirk	GRE	Falkirk	GRE
Change in benefit obligation:				
Benefit obligation — beginning of year	\$ 42,395	\$ 50,628	\$ 41,107	\$ 52,175
Service cost	1,058	447	1,074	515
Interest cost	2,685	3,175	2,461	2,985
Actuarial losses (gains)	1,114	1,518	(1,265)	(1,535)
Curtailment		(1,043)		
Benefits paid	<u>(1,038)</u>	<u>(3,567)</u>	<u>(982)</u>	<u>(3,512)</u>
Benefit obligation — end of year	<u>46,214</u>	<u>51,158</u>	<u>42,395</u>	<u>50,628</u>
Change in plan assets:				
Fair value of plan assets — beginning of year	37,171	42,874	33,436	39,508
Actual return on assets	(9,844)	(8,341)	4,713	4,067
Employer contributions	803	1,393	4	2,811
Benefits paid	<u>(1,038)</u>	<u>(3,567)</u>	<u>(982)</u>	<u>(3,512)</u>
Fair value of plan assets — end of year	<u>27,092</u>	<u>32,359</u>	<u>37,171</u>	<u>42,874</u>
Funded status — end of year	<u>\$ (19,122)</u>	<u>\$ (18,799)</u>	<u>\$ (5,224)</u>	<u>\$ (7,754)</u>

As of December 31, 2008 and 2007, amounts recognized as components of net periodic benefit cost are as follows (in thousands):

	2008		2007	
	Falkirk	GRE	Falkirk	GRE
Other noncurrent liabilities	<u>\$ 19,122</u>	<u>\$ 18,799</u>	<u>\$ 5,224</u>	<u>\$ 7,754</u>

As of December 31, 2008 and 2007, amounts not yet recognized as components of net periodic benefit cost are as follows (in thousands):

	<u>2008</u>		<u>2007</u>	
	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>
Transition obligation	\$ -	\$ 581	\$ -	\$ 643
Prior service cost	2,300	277	2,720	446
Accumulated loss (gain)	<u>13,720</u>	<u>19,255</u>	<u>(331)</u>	<u>7,572</u>
	<u>\$ 16,020</u>	<u>\$ 20,113</u>	<u>\$ 2,389</u>	<u>\$ 8,661</u>

The accumulated benefit obligation for the GRE defined benefit pension plans reflected above were \$49.4 million and \$47.9 million as of December 31, 2008 and 2007, respectively. The accumulated benefit obligation for the Falkirk defined benefit pension plan was \$40.1 million and \$36.6 million as of December 31, 2008 and 2007, respectively.

Components of net periodic benefit cost for the GRE and Falkirk defined benefit pension plans as of December 31, 2008, 2007, and 2006, were as follows (in thousands):

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>
Service cost	\$ 1,058	\$ 447	\$ 1,074	\$ 515	\$ 1,096	\$ 578
Interest cost	2,685	3,175	2,461	2,985	2,234	2,860
Expected return on assets	(3,234)	(3,343)	(2,926)	(3,040)	(2,641)	(2,690)
Amortization of prior service cost	330	103	359	102	359	103
Recognized net actuarial loss	5	475	6	909	128	1,240
Curtailment loss		66				
Amortization of net transition obligation		<u>63</u>		<u>63</u>		<u>63</u>
Net periodic benefit cost	<u>\$ 844</u>	<u>\$ 986</u>	<u>\$ 974</u>	<u>\$ 1,534</u>	<u>\$ 1,176</u>	<u>\$ 2,154</u>

The estimated amounts to be amortized from deferred charges into net periodic benefit costs in 2009 are \$0.3 million for the Falkirk plans and \$2.7 million for the GRE plans.

Weighted-average assumptions used to determine benefit obligations for GRE and Falkirk defined benefit pension plans as of December 31, 2008, 2007, and 2006, were as follows:

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>
Discount rate	6.30 %	6.30 %	6.25 %	6.30 %	5.90 %	5.80 %
Rate of compensation increase	3.75	3.75	3.75	3.75	3.75	3.75

Weighted-average assumptions used to determine periodic benefit cost for GRE and Falkirk defined benefit pension plans as of December 31, 2008, 2007, and 2006, were as follows:

	2008		2007		2006	
	Falkirk	GRE	Falkirk	GRE	Falkirk	GRE
Discount rate	6.25 %	6.30 %	5.90 %	5.80 %	5.60 %	5.55 %
Rate of compensation increase	3.75	3.75	3.75	3.75	3.75	3.75
Expected return on assets	9.00	8.00	9.00	8.00	9.00	8.00

GRE's and Falkirk's defined benefit pension plan asset allocation at December 31, 2008 and 2007, were as follows:

	2008		2007	
	Falkirk	GRE	Falkirk	GRE
Equity securities	61 %	47 %	64 %	60 %
Debt securities	37	53	34	36
Other	<u>2</u>	<u> </u>	<u>2</u>	<u>4</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

The equity securities are invested in various mutual funds encompassing a range of investment options. The debt securities are mostly invested in U.S. Treasury or agency securities, with a small portion invested in bond mutual funds. The target allocation, for both GRE and Falkirk, is 60% equity and 40% debt and is rebalanced periodically to maintain that ratio.

To develop the expected long-term rate of return on asset assumptions, GRE and Falkirk considered the historical returns and the future expectations for returns on each asset class, as well as target allocation of the pension portfolio. This resulted in 2008 and 2007 long-term rate of return assumptions of 8.0% for GRE, and 8.5% and 9.0% for Falkirk, respectively.

As of December 31, 2008, the following are the expected future benefits to be paid (in thousands):

Years Ending December 31	Falkirk	GRE
2009	\$ 1,333	\$ 3,424
2010	1,496	3,542
2011	1,763	3,679
2012	2,051	3,913
2013	2,360	4,136
2014–2018	17,292	22,660

GRE and Falkirk expect to make contributions of approximately \$0.4 million and \$1.1 million, respectively, to the defined benefit pension plans during 2009.

GRE has a defined contribution plan that covers all employees not covered in the GRE defined benefit plan. The total cost to GRE for this plan was \$4.0 million, \$3.5 million, and \$3.0 million in 2008, 2007, and 2006, respectively. GRE also made matching contributions to a defined contribution savings plan of \$3.0 million, \$2.6 million, and \$2.2 million in 2008, 2007, and 2006, respectively. Falkirk's contributions to the defined contribution pension plan were \$0.5 million, \$0.4 million, and \$0.3 million for 2008, 2007, and 2006, respectively. Falkirk's contributions to a defined contribution savings plan were \$1.3 million, \$1.2 million, and \$1.1 million for 2008, 2007, and 2006, respectively.

Postretirement Medical Benefits — Employees retiring from GRE who elected to remain in the defined benefit pension plan, have attained age 55, and have at least 10 years of service are entitled to participate in the GRE medical insurance plan. Benefits to the former employees are in the form of monthly payments to cover a portion of the premium charged for participation in the program. Employees retiring from Falkirk also are eligible to participate in Falkirk's medical insurance plan with the benefit in the form of a supplement to the premium.

Costs for the unfunded postretirement medical plan are recognized in the year the employees render service.

Changes in benefit obligations for the years ended December 31, 2008 and 2007, and amounts recognized in the consolidated balance sheets as of December 31, 2008 and 2007, were as follows (in thousands):

	2008		2007	
	Falkirk	GRE	Falkirk	GRE
Change in benefit obligation:				
Benefit obligation — beginning of year	\$ 7,291	\$ 2,926	\$ 5,117	\$ 3,472
Service cost	200	9	139	13
Interest cost	461	168	301	178
Plan amendment	(402)		525	
Actuarial (losses) gains	(134)	(121)	1,564	(313)
Benefits paid	(234)	(303)	(355)	(424)
Benefit obligations — end of year	<u>\$ 7,182</u>	<u>\$ 2,679</u>	<u>\$ 7,291</u>	<u>\$ 2,926</u>

As of December 31, 2008 and 2007, amounts recognized in the consolidated balance sheets are as follows (in thousands):

	2008		2007	
	Falkirk	GRE	Falkirk	GRE
Current liabilities	\$ 536	\$ 363	\$ 455	\$ 359
Other noncurrent liabilities	6,646	2,316	6,836	2,567

As of December 31, 2008 and 2007, amounts not yet recognized as components of net periodic benefit costs are as follows (in thousands):

	<u>2008</u>		<u>2007</u>	
	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>
Prior service credit	\$ (2,933)	\$ (250)	\$ (3,147)	\$ (298)
Accumulated loss	<u>1,806</u>	<u>1,268</u>	<u>2,221</u>	<u>1,496</u>
	<u>\$ (1,127)</u>	<u>\$ 1,018</u>	<u>\$ (926)</u>	<u>\$ 1,198</u>

Components of net periodic postretirement benefits cost (credit) for December 31, 2008, 2007, and 2006, were as follows (in thousands):

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>	<u>Falkirk</u>	<u>GRE</u>
Service cost	\$ 200	\$ 9	\$ 139	\$ 13	\$ 163	\$ 21
Interest cost	461	168	301	178	321	195
Amortization of prior service credit	(493)	(49)	(562)	(49)	(614)	(48)
Recognized net actuarial losses	<u>178</u>	<u>107</u>	<u>19</u>	<u>135</u>	<u>174</u>	<u>131</u>
Net periodic benefit cost (credit)	<u>\$ 346</u>	<u>\$235</u>	<u>\$ (103)</u>	<u>\$277</u>	<u>\$ 44</u>	<u>\$299</u>

The estimated amounts to be amortized from deferred charges into net periodic benefit costs in 2009 are a net credit of \$0.4 million for the Falkirk plan and \$0.1 million for the GRE plan.

The weighted-average assumptions used to determine postretirement obligations and net periodic postretirement benefit costs for the years 2008, 2007, and 2006 are the same applicable assumptions used for the defined benefit pension plans.

As of December 31, 2008, the following are the expected future benefit payments to be paid (in thousands):

Years Ending December 31	Falkirk	GRE
2009	\$ 536	\$ 363
2010	593	355
2011	604	355
2012	647	277
2013	689	278
2014–2018	4,314	1,087

The effect of a one percentage point change in health care cost trend rates on service and interest costs is not material in relation to the consolidated financial statements taken as a whole.

11. VALUE OF FINANCIAL INSTRUMENTS

Various methods and assumptions were used to estimate the fair value of each class of the GRE financial instruments for which it is feasible to estimate that value. The carrying amount of restricted investments and cash and cash equivalents approximates the fair value due to the short maturities of the instruments.

For funds reserved for debt service and other investments, principally capital term certificates, the carrying amount is assumed to approximate fair value, as these instruments generally must be held as a condition of financing. The fair value of the long-term obligations is based upon present value models using current rates available. The carrying values of the long-term obligations, other than capital leases, as of December 31, 2008 and 2007, were \$1.99 billion and \$1.62 billion, respectively, and the estimated fair values were \$2.02 billion and \$1.69 billion, respectively.

12. MEMBER RELATED-PARTY TRANSACTIONS

GRE provides electric and other services to the members. GRE received revenue of \$686.1 million, \$586.1 million, and \$510.6 million in 2008, 2007, and 2006, respectively, for these services. GRE also receives various services from the members and paid \$8.4 million, \$6.5 million, and \$5.4 million for these services in 2008, 2007, and 2006, respectively. GRE has accounts receivable from the members of \$127.0 million and \$93.1 million at December 31, 2008 and 2007, respectively. GRE has notes receivable from the members of \$10.3 million and \$12.1 million as of December 31, 2008 and 2007, respectively. These notes were issued at face value and have an effective average interest rate of 5% at December 31, 2008 and 2007.

GRE has notes payable to the members of \$15.0 million and \$18.6 million at December 31, 2008 and 2007, respectively. These notes relate to funds invested with GRE by the members under a member investment program. These funds are used by GRE to reduce short-term borrowings. The members receive investment earnings based on a CFC investment rate adjusted for administrative costs.

13. ASSET RETIREMENT OBLIGATIONS

GRE has adopted FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, and FIN No. 47, *Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement No. 143*. An asset retirement obligation is the result of legal or contractual obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and/or the normal operation of a long-lived asset. GRE allocates the amortization for the offsetting capitalized asset retirement cost to expense using the straight-line method over the remaining useful life of the related long-lived asset being retired.

GRE has recorded obligations related to capping and reclamation of ash disposal sites at its coal-fired power plants, obligations related to future removal and disposal of asbestos, and obligations related to the disposal of equipment containing polychlorinated biphenyls. Falkirk has recorded an obligation related to the costs to close its surface mines and reclaim the land disturbed as a result of normal mining operations. There are no assets legally restricted for purpose of settling these obligations.

GRE also has an obligation to retire its direct current transmission line upon abandonment. This line transmits the energy from the CCS in North Dakota to the GRE service territory in Minnesota. GRE has not recorded a liability related to this obligation because the fair value cannot be reasonably estimated due to the retirement date being indefinite at this time.

A reconciliation of the beginning and ending aggregate carrying amount of the obligations as of December 31, 2008 and 2007, is as follows (in thousands):

	2008	2007
Balance — beginning of year	\$ 23,230	\$ 22,416
Obligations recorded as a result of change in estimated cash flows	1,340	(433)
Accretion expense	1,456	1,387
Obligations settled	<u>(167)</u>	<u>(140)</u>
Balance — end of year	<u>\$ 25,859</u>	<u>\$ 23,230</u>

These obligations are recorded in other noncurrent liabilities in the consolidated balance sheets. The obligations settled are the only transactions recognized in the statements of cash flows.

14. BLUE FLINT ETHANOL LLC

Blue Flint Ethanol LLC (Blue Flint) was formed in June 2005 by GRE and HES Ethanol Holdings, LLC (HES), with each having respective ownership percentages of 49% and 51%. Blue Flint was formed for the purpose of building and operating a corn ethanol plant located near Falkirk, ND, with an annual production capacity of approximately 50 million gallons. Blue Flint began ethanol production in February 2007. GRE and HES collectively contributed equity of 20% of the estimated \$95.5 million construction costs, with the balance debt financed. The investment is recorded using the equity method of accounting. The following is the investment activity through December 31, 2008 (in thousands):

	2008	2007	2006
Beginning equity investment balance	\$ 9,127	\$ 8,198	\$ -
Cash invested		961	9,359
GRE's share of Blue Flint's (loss) income	(1,111)	540	(673)
GRE's share of Blue Flint's other comprehensive loss	<u>(659)</u>	<u>(572)</u>	<u>(488)</u>
Ending equity investment balance	<u>\$ 7,357</u>	<u>\$ 9,127</u>	<u>\$ 8,198</u>

In 2008, GRE recorded \$2.4 million of income from the state of North Dakota ethanol producer's fund. This amount, along with GRE's share of Blue Flint's net income or loss, are recorded in nonutility operations in the consolidated statements of revenues, expenses, and members' patronage capital. GRE's share of Blue Flint's accumulated other comprehensive losses relate to an interest rate swap agreement designated as a cash flow hedge, which Blue Flint recorded at fair value. GRE had accounts receivable from Blue Flint of \$0.5 million as of December 31, 2008 and 2007.

15. GREAT AMERICAN ENERGY

GRENAC, LLC d/b/a Great American Energy (GAE) was formed in February 2007 by GRE and The North American Coal Corporation (NACC), with each having an equal ownership share. GAE will develop, construct, and own a coal load out facility, which will be used to provide refined coal to GRE's Spiritwood Generating Station, currently being constructed near Jamestown, North Dakota, and to other third parties. GRE has made equity contributions through December 31, 2008, of \$4.9 million. The investment is recorded using the equity method of accounting. GRE recorded its share of GAE's net losses through December 31, 2008, of \$0.1 million resulting in an investment of \$4.8 million as of December 31, 2008.

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