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EKPC Leaders Commit to Work Closely With PSC To Address Concerns

WINCHESTER, Ky.—The leaders of East Kentucky Power Cooperative (EKPC) committed to work closely with the Kentucky Public Service Commission (PSC) to address issues identified in a consultant’s audit report, which was released Thursday.

“Our Board is committed to working with the Public Service Commission to do what is necessary to bring about meaningful and comprehensive change in the Board and management of East Kentucky Power Cooperative,” said Wayne Stratton, chairman of EKPC’s board of directors. “Our entire Board takes very seriously the findings, conclusions and recommendations contained in this report.”

Stratton also pledged to work with the Commission to protect EKPC’s financial integrity. The cooperative experienced financial challenges in recent years. Stratton noted EKPC has had four consecutive years of positive margins totaling more than \$110 million.

“East Kentucky Power Cooperative’s financial condition is improving and we are confident it is on the right track,” Stratton said.

In December 2008, the PSC ordered the audit after expressing concerns about EKPC’s financial condition and about the structure of EKPC’s board of directors. Liberty Consulting Group conducted the audit and developed the report, which contains findings, conclusions and recommendations that are critical of EKPC’s board and management.

Already, EKPC is taking steps to address many of the issues raised in the report, Stratton said. The Board has engaged a consultant to comprehensively assess and enhance governance policies, guidelines and practices, with emphasis on industry best practices. The Board and management also are launching a fresh strategic planning initiative to establish the course for the organization.

Anthony “Tony” Campbell, President & CEO of the EKPC, noted the cooperative has taken additional steps to respond immediately:

- Filled the position of internal auditor.
- Enacted a Whistle Blower policy.
- Updated EKPC’s 20-year financial forecast and it includes potential costs associated with government regulation of carbon emissions.

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- Conducting a comprehensive assessment of risk management and developing a risk diagnostic tool to identify, assess and help mitigate risk.
- Held discussions with other electric utilities about opportunities to partner in order to reduce costs and leverage capabilities
- Evaluating forced outage insurance as a possible means of mitigating risk.
- Evaluating the need for additional interconnections on our transmission system.
- Evaluating membership in a regional transmission organization, and the costs and benefits that might offer.

“This audit report details opportunities to improve,” Campbell said. “Working hand in hand with the Commission, we will seize those opportunities and we will become a better organization.”

EKPC is a not-for-profit, member-owned generation and transmission (G&T) cooperative. EKPC generates electricity at power plants and transmits it over high-voltage transmission lines to 16 member-owner cooperatives. Those 16 cooperatives, which also are not-for-profit and member-owned, serve more than 500,000 homes, farms and businesses in 87 Kentucky counties. The board of each of the 16 cooperatives chooses a member of its board to serve on EKPC’s board of directors.

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EKPC is a not-for-profit organization providing wholesale electricity to 16 distribution cooperatives that serve 500,000 Kentucky homes, farms, businesses and industries across 87 counties. EKPC provides power through plants located in Mason, Clark and Pulaski counties, renewable energy plants in Boone, Laurel, Greenup, Hardin and Pendleton counties, along with gas peaking units, hydro power and more than 2,800 miles of transmission lines. Nearly 8 percent of EKPC’s generating capacity comes from renewable sources. Together, EKPC and the member cooperatives are known as Kentucky’s Touchstone Energy Cooperatives.

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April 22, 2010, statement of Wayne Stratton, Chairman of the Board of Directors of East Kentucky Power Cooperative, regarding release of Liberty Consulting Group's audit report:

Today, the Kentucky Public Service Commission released a report by the Liberty Consulting Group summarizing an audit of the Board and management of East Kentucky Power Cooperative.

East Kentucky Power Cooperative's entire Board takes very seriously the findings, conclusions and recommendations contained in this report. We are determined to see our Board and management processes enhanced. In response to this report, our Board is committed to working with the Kentucky Public Service Commission to do what is necessary to bring about meaningful and comprehensive change in the Board and management of East Kentucky Power Cooperative.

For several years now, the Commission has expressed concerns about the cooperative's financial well-being. As Board members, we recognize our fiduciary responsibility to protect EKPC's financial integrity. We are committed to meeting that responsibility.

Certainly, our cooperative has experienced financial challenges. But East Kentucky Power Cooperative's financial condition is improving and we are confident it is on the right track. Our cooperative has had four consecutive years of positive margins, totaling more than \$110 million. This is good news. But our Board will remain diligent. We must continue to build our Cooperative's equity, and the Board is committed to making that happen. We must ensure that our cooperative implements our industry's best practices in order to have the proper internal checks and balances in place to protect East Kentucky Power Cooperative's financial integrity. Our Board and management will work with the Kentucky Public Service Commission to ensure continued financial improvement of our cooperative.

We are committed to ensuring that our board structure and decision-making processes are fundamentally sound. To that end, the Board has engaged the National Consulting Group, a business unit of the National Rural Electric Cooperative Association. The National Consulting Group is leading our Board in an initiative to comprehensively assess and enhance the governance policies, guidelines and practices.

Our goal is to identify and implement our industry's best practices in Board governance. As part of this assessment, we will look at best practices in Board structure, composition, qualifications, education, training, development and compensation. We are committed to improving our Board members' engagement in the business of East Kentucky Power Cooperative. As Board members, we understand this means rolling up our sleeves, working harder and devoting more time to preparing for and participating in Board and committee meetings. It means engaging in the hard work of decision-making. We will work with the Public Service Commission to ensure we are taking the right steps to be the best we can be.

We recognize the critical importance of constant strategic planning. The National Consulting Group also is leading our Board and management in an initiative to renew East Kentucky Power Cooperative's strategic plan. Once our strategic plan has been reinvigorated, then strategic planning will become a living, ongoing process at East Kentucky Power Cooperative, not a chore to be performed once every few years. Going forward, strategy will be a part of every Board meeting.

We are committed to working with the Public Service Commission to bring about fundamental, meaningful change. Such change does not occur overnight. But we are committed to making it happen as quickly as possible.

With me today is Tony Campbell, the President and CEO of East Kentucky Power Cooperative. The Board hired Tony 10 months ago, when Liberty was just beginning its work to collect information about our cooperative. Like the Board members, Tony has a set of challenging tasks ahead of him. Certainly, this audit report points to many areas where Tony's leadership will be critical. The Board and I have great confidence that Tony Campbell is the right person to lead the management of this organization forward, and to work with the Board and the Public Service Commission to make certain we are heading in the right direction. Certainly, the Board will be working very closely with Tony to make sure our management team is taking the steps necessary to properly infuse organizational change, particularly changes in our cooperative's strategy.

We are a cooperative. That means East Kentucky Power Cooperative is owned by the organizations it serves. And each of those organizations is a cooperative, which is owned by the people and businesses they serve. Our business model is fundamentally different than other models. And the cooperative model works. Decades ago, the cooperatives brought electricity to some of the most remote parts of Kentucky and the United States. Today, they continue to provide reliable, affordable electric service to remote areas and rural areas, as well as some of the most rapidly developing areas of our Commonwealth.

Sixteen distribution cooperatives own East Kentucky Power Cooperative. Together, our cooperatives serve more than 500,000 homes, farms and businesses in 87 counties. For more than 60 years, East Kentucky Power Cooperative has provided affordable, reliable electricity for Kentuckians. We are confident East Kentucky Power Cooperative will be around for many years to come.

We look forward to the opportunity to work with Liberty Consulting Group and the Kentucky Public Service Commission to implement strategies and tactics that will make East Kentucky Power Cooperative a better organization and one that can be held up nationally as an example of demonstrating best practices among cooperatives nationwide.

April 22, 2010, statement of Anthony “Tony” Campbell, President & CEO of East Kentucky Power Cooperative, regarding the release of the Liberty Consulting Group’s audit report:

When I came to East Kentucky Power Cooperative 10 months ago I saw an organization that had experienced some challenges in recent years, as have many electric utilities across the nation. But I also saw an organization that is recognized among generation and transmission cooperatives nationwide as a leader. East Kentucky Power Cooperative has a long history of blazing trails for other cooperatives around the country with initiatives like helping to establish the Touchstone Energy brand, the Cooperative Finance Corp. and the National Renewables Cooperative Organization. I’m proud to be part of an organization that has demonstrated time and again its commitment to looking down the road, and striving to find ways to become better.

The electric utility industry is extremely complex, and it becomes more complex each day. And, of course, this is an industry that is extremely capital intensive. We are called upon to make decisions that cost millions of dollars. So cost and complexity certainly are challenges in our industry. And we must always keep in mind that more than 1.5 million Kentuckians depend on us to provide reliable, affordable power. Those people and businesses who are served by our 16 member cooperatives deserve the assurance that the Board and management of East Kentucky Power Cooperative are making decisions in the most thorough, most professional manner possible.

I’m committed to working with the Kentucky Public Service Commission to make that happen. I see a lot of opportunity to improve the management of East Kentucky Power Cooperative. We can do better and we will do better. This audit report details many opportunities to improve. Working hand in hand with the Commission, we will seize those opportunities and we will become a better organization.

We first began learning the findings of this audit report during discussions last year with the Public Service Commission and with Liberty Consulting. We immediately recognized opportunities to improve and we immediately began implementing changes.

- We have filled the position of internal auditor.
- Our Board has enacted a Whistle Blower policy.
- Board and senior management have participated in a CEO Transition Workshop that focused on establishing clear communication, expectations, working relationships and procedures to assist me as a new CEO.
- We have updated our 20-year financial forecast and it includes potential costs associated with government regulation of carbon emissions.
- We have been talking with other electric utilities about opportunities to partner in order to reduce costs and leverage capabilities.

- We are evaluating forced outage insurance as a possible means of mitigating risk.
- We are evaluating the need for additional interconnections on our transmission system.
- We are evaluating membership in a regional transmission organization, and the costs and benefits that might offer.

And it's also important to note that East Kentucky Power Cooperative's executive team has undergone and is undergoing significant changes. I've shifted some duties around. I've created two new executive-level positions. Two vice presidents have moved on to other opportunities. And we currently are conducting a search to replace our CFO who is retiring. I'm committed to having the right people in place to lead this organization and to make it even better.

This audit report talks extensively about the need to improve risk management at East Kentucky Power Cooperative. I agree. Very soon after I started, I recognized the need to make improvements. So we have brought in two consulting firms to conduct a comprehensive assessment of risk management throughout the organization and to establish a risk diagnostic tool to help us better identify, assess and mitigate risks in an organized and systematic manner. In addition, risk management policies are being updated, and a new internal risk management committee is being formed, among others. These committees will be populated with EKPC risk management employees, along with outside risk management experts.

The strategic planning process that Mr. Stratton discussed will set the direction for this organization. It will help us address many of the recommendations in the management section of the report, including those related to assets, power supply portfolio, financial targets and budgeting.

We understand how critical it is that EKPC's financial integrity remains strong. I am committed to continuing to build EKPC's equity. I believe we are now headed in the right direction, but we need to maintain our momentum to continue that improvement. In today's world of volatile fuel and commodity prices, financial and credit market uncertainty, and increased environmental regulation, that will certainly be a challenge, but it is one that I sincerely believe EKPC can meet.

In coming days, EKPC will be filing two requests with the Public Service Commission that are important to maintaining our cooperative's financial integrity.

First, EKPC will be requesting the PSC's approval to establish a three-year revolving credit facility not to exceed \$500 million. This credit facility will replace EKPC's existing \$650 million revolving credit facility, which expires later this year, and which has been paid down significantly. This revolving credit facility is utilized by EKPC as liquidity. It is necessary to provide critical interim financing for essential capital-intensive projects until permanent financing is established.

And let me clarify that this credit facility is not related to EKPC's recent withdrawal of its request for PSC approval to establish private financing for the Smith #1 unit. As we said when that request was withdrawn, EKPC intends to step back and reassess its immediate needs for financing that project, but we intend to refile the request pending the outcome of that reassessment.

Also in coming days, EKPC will be filing notice of our intent to ask for a base rate increase to provide an additional \$50 million in annual revenue. We will request the increase go into effect Jan. 1, 2011. For the typical household served by one of our member owners, this increase will amount to, on average, about \$4 per month.

Please note, EKPC's decision to request a rate increase is not being driven by this audit process. Rather, it is a prudent business decision that was made sometime back following normal, ongoing, and comprehensive analyses of our cooperative's projected costs, revenues and financial needs. That analysis indicated EKPC will need a rate increase in 2011 in order to continue on the aggressive equity-building program currently in place, and to strengthen our cooperative's overall financial condition. Therefore, management recommended and the Board approved this request for a rate increase.

We recognize the need to balance the undeniable tension between keeping EKPC financially strong and holding the line on rate increases. We realize that many of our member-owner customers are suffering from the recent recession, and EKPC is committed to minimize the rate impact on them. Certainly, we have taken steps to keep costs in check. In fact, last year our efforts at cost containment produced savings of \$48 million, a great improvement over our savings goal of \$24 million.

The Board and management recognize the need to protect EKPC's financial integrity and to improve our organization. I've seen the dedication of our Board members. I believe they are willing to do the hard work necessary to make us a better cooperative. Since I've been at EKPC, I can tell you I've seen the Board's engagement improve significantly. Board meetings are lasting much longer and our Directors are very engaged in productive discussions about the business of this organization.

I mentioned that EKPC has been a pioneer among cooperatives. I see this audit report as an opportunity to lead the way again, this time as a model for best practices for the management of generation and transmission cooperatives nationwide.

In closing I pledge to continue working side-by-side with the Kentucky Public Service Commission. With the Commission's help, the patience of our members, the hard work and dedication of EKPC employees, and the hard work and dedication of our Board of Directors, we can ensure that East Kentucky Power Cooperative remains financially strong and is able to provide safe and reliable electric service at an affordable rate to its customers.