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United States Department of Agriculture
Rural Development

Business and Cooperative Programs • Housing and Community Facility Programs • Utilities Programs
Washington, DC 20250

February 19, 2008



Mr. Tim Gregori
General Manager
Southern Montana Electric
Generation and Transmission Cooperative, Inc.
23521 Gabel Rd., Suite 5
Billings, Montana 59102-7310

Dear Mr. Gregori:

I fully understand and appreciate the dilemma that the members of Southern Montana Electric are facing with the loss of power now supplied to your members by the Bonneville Power Administration.

I have been closely and carefully monitoring the developments with the proposed Highwood Generation Station. The inherent risks associated with compounded delays make the situation more problematic as well as increasing the cost of the plant which will be passed on in the form of higher member rates raise concerns about financial feasibility.

Additionally, as you know, the Agency is precluded from financing base load generation plants in Fiscal Year 2008 and I suspect that will be the situation in Fiscal year 2009. Costs will continue to increase throughout this period.

With all the facts considered: No base load generation loans probably though 2009; continued cost increases further exacerbated by the added time to reach loan approval; the feasibility of the project with extra time and additional cost; and the uncertainty of the litigation now filed compels me to inform you the Agency will not be able to finance the

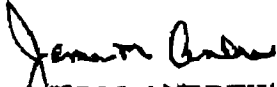
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proposed Highwood Station Plant. Add to the above facts concern exists that approximately 40 percent of Southern Montana's capacity in the proposed plant is not under contract through the entire term of the proposed financing from the Agency.

Sincerely,



JAMES M. ANDREW
Administrator
Utilities Programs
JMA/cpe

cc: **Bill FitzGerald, President**
John Prinkki, Vice President
Robert F. Harl
Joe Dirksen
Gerhard Helm