

Report of Management

Management is responsible for the preparation of all information contained in this Annual Report, including the financial statements. Management uses its best judgment to ensure that such statements reflect fairly the financial position, results of operations and cash flows of the Association. Tri-State maintains a system of internal controls that is designed to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in conformity with U.S. generally accepted accounting principles and that assets are safeguarded. The Board of Directors, through its Finance Committee consisting only of directors, has responsibility for determining that management fulfills its responsibilities for the preparation of financial statements and financial control of operations. The Finance Committee meets periodically with management and the independent auditors to discuss internal control, financial reporting and auditing matters.

Report of Independent Auditors

The Board of Directors of Tri-State Generation and Transmission Association, Inc.

We have audited the accompanying consolidated statements of financial position of Tri-State Generation and Transmission Association, Inc. (the Association) as of December 31, 2010 and 2009, and the related consolidated statements of operations, equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Association'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 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. We were not engaged to perform an audit of the Association's internal control over financial reporting. Our audits included 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 the Association'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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Association at December 31, 2010 and 2009, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2010 in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 16, 2011 on our consideration of the Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The logo for Ernst & Young LLP, featuring the company name in a stylized, cursive script font.

February 16, 2011

Consolidated Statements of Financial Position

<i>As of December 31, (Thousands)</i>	2010	2009
ASSETS		
Electric plant		
In service	\$ 4,313,089	\$ 4,163,867
Construction work in progress	201,011	133,111
Total electric plant	4,514,100	4,296,978
Less allowances for depreciation and amortization	(1,616,952)	(1,502,234)
Net electric plant	2,897,148	2,794,744
Other assets and investments		
Investments in other associations	113,436	110,368
Investments in coal mines	30,445	30,976
Deferred equity note	8,442	8,851
Other noncurrent assets	15,097	15,549
Total other assets and investments	167,420	165,744
Current assets		
Cash and cash equivalents	205,452	145,585
Deposits and advances	17,094	16,323
Accounts receivable—members	86,063	84,460
Other accounts receivable	29,041	27,783
Coal inventory	39,312	49,371
Materials and supplies	54,780	52,215
Total current assets	431,742	375,737
Deferred charges	297,845	352,530
Total assets	\$ 3,794,155	\$ 3,688,755
EQUITY AND LIABILITIES		
Capitalization		
Patronage capital equity	\$ 713,807	\$ 652,613
Noncontrolling interest	119,983	129,675
Total patronage capital equity and noncontrolling interest	833,790	782,288
Long-term debt	2,491,538	2,509,129
Total capitalization	3,325,328	3,291,417
Current liabilities		
Member advances	8,299	8,539
Accounts payable	80,238	67,465
Accrued expenses	86,929	64,645
Current maturities of long-term debt	146,011	122,486
Total current liabilities	321,477	263,135
Deferred credits and other liabilities	144,367	126,035
Accumulated postretirement benefit and postemployment obligations	2,983	8,168
Commitments and contingencies	—	—
Total equity and liabilities	\$ 3,794,155	\$ 3,688,755

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

Consolidated Statements of Operations

<i>For the years ended December 31, (Thousands)</i>	2010	2009	2008
Operating revenues			
Member electric sales	\$ 981,126	\$ 926,428	\$ 869,960
Non-member electric sales	208,357	209,126	257,837
Other	22,933	28,342	32,841
	1,212,416	1,163,896	1,160,638
Operating expenses			
Purchased power	263,806	242,480	279,132
Fuel	258,767	244,755	246,239
Production	108,067	98,582	93,769
Lease expense	22,711	71,115	64,991
Transmission	102,805	98,300	88,729
General and administrative	18,694	16,514	11,589
Generation maintenance	98,095	83,773	83,907
Transmission maintenance	18,981	16,828	17,849
Depreciation and amortization	131,739	104,973	98,936
Income taxes	(9,738)	7,615	1,954
	1,013,927	984,935	987,095
Operating margins	198,489	178,961	173,543
Other income			
Interest income	20,932	11,013	9,498
Allowance for equity funds used during construction	—	1,306	3,443
Capital credits from cooperatives	6,162	12,712	19,252
Other income	5,203	3,708	3,980
	32,297	28,739	36,173
Interest and other deductions			
Interest expense, net of amounts capitalized	147,243	97,560	97,567
Other deductions	11,138	5,476	5,700
	158,381	103,036	103,267
Net margins including noncontrolling interest	72,405	104,664	106,449
Net loss attributable to noncontrolling interest	4,739	210	—
Net margins attributable to the Association	\$ 77,144	\$ 104,874	\$ 106,449

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

Consolidated Statements of Equity

<i>For the years ended December 31, (Thousands)</i>	2010	2009	2008
Patronage capital equity at beginning of year	\$ 652,613	\$ 557,488	\$ 471,570
Net margins attributable to the Association	77,144	104,874	106,449
Unrealized gain (loss) on securities available for sale	144	251	(531)
Unrecognized actuarial gain on postretirement benefit obligation	4,152	—	—
Comprehensive income	81,440	105,125	105,918
Retirements	(20,000)	(10,000)	(20,000)
Reduction attributable to acquisition of noncontrolling interest	(246)	—	—
Patronage capital equity at end of year	713,807	652,613	557,488
Noncontrolling interest at beginning of year	\$ 129,675	\$ —	\$ —
Equity at acquisition attributable to noncontrolling interest	—	129,885	—
Net loss attributable to noncontrolling interest	(4,739)	(210)	—
Equity distribution to noncontrolling interest	(51)	—	—
Noncontrolling interest acquired by the Association	(4,902)	—	—
Noncontrolling interest at end of year	119,983	129,675	—
Total patronage capital equity and noncontrolling interest at end of year	\$ 833,790	\$ 782,288	\$ 557,488

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

Consolidated Statements of Cash Flows

<i>For the years ended December 31, (Thousands)</i>	2010	2009	2008
Operating activities			
Net margins including noncontrolling interest	\$ 72,405	\$ 104,664	\$ 106,449
Adjustments to reconcile net margins to net cash provided by operating activities:			
Depreciation and amortization	131,739	104,973	98,936
Capital credit allocations from cooperatives and income from coal mines (over) under refund distributions	(4,112)	(9,565)	(12,578)
Allowance for equity funds used during construction	—	(1,306)	(3,443)
Recognition of deferred revenue	(5,599)	—	—
Deferred revenue	—	—	10,000
Changes in operating assets and liabilities:			
Accounts receivable	(2,830)	(8,066)	(7,987)
Coal inventory	10,059	(24,665)	(6,634)
Materials and supplies	(2,565)	(1,447)	(5,731)
Prepaid lease expense	—	(16,509)	(14,492)
Accounts payable and accrued expenses	30,849	(10,485)	20,837
Other	10,741	39,963	4,746
Net cash provided by operating activities	240,687	177,557	190,103
Investing activities			
Purchases of plant, net of retirements	(232,805)	(298,791)	(116,208)
Changes in deferred charges	62,337	(40,264)	(22,020)
Changes in other noncurrent assets	1,237	16,878	(22,619)
Net cash used in investing activities	(169,231)	(322,177)	(160,847)
Financing activities			
Member advances	(240)	72	44
Payments of long-term debt	(220,466)	(171,141)	(124,636)
Advance payments to RUS and funds on deposit with trustees	(337,309)	(79,889)	(25,282)
Retirement of patronage capital	(15,792)	(10,000)	(20,000)
Proceeds from issuance of debt	562,218	465,290	91,144
Net cash provided by (used in) financing activities	(11,589)	204,332	(78,730)
Net increase (decrease) in cash and cash equivalents	59,867	59,712	(49,474)
Cash and cash equivalents—beginning	145,585	85,873	135,347
Cash and cash equivalents—ending	\$ 205,452	\$ 145,585	\$ 85,873
Supplemental information:			
Cash paid for interest	\$ 105,721	\$ 107,537	\$ 102,267
Cash paid for income taxes	\$ —	\$ 9,681	\$ 2,265

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

Notes to Consolidated Financial Statements

Note 1—Organization

Tri-State Generation and Transmission Association, Inc. (the “Association”) is a wholesale power supply cooperative. During 2010, it provided power to 44 member distribution systems that serve major parts of Colorado, Nebraska, New Mexico and Wyoming. The Association also sells a portion of its power to other utilities in the region under long-term contracts (see Note 10) and market sale arrangements. In 2010, 2009 and 2008, total megawatt-hours sold were 18.9, 18.6 and 19.0 million, respectively, of which 80, 77 and 74 percent, respectively, were sold to members. Total revenue from electric sales was \$1.2, \$1.1 and \$1.1 billion for 2010, 2009 and 2008, respectively, of which 82, 82 and 77 percent, respectively, were from member sales. Energy resources were provided by generation and purchased power, of which 67, 68 and 68 percent were from generation for 2010, 2009 and 2008, respectively.

The Association has wholesale power contracts with 42 of its members through the year 2050 and with 2 of its members through the year 2040 whereby each member is obligated to purchase at least 95 percent of its requirements from the Association and can elect to provide up to 5 percent of its requirements from generation owned or controlled by the member. Seven members have made such an election. Power is provided to members at rates determined by the Board of Directors. Rates are designed to recover all costs and provide margins to increase members’ equity.

An undivided interest in the jointly owned facilities of the Yampa Project, the Missouri Basin Power Project (“MBPP”), and the San Juan Project (“San Juan”) are owned by the Association. Each participant in these facilities provides its own financing. The Association receives a portion of the total output of the generating stations, which approximates its percentage ownership. The operating agent for each of these projects allocates to the Association its share of fuel and other operating costs.

The Association employs 1,182 people, of which 322 are subject to collective bargaining agreements.

Note 2—Summary of Significant Accounting Policies

Basis of Consolidation:

The consolidated financial statements include the accounts of the Association and its 99 percent interest in Western Fuels-Colorado, a limited liability company organized for the purpose of acquiring coal reserves and supplying coal to the Association. The consolidated financial statements also include, on a pro rata basis, the Association’s undivided interest in jointly owned facilities (see Note 1). All significant intercompany balances and transactions have been eliminated in consolidation. The accompanying consolidated statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) as applied to regulated enterprises and as prescribed by the Rural Utilities Service (“RUS”).

On December 18, 2009, the Association acquired a 49 percent equity interest (including the 1 percent general partner equity interest) in the Springerville Unit 3 Partnership LP (the “Springerville Partnership”). The Association has the full, exclusive and complete right, power and discretion to operate, manage and control the affairs of the Springerville Partnership. Therefore, beginning on December 18, 2009, the consolidated financial statements of the Association include its interest in the Springerville Partnership. The Springerville Partnership is the 100 percent owner of the Owner Lessor in the Springerville Generating Station Unit 3 Lease in which the Association is the lessee. The Springerville Partnership and the Owner Lessor were consolidated by the Association in accordance with the accounting guidance for business combinations and consolidations and pursuant to this guidance the acquisition was accounted for as an acquisition of assets. Under the asset acquisition approach, the Association’s pre-acquisition prepaid lease balance associated with the Springerville Generating Station Unit 3 Lease would ordinarily have been expensed as a loss on the acquisition of assets. However, the current recognition of the \$106.7 million expense was deferred under the accounting requirements related to regulated operations and the amount of the deferral is accounted for as a regulatory asset (see Note 2—Accounting for Rate Regulation).

As of the December 18, 2009 acquisition, the Association’s consolidation of the Springerville Partnership and the Owner Lessor results in 100 percent of the Springerville Generating Station Unit 3 Lease expense being eliminated. Therefore, there is no longer Springerville lease expense subsequent to the acquisition. Instead, 100 percent of the assets, liabilities and expenses of the Springerville Partnership and the Owner Lessor (consisting solely of the Springerville Generating Station Unit 3 assets, debt and related expenses) are included in the consolidated financial statements of the Association (see Notes 4 and 7).

The December 18, 2009 acquisition was accounted for as an acquisition of assets. Therefore, in the initial consolidation at acquisition the Association recorded the Springerville Generating Station Unit 3 assets at fair value as an addition to electric plant in service of \$980.4 million. This value was equal to the \$850.5 million of total consideration given by the Association in this arm’s-length acquisition and the \$129.9 million estimated fair value of the noncontrolling equity interest. The consideration consisted of \$124.8 million of cash paid by the Association and the assumption through consolidation of the Owner Lessor’s total long-term debt recorded at an estimated fair value of \$708.5 million and the related accrued interest at acquisition of

\$17.2 million. The \$129.9 million fair value of the 51 percent noncontrolling equity interest was based upon the \$124.8 million fair value of the 49 percent controlling equity interest acquired by the Association in this arm's-length transaction. The total ownership equity at acquisition was \$254.7 million.

The revenue and expenses of the Springerville Partnership (consisting solely of the Springerville Generating Station Unit 3 Lease revenue, the depreciation on the Springerville Generating Station Unit 3 asset cost determined at acquisition and the interest on the long-term debt recorded at acquisition) for the period December 18, 2009 through December 31, 2009 net to a loss of \$412,000. The loss attributable to the noncontrolling equity interest was \$4.7 million and \$210,000 for 2010 and 2009, respectively.

On December 22, 2010, the Association increased its equity interest in the Springerville Partnership to 51 percent by acquiring an additional 2 percent equity interest in the Springerville Partnership. The Association paid cash of \$5,148,000 for the 2 percent equity interest of \$4,902,000 as of this date. The acquisition was accounted for as an equity transaction. Therefore, the \$5,148,000 acquisition resulted in the noncontrolling interest being reduced by \$4,902,000 and the \$246,000 cash paid in excess of the equity interest being recorded as a reduction in patronage capital equity attributable to the acquisition of the noncontrolling interest. Since the 2 percent acquisition was accounted for as an equity transaction, the acquisition does not result in any adjustments to the cost of the assets and the amount of the liabilities originally recorded in the December 18, 2009 acquisition. It also does not impact the amount of the associated expenses.

Since the Springerville Generating Station Unit 3 Lease revenue and expense are eliminated in consolidation beginning on December 18, 2009, only the Springerville Generating Station Unit 3 depreciation and the interest on the long-term debt are included in the consolidated statements of operations. Depreciation expense of \$21.0 million and \$818,000 in 2010 and 2009, respectively, are included in depreciation and amortization and interest expense of \$40.6 and \$1.5 million in 2010 and 2009, respectively, are included in interest expense.

Use of Estimates:

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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 may differ from those estimates.

Electric Plant and Depreciation:

Electric plant is stated at cost. The cost of internally constructed assets includes payroll, allowance for equity funds used during construction, overhead costs and interest charged during construction. The amount of interest capitalized during construction was \$13.0, \$8.4 and \$3.6 million during 2010, 2009 and 2008, respectively. At the time that units of electric plant are retired, original cost and cost of removal, net of the salvage value, are charged to the allowance for depreciation. Replacements of electric plant that involve less than a designated unit value are charged to maintenance expense when incurred. Electric plant is depreciated based upon estimated useful lives that are periodically re-evaluated.

Allowance for Equity Funds Used During Construction ("AFUDC"):

AFUDC represents the cost of internal capital used for construction purposes. AFUDC was capitalized as part of the cost of plant and was credited to income until April 2009. Since this date, all construction funding has been provided by borrowed funds. Internal capital interest rates of 6.1 and 6.3 percent were used for AFUDC for 2009 and 2008, respectively.

Leases:

The accounting for lease transactions in conformity with GAAP requires management to make various assumptions, including the discount rate, the fair market value of the leased assets and the estimated useful life, in order to determine whether a lease should be classified as operating or capital.

The Association has certain power sales arrangements that are required to be accounted for as operating leases since the arrangements are in substance leases because they convey the right to use power generating equipment for a stated period of time. The contracts under which sales are made to Public Service Company of Colorado ("PSCO") out of the Association's Knutson and Limon Generating Stations are such arrangements. Under these contracts, PSCO directs the use of both of the two Knutson generating units and one of the two Limon generating units over the terms of the contracts under tolling arrangements whereby PSCO provides its own natural gas for generation of electricity. The arrangements are therefore accounted for as operating leases. The Limon contract was suspended for a period of four years beginning in May 2009 and the Knutson contract was suspended for a period of three years beginning in May 2010 to allow the Association to utilize the output of the turbines. Both turbine contracts resume with PSCO under the original tolling arrangements for the

Notes to Consolidated Financial Statements

period May 1, 2013 to April 30, 2016. The Association also has similar tolling arrangements involving the Association's Pyramid Generating Station. One arrangement involved a 40 megawatt unit under a three month contract during 2010 and another involves a 40 megawatt unit under a contract with Shell Energy North America through September 30, 2014. The revenues from these operating leases of \$7.9, \$19.8 and \$24.4 million for 2010, 2009 and 2008, respectively, are accounted for as lease revenue and are reflected in other operating revenue on the statements of operations. The generating units used in these gas tolling arrangements have a total cost and accumulated depreciation of \$136 and \$35.7 million, respectively, as of December 31, 2010 and of \$136 and \$31.5 million, respectively, as of December 31, 2009. The minimum future lease revenues under these gas tolling arrangements at December 31, 2010 are as follows (thousands):

	2011	\$ 600
	2012	600
	2013	14,159
	2014	21,480
	2015	21,030
	Thereafter	7,010
		\$64,879

The Association has entered into power purchase arrangements that are required to be accounted for as operating leases since the arrangements are in substance leases because they convey to the Association the right to use power generating equipment for a stated period of time. One such agreement began in June 2008 for the use of generating equipment at the Rawhide Generating Station (owned by Platte River Power Authority). Additionally, two agreements began in 2009 that give the Association the use of generating equipment at the Ft. Lupton Generating Station (owned by Thermo Cogeneration Partnership) and at the Brush Generating Station (owned by Brush Cogeneration Partners). Under these agreements, the Association directs the use of the contracted generating equipment over the terms of the contracts under tolling arrangements whereby the Association provides its own natural gas for generation of electricity. These tolling arrangements are discussed further in Note 7.

Investments in Other Associations:

Investments in other associations primarily include the Association's investment in the patronage capital of other cooperatives. Allocations of capital credits from other cooperatives are based on the Association's patronage with the cooperatives. Cash retirements of capital credits from other cooperatives reduce the investment balances. Investments in other associations are as follows (thousands):

	2010	2009
Basin Electric Power Cooperative	\$ 60,393	\$ 57,243
National Rural Utilities Cooperative Finance Corporation	44,604	45,167
CoBank, ACB	4,040	3,739
Western Fuels Association	1,927	1,971
Other	2,472	2,248
Investments in other associations	\$113,436	\$110,368

Investments in Coal Mines:

The Association and certain participants in the Yampa Project are members of Trapper Mining, Inc. ("Trapper Mining") which is organized as a cooperative and is the owner and operator of the Trapper Mine near Craig, Colorado. The Association also owns 99 percent of Western Fuels-Colorado which is the owner and operator of the New Horizon Mine near Nucla, Colorado. In addition, the Association has partial ownership in Western Fuels Association ("WFA"), which, through its ownership in

Western Fuels-Wyoming, is the owner and operator of the Dry Fork Mine near Gillette, Wyoming. The Association also owns a 50 percent undivided ownership in the land and the rights to mine the property known as Fort Union Mine which is located adjacent to the Dry Fork Mine. Investments in coal mines are as follows (thousands):

	2010	2009
Trapper Mine	\$11,501	\$11,089
New Horizon Mine	12,993	11,565
Dry Fork Mine	4,127	6,298
Fort Union Mine	1,824	2,024
Investments in coal mines	\$30,445	\$30,976

Deferred Equity Note:

During 1981 and 1982, the Association sold certain tax benefits under the safe harbor leasing provision of the Internal Revenue Code. The initial proceeds were recorded in deferred credits and are being amortized into income at \$715,000 per year through 2024. The unamortized balance at December 31, 2010 and 2009 was \$9.7 and \$10.4 million, respectively. The 1981 lease included a \$34.7 million deferred equity note, payable annually, that has been recorded on a discounted basis at 10 percent, which approximates its fair value of \$8.4 and \$8.9 million at December 31, 2010 and 2009, respectively.

Cash and Cash Equivalents:

The Association considers highly liquid investments with an original maturity of three months or less to be cash equivalents.

Marketable Securities:

The Association's investment in fixed maturity securities is classified as either held-to-maturity, available-for-sale or trading. If the Association had investments in debt securities that the Association had both the positive intent and ability to hold to maturity the investments would be carried at amortized cost. The Association does not have any such investments. Investments in debt securities that the Association does not have the positive intent and ability to hold to maturity are classified as available-for-sale or trading and are carried at fair value. Classification of debt securities is made at the time of purchase and, prospectively, that classification is reevaluated as of each balance sheet date. Unrealized holding gains and losses on securities classified as available-for-sale are carried as a separate component of members' equity. Unrealized holding gains and losses on securities classified as trading would be reported in margins. The Association does not have any such investments. Realized gains and losses on sales of investments, and declines in value judged to be other-than-temporary, are recognized on the specific identification basis. Net realized gains are included in other income and net realized losses are included in other deductions.

Marketable securities held by the Association are related to the directors' and executives' elective deferred compensation plans and consist of investments in stock funds, bond funds and money market funds. At December 31, 2010, the cost and estimated fair value of the investments based upon their active market value were \$1.5 and \$1.4 million, respectively, with a net unrealized loss balance of \$83,000. At December 31, 2009, the cost and estimated fair value of the investments were \$1.7 and \$1.5 million, respectively, with a net unrealized loss balance of \$227,000. The estimated fair value of the investments is included in other noncurrent assets on the statements of financial position. The change in the net unrealized gain or loss is reported separately as a component of comprehensive income as shown on the statements of equity.

Derivatives:

The Association is exposed to certain risks in the normal course of operations in providing a reliable and affordable source of wholesale electricity to the member distribution systems. These risks include commodity price risk which represents the risk of loss due to changes in market prices that may impact the Association's financial performance. To manage this exposure, the Association has entered into physically-delivered forward commodity contracts of various durations. These contracts are evaluated in accordance with the accounting guidance for derivatives and hedging. To the extent that the contracts are considered derivatives, the Association assesses whether or not the normal purchase or normal sale exception applies. For contracts that this exception cannot be applied, the accounting guidance for derivatives and hedging requires recognition of all qualifying derivative instruments as either assets or liabilities on the statements of financial position and measurement of those instruments at fair value. Furthermore, the accounting guidance requires that changes in the fair value of derivatives are to be recorded in current earnings if the instrument is not designated as a hedge.

Notes to Consolidated Financial Statements

The Association has entered into certain forward purchase agreements for the future delivery of natural gas in order to ensure an adequate supply of natural gas at a price certain for the generation of electricity. In 2010, an agreement was entered into for delivery of natural gas in 2011. In 2008, agreements were entered into for delivery of natural gas in 2009 and 2010. These fixed-price, fixed-quantity physical contracts are considered derivative instruments and are recorded at fair value. The valuation assumptions utilized to measure the fair value of these commodity derivatives were observable inputs based on market data obtained from independent sources and are considered Level 2 inputs (quoted prices for similar assets, liabilities (adjusted) and market-corroborated inputs). Specifically, the fair value is based upon actively quoted prices in the gas market. Hedge accounting treatment has not been elected for the natural gas agreements.

At December 31, 2010, the derivative gas contract has a fair value that is \$239,000 above its fixed contract price and is recorded in deferred charges. At December 31, 2009, the derivative gas contracts have fair values that are \$1.6 million below their fixed contract prices and these are recorded in deferred credits and other liabilities. The gain and losses resulting from the changes in fair value of the derivatives would ordinarily have been recorded in fuel expense. However, the current recognition of the mark to market gain and losses was deferred under the accounting requirements related to regulated operations (see Note 2—Accounting for Rate Regulation). Under these requirements, a gain is deferred and accounted for as a regulatory liability rather than as a negative fuel expense. A loss is deferred and accounted for as a regulatory asset rather than as a positive fuel expense. This accounting results in the deferred derivative mark to market gain/loss recorded as a regulatory liability/asset being equal to the balance in the corresponding derivative mark to market fair value recorded in deferred charges or deferred credits and other liabilities. At December 31, 2010, the deferred derivative mark to market gain of \$239,000 is recorded as a regulatory liability in deferred credits and other liabilities. At December 31, 2009, the deferred derivative mark to market loss of \$1.6 million is recorded as a regulatory asset in deferred charges. The change in these accounts is included in the operating section of the statements of cash flows.

Under this regulatory accounting approach, the process of marking the derivatives to market and deferring the recognition of the mark to market gain/loss continues until each derivative purchase contract is settled. At the time of the delivery/settlement of each derivative contract, fuel expense is recognized for the amount actually owed under the contract and the derivative contract fair value asset/liability and the corresponding derivative regulatory liability/asset are eliminated. Therefore, the mark to market accounting never impacts fuel expense.

This regulatory accounting treatment of mark to market gains and losses results in each of the derivative natural gas purchases being recognized as an expense at delivery/settlement which matches the cost recovery included in the Association's rates.

The following table summarizes the notional amounts of outstanding natural gas futures contracts with fixed price terms that comprise the mark to market values as of December 31 (thousands):

Commodity	Natural gas
Unit of Measure	MMBTU
2010 Quantity	620
2009 Quantity	1,240
2010 Contract Price/MMBTU	\$4.00
2009 Contract Price/MMBTU Low/High	\$6.56/\$7.40

The fair values of the derivative instruments reflected in the consolidated statements of financial position as of December 31 are as follows (thousands):

Balance Sheet Location	2010	2009
Derivatives in an asset position not designated as hedging instruments:		
Natural gas futures contracts	\$239	\$ —
Deferred charges		
Derivatives in a liability position not designated as hedging instruments:		
Natural gas futures contracts	\$ —	\$1,550
Deferred credits and other liabilities		

The following table reconciles the beginning and ending balances of the Association's net regulatory liability that pertains to the 2010 natural gas futures contract that was in a net gain position and included in deferred credits and other liabilities (thousands):

	2010	2009
Beginning Balance	\$ —	\$ —
Changes in fair value recognized in regulatory liability	239	—
Eliminated from regulatory liability at contract settlement	—	—
Ending Balance	\$ 239	\$ —

The following table reconciles the beginning and ending balances of the Association's net regulatory asset that pertains to the 2008 natural gas futures contracts that were in a net loss position and included in deferred charges (thousands):

	2010	2009
Beginning Balance	\$ 1,550	\$ 6,280
Changes in fair value recognized in regulatory asset	2,084	5,061
Eliminated from regulatory asset at contract settlement	(3,634)	(9,791)
Ending Balance	\$ —	\$ 1,550

Certain of the Association's derivative instruments contain provisions that require the Association's debt to maintain an investment grade credit rating from each of the major credit rating agencies. If the Association's debt were to fall below investment grade, the counterparties to the derivative instruments could request immediate payment or demand collateralization on derivative instruments in net liability positions. As of December 31, 2010, the Association's credit rating was investment grade and therefore no collateral has been required to be posted.

Inventories:

Coal inventories of \$32.8 and \$42.6 million at December 31, 2010 and 2009, respectively, are stated at LIFO (last-in, first-out) cost. The remaining coal inventories, other fuel, and materials and supplies inventories are stated at average cost.

SO₂ Emission Allowances:

The Association has received an annual allocation of SO₂ (sulfur dioxide) emission allowances from the Environmental Protection Agency as part of a nationwide program to limit SO₂ emissions. An allowance provides authority to emit one ton

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of SO₂. Under this program, the Association has received more SO₂ allowances than it has utilized. The unutilized SO₂ allowances have no cost basis and are therefore not recorded on the balance sheet.

Asset Retirement Obligations:

The Association accounts for obligations associated with the future retirement of tangible long-lived assets and the related asset retirement costs.

Coal Mines: The Association has asset retirement obligations for the final reclamation costs and post-reclamation monitoring related to the New Horizon Mine and the Fort Union Mine.

Fossil Steam Generation: The Association, including its undivided interest in jointly owned facilities, has asset retirement obligations related to equipment, dams, ponds, ground water, wells and underground storage tanks at the fossil steam generating stations.

Aggregate carrying amounts of asset retirement obligations are as follows (thousands):

	2010	2009
Asset retirement obligation at beginning of year	\$6,241	\$6,247
Liabilities incurred	749	—
Liabilities settled	(247)	(261)
Accretion expense	330	257
Change in cash flow estimate	(312)	(2)
Asset retirement obligation at end of year	\$6,761	\$6,241

The Association also has asset retirement obligations with indeterminate settlement dates. These are made up primarily of obligations attached to transmission and other easements that are considered by the Association to be operated in perpetuity and therefore the Association does not have sufficient information to reasonably estimate the fair value of the obligation. A liability will be recognized in the period in which sufficient information exists to estimate a range of potential settlement dates as is needed to employ a present value technique to estimate fair value.

Memberships:

Fifty \$5 memberships are authorized of which 44 are outstanding at December 31, 2010 and 2009.

Patronage Capital:

Net margins of the Association are treated as advances of capital by the members. Beginning in 2008 and prior to the merger with Plains Electric Generation and Transmission Cooperative, Inc. ("Plains") in June 2000, the net margins have been allocated to the members on the basis of their electricity purchases from the Association. Subsequent to the merger in 2000 through 2007, the net margins were accounted for on the basis of allocation units and the net margins of each allocation unit were allocated to the members thereof based on their electricity purchases from the Association. One allocation unit consisted of the members of the Association before the merger and another allocation unit consisted of the former members of Plains that became members of the Association. Net losses are not allocated to members, but are offset by future margins.

Accumulated Postretirement Benefit and Postemployment Obligations:

The Association sponsors a medical plan for all employees of the Association. The plan provides postretirement medical benefits to all full-time employees and retirees (who have attained age 55) that elect to participate, and postemployment medical benefits to employees on long-term disability. The plan was unfunded at December 31, 2010, is contributory (with retiree premium contributions equivalent to employee premiums, adjusted annually) and contains other cost-sharing features such as deductibles.

The postretirement medical benefit liability balances of \$2.7 and \$7.2 million at December 31, 2010 and 2009, respectively, are included in accumulated postretirement benefit and postemployment obligations. The \$4.5 million reduction in the liability resulted primarily from a \$4.7 million actuarial gain determined by an actuarial study performed in 2010. \$4.2 million of the gain was not recognized in net margins during 2010 but is instead reported separately as a component of comprehensive

income at December 31, 2010 (as shown on the statements of equity). The unrecognized gain in excess of 10 percent of the projected benefit obligation is amortized over the average remaining service lives of the active plan participants which results in an annual recognition of the gain of \$358,000.

The postemployment medical benefit liability balances of \$291,000 and \$971,000 at December 31, 2010 and 2009, respectively, are included in accumulated postretirement benefit and postemployment obligations. The 2010 liability balance was determined by an actuarial study performed in 2010.

Electric Sales Revenue:

Revenue from electric energy deliveries is recognized when delivered.

Other Operating Revenue:

Other operating revenue consists primarily of wheeling revenue and lease revenue. Wheeling revenue is received when the Association charges other energy companies for transmitting electricity over the Association's transmission lines. The lease revenue is primarily from certain power sales arrangements that are required to be accounted for as operating leases since the arrangements are in substance leases because they convey to others the right to use power generating equipment for a stated period of time. These leases are discussed further in Note 2—Leases.

Deferred Revenues:

The Association has recognized the benefit of certain deferred revenues assumed from Plains in connection with the merger in 2000. Prior to the merger, twelve former Plains members made payments totaling \$47.6 million to Plains for the prepayment of purchased power and one former Plains member made an \$11.8 million payment to Plains in order to buy out of its relationship with Plains. Plains recorded the amounts as deferred revenues. The Association assumed the deferred revenues upon merging with Plains and included them in deferred credits and other liabilities. None of these deferred revenues was recognized in revenue during 2009 and 2008 and the balances in the deferred revenue accounts for the member prepayment and buyout payment were \$4.8 and \$0.8 million, respectively, at December 31, 2009. During 2010, the \$4.8 million member prepayment was recognized in member electric sales revenue and the \$0.8 million buyout payment was recognized in other operating revenue. Therefore, there are no balances remaining in the deferred revenue accounts for the member prepayment and buyout payment at December 31, 2010.

During 2007, the Association deferred the recognition of \$20 million of non-member electric sales revenue earned during 2007 in accordance with regulatory accounting requirements and the approval of RUS. The \$20 million deferred revenue is included in deferred credits and other liabilities. This deferred revenue will be recognized in non-member electric sales revenue prior to 2013.

During 2008, the Association deferred the recognition of \$10 million of non-member electric sales revenue earned during 2008 in accordance with regulatory accounting requirements and the approval of RUS. The \$10 million deferred revenue is included in deferred credits and other liabilities. This deferred revenue will be recognized in non-member electric sales revenue prior to 2014.

The total of these deferred revenues is \$30.0 and \$35.6 million at December 31, 2010 and 2009, respectively, and is included in deferred credits and other liabilities. The accounting for deferred revenues is discussed further in Note 2—Accounting for Rate Regulation.

Income Taxes:

The Association is a non-exempt cooperative subject to federal and state taxation and, as a cooperative, is allowed a tax exclusion for margins allocated as patronage capital. The liability method of accounting for income taxes is utilized, whereby changes in deferred tax assets or liabilities result in the establishment of a regulatory asset or liability. A regulatory asset or liability associated with deferred income taxes generally represents the future increase or decrease in income taxes payable that will be received or settled through future rate revenues.

Accounting for Rate Regulation:

The Association is subject to the accounting requirements related to regulated operations. In accordance with these accounting requirements, some revenues and expenses have been deferred at the discretion of the Association's Board of Directors (which has budgetary and rate-setting authority) and with the approval of RUS. Regulatory assets are included in deferred charges. Regulatory liabilities are included in deferred credits and other liabilities. The regulatory assets and liabilities are recognized as expenses and income in future periods at the discretion of the Board of Directors.

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The Association was the lessee under five individual lease agreements of Craig Generating Station Unit 3 with a lease term through 2018. Lease expense was recorded on a straight-line basis over the term of the lease based on total scheduled lease payments to be paid over the life of the lease. Amounts paid in excess of or below recorded lease expense were recorded as prepaid lease expense. Beginning in 2002, the Association began acquiring the equity ownership interests in the five separate leases. As of December 31, 2005, the Association had acquired 78 percent of the equity ownership interests and, as of December 31, 2006, the Association had acquired 100 percent of the equity ownership interests. The acquisition of these equity interests was accounted for under ownership accounting beginning in 2005. Under ownership accounting, the Association would ordinarily have been required to recognize the balance of the prepaid lease as a current expense. However, the current recognition of the prepaid lease expense was deferred under the accounting requirements related to regulated operations and the amount of the deferral is accounted for as a regulatory asset. The regulatory asset for the deferred prepaid lease expense is being amortized into expense each year through the remaining original life of the lease ending in 2018. The amortization of the deferred prepaid lease expense associated with the lease of Craig Generating Station Unit 3 was \$6.5 million in 2010, 2009 and 2008 and is included in depreciation and amortization. The deferred prepaid lease balance was \$48.5 and \$55.0 million at December 31, 2010 and 2009, respectively, and is included in deferred charges.

On December 18, 2009, the Association acquired a 49 percent equity interest (including the 1 percent general partner equity interest) in the Springerville Partnership which is the 100 percent owner of the Owner Lessor in the Springerville Generating Station Unit 3 Lease. The Association is therefore consolidating the Springerville Partnership as an acquisition of assets (see Note 2—Basis of Consolidation and Note 7). The Association had a pre-acquisition prepaid lease balance of \$106.7 million as of December 18, 2009 associated with the Springerville Generating Station Unit 3 Lease. Under the asset acquisition approach used in the accounting for this transaction, the pre-acquisition prepaid lease balance would ordinarily have been expensed as a loss on the acquisition of assets. However, the current recognition of the \$106.7 million expense was deferred under the accounting requirements related to regulated operations and the amount of the deferral is accounted for as a regulatory asset. The regulatory asset for the deferred prepaid lease expense is being amortized into expense beginning December 18, 2009 through the remaining life of Springerville Generation Station Unit 3 ending in 2056. The amortization of the deferred prepaid lease expense associated with the Springerville Generating Station Unit 3 Lease was \$2.3 million and \$89,000 in 2010 and 2009, respectively, and is included in depreciation and amortization. The deferred prepaid lease balance was \$104.3 and \$106.6 million at December 31, 2010 and 2009, respectively, and is included in deferred charges.

The regulatory asset related to deferred income tax expense is discussed further in Note 2—Income Taxes. The regulatory asset and regulatory liability related to deferred derivative mark to market loss and gain are discussed further in Note 2—Derivatives. The regulatory liability related to deferred revenues is discussed further in Note 2—Deferred Revenues.

Regulatory assets and liabilities are as follows (thousands):

	2010	2009
Regulatory assets		
Deferred income tax expense	\$ 27,555	\$ 14,569
Deferred derivative mark to market loss	—	1,550
Deferred prepaid lease expense—Craig 3 Lease	48,549	55,022
Deferred prepaid lease expense—Springerville 3 Lease	104,331	106,622
	180,435	177,763
Regulatory liabilities		
Deferred revenues	30,000	35,599
Deferred derivative mark to market gain	239	—
	30,239	35,599
Net regulatory asset	\$150,196	\$142,164

Interchange Power:

The Association occasionally engages in interchanges, or non-cash swapping, of energy. Based on the assumption that all energy interchanged will eventually be received or delivered in-kind, interchanged energy is generally valued at the average cost of fuel to generate power. Additionally, portions of the energy interchanged are valued per contract with the utility involved in the interchange. When the Association is in a net energy advance position, the advanced energy balance is recorded as an asset. If the Association owes energy, the energy balance owed to others is recorded as a liability. The net activity for the year is included in purchased power expense. The interchange asset of \$123,000 at December 31, 2010 is included in deposits and advances and the interchange liability of \$2.4 million at December 31, 2009 is included in accounts

payable. The net interchange activity recorded in purchased power expense was \$(2.5) million, \$348,000 and \$2.4 million in 2010, 2009 and 2008, respectively.

Evaluation of Subsequent Events:

The Association evaluated subsequent events through February 16, 2011 which represents when the consolidated financial statements were available to be issued. As of this date, there were no subsequent events that require an adjustment to the consolidated financial statements or that require disclosure in the consolidated financial statements. The Association has not evaluated subsequent events after the available to be issued date.

New Accounting Pronouncements:

In June 2009, the Financial Accounting Standards Board (“FASB”) issued new guidance on the consolidation of variable interest entities. This guidance replaces the quantitative-based risks and rewards calculation for determining whether an enterprise is the primary beneficiary in a variable interest entity with an approach that is primarily qualitative. The new guidance requires ongoing assessments of whether an enterprise is the primary beneficiary of a variable interest entity and requires additional disclosures about an enterprise’s involvement in variable interest entities. The Association adopted this new guidance in 2010 but it did not have a material impact on its financial position or results of operations.

Reclassifications:

Certain reclassifications have been made to the prior year financial statements to conform to the 2010 presentations.

Note 3—Electric Plant

The Association’s investment in electric plant and the related annual rates of depreciation or amortization calculated using the straight-line method are as follows (thousands):

	Annual Depreciation Rate	2010	2009
Generation plant	2.1% to 3.10%	\$ 2,961,684	\$ 2,949,081
Transmission plant	2.0% to 2.88%	844,015	813,855
General plant	3.0% to 30.00%	280,284	255,337
Other	2.8% to 5.60%	227,106	145,594
Electric plant in service (at cost)		4,313,089	4,163,867
Construction work in progress		201,011	133,111
Less allowances for depreciation and amortization		(1,616,952)	(1,502,234)
Electric plant		\$ 2,897,148	\$ 2,794,744

At December 31, 2010, the Association had \$51.8 million of commitments to complete construction projects of which approximately \$36.1, \$14.7 and \$1.0 million are expected to be incurred in 2011, 2012 and 2013, respectively.

The Purchase Option and Development Agreement was executed on July 26, 2007 between the Association and Sunflower Electric Power Corporation (“Sunflower”) and other Sunflower parties. The agreement calls for the Association to make option payments totaling \$55 million to Sunflower and/or the other Sunflower parties in exchange for the development rights to develop one or two new coal-fired generating units at Sunflower’s existing single-unit Holcomb Station in western Kansas. Upon execution, \$25 million was paid. In 2008, \$5 million was paid and the remainder will be paid on the purchase date. The purchase date will be designated by the Association, Sunflower and the other parties to the Purchase Option and Development Agreement after the Association exercises its option to acquire the development rights. The purchase date cannot currently be estimated due to legal uncertainties surrounding the status of the necessary air permits. The original air permit application was denied by the Kansas Department of Health and Environment (“KDHE”) in October 2007 and the Association and Sunflower appealed the denial to the Kansas courts. Subsequent to the denial of the air permit, Sunflower entered into an agreement with the governor of Kansas that could result in the KDHE issuing a permit for one new coal-fired generating unit at Holcomb Station of 895 megawatts. As a result of the agreement, Sunflower and the Association withdrew their appeal of the denial of the original air permit application. The KDHE issued the new permit on December 16, 2010. The Sierra Club filed an appeal of the new permit with the Kansas Court of Appeals on January 14, 2011. Sunflower and the Association intend to intervene in the appeal. Excluding the cost of land and water rights, the cost of developing the units incurred by the Association as of December 31, 2010 is \$57.4 million. The Association is unable to project the ultimate outcome of this

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matter, but it intends to pursue the revised air permit process to conclusion. The Association is unable to project when the air permit application process may conclude.

Note 4—Long-Term Debt

The mortgage notes payable and pollution control revenue bonds are secured on a parity basis by a Master First Mortgage Indenture, Deed of Trust and Security Agreement. Substantially all the assets, rents, revenues and margins of the Association are pledged as collateral. The Springerville certificates are secured by the assets of the Springerville Generating Station Unit 3 (see Note 7). All long-term debt contains certain restrictive financial covenants and consists of the following (thousands):

	2010	2009
Mortgage notes payable		
2% RUS, due through 2017	\$ 326	\$ 455
5% RUS, due through 2026	11,238	14,795
2.66% to 12.01% FFB, 5.34% average for 2010, due through 2039	1,214,625	1,208,609
6.05% to 9.05% CFC, 7.70% average for 2010, due through 2022	171,627	187,641
6.17% to 7.24% CoBank, ACB, 6.35% average for 2010, due through 2036	77,100	81,230
First Mortgage Bonds, Series 2010A, 6.00% due 2040	499,330	—
First Mortgage Obligation, Series 2009C, Tranche 1, 6.00%, due 2019	190,000	190,000
First Mortgage Obligation, Series 2009C, Tranche 2, 6.31%, due 2021	110,000	110,000
Variable rate CFC, as determined by CFC, 4.95% average for 2010, due through 2026	862	897
Variable rate Grantor Trust Obligations, as determined by CFC, 0.61% average for 2010, due 2017	27,490	30,220
Variable rate, Credit Agreement, LIBOR based revolving credit	—	102,200
Pollution control revenue bonds		
Platte County, WY Daily Adjustable Rate Series 1984, 0.49% average for 2010, due 2014	48,000	48,000
City of Gallup, NM, 5.00%, Series 2005, due through 2017	35,134	39,458
Moffat County, CO Variable Rate Demand Series 2009, 0.26% average for 2010, due 2036	46,800	46,800
Springerville certificates		
Series A, 6.04%, due 2018	253,822	281,951
Series B, 7.14%, due 2033	425,560	426,416
Other	1,443	1,490
Less advance payments to RUS	(475,215)	(137,906)
	2,638,142	2,632,256
Less funds on deposit with trustees	(593)	(641)
Total debt	2,637,549	2,631,615
Less current maturities	(146,011)	(122,486)
Long-term debt	\$2,491,538	\$2,509,129

In January 2007, the Association entered into an agreement (the "Credit Agreement") with Credit Suisse Cayman Islands Branch as Administrative Agent, and with Credit Suisse Securities (USA) LLC and Lehman Brothers Inc. ("Lehman") as Joint Lead Arrangers for an unsecured revolving credit facility with a total commitment of \$250 million for a term of five years.

Later in 2007, the Association secured the Credit Agreement. In September 2008, Lehman filed for bankruptcy and subsequently defaulted on a requested advance. The total commitment from Lehman was \$50 million. At the time of the default, the Association had \$95 million advanced under the Credit Agreement, of which \$19 million was from Lehman. Lehman's default impacted the remaining \$31 million of Lehman's commitment. In March 2009, an amendment to the Credit Agreement was finalized that formally reduced the Lehman commitment from \$50 million to \$19 million resulting in a total commitment under the Credit Agreement of \$219 million. In July 2010, the Association repaid \$95 million of the outstanding balance under the Credit Agreement. This terminated the \$19 million commitment from Lehman resulting in a total commitment under the Credit Agreement of \$200 million. As of December 31, 2010, the \$200 million is undrawn. The Association is subject to a number of customary covenants under the Credit Agreement and was in compliance with all of them as of the date of the last advance.

The Platte County bonds may be "put" back for remarketing at any time and may be converted to a long-term fixed rate at the option of the Association. A \$49.1 million letter of credit with National Rural Utilities Cooperative Finance Corporation ("CFC") secures payment of these bonds and as of December 31, 2010 had an expiration date of November 2011.

In May 2007, after the Association acquired 100 percent of the equity ownership interests in the Craig Generating Station Unit 3 lease, the Association and other parties to the Craig Generating Station Unit 3 lease agreed to terminate the lease structure. This resulted in the Association obtaining direct ownership of Craig Generating Station Unit 3 and the assumption of the Moffat County pollution control revenue bonds, the Moffat County, CO Weekly Adjustable Rate Series 1984 (Series 1984 Bonds). The Series 1984 Bonds were scheduled to mature in 2010 and bore a weekly adjustable variable interest rate. The guarantee of the payment of principal and interest on the Series 1984 Bonds was provided by a combination of bond insurance provided by AMBAC Indemnity Corporation ("AMBAC") and a liquidity facility with JPMorgan Chase Bank. In February 2009, the Association refunded the Series 1984 Bonds and issued the \$46.8 million Moffat County, CO, Variable Rate Demand Pollution Control Revenue Refunding Bonds, Series 2009 (Series 2009 Bonds) with a 364 day, direct pay letter of credit provided by Bank of America, N.A., and the Association redeemed the Moffat County, CO Weekly Adjustable Rate Series 1984 bonds in the amount of \$46.8 million. In December 2010, the letter of credit from Bank of America, N.A. was extended for an additional 364 days to mature in February 2012.

In June 2010, the Association issued the Series 2010A First Mortgage Bonds in an aggregate principal amount of \$400 million. In October 2010, the Association exercised an option to reopen the Series 2010A First Mortgage Bonds and issued an additional \$100 million. This resulted in an aggregate principal amount of \$499 million net of premiums and discounts for the Series 2010A First Mortgage Bonds.

On December 18, 2009, the Association acquired a 49 percent equity interest (including the 1 percent general partner equity interest) in the Springerville Unit 3 Partnership LP (the "Springerville Partnership"). The Association has the full, exclusive and complete right, power and discretion to operate, manage and control the affairs of the Springerville Partnership. Therefore, beginning on December 18, 2009, the consolidated financial statements of the Association include its interest in the Springerville Partnership. The Springerville Partnership is the 100 percent owner of the Owner Lessor in the Springerville Generating Station Unit 3 Lease (see Note 7) in which the Association is the lessee. As of the December 18, 2009 acquisition, the Association's consolidation of the Springerville Partnership and the Owner Lessor results in 100 percent of the Springerville Generating Station Unit 3 Lease expense being eliminated. Therefore, there is no longer lease expense subsequent to the acquisition. Instead, 100 percent of the assets, liabilities and expenses of the Springerville Partnership and the Owner Lessor (consisting solely of the Springerville Generating Station Unit 3 assets, debt and related expenses) are included in the consolidated financial statements of the Association (see Note 2—Basis of Consolidation). Therefore, 100 percent of the Tri-State Generation and Transmission Association, Inc. 2003 Series A and Series B Pass Through Trust Certificates totaling \$708 million, in the par amount of \$675 million plus a premium to reflect the fair market value as of December 18, 2009 in the amount of \$33.0 million are shown in the debt table above as of December 31, 2009. The debt was recorded at the acquisition date fair value since the acquisition was accounted for as an acquisition of assets (see Note 2—Basis of Consolidation).

On December 22, 2010, the Association increased its equity interest in the Springerville Partnership to 51 percent by acquiring an additional 2 percent equity interest in the Springerville Partnership. Since the 2 percent acquisition was accounted for as an equity transaction, this acquisition does not impact the cost of the assets and the amount of the liabilities originally recorded in the December 18, 2009 acquisition. Therefore, there are no changes to the associated debt other than amortization of the originally recorded debt.

At December 31, 2010, the Association had \$150 million of unused committed lines of credit with scheduled expirations of \$50 million in 2011 and \$100 million in 2013. Subsequent to year end, \$25 million of the \$50 million expiring in 2011 was extended to 2014 and \$50 million of the \$100 million expiring in 2013 was extended to 2014. All lines of credit are expected to be renewed upon expiration.

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RUS allows borrowers to make advance payments that will be used to pay future debt. These advances are irrevocable and can only be used to pay RUS or Federal Financing Bank ("FFB") debt. The advance payments earn interest at a 5 percent rate. The amounts advanced to RUS are \$475 and \$138 million as of December 31, 2010 and 2009, respectively.

At December 31, 2010, the Association had FFB commitments to advance additional construction funds of \$278 million.

Annual maturities of long-term debt at December 31, 2010 are as follows (thousands):

	2011	\$ 146,011
	2012	171,766
	2013	177,580
	2014	207,547
	2015	162,052
	Thereafter	1,773,186
		\$2,638,142

Note 5—Fair Values of Financial Instruments

Certain methods and assumptions were used by the Association in estimating its fair value disclosure. The fair values of long-term debt were estimated using discounted cash flow analyses based on the Association's current incremental borrowing rates for similar types of borrowing arrangements. Fair values of marketable securities are presented in Note 2—Marketable Securities and the fair values of derivative instruments are presented in Note 2—Derivatives. The carrying amounts and fair values of the Association's long-term debt are as follows (thousands):

	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
RUS	\$ 11,564	\$ 12,661	\$ 15,250	\$ 16,715
FFB	1,214,625	1,317,981	1,208,609	1,293,169
CFC	172,489	191,457	188,538	201,046
First Mortgage Bonds, Series 2010A	499,330	502,315	—	—
First Mortgage Obligations, Series 2009C	300,000	336,585	300,000	333,615
Pollution control revenue bonds	129,934	129,087	134,258	131,540
Credit Agreement	—	—	102,200	122,459
Grantor Trust Obligations	27,490	27,624	30,220	28,872
CoBank, ACB	77,100	78,388	81,230	73,336
Springerville certificates	679,382	760,962	708,367	708,367
Other	1,443	1,254	1,490	1,195
	3,113,357	3,358,314	2,770,162	2,910,314
Less: Advance payments to RUS	(475,215)	(475,215)	(137,906)	(137,906)
Funds on deposit with trustees	(593)	(593)	(641)	(641)
	\$2,637,549	\$2,882,506	\$2,631,615	\$2,771,767

Note 6—Income Taxes

Under the liability method, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for income tax purposes. Components of the Association's net deferred tax liability are as follows (thousands):

	2010	2009
Deferred tax assets		
Safe harbor lease receivables	\$ 45,041	\$ 46,371
Net operating loss carryforwards	14,709	—
Alternative minimum tax credit carryforwards	3,834	12,959
Deferred debt charges	3,940	4,942
Deferred revenues	11,289	13,396
Other	23,149	22,777
	101,962	100,445
Deferred tax liabilities		
Asset basis differences including safe harbor assets	83,218	73,600
Depreciation	20,501	17,210
Capital credits from other associations	25,798	24,204
	129,517	115,014
Net deferred tax liability	\$ (27,555)	\$ (14,569)

The \$13.0 million increase in the net deferred tax liability from \$14.6 million at December 31, 2009 to \$27.6 million at December 31, 2010 is not recognized as a tax expense in 2010 due to the Association's regulatory accounting treatment of deferred taxes. Instead, the tax expense is deferred and reflected as an increase in the regulatory asset established for deferred income tax expense. This regulatory asset account therefore has a \$27.6 and \$14.6 million balance for deferred income tax expense at December 31, 2010 and 2009, respectively. The accounting for regulatory assets is discussed further in Note 2—Accounting for Rate Regulation.

During 2010, the Association incurred a \$45.2 million net operating loss of which \$6.1 million will be carried back to 2008 and 2009. At December 31, 2010, the Association has, after the carryback, a net operating loss carryforward of \$39.1 million which, if not utilized, will expire in 2030. The future reversal of existing temporary differences will more-likely-than-not enable the realization of the net operating loss carryforward.

The Association had an income tax benefit of \$9.7 million for 2010 and income tax expense of \$7.6 and \$2.0 million for 2009 and 2008, respectively. The Association had \$3.8 million of alternative minimum tax credit carryforwards at December 31, 2010 to offset future regular taxes payable.

Note 7—Leases

Springerville Generating Station Unit 3 Lease:

In October 2003, the Association entered into a series of agreements to develop a 418-megawatt, coal-fired generating facility near Springerville, Arizona, called Springerville Generating Station Unit 3. In accordance with the agreements, the Association acted as the construction agent for the benefit of Springerville Unit 3 Holding LLC (the "Owner Lessor") to oversee the construction of the Springerville project.

Construction funding for the Springerville project was acquired solely by the Owner Lessor. The two primary sources of these construction proceeds were the issuance of a \$760 million bond issue and the infusion of owner equity. The bond proceeds are comprised of two series which were issued October 21, 2003. The first issue was in the amount of \$355 million with a coupon rate of 6.04 percent and will amortize over a period maturing on January 31, 2018. The second issue was in the amount of \$405 million with a coupon rate of 7.144 percent and will amortize over a period maturing on July 31, 2033.

Construction was completed and the lease commenced on July 28, 2006. Pursuant to the Facility Lease Agreement, the Association is committed to make semiannual lease payments for a 34-year lease term extending through July 2040. The semiannual lease payments are comprised of amounts equal to the long and short-term bond commitments as well as

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the repayment of equity funds to the Owner Lessor. In turn, the Owner Lessor's obligation is to pay principal and interest on the bonds with the lease payment proceeds received from the Association.

On December 18, 2009, the Association acquired a 49 percent equity interest (including the 1% general partner equity interest) in the Springerville Partnership which is the 100 percent owner of the Owner Lessor. The Association has the full, exclusive and complete right, power and discretion to operate, manage and control the affairs of the Springerville Partnership. Therefore, beginning on December 18, 2009, the consolidated financial statements of the Association include its interest in the Springerville Partnership and the Owner Lessor.

The Owner Lessor qualifies as the owner of the facility and the lease qualifies as an operating lease. Prior to December 18, 2009, the lease was accounted for as an operating lease by the Association and lease expense for the Springerville Generating Station Unit 3 Lease was recorded on a straight-line basis over the term of the lease based on total scheduled lease payments to be paid over the life of the lease. Amounts paid in excess of or below recorded lease expense were recorded as prepaid lease expense. As of the December 18, 2009 acquisition, the Association's consolidation of the Springerville Partnership and the Owner Lessor results in 100 percent of the Springerville Generating Station Unit 3 Lease expense being eliminated. Therefore, there is no longer lease expense subsequent to the acquisition. The Association incurred lease expense of \$0, \$53.7 and \$55.9 million in 2010, 2009 and 2008, respectively. After the acquisition, 100 percent of the assets, liabilities and expenses of the Springerville Partnership and the Owner Lessor (consisting solely of the Springerville Generating Station Unit 3 assets, debt and related expenses) are included in the consolidated financial statements of the Association (see Note 2—Basis of Consolidation).

On December 22, 2010, the Association increased its equity interest in the Springerville Partnership to 51 percent by acquiring an additional 2 percent equity interest in the Springerville Partnership. Since the 2 percent acquisition was accounted for as an acquisition of equity, this acquisition does not impact the cost of the assets and the amount of the liabilities originally recorded in the December 18, 2009 acquisition. It also does not impact the amount of the associated expenses.

The Association had a pre-acquisition prepaid lease balance of \$106.7 million as of December 18, 2009 associated with the Springerville Generating Station Unit 3 Lease. Under the asset acquisition approach used in the accounting for this transaction, the pre-acquisition prepaid lease balance would ordinarily have been expensed as a loss on the acquisition of assets. However, the current recognition of the \$106.7 million expense was deferred under the accounting requirements related to regulated operations and the amount of the deferral is accounted for as a regulatory asset (see Note 2—Accounting for Rate Regulation). The regulatory asset for the deferred prepaid lease expense is being amortized into expense beginning December 18, 2009 through the remaining life of Springerville Generating Station Unit 3 ending in 2056. The amortization of the deferred prepaid lease expense associated with the Springerville Generating Station Unit 3 Lease was \$2.3 million and \$89,000 in 2010 and 2009, respectively, and is included in depreciation and amortization. The deferred prepaid lease balance was \$104.3 and \$106.6 million at December 31, 2010 and 2009, respectively, and is included in deferred charges.

Upon reaching a 51 percent equity ownership interest in the Springerville Partnership at December 22, 2010, the Association's commitments for Springerville Generating Station Unit 3 Lease payments reflect the amount of the payments less the debt commitments for the Springerville certificates reflected in Note 4 and the amount of the payments that come back to the Association as the 51 percent equity owner of the Springerville Partnership. The lease payment commitments relating to repayment of 49 percent of the equity funds at December 31, 2010 are as follows (thousands):

2011	\$	50
2012		51
2013		54
2014		55
2015		56
Thereafter		188,942
		<u>\$189,208</u>

In the 29th year of the lease and at the end of the 34-year lease term, the Association will have an option to acquire any remaining portion not previously purchased of the leased facility for a fair market value price determined in October 2003 as of each of those dates. Alternatively, at the end of the 34-year lease term, the Association will have an option to renew the lease for a term of up to 42 months and a second option to extend the lease for an additional term of up to 54 months.

In accordance with the Facility Lease Agreement and other related agreements, the Association has provided guarantees to the Owner Lessor for certain events that extend through the term of the lease. These include customary general and tax

indemnities as well as protection for the Owner Lessor against changes in regulatory law that would have a detrimental impact on the lease assumptions. Upon acquiring the 49 percent equity interest in the Springerville Partnership on December 18, 2009 (and thereby an effective 49 percent ownership in the Owner Lessor), the Association only continued to have guarantees to others with respect to the 51% equity interest owners. After increasing its equity interest in the Springerville Partnership to 51 percent on December 22, 2010, the Association only continued to have guarantees to others with respect to the 49 percent equity interest owners. The Association believes that the likelihood of these guarantee events occurring is remote and therefore no liability is recorded as of December 31, 2010 and 2009.

Generating Stations with Gas Tolling Arrangements:

The Association has entered into power purchase arrangements that are required to be accounted for as operating leases since the arrangements are in substance leases because they convey to the Association the right to use power generating equipment for a stated period of time. One such agreement began in June 2008 for the use of the Rawhide Generating Station (owned by Platte River Power Authority). This agreement allows the Association to toll natural gas for 100 megawatts of power from the combustion turbines beginning in 2008 that declines to 50 megawatts in 2012. Additionally, the Association has 10-year agreements with Thermo Cogeneration Partnership to toll natural gas at the Ft. Lupton Generating Station for 150 megawatts which began on July 1, 2009 and with Brush Cogeneration Partners to toll natural gas at the Brush Generating Station for 72 megawatts which began on October 1, 2009. Under these agreements, the Association directs the use of the contracted generating equipment over the terms of the contracts under tolling arrangements whereby the Association provides its own natural gas for generation of electricity. These agreements are therefore in substance leases and are accounted for as operating leases. The Association's operating lease commitments for these gas tolling arrangements at December 31, 2010 are as follows (thousands):

	2011	\$ 19,210
	2012	16,865
	2013	15,686
	2014	15,954
	2015	16,240
	Thereafter	62,143
		<u>\$146,098</u>

Note 8—Related Parties

Yampa Project:

The Association acts as the operating agent for participants of the Yampa Project and related common facilities.

Basin Electric Power Cooperative (“BEPC”):

BEPC is a wholesale power supply cooperative of which the Association is a member. The Association purchased power from BEPC at a cost of \$86.0, \$71.9 and \$65.5 million in 2010, 2009 and 2008, respectively. The Association's investment in BEPC was \$60.4 and \$57.2 million at December 31, 2010 and 2009, respectively, and is included in investments in other associations. The Association's share of BEPC capital credit allocations was \$3.2, \$7.7 and \$13.4 million in 2010, 2009 and 2008, respectively, and is included in capital credits from cooperatives.

National Rural Utilities Cooperative Finance Corporation:

Investments in other associations includes a \$44.6 and \$45.2 million investment in CFC as of December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the total outstanding debt owed to CFC was \$172 and \$189 million, respectively. The Association's share of CFC capital credit allocations for 2010, 2009 and 2008 was \$1.4, \$1.4 and \$1.9 million, respectively, and is included in capital credits from cooperatives.

Notes to Consolidated Financial Statements

CoBank, ACB (“CoBank”):

Investments in other associations included a \$4.0 and \$3.7 million investment in CoBank as of December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the total outstanding debt owed to CoBank was \$77.1 and \$81.2 million, respectively. The Association's share of CoBank capital credit allocations for 2010, 2009 and 2008 was \$861,000, \$939,000 and \$1.2 million, respectively, and is included in capital credits from cooperatives.

Trapper Mining:

The Association and certain participants in the Yampa Project own Trapper Mining. Organized as a cooperative, Trapper Mining is the Yampa Project's primary coal supplier. The Association's membership interest in Trapper Mining of \$11.5 and \$11.1 million at December 31, 2010 and 2009, respectively, is accounted for as an investment in coal mines. The Association's share of coal purchases from Trapper Mining was \$15.3, \$15.3 and \$15.2 million in 2010, 2009 and 2008, respectively. The Association's investment in Trapper Mining is recorded using the equity method. In 2010, 2009 and 2008, gains of \$412,000, \$2.4 and \$1.9 million, respectively, are included in capital credits from cooperatives.

Western Fuels Association:

WFA is a non-profit membership corporation organized for the purpose of acquiring and supplying fuel resources to its members, which include the Association and BEPC. WFA supplies fuel to MBPP through contracts with coal companies and through its ownership in Western Fuels-Wyoming, which owns and operates the Dry Fork Mine. The Association also receives coal supplies directly from WFA for the Escalante Generating Station in New Mexico and spot coal for the Springerville Generating Station in Arizona. The Association's share of coal purchases from WFA was \$72.8, \$65.4 and \$73.5 million in 2010, 2009 and 2008, respectively.

The Association advanced funds to WFA, through MBPP, for mine and equipment purchases and mine development costs. The fund advance balance of \$4.1 and \$6.3 million at December 31, 2010 and 2009, respectively, is included in investments in coal mines. The Association's membership interest in WFA, including interest through MBPP in WFA, totals \$1.9 and \$2.0 million at December 31, 2010 and 2009, respectively, and is included in investments in other associations. The Association's investment in WFA is recorded using the equity method. The 2010, 2009 and 2008 gain (losses) of \$(44,000), \$(102,000) and \$463,000, respectively, are included in capital credits from cooperatives.

Note 9—Pension Plan

All employees of the Association participate in the National Rural Electric Cooperative Association Retirement and Security Program. Contributions to the Retirement and Security Program fluctuate from year to year. The Association's contributions totaled \$23.1, \$15.7 and \$13.1 million in 2010, 2009 and 2008, respectively. Contributions for all participating employers are actuarially determined to fund the benefits of all retirees as the benefits become due and future contributions could increase as new determinations are made. In this master multiemployer defined benefit plan, the accumulated benefits and plan assets are not identified separately by individual employer.

Note 10—Commitments And Contingencies

Sales:

The Association has delivery obligations under resource-contingent firm power sales contracts with PSCO totaling 225 megawatts in the summer season and 275 megawatts in the winter season. These contracts expire in 2011, 2016 and 2017. Also with PSCO, the output of the two gas turbines at Knutson Generating Station and one gas turbine at the Limon Generating Station has been sold under two contracts for a total of 210 megawatts in tolling capacity sales that expire in 2016. The tolling arrangements at Knutson and Limon are accounted for as operating leases and the lease revenues are reflected in other operating revenue on the statements of operations. The Limon turbine contract was suspended for a period of four years beginning in May 2009 and the Knutson turbine contract was suspended for a period of three years beginning in May 2010 to allow the Association to utilize the output of the turbines. Both turbine contracts resume with PSCO under the original tolling arrangements for the period May 1, 2013 to April 30, 2016.

In addition, the Association has (1) a resource-contingent firm power sales contract of 100 megawatts to Salt River Project through August 31, 2036, (2) a firm power sales contract committing up to 13 megawatts to BEPC through 2025, (3) a resource-contingent firm power sales contract with PacifiCorp committing 25 megawatts through 2020, (4) a resource-contingent firm power sales contract with Shell Energy North America of 50 megawatts through September 30, 2014 and (5) a resource-contingent tolling power sales contract with Shell Energy North America of 40 megawatts from the Pyramid Generating Station through September 30, 2014. The tolling contract at Pyramid is accounted for as an operating lease and the lease revenue is reflected in other operating revenue on the statements of operations.

Purchase Requirements:

The Association is committed to purchase coal for its generating plants under long-term contracts that expire between 2014 and 2034. These contracts require the Association to purchase a minimum quantity of coal at prices that are subject to escalation clauses that reflect cost increases incurred by the suppliers and market conditions. The projection of contractually committed purchases is based upon estimated future prices. At December 31, 2010, the annual minimum coal purchases under these contracts are as follows (thousands):

	2011	\$ 137,592
	2012	143,605
	2013	148,660
	2014	147,191
	2015	113,412
	Thereafter	426,664
		<u>\$1,117,124</u>

Indemnities:

The Association agreed to indemnify certain lessors and purchasers of the tax benefits under the safe harbor leases (see Note 2—Deferred Equity Note) should certain disqualifying events occur, the most significant being the failure of the Association to maintain its status as a taxable entity. Certain other safe harbor leases, not acquired by the Association, also contain indemnity responsibilities that were assumed in 1992. Should a disqualifying event occur related to 2010 or prior, specified payments must be made to the lessors and purchasers of \$15.9 million, decreasing ratably through expiration in 2024.

Environmental:

The Association's electric generation facilities are subject to various operating permits and must operate within guidelines imposed by numerous environmental regulations. The Association believes these facilities are currently in compliance with such regulatory and operating permit requirements.

Deregulation:

The operating environment of the electric utility industry has moved toward partially regulated competition with the passage of the 1992 Energy Policy Act and subsequent Federal Energy Regulatory Commission orders that deregulate sales among power resellers. As a result, end-user deregulation was left to the states, and the Association is actively monitoring proposed legislation. The effects of potential legislation on the financial position or results of operations of the Association are not known at this time.

Notes to Consolidated Financial Statements

Legal:

On October 19, 2004, WFA and BEPC filed a complaint with the Surface Transportation Board (“STB”) alleging that the shipping rates instituted by the BNSF Railway Company (“BNSF”) for the delivery of coal to the Laramie River Station were unjust and unreasonable. On July 27, 2009, the STB issued its final decision, upholding the complaint and ordering refunds and shipping rate reductions to WFA and BEPC. On September 2, 2009, BNSF appealed the STB decision to the United States Court of Appeals for the DC Circuit. Notwithstanding the appeal, BNSF refunded certain amounts and reduced shipping rates. Those reductions were passed on to WFA’s and BEPC’s members, including the Association. However, those reductions are subject to refund in the event BNSF is ultimately successful in its appeal. Due to uncertainties regarding the ultimate outcome of this matter, the Association did not recognize the benefit of the receipt of \$29.4 million in 2009 in the consolidated statements of operations. Instead, the \$29.4 million was recorded as a liability and is included in deferred credits and other liabilities at December 31, 2010 and 2009. The receipt of the cash in 2009 is reflected in operating activities—other on the consolidated statements of cash flows. To the extent that the issue related to the cash receipt is ultimately resolved in favor of the Association, the benefit will be recorded as a reduction in fuel expense at that time. The Court of Appeals affirmed the District Court Decision on May 11, 2010. On or about December 2, 2010, BNSF filed a Petition for Certiorari with the United States Supreme Court. The Association is unable to project the outcome of this matter.

On September 28, 2009, five of the Association’s Nebraska members filed suit in the United States District Court for the District of Nebraska alleging that the Association, inter alia, had breached its member contracts with those five members. The suit seeks a separate rate to be applied to the five members and/or an order of the Court permitting the five members to withdraw from the Association on terms to be determined by the Court. On August 19, 2010, the Nebraska court granted the Association’s motion and transferred venue of the case to the District of Colorado. The Association denies the claims and intends to assert all available defenses. The Association is unable to project the outcome of the litigation.

On April 10, 2010, the Sierra Club filed suit in the United States District Court for the District of New Mexico against the San Juan Coal Company, Public Service company of New Mexico, PNM Resources and Billiton, Ltd. The suit alleges violations of the Resource Conservation and Control Act (“RCRA”) and the Surface Mining Control and Reclamation Act of 1977 (“SMCRA”) with respect to the operation of the San Juan Generating station in New Mexico. The San Juan Coal Company provides fuel to the San Juan Generating Station. The Association is not an owner of the San Juan Coal Company. It owns less than 5 percent of the San Juan Generating Station. Pursuant to the existing Operating Agreements, Public Service Company of New Mexico, as the Operating Agent of the San Juan Generating Station, is defending the action. The Association is not a party to the case and is unable to project the outcome of the litigation.

Tri-State/Member System Consolidated Financial Data

(Unaudited)

<i>(Thousands)</i>	Total Assets	Equity	Net Margins	Equity as % of Assets
2010				
Members	\$3,320,321	\$1,536,068	\$ 115,773	46.3
Tri-State	3,794,155	833,790	77,144	22.0
Less eliminations	(804,345)	(709,511)	(77,144)	
System consolidation	\$6,310,131	\$1,660,347	\$ 115,773	26.3
2009	6,114,514	1,571,203	130,560	25.7
2008	4,805,372	1,302,436	138,924	27.1
2007	4,630,006	1,200,219	143,862	25.9
2006	4,447,187	1,086,235	92,798	24.4

<i>Members Only (Thousands)</i>	2010	2009	2008	2007	2006
Revenues	\$1,437,195	\$1,355,178	\$1,290,934	\$1,148,722	\$1,022,645
Operating margins	33,274	23,530	36,664	37,914	36,167
Net margins	115,773	130,560	138,924	143,862	92,798
Plant in service (net)	2,124,009	2,061,546	1,958,336	1,840,024	1,727,015
Total assets	3,320,321	3,171,371	2,934,692	2,729,313	2,511,866
Long-term debt	1,403,054	1,363,741	1,275,200	1,201,665	1,145,829
Equity	1,536,068	1,441,528	1,302,436	1,200,219	1,086,235
Equity as a % of assets	46.3	45.5	44.4	44.0	43.2
Average retail rate (mills/kWh)	98.9	99.1	95.9	89.8	82.4
Times Interest Earned Ratio	2.65	2.91	3.12	3.28	2.59
Debt Service Coverage Ratio	2.23	2.32	2.54	2.51	2.28

Source: 2010 Members' Form 7s.

Tri-State Generation and Transmission Association, Inc. is committed to a policy of considering individuals without regard to race, color, sex, sexual orientation, religion, national origin or age in decisions involving hiring, promoting, transferring, training or any other terms or conditions of employment. Furthermore, Tri-State will take affirmative action in the hiring, promoting, transferring and training of special disabled veterans of the Vietnam era and disabled individuals.



A Touchstone Energy Cooperative 

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