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INSTALLATION OF EMISSION CONTROL EQUIPMENT AND ASSOCIATED FACILITIES AT GALLATIN FOSSIL PLANT

On August 18, 2011, the TVA Board of Directors approved the funding for the installation of additional emission controls and associated facilities at TVA's Gallatin Fossil Plant. The Board's approval was expressly conditioned on satisfactory completion of all required environmental reviews. The Board delegated to the Chief Executive Officer the authority to make future decisions about these Gallatin projects.

I have been informed that TVA now has completed all required environmental reviews. An Environmental Assessment (EA) has been completed in accordance with the National Environmental Policy and it has been determined that the proposed actions would not significantly impact the environment. TVA has consulted with the U.S. Fish and Wildlife Service (Service) about the projects' potential effects on species listed as endangered or threatened under the Endangered Species Act. The Service has concurred with TVA's determination that there will be no effect on most listed species and that other listed species are not likely to be adversely affected. Finally, TVA has coordinated the proposed projects with the Tennessee Historic Perseveration Officer and interested federally-recognized Indian tribes in accordance with the National Historic Preservation Act.

A final decision on whether to proceed with the proposed projects can now be made. In making this decision, I have considered the Final EA and the comments that TVA received on it.

TVA released a draft of the EA for public review and comment. In response, TVA received almost 1,200 comments from federal and state agencies, environmental advocacy groups, other entities, and individuals. Many of these were form letters or emails that were prepared and distributed for use by the Sierra Club. TVA also received a few letters primarily from the Sierra Club and other environmental advocacy groups that provided more detailed, substantive comments on the EA. TVA reviewed and responded to these comments in the Final EA. The general theme of the comments opposing the projects was that TVA should retire the Gallatin coal units and rely on energy efficiency or some other, cleaner energy resource like natural gas.

In addition to TVA's environmental review determinations and the public comments it has received, the following are important considerations in whether to proceed with the proposed projects:

- The TVA Board approved entering into a Clean Air Act compliance agreement with the U.S. Environmental Protection Agency and a substantially similar consent decree with the States of Alabama, Tennessee, Kentucky, and North Carolina and three environmental advocacy groups, including the Sierra Club, in April 2011. Under those agreements, TVA agreed to retire 18 of its 59 coal-fired units and it was accorded the discretion to decide how to reduce emissions at its other units, including Gallatin. The

Sierra Club and other parties to the consent decree expressly recognized that the consent decree provided TVA a great deal of flexibility to control its remaining units to a greater or lesser degree and that this approach was "adequate and reasonable." The projects proposed at Gallatin would comply with these agreements.

- Under EPA's recent Mercury and Air Toxics Standards (MATS) rule, TVA and other operators of coal-fired power plants must take action to reduce emissions from their plants. Compliance with the rule is required by April 16, 2015, but States can extend this deadline by one year to April 16, 2016. This is a very tight schedule for completing the actions necessary to comply with the MATS rule and TVA anticipates that it will need an extension in order to complete the compliance projects proposed for Gallatin. Any delay in commencing and completing those projects could jeopardize TVA's ability to comply with the MATS rule.
- The proposed control projects would substantially reduce emissions from Gallatin. Sulfur dioxide and nitrogen oxide emissions would be reduced by approximately 96 and 90 percent, respectively. Emissions of mercury and other toxic pollutants also would be substantially reduced. The proposed dry coal combustion product landfill would be double lined and provide TVA a more environmentally better means of managing Gallatin's ash and other combustion products. Collectively, the proposed projects would greatly reduce the plant's impact on the environment.
- The cost of these projects is approximately $1.1 billion. This is more than TVA's cost to complete the new 880 MW natural gas combined cycle plant at John Sevier, approximately $790 million. On a kilowatt basis, the Gallatin projects cost approximately $1,000/kW. New combined cycle natural gas plants are being built for approximately the same cost per kW, $1,000/kW. Both Gallatin and combined cycle natural gas plants likely will have to make additional environmental investments in the future, but the investments to meet new regulations at coal plants are expected to be more.
- TVA's March 2011 Integrated Resource Plan (IRP) and associated Final Environmental Impact Statement evaluated a wide range of strategies and actions for meeting demand for electricity from the TVA system in the future. The Board approved a planning direction that commits TVA to achieving a more balanced, diverse portfolio of energy resources on the TVA system. This includes relying more on nuclear and natural gas generation, renewable energy and energy efficiency; energy resources that are cleaner than coal-fired generation. TVA is in the process of implementing this planning direction and is working to increase its use of all of these resources. However, a balanced portfolio includes continued use of some of TVA's coal-fired resources.
- The planning direction approved by the Board specifically includes retiring from 2,400 to 4,700 MW of TVA's coal-fired capacity. The Clean Air Act agreements with EPA, the States, and environmental advocacy groups committed TVA to retire 18 of its coal units with a total combined capacity of 2,032 MW (net dependable). TVA expects to retire more of its coal units. As part of its IRP studies, TVA analyzed the merits of retiring each of its coal-fired units and ranked the units in groups from best to worst candidates for retirement. The Gallatin units were ranked in the group that should be considered

last for retirement. Saying this differently, it was determined that TVA should continue to operate the Gallatin units and only consider them for retirement after other units are retired. Subsequent analyses confirmed these results.

- The Gallatin coal units were placed into commercial operation from November 1956 to August 1959. The units fulfill two important roles on the TVA system. First, they are the primary source of real or actual energy used in the Nashville area. Second, they provide critical voltage support for the area and are important to maintaining reliable electric service in the area. Despite their ages, these units have been some of the best performing coal units on the TVA system. Not only does the plant's reliability (based on forced outage rates) place it in the top quartile of TVA's coal fleet, no plant has a better reliability record over the last five years.
- The normal number of employees at Gallatin varies, but generally is around 150. They and their families are an important part of the local community. These employees have demonstrated a continuing commitment to good performance and have won a number of environmental excellence awards for innovative projects to enhance the plant's environmental performance and make it more cost effective.

Weighing all of these factors, especially the comments we have received and the cost of these projects, I think it is a close question whether to proceed with the projects. I have concluded that the Board's direction from the IRP to achieve and maintain a more balanced portfolio tips the decision in favor of proceeding with the proposed projects. TVA is going to retire more coal units in the future, but the Gallatin units are performing very well and there are better candidates for retirement on the TVA system.

The proposed projects will greatly improve Gallatin's environmental profile and help ensure that this plant can continue to operate in the future in compliance with applicable requirements and the commitments TVA made in the Clean Air agreements to U.S. EPA and others, including the Sierra Club.

I authorize you to proceed with these projects.

William D. Johnson
President and
Chief Executive Officer
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