

A New Direction? Analysis says yes.

A leadership position we do not want. Beartooth Electric members pay the highest electricity rates in Montana. Between 2004 when BEC helped start a new wholesale power cooperative, Southern Montana Electric, and 2011 when Southern declared bankruptcy our costs to purchase power and the rates we charged members more than doubled. Rates held steady from 2012 until now. As we reported at member meetings early in April, we finally are on financial ground that positions us to begin, carefully, reducing rates and changing that 10-year trend line.

Can we afford to decrease rates? We plan to begin reducing rates in 2015 because of projected savings in two areas. First, cost reductions resulting from the management agreement with Lower Valley Energy will produce savings to support a small decrease in 2015. Second, this year's budget markedly reduces expenses for legal and other services we have employed over the past three years to help secure a sustainable (for BEC) resolution of Southern's bankruptcy. Additionally, we calculate that between 2004 and 2010 BEC paid Southern nearly \$5 million on top of the high rates we paid to purchase power and invest in the Highwood Generating Station (HGS). Those cash calls and mind-bending expenses will not recur. While there still is exposure to additional Southern costs, the risk is lower than at any time in Southern's history.

In March an independent firm presented a Cost of Services Analysis to the BEC due diligence committee and board. The COSA, an industry-standard analysis tool for co-ops, confirms reductions in costs at BEC in 2015 and a corresponding reduction in required revenue. From a second perspective BEC Financial models, developed with the help of a separate firm, look at the longer-term impacts of a Southern exit and predict cost reductions that support member rate reductions.

With the bankruptcy resolved and an exit from Southern in sight we calculate that BEC can supply power responsibly and provide a demonstrably affordable initial rate decrease – a small step on the new trend line.

At a member meeting in Columbus BEC Manager Jim Webb set the criteria for evaluating our performance. "What matters," he said, "is that we supply quality service for members and reduce costs so the board can reduce rates."

Southern Montana Electric. Leaving Southern -- the sooner the better -- will help reduce rates at BEC. Reaching agreement on an early exit from Southern has been harder than expected, but we believe we are close. If we do not secure an immediate exit we will leave Southern when the HGS notes are paid. Southern anticipates complete payment of the notes within two years.

What's next? We are actively analyzing power supply options to follow our current power contract that ends in October 2017. Working with an established

power resource firm we reviewed market projections and potential approaches for a search for power at BEC. The firm's report notes a favorable market and suggests approaches for a search for power. Our new management team, the due diligence committee, and the board have set a priority on defining a search process and identifying criteria for evaluating supply options.

Stay informed. Stay involved. We are managed by a team from the co-op with the lowest residential rates in the country and a history of excellent management and member services. We will be making major decisions about power supply and maintaining our system – the nuts and bolts that affect both your rates and your service. Please pay attention and provide input. Board trustees welcome your calls and comments.

The reports cited in this report are available from the co-op and on our website www.beartoothelectric.com.

Arleen Boyd, Due Diligence Chair, District 5 Trustee
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