Risk Management Report – November 2016

Risk Management Meeting with Bylaw Committee and Policy Committee November 8, 2016, Red Loge office.
Committees and Board Present: David Alberi, Dick Nolan, Frank Willett, Bill Pascoe, Judith Gregori, Deb Thomas, Janet Luloff, Mike Specht, Burt Williams, Sharlene McComa Roxie Melton, Arleen Boyd, Dan Dutton. Attendees via phone and video: David Peterson, Larry Martin, Jim Webb, Angie Jennings.

Agenda

- Letter from LVE
- Governance issues
- Standalone and merger comparison – status
- Analysis options
- Board action alternatives

Committees agreed that either Jim or David could correct some mistaken conclusions in Rod Jensen's letter to the board. The BEC bylaws require member approval for construction of generation facilities, but only notice to members for power contracts and long-term debt (see included Risk Management Discussion Points). LVE will not support those provisions and members of the bylaw committee noted that these were key – if merged LVE could make any decisions regarding power supply, including building generation or a G&T membership for the BE region in the future.

The group discussed the BEC survey results showing over one third of respondents not supporting a merger, many undecided and fewer in favor. The group agreed that merger approval would be difficult to attain because many members do not want to give up their co-op. A compelling case for merger would require a significant rate advantage and additional benefits in reliability, member programs, and services.

The current risk management comparison of merging and remaining independent (standalone) assumes that under merger BEC will be responsible for paying its power supply costs and distribution expenses. A&G expenses for the BEC area would be part of the shared co-op expense and offer the merger opportunity for savings. A&G represents approximately twenty-five percent of BEC expenses. Without the full merger analysis BEC cannot accurately project potential member rates. The group discussed whether an approximation or range of possible rate impact from estimated A&G savings could allow BEC to evaluate going forward. At what point would the potential rate reduction be too small to justify performing the full analysis of other potential benefits and recommending that BEC be absorbed into LVE?

As requested at the last committee and board meeting Bill Pascoe presented a spreadsheet representation (attached/included in packet) of the critical-path for merger evaluation. The list of critical path analysis actions also notes supporting action (legal examination, governance comparisons, negotiations). With the LVE board letter statement that LVE will from this time forward "manage Beartooth under strict adherence to management agreement terms," the spreadsheet presents costs assuming BEC responsibility for all analysis expenses. The committee endorses the analysis approach prior to making a merger recommendation but recommends that the time and expense be evaluated in the context of possible alternative actions outlined in the attached report.

The group discussed the possibility of continuing to work with LVE without a merger and endorses approaching LVE with proposals for cooperating without merging. Possibilities include: continue the existing management agreement; cooperate in areas currently covered by the agreement, but hire a manager to relieve LVE of management responsibilities; continue O&M and engineering cooperation with compensation sufficient to make it desirable for LVE.

Attorney Larry Martin noted that the management agreement or shared services agreement eliminates the legal risks, still undefined, in a two-state merger. There are challenges of governance issues between the two co-ops.

The governance list prepared by risk management, bylaw and policy committees was scheduled for review by Jim Webb and Richard Peck to identify sticking points and potential solutions. The group recommends keeping the consulting arrangement with Peck on hold until the board decides whether the merger analysis is going forward as originally planned. The detailed points on the list would require examination and negotiation should the BEC Board continue on the merger path.

Issues with Standalone Forecast (document attached). With the current merger and standalone forecasts in different formats and needing corrections and additions Frank Willett outlined what is needed for standalone information to provide both a solid financial analysis for independent BEC and a basis for a merger comparison. Whether a merger is contemplated or not, the information is necessary for financial planning at BEC. Several committee members endorsed the idea as what many member are asking for: a real analysis of standalone BEC that will allow what-if looks at standalone with shared services or other cost savings measures.

Group reviewed Arleen's report (attached/included) on shared services in the Montana region. It indicates that sharing services is becoming common and opportunities are likely available. Co-ops are becoming aware of the potential opportunities for reducing costs by sharing services and may consider taking such actions in the future.   Some committee members said that examination of that potential is what members have been asking for. David suggested that BEC could investigate potential shared services opportunities with Montana co-ops. Arleen said that an investigation of potential areas for co-op sharing could be done without any implication of intention to do anything. Several co-ops are asking how, theoretically, such agreements could be done and what they could cover.

<u>Recommendations:</u>

Explore options for continuing to work with LVE without a merger.
Review options for merger analysis and decide on a path (see attached merger rate analysis schedule that Bill Pascoe presented at the meeting).
Pursue Frank Willett's risk management recommendation to assemble the data for the standalone forecast and complete a model that allows ready review of what-if options.
Keep consulting agreement with Richard Peck on hold pending board decision on continuation of merger path.

<u>Questions</u>

What options are available to reduce costs as a standalone including sharing services with other in-state co-ops?
Is there a rate reduction level that would be acceptable to members as justifying a merger?
What are the implications for future management and the retiring board if up to one third of BEC members did not want to merge?