

Risk Management/Southern/Legal Board Report, May 2016

Risk Management

We delayed the May risk management meeting until June 17 because we expect to have by then critical materials that currently are being developed: A 7-year financial forecast for Beartooth as an independent co-op that is being drafted by Wade Hirschi and an analysis performed by E3 Analytics of the impact on member rates from the potential Fall River and Lower Valley consolidation. The methodology for assessing the impact of savings on rates is expected to be useful in calculating rate impact for Beartooth and LVE in a potential merger or consolidation.

The Risk Management Selection Committee reached agreement with GDS Associates, Inc. to perform the initial phase of an independent evaluation of our due diligence/risk management process, conclusions regarding NorthWestern Energy acquisition, and the ongoing merger vs. standalone comparison.

The initial assessment will be a review of existing documents including the results of the NWE model for acquisition. The second phase of the analysis will advise on the merger/standalone comparison. The scope of work for the initial phase is attached.

Next Risk Management meeting is June 17 in Red Lodge. The agenda will include:

- Review 7-year financial projection for standalone BEC
- Review E3 analysis of report on consolidation of Lower Valley and Fall River
- Prepare governance comparison framework
- Discuss a recommended process for developing a memorandum of understanding/contract for a merger and identify necessary issues to address

Southern Montana Electric

Southern Montana Electric passed a resolution to take no further action to appeal the FERC decision to deny the Southern request for payment from NorthWestern for the LGIA investment at the Highwood Generating Station site. We agreed with the decision and took no further action to appeal the ruling.

Southern financials show that full payment of the HGS noteholder obligation will be completed by June 1. Under the bankruptcy reorganization the noteholders assumed responsibility for administering the required construction lienholder payments for which BEC shares responsibility. The payments are made to the noteholders who pay the lienholders. The lienholder final payment of approximately \$1 million is scheduled for June. Once the noteholders are paid, BEC has no further obligation to pay Southern expenses as we have been doing under the exit agreement.

Legal

Our counsel has prepared a memo outlining the issues surrounding the FERC ruling to pay refunds for Schedule 3 transmission service overcharges, which you will receive before the board meeting. Our exit agreement with Southern provides for BEC to receive payment of our share of the overcharge refund. Counsel will report on discussions with Southern's counsel on how Southern will handle the payment from FERC and how payment will be made to Beartooth. The FERC ruling orders payment within 30 days. NWE announced its intention to appeal the decision in court. An appeal must be filed within 60 days of the ruling. Our attorneys will report on the likely outcome of the payment schedule and appeal timing.

We have asked counsel to reexamine the exit agreement and confirm that all requirements for BEC and Southern are in order.

Larry Martin will report to the board at the May 31 board meeting on the status of the Columbus fire case and will review a memo outlining the issues surrounding the FERC ruling for refunds of NorthWestern Energy overcharges for Schedule 3 transmission services to Southern and other

wholesale power suppliers. Most of the information is public but we will receive an attorney/client briefing on legal issues surrounding the NWE payments anticipated for BEC in closed session.

Counsel will review the report from Dorsey Whitney and report at the June board meeting on recommended action for BEC regarding legal requirements under Montana law for merger agreements.