

Risk Management

The Committee met April 20, 2016. Committee members present: Dave Alberi, Judith Gregori, Frank Willett, David Peterson, Roxie Melton, Arleen Boyd with Bill Pascoe on the phone.

Attending by phone: Larry Martin, BEC legal counsel, and Gail Tabone from EES Jim Webb and Wade Hirschi attended by video connection.

The committee reviewed the EES Evaluation of Potential Consolidation Between Lower Valley Energy, Fall River Cooperative and Beartooth Electric Cooperative, including comments and questions from committee members. Despite the current uncertainty about the consolidation between LVE and FREC, having the report as accurate and clear as possible is important because:

- Consolidation could occur soon or arise as a possibility again later causing BEC to be in a cooperative including all three parties.
- The assumptions about savings at BEC are very close for merger or consolidation -- the big differences were in the power supply issues that now are not included in the report.
- The procedure for rate setting is most important and, while not fully defined, is likely similar in both scenarios.
- We will provide the EES report to the independent consultant reviewing our due diligence/risk management process as the EES report addresses many of the key issues we have used for due diligence and will be examining.

The current EES document has changes suggested by the committee and remaining changes will be made for a final version. The report refers to procedures and assumptions that raise fundamental questions to be addressed outside the scope of the report. We highlighted those issues in committee. The board will receive a copy with those issues highlighted. The most critical question raised is how rates will be set, which the EES study flagged but did not address.

The committee noted that critical information required for comparison of the standalone and merger options includes the rate model that LVE has commissioned E3 Consulting to prepare and a 7-year forecast for standalone BEC based on current numbers and an update of financial forecast information reviewed in January. The E3 model will address the consolidation savings and potential rate impact on LVE and Fall River Electric. Jim Webb expects the model to be completed within two months. The model could then be used (cost to BEC to be determined) to provide rate predictions for BEC and LVE with implementation of a merger. Wade Hirschi plans to complete a seven-year forecast in the same timeframe.

After Wade's presentation the committee focused on the need to understand how the proposed rate setting would work in to calculate the suggested COSA information (costs attributed to each separate region) and the costs included in shared overhead. There was agreement that clarification now would make the comparative evaluation more focused and that exactly how those categories would be defined and calculations applied would be a critical part of the process of crafting an agreement for a merger or consolidation. Understanding the scope and content of that agreement (to be negotiated) will be critical to projecting the impact of a merger on members.

Data required to complete comparison of a merger to remaining an independent co-op include:

- Updated EES report

- Updated standalone forecast
- Seven-year forecast
- E3 Rate model

Next steps – In addition to numbers and rate comparisons the risk management evaluation requires looking at qualitative risks and benefits that are not so easy to quantify. These include improvements at BEC resulting from LVE staffing, expertise and performance under the management agreement. The important assessment of governance issues and corporate culture will include the legal evaluation of bylaws and policies to ensure compliance with Montana law.

Governance issues include:

- Transparency
- Bylaws, policies, articles of incorporation
- Board representation and election process
- Member access and involvement

Next steps in risk management evaluation include:

- Define and compare governance in each option
- Evaluate potential qualitative benefits
- Evaluate numbers in merger/standalone document
- Prepare for comparison and review by independent consultant

Independent consultant – Responses to our updated request for services to evaluate our due diligence examination of alternatives for BEC and examine the remaining options are due April 29. We have divided the process in two parts: 1) examination of the process and information we have used and are using to assess alternatives followed by 2) an analysis of the actual options when we know the status of plans regarding a potential LVE/FREC consolidation. We expect completion of the first phase by May 27.

Legal – Larry Martin reports that the risk management meeting provided information to better understand the issues and numbers addressed in the EES study and the initial merger/standalone numbers developed by Wade Hirschi. He is prepared to review bylaws and other material for compliance with requirements under Montana law to protect member rights and to cooperate with the firm looking at the requirements for LVE and FREC.

Larry will report to the board on discussion among the Southern and BEC lawyers regarding the FERC decision, announced on May 21, granting NorthWestern Energy's request to close the Large Generation Interconnection Agreement with Southern and deny payment requested by Southern for investment in the transmission interconnection facility and equipment upgrade costs.

Southern Montana Electric and SME

The SME final documents for dissolution have been sent to the BEC board and risk management committee. Current financial reports at Southern project payment of the Highwood Generating Station notes July 2016. When the notes are paid BEC will no longer pay A&G costs to Southern

Arleen Boyd