

Due Diligence Report November, 2013

November 14 Hearing on Motion to Remove Southern Montana Electric G&T Cooperative Trustee Lee Freeman. The motion was filed by Fergus Electric Cooperative and joined by Beartooth and Mid Yellowstone Electric Cooperatives. Testimony supporting the motion came from Beartooth, Fergus and Mid Yellowstone. The motion requested removal based on changed circumstances making a trustee no longer necessary: Southern's member co-ops, previously deadlocked on all issues are now united in their desire to liquidate Southern and are capable of working together to accomplish the liquidation. The trustee testified that the reasons for his appointment were more complicated than just eliminating a deadlock. He testified that he had been required to address bad contracts and other problems resulting from mismanagement and incompetence by the previous general manager and Southern's board. The judge took the matter under advisement and no decision has yet been announced.

BEC Financial Model. We continue to examine potential impact on BEC rates resulting from the wholesale power rates in the trustee's plan and those we could obtain independently. The trustee's plan will result in rate increases for BEC members. We have informed the trustee in court that our members cannot afford rate increases.

BEC is in-process with its annual budget process. The finance committee and board have a stated goal to develop a budget without rate increases for BEC members in 2014.

December 10 Southern Montana Electric Bankruptcy Hearing, U.S. Bankruptcy Court, Billings. The Court will hear arguments on a motion filed by Prudential to dismiss the BEC case to deny use of its wholesale power contract as collateral. The Court also will address a motion to approve the disclosure information filed with the Liquidation Plan filed by Southern's four member cooperatives.

December 10 court conference will schedule hearing for claims and counterclaims in the adversary proceeding filed by Southern's member cooperatives. The four co-ops have jointly asserted that Southern's wholesale power contracts may not be assumed and are void for failure of consideration. Those contracts currently are the primary collateral claimed by Prudential and Modern Woodmen, holders of the notes for HGS debt.

Trustee's Proposed Plan to Reorganize Southern. The trustee has filed a plan to reorganize Southern and require its four member co-ops to remain together with a new contract to buy electric energy. In the plan's energy contract with Morgan Stanley Capital Group, Inc. the trustee provides concessions, including a significant security deposit, and agrees to keep the Highwood Generating Station operations-

ready for at least 10 years. Under the trustee's plan, operating expenses for Southern and HGS add millions of dollars each year in costs to be covered by Southern's wholesale power rate. HGS operations costs far exceed any potential revenue. We are analyzing the plan and its potential impacts.

Wholesale Power Rate. Under the trustee's plan our wholesale power rate from Southern includes:

- Cost of electricity from Morgan Stanley
- Cost of NorthWestern Energy network transmission
- Cost of keeping HGS operations-ready
- Southern's corporate operations costs
- Debt paid to HGS noteholders
- Ongoing employment of the trustee and legal professionals to represent the interests of the bankruptcy estate as needed.

Members' Proposed Liquidating Plan. Southern's four member co-ops have filed a plan to liquidate Southern.

- The Wholesale Power Contracts with Southern's members will be rejected and terminated. This will allow each member to buy power from any third party.
- HGS will be surrendered to Prudential subject to all liens.
- All of the members will release all claims and interests that they have against Southern.
- Details of other debt resolution are in the plan filed with the court.

The two competing plans are before the court. Approval of the disclosure information filed with the liquidation plan is scheduled for hearing on December 10. The trustee may file amendments to his plan and disclosure statement and ask for a hearing on December 10 as well. This could put the two competing plans on the same schedule for confirmation hearings. Disclosure for a plan must be approved before confirmation hearings may be scheduled.

Contact with Potential Power Suppliers. We continue our ongoing monitoring of power supply options. Following the trustee's examination of BEC we have responded to his demands for information we have received from potential suppliers.