

BEC Board Due Diligence Report, Southern, SME – April 28, 2014

Update on Southern Bankruptcy

On April 21, 2014 Southern Montana Electric Generation and Transmission Cooperative (Southern) filed a reorganization plan in U.S. Bankruptcy Court. Based on a settlement agreement between Southern and the Prudential- associated noteholders, the plan provides for payment of \$21 million to the noteholders over four years. The Highwood Generating Station assets will be sold by a trust to be created under the plan with proceeds of the sale going to the noteholders.

The court granted Southern's request for expedited hearings on the plan and its disclosure statement that includes details and implementation information. The order issued by Judge Ralph B. Kirscher sets the following dates:

- May 5 – last day to file objections to the disclosure statement
- May 9, 9:00 A.M. Charles N. Pray Courtroom, third floor of Missouri River Courthouse, 125 Central Avenue West, Great Falls -- hearing on the disclosure statement – video connection in Billings to be announced
- May 20, Bighorn Courtroom (Room 5503), 2601 Second Avenue North, Billings – hearing on plan of reorganization

The plan includes a process whereby BEC may withdraw its membership from Southern, subject to approval by the other Southern members, upon payment of its share of “the outstanding balance of the Restructured Notes.”

BEC Exit Negotiations with Southern Member Co-ops -- The lawyers for the Southern member co-ops have secured a mediator and set the date for the first mediation session in mid May. Additional negotiation may occur before that date. Arleen and Richard will report on the negotiation strategy in closed session. The negotiation process includes mediation and arbitration if an impasse is reached.

Southern Montana Electric – Southern's meeting focused on the agreement with the noteholders and review of some of the questions BEC presented Southern's counsel on the plan and disclosure material prepared for filing. Southern voted to give counsel authority to file the disclosure and plan. The board discussed an accelerated schedule proposed by counsel for the confirmation process. Counsel agreed with BEC's position that the schedule must include time for review of the actual financial projections for Southern's performance under the plan, the actual note to be signed with the noteholders, and the HGS trust document.

SME—SME met to examine its position as the guarantor of Southern's First Interstate Bank loan for \$600,000. The loan is secured by an SME-owned property adjacent to HGS that once was appraised at over \$1 million. SME voted to look at how to sell the property. A sale of a major co-op asset is governed by Montana law

requiring a specified timeframe for notifying members, providing appraisals, and offering opportunity for other co-ops to bid on the property. Southern's recently engaged counsel is preparing a list of appraisers. SME is not a party in the Southern bankruptcy.

Due Diligence Committee and board members have reviewed the plan and disclosure and provided comments. We have examined the reports supplied by Southern looking at the 4-year financial projection for Southern under the proposed plan. The committee endorses the request by BEC representatives on Southern's board for financial projections based on real cash flow and income statements – the numbers being used now are averages and the rate projections are optimistic and not yet based on analysis of indicative pricing from power suppliers. Southern has agreed to prepare the financial projections based on real numbers and to provide sensitivity analysis of various price points for power. The due diligence committee has prepared an analysis using a reasonable power price higher than the current projections. A higher than estimated price for power could show

FERC Order – The FERC regulatory commission on April 17 issued an order affirming the administrative law judge ruling (September 2012) that rejected the basis for the 2011 NorthWestern increases in ancillary services charges (Schedule 3). The commission ruled that, "For the reasons discussed herein and in the Initial Decision, we find that the Schedule 3 rates proposed by NorthWestern have not been shown to be just and reasonable, and that the rates resulting from the findings and methodology adopted in the Initial Decision are just and reasonable. Accordingly, NorthWestern must make appropriate refunds." This decision could result in significant refunds to Southern Montana Electric.

BEC plans meetings in districts to inform members of developments with the bankruptcy and BEC's efforts to leave Southern. NWE plans meetings in Nye and the Reed Point area to discuss their new transmission line plans. We will coordinate so that the schedules do not conflict.