



For Immediate Release
May 21, 2012

**Beartooth Electric Cooperative Request for Analysis
Mail Date: May 13, 2011**

**To: Lee Freeman, Trustee Southern Montana Electric Generation and
Transmission Cooperative P.O. Box 1295 Livingston, MT 59047**

Subject: Beartooth Electric Cooperative Request for Analysis

Dear Trustee Freeman,

The Beartooth Electric Cooperative (BEC) Due Diligence Committee is investigating wholesale power alternatives that might be available should our contract with Southern change or no longer apply.

The committee has met with five Generation and Transmission Cooperatives, potential co-op partners, and Investor Owned Utilities. All have expressed interest in exploring potential connections with BEC. All conversations have been informational only, recognizing that BEC has an all-requirements contract with Southern.

BEC is conducting due diligence investigation of potential wholesale power suppliers. We are developing a detailed comparison of key factors relating to power suppliers -- for committee analysis and as a report to the board. The factors include:

1. Wholesale power rates for BEC
2. Contract terms – duration, rate changes, load forecasts
3. Type of membership or business relationship
4. Business and business practices – size, mission, transparency, voting provisions, short and long term plans for growth and power supply
5. Power resources and generation plans
6. Resource management plans
7. Support for member programs, including conservation and load management.

This comparative evaluation of potential suppliers is the responsibility of BEC and its due diligence committee. We are certain that the Southern trustee and other Southern members are using similar criteria in their conversations with potential power suppliers, some of which BEC has attended.

This letter is a request for analysis by Southern of the Highwood Generation Station and quantification of the value of reorganizing Southern versus closing it down. These analyses will help the BEC Due diligence Committee and Board of Trustees understand and evaluate the cooperative's financial exposure and plan for managing the co-op business in light of the Southern bankruptcy. We are asking you to secure expertise to prepare the following analyses and share the results with Southern's member cooperatives before you submit a bankruptcy plan to the court:

A cost/return analysis of HGS (40 and 120 MW) under various business and market scenarios using current data and assumptions

- A full examination and update of the current engineering data and financial assumptions relating to HGS followed by an analysis of the market value and potential HGS use (40 and 120 MW) by a major G&T
- A preliminary comparison of costs to Southern's member systems of a reorganization of Southern under Chapter 11 versus liquidation.

Analysis is required on HGS similar to a BEC analysis, proposed and passed by the BEC board, but not carried out last year. That proposal was for a financial analysis of Phase One and, separately, Phase Two to calculate the impact of each Phase on BEC rates, year by year through 2019. Now we need to know the actual cost of bringing online HGS Phase One only, and Phase One with Phase Two and whether either plant configuration can cost-effectively meet market requirements based on likely power supply, load, and business scenarios. This is straightforward cost/return analysis using currently accepted data and assumptions with sensitivity analysis to test outcomes. The analysis will reveal the costs and returns for an owner/operator of HGS. Additionally, the results of the analysis should be examined relating to at least two major assumptions:

1. The current participating member systems continue to be directly responsible for HGS and meet obligations to Prudential Finance or a successor as the indenture documents require
2. A buyer is found for HGS during the bankruptcy, purchases the plant at a discount, and the member systems are responsible for some portion of the remaining obligation to Prudential after bankruptcy negotiations are completed.

The evaluation of the HGS engineering data available today and the identification of inaccurate and missing information will allow for a solid projection of HGS performance for all of the use scenarios that have been presented for the generation plant. This will allow the participating HGS Southern members to understand how, when, for what, and at what cost the plant might become operational.

We recognize that the financial impact on participating members was not adequately analyzed at Southern before the decision to build HGS was made. We also believe that the various use scenarios were created after the design/engineering phase of the project was completed. We believe that the

firming, peaking, and other scenarios were put forward to convince potential lenders and Southern's member cooperatives that building HGS was a good investment even when its intended use, as an expanded baseload plant, could not be justified financially because the member co-ops already had contracted for twice the power needed to meet their needs through 2019. Operating the plant at Southern without the bankruptcy would have produced extremely expensive power that would have been blended into Southern's power supply, resulting in higher rates for the member systems without accountability as to the cause. Moreover, member systems already had spent approximately \$37 million on planning, contracts, and construction for the initially proposed coal-fired generation station that never received funding. Approximately \$27 million (after write-off at Southern's member systems) of those investments have been brought forward to today's HGS and are not reflected in any valuation of the plant that we have seen.

We fear that the actual value of the plant on the market is well below its cost, even before the discounting that is inevitable in a bankruptcy. We need to know whether the current 40 MW plant is engineered and built to provide, without further modification, power for peaking, firming, capacity reserve or other purpose and, if so, whether it can serve those markets with competitively priced power. HGS viability for those applications determines its marketability which represents the difference for us between heavy debt spread out over time and (business as usual with a very tight belt) and disaster planning.

We also need to know, as would any potential investor, the value of the plant as a platform for a combined cycle 120 MW (or greater) resource and when and at what cost such an expansion might be a reasonable addition to the resource portfolio of a large G&T. This would give us information to evaluate the potential opportunity to sell the plant or find investors.

At recent meetings with Southern three G&Ts have each said that any consideration of HGS as a portfolio resource would follow a full engineering and business analysis like those they routinely do for all resource options. Their analyses typically include examination of projections of economic conditions, load requirements, location relative to transmission and other costs, and specific business/use opportunities like firming for a wind generation resource. Analyses like these are complex, with multiple sensitivities built in. The G&Ts have developed sophisticated models and run these calculations expertly.

Since they routinely perform such analyses, we propose approaching Great River Energy, Tri State, and Basin and engaging one of them to perform an analysis of the value of the plant and the business case for acquiring HGS or partnering with the responsible co-ops to pay for and operate the plant. Sharing the analysis with the participating Southern members would give us confidence in the data related to the plant and enable us to perform return on investment calculations with best and worst case scenarios to help plan for the potential outcomes relating to HGS.

We are asking the Southern Trustee to ask for such analysis from the G&Ts and to contract with at least one of them to deliver the analysis to Southern

members.

Additionally, BEC requests that the Trustee commission a comparative analysis of the financial impact on member systems of reorganization versus liquidation under the current Southern bankruptcy. Independent of potential objections or actions by creditors, Southern's members need to know which path, were it available, would deliver the better financial outcome for their members. While member systems can develop return on investment analyses relatively easily, developing an analysis of bankruptcy options requires expertise well beyond the application of standard analytical tools and beyond the reach, financially, of Southern's individual member cooperatives. We understand that the court may require justification for reorganization versus liquidation in a final bankruptcy plan. We, however, need to see that evaluation now – prior to the development of a plan so that we may provide input to the bankruptcy plan and process.

Requested Action

We need the results of serious analysis now. We are planning and budgeting on a short term basis because we are unable to project our future power supply, the value of an \$85 million "asset" that we have yet to pay for, or the magnitude of our responsibility for other Southern debt. A realistic analysis of the HGS asset/liability will help us put the largest potential liability in context for our planning processes. Along with a financial comparison of liquidation and reorganization options, it will help us frame projections for how we might approach any power supply entity as the amount of equity and debt we carry into negotiations will significantly affect our bargaining position.

We are asking for:

- Cost/return analysis of HGS (40 and 120 MW) under various business and market scenarios using current data and assumptions
- A full examination and update of the current engineering data and financial assumptions relating to HGS followed by an analysis of the market value and potential HGS use (40 and 120 MW) by a major G&T
- A preliminary comparison of costs to Southern's member systems of a reorganization of Southern under Chapter 11 versus liquidation.

Thank you for your attention. Please respond as soon as possible. These issues are under constant scrutiny by our board and we need to move forward with adequate information to make solid decisions for our members.

Yours truly,

Arleen Boyd, Trustee

Beartooth Electric Cooperative, Southern Montana Electric Generation and Transmission Cooperative, and SME Electric Cooperative

Copy: Lawrence Martin, Martin Smith, Jeff Weldon, Roxie Melton, Richard Peck