

An Examination of the Burns & McDonnell Report

This document serves as a section by section critique of the *Organizational and Financial Review of Electric City Power* prepared by the consulting firm Burns & McDonnell, and submitted to the City of Great Falls in November 2009.

This document details errors in the Burns & McDonnell report and disputes the Burns and McDonnell conclusions and recommendations relative to the viability of Electric City Power (ECP). The consultants posit that ECP can raise rates on its customers, thus allowing ECP to pay for itself over a long term while still pricing electric-power competitively. This conclusion, however, is premised on serious errors of fact and analysis by the consultants.

The following problems are surveyed below:

- The cost of NorthWestern electric power is dramatically overstated, because of an error in the consultants' calculation. [Table 3.1 of the consultants' report overstates the cost of NWE power by nearly \$2.5 million] This misstatement facilitates the report's false claim that Southern Montana Electric G&T Cooperative (SMEC) enjoys a competitive advantage against NWE. In reality, the true cost of ECP's electricity is greater, on average, than NWE-transmitted electricity. With the expiration of preference-power contracts in the coming years, SMEC prices will only grow. Moreover, ECP does not enjoy enough of a competitive advantage in its market to allow rates to be raised the proposed 10%.
- The City, while no longer participating in the construction of the Highwood Generating Station (HGS), is nonetheless obligated to bear some of the risk because of the requirement of ECP to buy electricity generated at HGS. The consultants understate the risk of buying power from a natural-gas-fired resource, and give an unrealistic expectation of the price of natural gas.
- The consultants, citing the "Montana Trade Act" [*sic*], failed to conduct an independent analysis of the power-supply contract between SME and PPL—which, in the absence of the HGS, is the source of ECP's electric power. The risks inherent to this contract, which extends until 2019, are minimized by the consultants. In reality, the contract obligates SMEC to get its electricity from the oldest and most unreliable plant in the PPL fleet (Corette), and also creates the problem of "net imbalances," which occur when bulk purchases of electric power do not line up neatly with customer usage. This is a serious problem which is, again, minimized by the consultants.
- The consultants undertook no thorough examination of the terms and conditions of the City's many contracts. If they had, they would have discovered that their primary recommendation—a proposed immediate 10% rate increase—is likely not permitted under the provisions of ECP customer contracts.
- Several key terms, including "net imbalances" and "the blended rate," are altogether poorly explained in the consultants' report, and potentially misleading.

This document corrects the consultants' flawed data and shows that, far from having a competitive advantage, ECP's operations are reliant on subsidies from taxpayers and other SMEC member co-ops. In this respect, the taxpayers of Great Falls have been made to bear huge debts on behalf of the municipal power company and, through their City Commission, have sold public assets like water rights to subsidize electricity used by ECP's small group of, largely, private consumers. Meanwhile, in order to sustain ECP's illusion of viability, SMEC enacted a special "blended rate" to apply to the City of Great Falls, effectively causing ratepayers in rural central and southern Montana to pay a share of ECP's electricity. This situation is entirely untenable. The City cannot in good conscience continue to use public assets to subsidize a power company which serves so few. SMEC member co-ops, likewise, cannot be expected to prop up ECP—especially when their owner/members have faced massive, almost unheard-of rate hikes at the hands of SMEC.

In general, the consultants persistently understate the risks inherent to the electric-power industry, and they do so in some fairly garbled language. Moreover, in addition to the major flaws listed as bullet points above, there are also a host of minor discrepancies between the B&M report and reality, as well as one or two recommendations which militate against the duty of all levels of government in Montana to be open and public-minded. As a whole, it is regretted that the City of Great Falls did not get better value for its money, for the Burns & McDonnell report is surely an insufficient product, grounded in facts which are simply incorrect. This document is intended to correct those errors, and give a better impression of ECP's and SMEC's dire state of operations.

SECTION-BY-SECTION ANALYSIS OF THE BURNS & MCDONNELL REPORT

Section 1.2 BACKGROUND

The first paragraph does correctly state that an affiliate of NorthWestern Energy (NWE) did breach its supply contract with the Montana League of Cities and Towns (MLCT). The authors fail to mention that the MLCT reached a settlement with NWE in which the City of Great Falls participated. While there may some basis for the implication that the customers of MLCT were victimized by this contract breach, one must understand that nearly all of the former customers of the old Montana Power Company (MPC) were victimized by the Legislature's decision in 1997 to enact "electricity" deregulation. The new paradigm created by that legislation subjected all former customers of MPC to the vagaries of the market for their electric supplies. No longer would "cost-based" power be available. The markets have not been kind to electricity customers.

The authors also fail to give a citation to the actual study commissioned by MLCT to consider acquiring NorthWestern assets. It must be understood that a key to that proposal was the notion that Montana Public Power, Inc. (MPPI) would qualify for a large quantity of BPA Preference Power at sufficiently low prices to keep the total portfolio cost low. During several meetings with the BPA, some of which were attended by representatives

of MPPI and the Public Service Commission, there was no basis to the supposition that MPPI would qualify for BPA preference power in the first place, or that BPA had any supplies of preference power to share with MPPI that wouldn't require reducing the amount available to existing preference power customers, primarily Electric Cooperatives and Public Utility Districts throughout the Columbia River basin. Therefore, the reader should doubt that the price of \$33.11/MWh cited in the first paragraph constitutes a realistic measure for comparison of anything.

On June 30, 2007, the NWE default supply rate was \$56.63/MWh, a 68% increase, as the consultants assert. However, they neglect to mention that for the fiscal year ending June 30, 2007, Electric City Power (ECP) customers paid, on average, \$51.73/MWh, and had they paid for the actual cost of the power from Southern Montana Electric Cooperative (SMEC) that year, they would have paid, on average \$58.77/MWh.¹ For the entire fiscal year, NWE residential customers paid, on average, \$49.91/MWh.²

Here, a brief explanation of how rates are set for the electricity that customers purchase from NWE. Except and until Colstrip 4 was placed into the rate base of NWE, every single electron of electricity sold to customers was produced by entities other than NWE, and NWE must secure those supplies from the market. Even with Colstrip 4 as a utility-owned resource, NWE must still secure a large amount of their supplies from others at market. Now here is an especially important point to keep in mind. NWE is not permitted to mark-up those inventories they receive from others for delivery to their customers. It is a straight dollar for dollar pass-through. They are not permitted one penny of profit on those market purchases. The offset to that arrangement is that they are to bear no loss from those exchanges either. The premise of no mark-up is to remove any incentive for them to secure supplies at higher, rather than lower prices. I must stress the importance of this as one considers the comparisons the consultants frequently make throughout their report between power supply costs from NWE versus SMEC and ECP.

At this point, someone might ask the obvious. If NWE isn't permitted a mark-up on power supply inventories, how do they make a profit? By and large, their opportunity for profit comes from their transmission and distribution services regulated by the PSC, interstate transmission services regulated by the Federal Energy Regulatory Commission, and, recently, the inclusion of Colstrip 4 into PSC-regulated rate-base.

Table 1.1 on page 1-3 contains some minor errors. Compared to information on file at the Montana Public Service Commission (PSC) the ending dates for Block 2 and Block 3 are incorrect as they extend through Dec. 31, 2011, not 2008. The amount for Block 2 doesn't indicate that the 8 MW is for off-peak and the 10 MW is for on-peak and each has a separate price. These errors are relatively minor and inconsequential, but they are

¹ From Burns & McDonnell Table 3.1, divide ECP revenues for 2007 by ECP MWh sales for the same period to arrive at average \$/MWh. Divide SMEC costs by ECP MWh sales in order to arrive at average \$/MWh if ECP customers had paid actual SMEC costs. This calculation is also included in my Corrected Table 3.1.

² This number is arrived at by calculating the average \$/MWh from the monthly default supply reports submitted to the PSC by NWE, and confirmed by PSC staff. See Exhibit #1.

worth mentioning because they belong to a pattern of errors that are, in fact, of major consequence.

The paragraph immediately following Table 1.1 is one of the most amazing flights of fantasy I have ever read. While the “blended rate” may cause the rates paid to SMEC by ECP to be on a par with the rates paid to SMEC by the SMEC member cooperatives, the consultants neglect to mention that that par situation is achieved more by the increases being paid by cooperative members, rather than decreases in costs to ECP. That is the reality. Yet, the consultants pretend that the lower “blended rate” is made possible because the arrangement somehow causes a smoothing in the hourly consumption patterns for all SMEC members, improves scheduling and provides advantages in negotiating long-term contracts. This is where the fantasy comes in. There is nothing inherent in the blended rate that causes a reduction in the volatility of the SME member consumption patterns. Customers’ patterns of consumption will continue to peak and trough during the hour, day and year as always. Since there is no change in consumption patterns, there is no greater ability to improve scheduling, and the actual quantity of load in the SMEC/ECP system with which to negotiate long-term contracts is unchanged. It is likely that SMEC came up with the cash to finance the lower blended rate to ECP by raising the rates charged to members of the cooperatives that belong to SMEC. The consultants were apparently not entitled to look at minutes of SMEC board meetings, which might have shown the motivation for this puzzling subsidy of ECP by SMEC member co-ops. This is discussed in greater detail later, in the discussion of the consultants report’s Table 2.2 in Section 2.

The final sentence in this same paragraph contains a minor error when the consultants reference block purchases of power in excess of “125 MWh.” I assume they meant 125 MW since 125 MWh are one-sixth of the monthly usage of the average NWE residential customer. Minor error aside, what really caught my eye was that the figure “125 MW” doesn’t square with the SMEC base-load of 205 MW, including ECP, on Burns & McDonnell page 2-4.

The next paragraph includes the first discussion of “net imbalances” in the report. The consultants imply that this “net imbalance” matter is relatively benign, and only later in the report do they describe the magnitude of the problem.³ Due to the “take or pay” nature of the underlying supply contracts mentioned in Table 1.1, SMEC/ECP must resell on the open market electricity that ECP customers do not use out of the original purchase blocks. And they must purchase on the open market when their customers use more than the purchased blocks. Surpluses that must be resold on the market occur when customers are using less than the amount committed to be purchased in the blocks. Typically, when ECP customers demand is at levels below the contracted amount, that reduction in use is duplicated throughout the region. Consequently, prices fall on the market, meaning SMEC/ECP are selling into a market frequently lower than the contracted price. Every sale below their contracted price then is at a loss and creates a deficit. Conversely, when ECP customers are demanding more power than available in the contracted blocks, customers throughout the region, typically, are duplicating that increased demand,

³ Finally, on page 3-6, section 3.6, Burns & McDonnell report the “net imbalance” liability of \$394,000.

driving prices up on the market. On these occasions, SMEC/ECP will then have to pay more for the power than the contracted price. The purchases above their contracted price are a second source of a deficit. This is a severe problem and, when later in the Burns & McDonnell report, the consultants finally report its magnitude, it is substantial.

The water credit, referenced first on page 1-4, was clearly a device to facilitate ECP marketing of electricity to prospective customers. Since it reduced the cash outlay necessary to acquire the electricity in Block 1 described in Table 1.1, ECP then proceeded to offer contracts to prospective customers based on the cash requirement, rather than the actual cost of the power. As a marketing device, prospective customers would be shown that their cost of power would be lower than receiving supply from NWE or other sources. Consequently, the water credit was little more than an incentive for customers to sign on with ECP. The expenditure of a publicly owned asset in order to acquire current electricity supplies for a few customers was a risky approach. If a plant is not built, the taxpayers of Great Falls will be on the hook. If a plant is built, the payback to the city will either come from the capital structure for financing the plant, or would be recovered from the ratepayers as a part of the fixed Operation & Maintenance costs of the plant. In either case, ratepayers certainly pay for it if a plant is built. Very little risk will be borne by the large commercial customers of ECP—those who actually benefited from this subsidy—because they could vacate their contracts if future rates were to rise to pay this obligation. No risk is borne by the management of either SMEC or ECP.

The final sentence in Section 1.3 on page 1-5 is an amazing admission, that “Burns & McDonnell has no reason to believe that the information provided by other parties, and on which it has relied, is inaccurate in any material respect.” Apparently, Burns & McDonnell abandoned President Reagan’s standard of “trust and verify,” and employed President George W. Bush’s standard employed with Vladimir Putin, “I looked into his eyes and saw his soul.” If they had actually tested the representations made to them by the management of SMEC and ECP, they would not have made the errors identified in this document throughout their report.

Section 2.1 ECP STAFFING

This section identifies the City of Great Falls employees who provided the administrative services for ECP. However, they do not report whether ECP compensated the City for these services. ECP collected 3% service charges from their customers. Were these receipts used to reimburse the City, or were these receipts used to minimize the magnitude of the accumulating deficits in ECP operations because the power supply rates charged to ECP customers were not sufficient to pay for the electricity supply costs charged by SMEC?

Section 2.2 ECP CUSTOMER BASE

Bizarrely, the consultants list only ECP customer energy usage for January, 2009, as shown in table 2.1. They did not report the monthly totals for these customers for the entire fiscal year, even though this is important information used to measure the volatility

of customer usage, which is an important component of measuring the origins and magnitude of the “net imbalances” problem previously mentioned.

It is also regrettable that the consultants failed to identify the key terms and conditions of the contracts between ECP and ECP customers, namely rates, service fees, how those rates and fees might be adjusted and any caps on those rates and fees. They also do not indicate whether the contracts contained terms and conditions for either party to cancel a contract. The contracts I have seen⁴ had an established rate for the first year of the contract, an annual limit on increases of 1% per year, and a cap the rate could not exceed through June 2011. There were fewer restrictions on adjustments to the service fees that could be charged, although these are contractually defined and not infinitely expansive. Provisions also exist for the customers to vacate their contracts. Are those provisions different for contracts that end in 2042 compared to contracts that end in 2022, compared to contracts that conclude in 2011? This is vital information in order to test the Burns & McDonnell assertion that ECP customers are better off than if they received their power supply from NWE.

The three items that were listed as part of the standard terms and conditions of the contracts are relatively inconsequential, especially compared to the terms and conditions related to rates.

Section 2.3 ECP CUSTOMER SERVICE

In the first bullet on page 2-3, Burns and McDonnell assert “almost all customers realized lower energy bills utilizing ECP than if they had contracted with NWE for their supply of electricity.” As shall be demonstrated in the dissection of Table 3.1, the only way the consultants are able to make this assertion is by overstating the cost of electricity from NWE for the five-year period, and ignoring the inherent taxpayer subsidy in the water credit. If ECP paid the real cost of electricity from SMEC, and if correct figures were used for NWE, the consultants’ report would show that ECP customers paid more than if they had contracted with NWE.

In the fourth bullet on page 2-3, Burns & McDonnell assert “customers have stated that as long as ECP remains cost competitive, they would prefer to renew their contracts with ECP in 2011 or” Since the ECP rates are only cost-competitive due to the water credit, which has expired, rates will need to rise to cover the actual costs of the power. At that point, it is not reasonable for ECP customers to expect rates to be cost-competitive.

In the final paragraph of Section 2.3, the authors again briefly discuss the “net imbalances.” Now the “net imbalances” are characterized as some sort of accounting matter. For the second time, the authors neglect to describe the magnitude and impact of those “net imbalances.”

⁴ Some contracts were submitted to the PSC by ECP in PSC Docket D2007.12.147. It is interesting to note that ECP neither sought nor received protective orders for any of the information they submitted in that docket.

Section 2.4.1 Background

The consultants mention the contract between ECP and SMEC that expires December 31, 2048. They offer no details about the terms and conditions of this important contract, except that it is a full-requirements contract. There is nothing in the consultants' report which discusses how rates are determined, or about relative rights and obligations for both parties to the contract. Nothing about quantities required for base-load, peak-load, or off-peak-load. Nothing about the restrictions on either party deciding to end the contract before December 31, 2048. This analysis was not conducted even though the ECP-SMEC contract is a fully public document.

In the final sentence of the first paragraph in this section, the consultants write, "Burns & McDonnell considered it essential that a due diligence review of SMEC's viability and operational and strategic plans for the future be evaluated." I couldn't agree more. However, I could not find anywhere in their report evidence that Burns & McDonnell reviewed the annual IRS Form 990 filings made by SMEC, information available to the public on the IRS website. I have attached as Exhibit #2, the SMEC filing for calendar 2008 which contains troubling information about the financial viability of SMEC. While SMEC belatedly filed this information with the IRS on November 23, 2009, Burns & McDonnell do not even indicate whether they had access to, or even were interested in reviewing, the underlying financial information that was finally and publicly disclosed in the November 23 filing by SMEC.

In the final sentence of the second paragraph in this section, there appears the numbers that do not comport with the 125 MW of implied load that appears on page 1-3 of the consultants' report. Either the consultants do not understand the difference between base-load and full-requirements, or if they do understand the difference, they did not test the numbers reported in this sentence. Full-requirements are the total amount of electricity customers would use during the course of a year, both on-peak and off-peak. Base-load, on the other hand, is the minimum amount of power consumed by customers each hour during the year. 205 MW and 904,000 MWh cannot both be base-load figures. Multiplying 205 MW by 8760 (the number of hours in a year) yields MWh for the year in the total of 1,795,800. Base-load cannot be both 904,000 MWh and 1,795,800 MWh. More likely, the 205 MW is a capacity amount necessary to meet peak-load in any given hour, or if it is the base-load number, the consultants were not given or did not report the necessary peak-load capacity. At this point, of course, we have no idea what the 125 MW reported earlier have to do with anything.

In the third paragraph in this section, the authors describe how much of SMEC's cooperative member requirements are covered by PPL Montana, Bonneville Power Administration and Western Area Power Administration. The consultants do not explain the price structure for any of these contracts, whether they are for base-load requirements or peaking requirements, all important considerations in understanding what has occurred and what changes are inevitable. There has never been any question that the SMEC cooperatives will lose their BPA contract, nor that that contract contained such favorable terms, that its loss would cause considerable financial consequences for the Cooperatives'

members. However, the reader should not infer from the authors' characterization of the new PPL Montana replacement contract that it is equivalent to the value of the BPA contract. Inevitably, the PPLM power is more expensive than the BPA power.

While Burns & McDonnell did not offer any information about the price structure of the PPLM contract, they did offer some of the terms and conditions of the contract that give one pause, and there is no evidence they assessed the risk or potential consequences of those terms. For example, they report that the contract between PPLM and SMEC is for output from the Corette coal plant in Billings, the oldest thermal plant in the PPLM fleet. That indicates that this is a unit-contingent contract, i.e. if the plant goes down, SMEC must immediately secure power supplies from some other source. Typically, a unit-contingent contract puts all the risk on the purchaser of the power, not the generator. Did Burns & McDonnell verify that the contract had provisions requiring PPLM to bear any of the burden for this risk in the event the Corette plant goes down? We can't tell from the text of the report. Certainly, by requiring a 60 day letter of Credit, PPLM was very careful to minimize their risk.

Then the consultants describe the "take-or-pay" features of the contract. There are contract-specific amounts that PPLM must deliver (and that SMEC must take) for both off-peak and on-peak hours. These contract-specific amounts are not disclosed in the Burns & McDonnell report. In any given hour, SMEC customers will inevitably use more or less power than the contract-specific amount, resulting in "net imbalance" problems. Because the consultants do not disclose the specific terms and conditions related to price, and offer no verification that the risks are mitigated in the contract provisions that are disclosed, the reader cannot assess whether the contract will "give member systems a power supply product that is affordable, predictable, and secure." Nor can the consultants "guarantee" customers a competitively priced product that protects them from market volatility. Consider the "net imbalance" problem.

Nowhere in the Burns & McDonnell discussion of this PPLM contract are the terms of the contract related to price and quantity disclosed, supposedly to comply with the "Montana Trade Act." [*sic*] There is a theory related to "trade secret" law that you cannot withhold from disclosure that which is otherwise available to the public. I have attached, as Exhibit #3, a spreadsheet available on the FERC website⁵ that details transactions between PPLM and SMEC. PPLM is required to report to FERC all of its sales of electricity, and that information is available to the public. As one can see on the spreadsheet, these reports include names of sellers and purchasers, transaction dates, transaction quantities, price per unit and total transaction cost. Each transaction is keyed to a contract ID. Since this information is readily available to the public, and any PPLM competitor, it cannot be protected, and any confidentiality agreement related to this information is rendered meaningless. Since any competitors in the industry would already have this information, and know what to do with it, the only persons left in the dark by the Burns & McDonnell report are the member/customers of the SMEC member cooperatives and the taxpayers of Great Falls.

⁵ <http://www.ferc.gov/docs-filing/eqr/data/spreadsheet.asp>

What these FERC reports do not include are whether or not:

- the contract is “unit contingent”
- the contract is “take-or-pay”
- the contract requires provisions for a “letter of credit.”
- the contract contains provisions related to “carbon taxation” or other matters.

Ironically, Burns & McDonnell may have failed to disclose information that is public, and therefore, not legally protectable, even while the consultants disclosed information that may be, arguably, protectable.

Section 2.4.2 Highwood Generating Station

While the coal-fired Highwood Station is now “water under the bridge,” the biggest problem was that the facility was a base-load facility sized well in excess of the reasonable base-load requirements of the SMEC customers. The “net imbalance” problem with this plant would have been enormous and well beyond the capacity of SMEC to manage. While the reluctance of RUS to fund coal-fired plants may have played a part in their decision not to finance the plant, the bigger problem was the exposure to volatile markets and “net imbalances” that the coal-fired plant represented.

The proposed natural-gas fired power plant is less susceptible to market exposure during peak-load periods since the technology is suited to meeting peak-load requirements, both technologically and financially. However, the estimate that the electricity would cost \$72/MWh from this plant, assuming natural gas at \$6.50/MMBtu, is fairly optimistic. Working from the information supplied by NWE energy as they analyzed the costs of electricity from an array of gas fired technologies for their 2007 Electricity procurement plan, and using the assumptions of \$6.50 gas and operating at 70% of capacity, one can find that electricity from a combined cycle plant (CCCT) might only cost about \$68/MWh. On the other hand, the simple cycle plant (SSST) would yield an electricity cost over \$86/MWh. As proposed, this plant would be two-thirds simple cycle and one-third combined cycle, which means average generation-cost would be, even under this optimistic speculation of natural gas’s price, above the \$72/MWh estimate. Using the same methodology, but assuming natural gas at \$13.00/MMBtu, the estimate rises for the combined cycle plant to \$127.20/MWh, and for the simple cycle plant, something like \$170/MWh. I have attached, as Exhibit # 4, the spreadsheets showing these calculations.⁶

For those who think that natural gas won’t go up to \$13.00, I need only remind folks that just as recently as June, July, and August of 2008, natural gas prices were exceeding \$11 and many of us feared they would reach as high as \$15. For the past year, natural gas prices have been relatively moderate in the \$5 and \$6 range. But as the recession eases, more gas-fired generation plants will come online and more of our nation’s transportation

⁶ The base sources for these tables are from the 2007 NWE electricity “default supply Procurement Plan” filing, Volume I, NWE tables 6-5 and 6-6. I added columns converting information consistently to \$/MWh, had PSC staff secure fuel cost in \$/MWh, and finally, applied operating the plant at different capacity levels.

fleet will convert to natural gas. There is considerable risk that \$6.50 natural gas may be the floor.

The risks faced by a natural-gas-fired power plant have never really been given a study. Both EES Consulting, working for Yellowstone Valley, and the United States Department of Interior have questioned the optimistic financial projections in the SMEC gas-fired generation proposal.

At the top of page 2-7, Burns & McDonnell finally make brief mention the suit Yellowstone Valley Electric Cooperative has filed to terminate its contract with SMEC and sever the relationship. YVEC argues that SMEC's targets keep moving, that it signed up because coal represented the lowest-cost power (a contention which SMEC's own documents support), and that SMEC's management has obligated its member co-ops and the City of Great Falls to an unreasonably large quantity of electricity. This is the only place in their report that the consultants even mention the matter. No one has any idea how the courts will finally rule in the matter, but the suit is of enormous financial consequence no matter how it turns out. The very brevity of the consultants' discussion of this matter implies that they don't think the matter is very significant. If this is so, they are wrong.

YVEC is the largest cooperative involved in SMEC. It has the largest load. Without YVEC, SMEC is but a shadow of its former self. If YVEC wins the suit, SMEC will have neither the customers nor load sufficient to assure the financial markets that SMEC can execute its business plans. On the other hand, if YVEC loses, SMEC will have on its hands a hostile and uncooperative business associate, again not terribly reassuring to the financial markets.

Section 2.4.3 Outlook for SMEC

Table 2.2 is riddled with errors and misrepresentations. One almost wonders where to start. The sentence immediately preceding the table implies that ECP customers share in the price advantage Beartooth Power customers enjoy on power supply vis-à-vis NWE customers. The SMEC costs for Beartooth customers presented in this table have no bearing on the costs paid by ECP customers. Without a doubt, Beartooth customers are going to have power supply rates much lower than the power rates for NWE customers, due to the WAPA and BPA contracts discussed above.

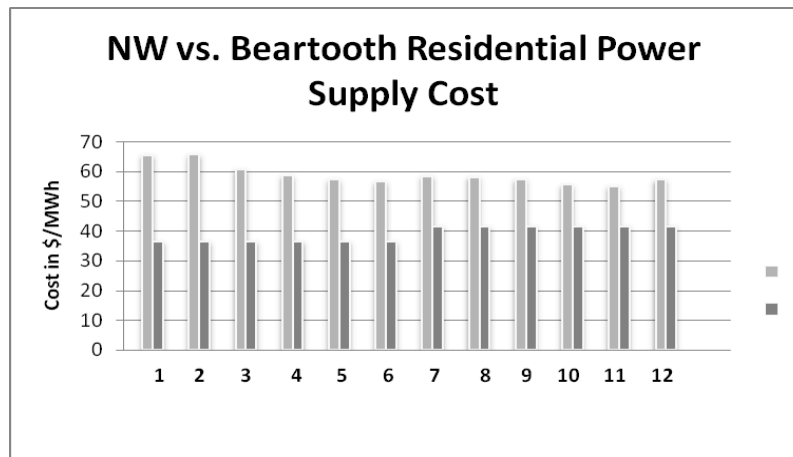
Beyond confusing Beartooth with ECP, there are fundamental errors in the table itself. The label on the left axis is labeled "cost in \$/MWh." In that case, the figures representing the power supply cost in \$/MWh for NorthWestern customers are obviously erroneous. The chart indicates that the NWE power supply costs for the first two months of Fiscal Year 2009 were somewhere just over \$80/MWh, and somewhere at or above \$70/MWh for the remaining months. In reality, power supply rates for NWE customers have never been \$70/MWh, much less \$80/MWh. In fact, the highest they have ever been was \$65.93/MWh in August, 2008.

How could the consultants possibly overstate NWE power supply rates by \$15 to \$16/MWh across the whole chart? Apparently they mislabeled the vertical, Y axis “cost in \$/MWh.” With close study, it quickly becomes apparent that instead of the price per MWh, the consultants are instead referring to the label across the top of Table 2.2: “NWE v. Beartooth Power Rate – Residential Customer; (1178 KWh). Apparently, they meant to represent the cost for power supply, in dollars, a customer using 1178 KWh would pay per month; it is unclear what impelled the consultants to use this seemingly arbitrary number. One may multiply the NWE power supply rate for each month per MWh by 1.1178 (1178 KWh equals 1.178 MWh) in order to derive the monthly cost for power for a NWE customer who used 1178 KWhs. Even once one corrects this data, there is further evidence of minor errors made by the consultants. For instance, the consultants label the range of the chart June 2008 to June 2009; in reality, the data the consultants use corresponds to the range July 2008 to July 2009, according to rates on file with the PSC. This information is all reflected in the **Corrected Table 2.2** below.

The consultants make one more critical error in their presentation of the comparison of NWE and SMEC rates. The monthly power supply costs for NWE customers in Table 2.2 are consistently overstated by about \$4.50 per month. After much research, it was discovered that Burns & McDonnell had neglected to include a \$3.78/MWh deferred supply credit that NWE customers had received each month during fiscal year 2009. This error was material and I will be discussing it later as I analyze Table 3.1. The errors in Table 2.2 represent sloppy work, and they have serious consequences for the viability of ECP.

Comparing monthly power supply costs for the average customer, whether it’s 1178 KWh for the average Beartooth residential customer or 750 KWh for the average NWE residential customer, is less valid than comparing power supply costs in \$/MWh. Few customers actually use the average, but each pays for the quantity of electricity consumed times the \$/MWh cost. Therefore, a Corrected Table 2.2 is inserted here for your review.

Corrected Table 2.2, Fiscal 2009



The NWE columns are in light gray, the BCE columns are in dark gray.

To be sure, the power supply costs in \$/MWh are higher for NWE customers than for Beartooth customers. This is largely due to the price of the WAPA and BPA power supplies that are available to cooperatives that are not available to other entities. For example, from Exhibit #5, we know that the cost of the WAPA power was less than \$18/MWh for SMEC in 2004 and 2005.⁷ While WAPA has proposed a rate increase for 2010, we can calculate that that power will still cost less than \$20/MWh.⁸ I have also included in Exhibit #5 tables showing the basis for BPA power costs for qualifying entities for the period. These advantageous prices from WAPA and BPA were blended with the market-based purchases from PPLM, which we can see from Exhibit 3, ranged from \$41.70/MWh to \$52.80/MWh, with most closer to \$50/MWh than \$45/MWh. Later in the Burns & McDonnell report, they claim that a table presents “an observable trend line” showing NWE costs increasing and ECP cost declining.” Look for the observable trend line in corrected Table 2.2. In January, 2009, BCE power supply rates increased 14% while NWE energy costs trended down for the year. As WAPA and BPA contracts providing low-cost power to SMEC expire, this trend will only continue.

On page 2-8, Burns & McDonnell assert that SMEC will be competitive with NWE because the PSC approved the gas-fired Mill Creek plant near Anaconda. Apparently, the consultants did not exercise their vaunted experience in the industry to understand the fundamental difference between the Mill Creek plant and the gas-fired plant proposed by SMEC. They apparently do not appreciate that the Mill Creek plant was not approved for energy supply, but strictly to provide regulation services. Those regulation services are for following volatile load and intermittent generation in order to provide steady and reliable electricity to customers. Those customers provided this service include, not only NWE customers, but also the customers of SMEC and ECP, among others, and the costs will be recovered in NWE transmission and distribution rates paid by City customers. The consultants then argue that SMEC rates will be competitive due to NWE cost with Coalstrip [*sic*]. The Colstrip 4 generation now included in NWE rate base is calculated to generate electricity at about \$60/MWh, compared to the aforementioned, optimistic estimate that the SMEC gas-fired plant will generate electricity at about \$72/MWh. It doesn't take a bookie, claiming inside information, to tell you where to place your bets in that trade-off.

Section 2.5 RIGHT-TO-KNOW PROVISIONS

Right out of the box, Burns & McDonnell describe Montana's right-to-know laws as an “on-going problem.” Apparently Burns & McDonnell don't understand that Montana's right-to-know provisions are enshrined in the Montana Constitution in order to protect the Montana public, taxpayers, and utility customers against insider dealing and back room arrangements.

⁷ “Pick-Sloan Missouri Basin Program—Eastern Division,” page 138. From the same document, we can find WAPA purchases made by NWE, PPLM, and Montana Dakota Utilities (MDU) at market rates substantially higher than the rates charged to SMEC.

⁸ “Department of Energy, Western Area Power Administration, Pick-Sloan Missouri Basin Program—letter dated December 18, 2009.

Somehow, five years of transactions between SMEC and ECP had accumulated liabilities for the taxpayers of Great Falls on June 30, 2009 of \$6.473 million according to Table 3.5 and the consultants say that the public's right-to-know is a problem!

I'm amazed that the Great Falls Tribune has not expended whole barrels of ink editorializing against this outrageous assertion and subsequent discussion of the matter by Burns & McDonnell, a consulting firm that is being paid with taxpayer dollars. The Great Falls Tribune, after all, brought suit against the Montana PSC (before I became a member), and rightfully so, because the PSC was granting protective orders for too much information submitted to the PSC by utilities and other parties before the Commission. That suit resulted in a landmark decision by the Montana Supreme Court and the public has much more access to information, as it should, than ever before.

Not only has the Tribune failed to editorialize against this outrage, their press accounts of the Burns & McDonnell report have failed to even mention this component of the report.

Section 3.1 OPERATING RESULTS

This section starts off with another lame discussion of "net imbalances" by the authors. Again, they imply that this is largely an accounting problem. And again, they fail to quantify the dimension of the problem, and in this instance make "net imbalances" sound like a quandary, but one with a happy solution: "If ECP customers purchase less energy than that provided from SMEC, ECP can sell the excess on the open market which benefits ECP's bottom line." As has been pointed out before, if ECP is selling power on the open market, it is entirely likely doing so at a loss and merely adding to its deficit.

Then we get to Table 3.1, in which the authors purport to show that ECP customers would have been better off even if they had had to pay the actual SMEC costs for power compared to what they would have paid if they had been customers of NWE. Except, there is a problem with the NWE costs reported on the table. A big problem.

Recall the discussion of Table 2.1, where an overstatement of NWE electricity supply costs of \$3.78/MWh for fiscal year 2009 was identified. If that error in calculation was carried forward to Table 3.1, an overstatement of NWE costs of \$615,000 is revealed for fiscal year 2009.⁹

To further test the question, I divided the \$10.182 million by the 163,208 MWh consumed by the ECP customers in fiscal year 2009. The resulting cost calculation was \$62.46/MWh. Now in only two months in fiscal year 2009 did the cost of power for NWE customers exceed \$62.46/MWh. For the other ten months, NWE electricity cost less than that amount, most months substantially less. Then I averaged the monthly \$/MWh cost and found that the average for fiscal year 2009 was \$58.72/MWh. Using this methodology, I found that Burns & McDonnell had overstated the NWE energy costs for 2009 by \$3.74/MWh or a total of \$609,000. This second methodology yielded slightly

⁹ Multiply the 163,028 MWh consumed by ECP customers by \$3.78.

lower numbers of the overstatement of NWE cost (\$3.78 -\$3.74, \$615,000-\$609,000), but did verify that the overstatement of NWE costs was carried forward from Table 2.2 to Table 3.1. During the balance of this document, I used the second methodology.

I, then, applied this same methodology for the four other fiscal years in Table 3.1. I discovered they overstated the NWE costs for fiscal 2008 by \$2.66/MWh and by \$429,000 for the year. For fiscal year 2007, the overstatement was a whopping \$10.29/MWh and \$1,290,000 for the year. In fiscal 2006, they had an understatement of \$1.13/MWh and \$92,000 for the year. The fiscal year 2005 overstatement was \$8.71/MWh and \$260,000 for the year. **The total overstatement for NWE costs for the five year period was \$2,496,000.** Therefore, the total realized savings for ECP customers compared to what they would have paid through NWE was \$112,000, not the \$2,608,000 claimed by Burns and McDonnell. **Had ECP customers paid their actual costs to SMEC, instead of transferring that liability to the City of Great Falls taxpayers, they would have paid \$1,866,000 more than as customers of NWE.**

Inserted here is a corrected Table 3.1 with columns that show the calculations for costs in \$/MWh and the correct figures for NWE costs in total and by \$/MWh.¹⁰ The final two columns show the overstatement (understatement) of NWE costs contained in the Burns & McDonnell Table 3.1.

Corrected Table 3.1

Fiscal Yr	ECP	ECP	ECP	SMEC	SMEC	NW	NW	Overstatement	
	Sales MWh	Revenues Total	Revenues \$/MWh	Costs Total	Costs \$/MWh	Costs Total	Cost \$/MWh	(under) NW cost	\$/MWh
2005	29,900	\$ 1,306,000	\$ 43.68	\$ 1,577,000	\$52.74	\$ 1,284,668	\$42.97	\$ 260,332	\$ 8.71
2006	81,184	\$ 4,072,000	\$ 50.16	\$ 4,503,000	\$55.47	\$ 3,752,927	\$46.23	\$ (91,927)	\$(1.13)
2007	125,370	\$ 6,486,000	\$ 51.73	\$ 7,368,000	\$58.77	\$ 6,256,987	\$49.91	\$ 1,290,013	\$10.29
2008	161,210	\$ 8,808,000	\$ 54.64	\$ 9,414,000	\$58.40	\$ 9,413,280	\$58.39	\$ 428,720	\$ 2.66
2009	163,028	\$ 9,497,000	\$ 58.25	\$ 9,285,000	\$56.95	\$ 9,572,923	\$58.72	\$ 609,077	\$ 3.74
Totals	560,692	\$30,169,000		\$32,147,000		\$30,280,785		\$ 2,496,215	
Average \$/MWh			\$ 53.81		\$57.33		\$54.01		\$ 4.45

Due to the errors I have reported in Table 3.1, the bulleted claims on page 3-3 about ECP savings over NWE rates are clearly erroneous.

¹⁰ To test the reasonableness of the SMEC costs being charged to ECP, I referred again to Exhibit #3. Assuming PPLM as the primary source of the electric supply delivered to ECP, I calculated the average cost of PPLM power to SMEC by \$/MWh for two months, August, 2008 and May, 2009. The average cost of PPLM power delivered to SMEC in August, 2008 was \$48.76/MWh, and in May, 2009, the average was \$48.41/MWh. These numbers should be compared to the average \$56.95/MWh that SMEC charged ECP for power in fiscal 2009.

Table 3.2 on page 3-3 is interesting only in that, while it purports to show that ECP will be operating with a positive cash flow for the next two fiscal years, it projects another annual deficit in the second year of the two.

Burns & McDonnell claim the fiscal woes of ECP can be solved with a 10% increase in ECP rates. Interestingly, the average \$/MWh for ECP rates from fiscal year 2005 to fiscal year 2006 increased by 14.8%; from fiscal 2006 to fiscal 2007, the increase was 3.3%; from fiscal 2007 to fiscal 2008, the increase was 5.6%; and from fiscal 2008 to fiscal 2009, the increase was 6.6%. The total increase for the five-year period was 33.3%.

Section 3.2 LONG-TERM ACCOUNTS PAYABLE (water credit)

I have already commented on the water credit in my discussion of Section 1.2

Section 3.3 LONG TERM NOTES PAYABLE (FIRST INTERSTATE BANK LOAN)

Table 3.3 Net Present Value and Table 3.4 Return on Investment are irrelevant due to the fact that ECP/SMEC performance to date has shown no capacity to outperform the market. Until the inclusion of Colstrip 4 into rate base, all NWE costs have been market-based. The \$72 estimate for the Highwood gas plant is about \$12 higher than energy costs from Colstrip 4. There is no out-performance of market here either. If SMEC only operate the HGS plant at 35% of capacity instead of 70%, per unit costs of generated electricity will increase by about 25%. If gas prices double, the cost of electricity from the plant will nearly double.¹¹

The reader should consequently not put too much stock in either Table 3.3 or Table 3.4.

Section 3.5 DUE OTHER CITY FUNDS (CURRENT)

The narrative in this section does not include the \$1.368 million included in line 4 in Table 3.5.

Section 3.6 OTHER ACCOUNTS PAYABLE

Finally, the consultants disclose the magnitude of the “net imbalances.” The accumulated liability is \$394,000. Since it is to be expensed over the next two years, I cannot tell whether they included it as part of the SMEC costs in Table 3.1, further contributing to the illusion that SMEC is competitive and viable. Interestingly and in a seeming contradiction, the consultants don’t use this number in line 6—“Accounts Payable”—in Table 3.5. Instead the number has transformed to \$197,000.

There is no narrative explanation anywhere of line 5 in Table 3.5, Accounts Payable – Energy Supplier, which is listed as \$791,000 of debt.

¹¹ See Exhibit #4.

Section 3.7 ECP LIQUIDATION SCENARIOS

Both the consultants' liquidation scenario and their non-liquidation scenario require 3% annual increases in service charges, and 5% annual increases in power rates on top of the 10% increase in power rates they propose now, on top of the 33.3% increase in power rates which have already occurred over a five-year period. All the while, several of the contracts with ECP customers promise their annual rate increases shall not exceed 1% per year. The consultants never address how, under the contracts ECP customers have signed, a 10% immediate rate increase (which is the premise of all of the liquidation scenarios) is legally permissible. The reader is left to speculate how this could unfold, or whether it could at all. In any case, as this report shows above, a 10% rate increase would hike ECP rates above its competitor NWE's rates.

Section 4.1 KEY BENEFITS TO CONTINUED OPERATION OF ECP

The first bullet asserts that ECP customers would have no choice but to return to NWE if ECP ceased to exist. That is absolutely not true. They could legally secure supplies directly from PPL Montana or some of the other electricity suppliers that continue to serve customers in Montana. Whether any other suppliers would be interested in serving ECP customers individually is another question.

It may be true ECP does not have to add additional customers to achieve and maintain profitability over the long-term, **they just have to keep increasing rates.**

Bullet number three on page 4-1, claiming savings for ECP customers, is simply not true. Those savings have happened on the backs of Great Falls taxpayers and other SMEC member co-ops.

Municipal electric utilities in other parts of the country typically have access to low-cost preference power from Federal Power agencies such as BPA, WAPA, and TVA. ECP simply does not have that access.

ECP is only making money currently because they shifted their "net imbalances" of \$394,000 off to a future period. Recent news reports indicate their "net imbalance" problem is only growing since they reported that their actual revenues in the first quarter of fiscal 2010 were actually \$230,000 less than budgeted.

SMEC has not shown itself to be a viable entity in producing and/or obtaining competitively priced energy. Their viability is also questionable due to the Yellowstone Valley Electric Cooperative suit against them. Their persistence in flaunting the public-right-to know provisions of the Montana Constitution casts doubt on their efficacy.

Sections 4.3 and 4.4 RISKS

Risks the consultants should have listed include:

- Yellowstone Valley Electric Cooperative suit against SMEC succeeds, or doesn't succeed.
- Their current inability to understand or manage "net imbalances" persists.
- ECP customers will come to understand the enormous rate increases proposed to achieve financial viability for ECP will eliminate any advantage they currently enjoy over other suppliers including NWE.
- Terms and conditions of contract between SMEC and ECP.
- The BBB investment rating for SMEC deteriorates, rather than improves.
- Natural gas prices will increase rapidly as the country emerges from recession. More natural gas plants are built and transportation transitions to natural gas.
- Significant ECP customers chose to exercise option to cancel contract.

Section 5 RECOMMENDATIONS

Given that the consultants' recommendations are predicated on their flawed analysis, it is not proper to give much credence to recommendations.

In the paragraph in this section, the consultants mention "stranded costs" related to the withdrawal of the City from SMEC. In a liquidation scenario, the City would not be meeting its "forecasted power needs through 2019" and, the consultants imply, the City would therefore bear the costs of further "net imbalances" for that amount of power it was anticipated to consume, even if the City is no longer a member of SMEC. The consultants do not state which provision of ECP-SMEC contracts governs this matter, and they make no attempt to discern this obligation's magnitude or to quantify the "stranded cost."

Section 5.1 SHORT-TERM RECOMMENDATIONS (2009-2010)

Again the consultants talk about a 10% rate increase for ECP customers. What if half of the load represented by ECP customers does not agree to the increase? Are the remaining customers going to be asked for a 20% increase?

Since the actual ECP savings compared to NWE costs are negligible, why wouldn't ECP customers calculate that a 10% increase, in addition to subsequent 5% annual increases, would cost them more than moving to NWE?

Is the recommendation that ECP hire a staff accountant a commentary on the competence of the city employees who have been doing the work so far, or is it an admission the City has been paying the "service costs" of ECP all along by delegating an otherwise employed member of the City's staff to "double-duty" on ECP?

How is continued ownership in HGS an asset if there are limitations on sale of "its undivided interest to a third party?"

Again, the recommendation to skirt Montana's constitutional provisions for the public right-to-know by withdrawing the City's representative from SMEC meetings is simply preposterous. SMEC's management has represented their project in discussions with financiers as having the backing of a municipal government, which makes SMEC and the HGS appear a more alluring and secure prospect, backed by the public's credit. This is an advantage to the business which partners with a public entity. But there is another side of the coin: Such a partnership must be more open than an exclusively private business, as Montana's Constitution and laws dictate. SMEC has consistently tried to have it both ways—profiting from the creditworthiness of Great Falls taxpayers, but then acting litigiously and moving to render private matters which are obviously not secret (the quantity of power sales under the SMEC-PPL contract, which the consultants were denied access to, is a prime example of this). Simply put, one cannot have it both ways, and it is hoped that the City will serve its citizens well by beginning a declassification process of the secret file of documents it keeps in relation to SMEC.

What is the problem to be solved by reducing the ECP Board to three members and to have them meet half as often? There has been no discussion of this anywhere else in the report.

This document has attempted to show how claims that ECP enjoys a competitive advantage are premised on incorrect data and faulty analysis. There are many unanswered questions, especially regarding the terms and conditions of contracts which govern ECP operations. It would seem imperative to move quickly to gain a better understanding of these obligations. I hope this document will be a valuable tool for the Great Falls City Commission as they proceed with their examination of the future of ECP.