

Montana Power Company – When Power Begets Power*

Montana is hardly the place to expect mistrust, deceit, and corporate drama but many Montanans can painfully provide a personal tale about poor management decisions at the Montana Power Company. Each story is unique and significant yet all demonstrate how myopic corporate strategies can wreak widespread havoc. An example of one such story is that of T.E. Stedman, a third generation Montanan and principal owner of Montana Resources, Inc., a copper and silver mine located just outside Butte. Stedman has spent most of his time during the past few years trying to find a way to reopen his company's mining operations that he was forced to cease in May-2001 because of the dramatic increase in energy costs. Most of his 300 employees had moved on to other jobs, and the house-size ore hauling trucks, conveyors, crushers, and grinders at the 600-foot deep pit were slowly deteriorating. Although energy costs had declined from their peak level two years ago, the current economic slump had depressed resource prices so operating costs still exceeded revenues.

Stedman was wondering whether he should join a class action lawsuit as a plaintiff. Several individuals, like Stedman, owned Montana Power Company (MPC) common stock and filed the lawsuit in August-2001. The lawsuit named as defendants the members of MPC's board of directors, three officers of both Touch America and Montana Power, and PPL Montana (the subsidiary of PPL Global that purchased the electric generating assets of MPC). The complaint alleged that MPC and its directors and officers had a legal obligation and a fiduciary duty to obtain shareholder approval before selling its former electric generation assets. The plaintiffs further argued that because shareholders did not vote on the sale of the generation assets, that transaction was void and the assets were, in effect, being held in constructive trust for the shareholders. The plaintiffs also made various claims of breaches of duty and negligence against the MPC board of directors, the individual officers, and the other named defendants.¹ There was also a lawsuit against Goldman Sachs, & Co., the Wall Street investment banking and securities firm MPC hired as its financial consultant to advise it in restructuring into Touch America, MPC's successor.

Joining the lawsuit might be a moot point, however, as Touch America had just announced that it was delaying filing its 2002 annual report with the Securities and Exchange Commission. There was widespread speculation that Touch America would soon file for bankruptcy or even liquidation. Stedman's emotions ranged from outrage to bewilderment. Why had the state's best-known company – a conservative, financially strong utility – pursued a high-risk expansion strategy? (See Appendix A for a time line of significant events.) Why did MPC push to have the energy markets in Montana deregulated, only to abandon its energy businesses and plunge into the telecommunication business? Who should he be angry at: Was Montana Power's demise simply another regulated company unable to survive in a deregulated marketplace or were its managers and directors somehow negligent? What was the role and obligation of Goldman Sachs, the company that reportedly received approximately \$20 million in fees from the sale of MPC's energy businesses? Or, as CBS's *Sixty Minutes* popular news show asked: "Who Killed Montana Power?"²

The Birth and Rise of Montana Power Company³

The history of the State of Montana is tied closely to the development of its natural resources. During the 1860s the discovery of gold brought prospectors to the area, followed by open range cattle ranching in the 1870s. Significant copper mining operations began in Butte in 1877 and the first railroads arrived in 1880. Butte became the world's leading copper producer during the 1880s, with more than 300 mines operating by 1884. Montana became a state in 1889. Between the late 1880s and the mid-1990s, Butte mines produced approximately one-third of all the copper used in the United States and supplied one-sixth of worldwide demand.

¹ Touch America Holdings Inc., SEC Form 10-K, 31-December-2001, p. 68.

² See CBS News, 10-August-2003 <http://www.cbsnews.com/stories/2003/02/06/60minutes/main539719.shtml>

³ See Appendix B for a brief history of the U.S. utility industry through most of the twentieth century.

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The proliferation of mining activity led to the demand for electricity to power sawmills, smelters, and electric trains used to transport workers and materials deep into underground mines. The first electricity generating facility in Montana was a hydroelectric plant constructed with a dam on the Missouri River in 1871. More dams and hydroelectric generating facilities soon followed, with much of the power being sold to Amalgamated Copper Company.⁴ To meet its power requirements, Amalgamated, under the leadership of John Ryan, acquired many small power producers. In 1912 these companies were merged and spun-off into a single company, Montana Power Company. In 1915 Amalgamated reorganized and adopted the name Anaconda Copper Mining Company.⁵

For the next half-century, Anaconda Copper Mining Company (later renamed the Anaconda Company and referred to as simply “the Company”) dominated local politics and business in the state. Anaconda expanded its Montana copper and aluminum mining operations, and until 1959 owned every major newspaper in the state.⁶ Anaconda also expanded globally to become the world’s largest copper mining company.⁷ In 1977 the Atlantic Richfield oil company purchased Anaconda (ARCO merged with BP Amoco in 2000) and in 1980 Anaconda closed its Montana mining operations and sold its assets. But Montana Power lived on.

Although they were never formally related, Anaconda and Montana Power shared John Ryan as president and they pursued similar efforts to exert political influence.⁸ Since its inception, the State of Montana Public Service Commission regulated MPC as a monopoly that was permitted (if not encouraged) to develop the state’s natural resources. MPC developed into a vertically integrated company that owned its fuel sources, generating facilities, transmission network, distribution wires, and customer meters. In return, MPC sold power to Montana businesses and residents at low rates. The cheap cost of electricity was a key element that allowed the state’s mining interests to expand rapidly. MPC grew to become the state’s sole *Fortune* “500” company, the only Montana company listed on the New York Stock Exchange, the largest employer in the state, and a company known for its commitment to the citizens of Montana.

The Winds of Change

The first ill winds began to blow in 1967 when Anaconda’s operations were shut down by a strike. Lasting more than eight months, the strike interrupted power contracts between the two giants and resulted in lower revenues for MPC. In 1971 the government of Chile seized Anaconda’s mines,⁹ causing Anaconda to lose \$357 million that year. The resulting financial pressure on Anaconda led to the closure of marginal operations in Montana that represented 20% of MPC’s gas sales and 10% of its electric sales.¹⁰

About the same time, MPC began to construct two coal-fired power plants at Colstrip, Montana. During the 1950s MPC had purchased coal leases near Colstrip that created enormous controversy. This coal, to be mined by MPC’s Western Energy subsidiary, would be burned to create the steam used to power the massive turbines.¹¹ MPC did not obtain an air quality permit before it began construction, arguing that it did not need the permit until later in the building process. This was a position that many viewed as

⁴ Michael Jamison, “A Company Built From the Ground Up,” *Missoulian*, 18-February-2001 and <http://www.missoulian.com/specials/power/power2.html>

⁵ “Generations of Power: History of Montana Power Company,” *Missoulian*, 18-February-2001 <http://www.missoulian.com/specials/power/power3.html>

⁶ Jim Robbins, “As Power Prices Surge, Montana, Too, Asks Why,” *New York Times*, 13-May-2001.

⁷ <http://www.missoulian.com/specials/100montanans/list/009.html>

⁸ Michael Jamison, “A Company Built From the Ground Up,” *Missoulian*, 18-February-2001 <http://www.missoulian.com/specials/power/power2.html>

⁹ One of the nationalized properties was the Chuquicamata mine, the largest open pit copper mine in the world.

¹⁰ Michael Jamison, “A Corporate Giant Rewires,” *Missoulian*, 18-February-2001 and <http://www.missoulian.com/specials/power/power2.html>

¹¹ *Ibid.*

arrogant and indicative of MPC's belief that, given its substantial influence in political and regulatory matters, it was assured of receiving all necessary permits and approvals.¹²

In 1972 the citizens of Montana passed a new state constitution that expanded the power of the governor, modernized the legislature, and enabled voters to enact and repeal laws through initiative and referendum. Following passage of the new constitution, the state legislature passed a series of environmental laws, including the Major Utility Siting Act, the Strip Mining and Reclamation Act, and the Coal Tax Trust Fund Act. The Major Utility Siting Act, in direct response to the Colstrip controversy, required that all environmental and economic analyses be completed before the final location of a utility power plant was approved. The Coal Tax Trust Fund Act instituted a 30% coal-severance tax on coal sold to out-of-state buyers. The money raised by the tax would be invested in a fund to be used when the state's coal resources were exhausted. The tax had a severe financial impact on MPC because the company had entered into long-term fixed price coal supply contracts with utilities in the Pacific Northwest and the contract prices did not include the coal-severance tax.¹³

On 16-October-1973 the Organization of the Petroleum Exploring Countries (OPEC) announced that, as a consequence of the Arabs' Yom Kippur War against Israel, it was reducing oil production and halting shipments to Western countries. The embargo created an immediate "energy crisis," increasing oil prices by 400% and leading to U.S. supply shortages.¹⁴ The Federal regulatory response was the creation of the Department of Energy in 1977 and passage of the National Energy Act of 1978 (Public Laws 95-617, 618, 619, 620, 621). The Public Utility Regulatory Policies Act of 1978 (PURPA, Public Law 95-617) requires utility companies to buy power produced by qualifying facilities, usually produced by cogeneration or from a renewable energy source.¹⁵ The effect of this legislation was to open energy generation to non-regulated suppliers. The impact on MPC was significant as it eventually purchased 100 megawatts of power,¹⁶ almost ten percent of its total capacity.

Colstrip 1 and Colstrip 2 came on-line in 1975 and 1976, respectively. OPEC boycotted again in 1979. Worries over energy shortages prompted MPC, in partnership with other Western utilities, to propose two additional plants, Colstrips 3 and 4. The resulting public furor was unprecedented. MPC argued that Colstrips 3 and 4 were investments in the future, a partnership with other regional utilities to ensure that the region would have abundant and cheap energy to continue fueling Montana's growth. Opponents argued, however, that the plants were not needed, citing the fact that MPC was already selling much of its power out-of-state. Moreover, the closing of Anaconda's Montana operations and the opening of the power grid to independent producers left MPC with excess generating capacity. MPC ultimately prevailed; Colstrip 3 began operating in 1984 and Colstrip 4 began operating in 1985. But the battle had destroyed MPC's relationships with its customers and regulators and the financial burden of the plants was ruinous. The Montana PSC approved only \$4 million of MPC's requested \$95 million rate increase to cover the construction costs of Colstrip 3, arguing that the plant was not necessary. With Colstrip 4 about to come on-line, and with no prospects of receiving rate increases to pay for it, MPC sold its interest in the plant, leased it back, and sold the power to West Coast cities.¹⁷

Responding to the Crisis

By the mid-1980s MPC found itself in the same position as many other utilities: excess generating capacity, the inability to charge rates that cover its costs, and forecasts of continued slow growth in the

¹² Ibid.

¹³ Ibid.

¹⁴ Brian Trumbore, "The Arab Oil Embargo of 1973-74," *StocksandNews* and <http://www.buyandhold.com/bh/en/education/history/2002/arab.html>

¹⁵ [www.energyvortex.com/energydictionary/public_utility_regulatory_policies_act_of_1978_\(purpa\).html](http://www.energyvortex.com/energydictionary/public_utility_regulatory_policies_act_of_1978_(purpa).html)

¹⁶ Michael Jamison, "A Corporate Giant Rewires," *Missoulian*, 18-February-2001 and <http://www.missoulian.com/specials/power/power1.html>. Capacity figures for the 1970s and 1980s are not available; in 1993 MPC owned generating capacity of 1.186 kW (Montana Power Company, SEC Form 10-K, 31-December-1993), p. 3.

¹⁷ Ibid.

demand for electricity. (Exhibits 1 to 3 contain selected financial data for MPC for the period 1983 to 2000.) Return on invested capital (ROIC) – the ratio of after-tax operating income to invested capital (funds provided by investors) – was in the 3% to 5% range, well below MPC’s cost of capital. Economic value added (EVA), a measure of a company’s economic (as opposed to accounting) profit for a single year, is found by taking after-tax operating profit and subtracting the annual cost of all capital employed by the firm. Presumably, if managers focus on maximizing EVA it will ensure that they make decisions that are consistent with long-term shareholder wealth maximization; unfortunately, MPC’s EVA was negative.

Many managers in the utility industry also believed that deregulation, begun with passage of PURPA, would increase in the years ahead. In response to their current situation and pessimistic view of the future, utilities began to diversify into non-regulated businesses including telecommunications. MPC had several non-regulated subsidiaries, the largest of which was Western Energy Company, a coal mining company. One of its smallest non-regulated companies, Telecommunications Resources, Inc. (TRI), began as a division that supplied microwave telecommunications between MPC’s far flung operations in Montana and was later spun-off as a separate subsidiary.¹⁸ Eventually MPC’s telecommunications network was upgraded from microwave to fiber-optics and TRI began to lay fiber-optic cable across the state. It expanded its operations by acquiring several small fiber-optic equipment and consulting companies. In 1990, TRI acquired a small long-distance provider called Touch America, allowing TRI to offer long distance services over its own fiber-optic network. After the purchase TRI reorganized and changed its name to Touch America, Inc.¹⁹

While MPC’s non-regulated telecommunications business was prospering, the regulated utility business came under more pressure. In 1992 Congress passed the Energy Policy Act (EPACT), a key provision of which was the establishment of “exempt wholesale generators” (EWGs) as entities that were not considered “utilities” and, therefore, not subject to the requirements of the Federal Power Act and PUHCA.²⁰ This action, in effect, deregulated the wholesale power market by allowing independent power producers to sell electricity to wholesale customers at competitive market rates. MPC viewed enactment of EPACT as the first step in the complete deregulation and restructuring of the utility industry. Utilities would no longer be vertically integrated companies that provided generation, transmission, and distribution for customers in designated markets; instead, separate companies would specialize in the unregulated generation or energy services business, or they could concentrate on the regulated transmission or local distribution business.²¹

The question for MPC was how to proceed given its expectation of an inevitable move to a deregulated industry structure. MPC chose not to be defensive, passively waiting for deregulation to impact its business. Instead, the company chose an aggressive strategy whereby it increased its emphasis on unregulated businesses and supported the deregulation of the retail transmission and distribution market in Montana.²² MPC and several large industrial customers successfully lobbied the state legislature to pass a deregulation bill in May-1997, the Electric Utility Industry Restructuring and Consumer Choice Act. The bill allowed the state’s industrial customers to negotiate long-term supply contracts with any electricity providers beginning in July-1998; residential and small businesses could contract with other suppliers beginning in July-2002.²³

Many groups in Montana opposed this Act, wondering what Montanans had to gain. Residential electricity rates in the state were the seventh lowest in the U.S. due to the state’s heavy reliance on cheaper

¹⁸ Ibid.

¹⁹ <http://www.tamerica.com/about/history.html>

²⁰ www.ncseonline.org/NLE/CRSreports/energy/eng-36.cfm?&CFID=7828359&CFTOKEN=82454224

²¹ <http://tonto.eia.doe.gov/FTPROOT/other/booklet.pdf>

²² Michael Jamison, “A Corporate Giant Rewires,” *Missoulian*, 18-February-2001 and

<http://www.missoulian.com/specials/power/power2.html>

²³ <http://www.naseo.org/committees/energyproduction/documents/montana3.html>

sources of hydroelectric (42%) and coal-fired (56%) power. With substantial coal and hydro resources and a small population, Montana exported about half of the electricity it produced, so an adequate supply of electricity seemed assured. However, under deregulation, MPC could sell its cheap power out-of-state at higher prices. Moreover, given the rural nature of Montana, competitive suppliers might not find it economical to serve the Montana market. The result was MPC remained the monopoly supplier, with rates set at the higher market price.

From MPC's perspective, success in a deregulated environment depended on its ability to recoup "stranded" costs.²⁴ Costs that the regulated rate setting procedures recover become unrecoverable, or stranded, in a competitive market environment. There are two situations that create stranded costs in the utility industry. First, utilities are required under PURPA to purchase power from independent power producers at a price equal to what the utilities would have incurred had they generated the energy themselves (so-called "avoided costs"). Many of these purchase contracts are long-term with fixed prices. Since the cost of generating power has decreased, utilities must now pay above-market prices for power. In a deregulated environment, lower market prices would exacerbate the utilities' losses. The second source of stranded costs relates to utilities' investments in generating capacity. Under regulation, utility rates are set such that a utility recovers the market cost of its investment by permitting prices to equal average costs of producing power. In a deregulated environment, the market price for power could fall to less than average costs of production, resulting in a portion of their investment becoming stranded (i.e., non-recoverable).²⁵ The investments in the Colstrip plants, especially units 3 and 4, created the potential for significant stranded costs for MPC.

MPC expected to be compensated for its stranded costs when the industry was deregulated. However, the governor's office had a different view. They took the position that MPC would receive a windfall if consumers were required to fully pay for its investments. With several hundred million dollars difference between MPC's and the governor's office estimates of the amount of stranded costs that should be paid, the survival of MPC depended on resolving this issue.²⁶

Strategic Transformation

Despite just securing the deregulation legislation it had sought, MPC made an abrupt change in strategic direction. Rather than remain in the utility business, MPC decided to sell its utility and energy assets and invest the proceeds in its Touch America subsidiary. While no one knows with certainty why this decision was made, there was no shortage of speculation. Some argued that this had been MPC's plan all along: deregulate the Montana market to increase the value of its utility assets and then sell out to the highest bidder. Others suggested that MPC was being prudent – faced with the uncertainty over recouping stranded costs and being a small player in a huge soon-to-be deregulated energy market, selling its assets was a low risk strategy. Still others saw the move as a high risk but high potential return bet on the telecommunications industry.²⁷

Touch America, once a tiny in-house telecommunications division, grew rapidly during the 1990s. In 1994 it began constructing a fiber-optic network from Spokane, Washington to Billings, Montana. In 1996 the company expanded its network into seven Western and Midwestern states. It created Touch America Colorado, a joint venture with New Century Energies (later to become Xcel Energy), that provided advanced high-speed data and voice communications services to businesses in the Denver metro

²⁴ Michael Jamison, "A Corporate Giant Rewires," *Missoulian*, 18-February-2001 and <http://www.missoulian.com/specials/power/power2.html>

²⁵ Michael V. Seitzinger, "Stranded Costs," *Electric Utility Restructuring Briefing Book*, Congressional Research Service, Library of Congress; and www.ncseonline.org/nle/crsreports/briefingbooks/electricity/ebelesc.cfm

²⁶ Michael Jamison, "A Corporate Giant Rewires," *Missoulian*, 18-February-2001 and <http://www.missoulian.com/specials/power/power2.html>

²⁷ Ibid.

area. Stockholders were jumping on the bandwagon,²⁸ and in 2000 Touch America purchased Qwest Communications' long-distance business in 14 states, increasing its customer base from 50,000 to 250,000. Touch America continued to grow and improve its service offerings including launching dedicated Internet access (DIA) service; deploying a state-of-the-art integrated billing, provisioning, and order entry system; enlarging the Missoula customer care center; and introducing a bigger and better network operations center.²⁹

The expansion of Touch America required resources. In December-1997 MPC announced that:

... it would offer for sale all of its Montana electric generating facilities, including 13 dams and four coal-fired plants of the regulated utility, as well as its unregulated leasehold interest in another coal-fired unit, its contracts for purchased power from qualifying facilities and Basin Electric Power Cooperative (Basin) and two power exchange agreements. The total book value of the electric generating facilities owned by the Company that are being offered for sale is approximately \$550,000,000 including approximately \$10,000,000 of fuel, materials and supplies.³⁰

On 17-December-1999 MPC sold substantially all of its electric generating assets to PPL Montana, LLC, a subsidiary of PP&L Global, Inc., for approximately \$758,600,000. The sale proceeds were used to repurchase shares of common stock, retire long-term debt, and make additional investments in Touch America. MPC no longer generated electricity after the sale, but did retain its transmission and distribution operations.³¹

On 25-January-2000 MPC announced that Goldman Sachs had been retained as an advisor to assist the company in evaluating options with respect to implementing a strategy to separate Touch America from Montana Power. (See Appendix C for Goldman Sachs' recent Code of Business Conduct and Ethics.) On 28-March-2000, MPC's Board of Directors announced that the company would begin the process of divesting all of its multiple energy businesses:

The decision to divest the energy businesses was based on a belief that the divestiture would allow a focus on Touch America's fast-growing telecommunications business, while enabling the energy companies to grow and add value under new ownership. Our Board of Directors concluded that our structure, which had been created to be responsive to the demands of a regulated utility business, could not continue to meet the demands and ensure the success of the different energy and telecommunications businesses.

Consequently, we retained Goldman, Sachs & Co. to assist us in the sale of our oil and natural gas businesses, coal businesses, independent power production business, and utility business. Goldman, Sachs also assisted us in the restructuring plan of our Company from an energy-related business to Touch America Holdings, Inc. (Touch America Holdings), a telecommunications business with a simple corporate structure more appropriate to a national telecommunications holding company.³²

The Touch America subsidiary was reorganized as Touch America Holdings on 27-September-2000. MPC sold its oil and natural gas operations on 31-October-2000, Continental Energy Services, Inc. (Continental Energy) on 21-February-2001, and its coal operations on 30-April-2001.³³ In its Proposed Restructuring Proxy Statement/Prospectus of 13-July-2001,³⁴ Montana Power listed one of its risk factors as "Risks Related to Competing in the Telecommunications Industry" which stated: "Touch America

²⁸ For instance, see Bill Mann, "A High Tech Company You Never Heard Of," *Fool on the Hill*, 29-September-1999 <http://www.fool.com/news/1999/foth990929.htm>.

²⁹ <http://www.tamerica.com/about/history.html>

³⁰ Montana Power Company, SEC Form 10-K, 31-December-1997, p. 3.

³¹ Montana Power Company, SEC Form 10-K, 31-December-1999, p. 5.

³² Montana Power Company, SEC Form 10-K, 31-December-2000, pp. 3-4.

³³ Touch America Holdings Inc., SEC Form 10-K, 31-December-2001, p.3.

³⁴ Source: <http://www.secinfo.com/dRqWm.4fvf8.htm>.

Holdings' operates in a highly competitive industry with participants that have greater resources and existing customers than Touch America Holdings, which could limit Touch America Holdings' ability to increase its market share." In spite of these and other risks, on 13-February-2002 MPC merged with The Montana Power, L.L.C, a wholly-owned subsidiary of Touch America Holdings, and shareholders of MPC became shareholders of Touch America Holdings.³⁵ The stock of Touch America Holdings closed at \$4.23 per share on 13-February-2002. On 15-February-2002, the energy transmission and distribution business were sold for \$602 million in cash and the assumption of \$488 million of existing debt to NorthWestern Corporation, a South Dakota-based provider of electric, natural gas, communications, and services to more than 2 million customers in Montana, South Dakota, and Nebraska. With this sale, all of the energy businesses were divested and the company became a stand-alone telecommunications company. Net proceeds from the sale of these assets were approximately \$1.3 billion.³⁶

Executive Compensation

In 1994 the board of directors at MPC consisted of 15 members, 11 of whom were non-employee directors. By 1998 the board had been reduced to 12 members, 10 of whom were non-employee directors. The board of directors of Touch America Holdings, the successor to MPC, consisted of 10 members, 8 of whom were non-employee directors. The board of directors consisted of several standing committees including audit, personnel, nominations, executive, environment and safety, and finance. (Exhibit 4 summarizes compensation for non-employee board members from 1991 to 2002.)

The personnel committee of the board of directors was responsible for making recommendations to the full board concerning the salaries of officers. MPC stated that compensation was designed to:

... provide compensation comparable to that offered by companies with similar businesses, allowing the company to successfully attract and retain the employees necessary to its long-term success; provide compensation which relates to the performance of the individual and differentiates based upon individual performance; provide an appropriate linkage between compensation and the creation of shareholder value through awards tied to the company's performance and through facilitating employee stock ownership; and provide internal equity among employees, assuring reasonable correspondence between salaries for positions and positional relationships.³⁷

In May-1992 shareholders approved the long-term incentive plan (LTIP) as a way to reward employees who make important contributions to the company and to attract and retain such employees. The plan provided for the granting of restricted stock, stock options, and dividend equivalent shares. The plan also provided a long-term incentive component in the executive compensation package that was explicitly tied to the achievement of certain company performance goals.³⁸

During 1994 the personnel committee engaged Towers Perrin, a compensation consultant, to evaluate the competitiveness of the compensation packages of MPC's top 13 executives. Towers Perrin concluded that:

... the company's base salaries were approximately 10% below competitive levels; that the absence of an annual bonus opportunity resulted in total cash compensation which was 26% below competitive practices; and, that because the company had not made any long-term incentive awards for several years, total compensation was, on average, 35% below competitive practices ... the absence of annual incentive and current long-term incentive grants resulted in total compensation to executives that was substantially below competitive practices and which was not sufficiently objectively related to the company's performance.³⁹

³⁵ Ibid.

³⁶ Ibid.

³⁷ Montana Power Company, SEC Form Schedule 14-A (Proxy), 24-February-1994, p. 10.

³⁸ Ibid, p. 11.

³⁹ Montana Power Company, SEC Form Schedule 14-A (Proxy), 9-May-1995, p. 10.

In response to the Towers Perrin report, the personnel committee adjusted salaries to bring them closer to competitive levels. The personnel committee also awarded options to purchase shares of common stock and the right to receive the equivalent, in cash, of the dividends on the shares underlying the options. The dividend equivalent awards were subject to the achievement of certain performance criteria over the three years from 1-January-1994 to 31-December-1996.⁴⁰

During 1997 the personnel committee retained the consulting firm Stern Stewart to help implement an EVA financial measurement system that contained an executive compensation incentive plan.⁴¹ The EVA plan, effective for the years 1998 to 2001, created opportunities for executives and high-level managers to earn cash bonuses based upon achieving target levels of EVA specified for each of the four years of the plan. Potential bonuses, ranging from 10% to 60% of executives' base salaries, were based on the company's actual EVA relative to the specified EVA targets.⁴²

In 1999 Hewitt Associates was retained by the personnel committee to evaluate the compensation packages of executives deemed to be critical to the success of the Touch America subsidiary. Hewitt compared MPC executive compensation levels to those for several groups of telecommunications companies. Based on this analysis, Hewitt concluded that MPC executive compensation packages were below competitive levels. In response, the personnel committee awarded special compensation in the form of performance-based stock options payable in 1999 and 2000.⁴³

In 2001 the personnel committee terminated the EVA bonus plan and amounts owed for previous years' performance were paid to employees in March-2001, March-2002, and the first quarter of 2003. At the same time, the committee adopted a short-term incentive plan called Success Sharing 2001. Under this plan bonuses were awarded when the company met targeted levels of sales revenue and earnings before interest, taxes, depreciation, and amortization (EBITDA). The potential bonus amount ranged from 25% to 100% of employee annual base pay.⁴⁴

As part of its restructuring plan, in 2000 MPC entered into change of control agreements with 36 company executives and high-level managers. The agreements provided that if:

... within three years after the occurrence of a change of control, the employee is terminated by MPC without cause, or the employee terminates employment with MPC for good reason, the employee is entitled to 299.9 percent for a 'Tier 1' participant, 200 percent for a 'Tier 2' participant and 100 percent for a 'Tier 3' participant of the sum of the highest annual rate of base salary paid to the employee during the three-year period immediately preceding the change of control and the highest annual bonus paid to such individual during such three-year period; 200 percent of the annual contribution to the employee's cash balance pension plan; the present value of the cost to provide welfare benefits under MPC's life insurance, health, dental, disability and other welfare plans for a period of three years following termination; and a prorated portion of the target annual bonus in the year in which the change of control occurred.

In addition, in the event that any amounts paid to a Tier 1 participant under his or her agreement or in connection with his or her termination are subject to federal excise taxes in connection with a change of control, MPC will pay an additional amount called a "Gross-Up Payment" equal to the amount of the taxes and any state or federal taxes on the Gross-Up Payment.⁴⁵

Under this agreement, Mr. Robert P. Gannon, CEO and chairman of the board, could terminate his employment between 15-February-2003 and 15-March-2003 and receive a lump sum payout of approximately \$4 million. He had come a long way: Before joining Montana Power in 1974 as an attorney,

⁴⁰ Ibid.

⁴¹ Montana Power Company, SEC Form Schedule 14-A (Proxy), 27-March-1998, pp. 9-10.

⁴² Ibid.

⁴³ Montana Power Company, SEC Form Schedule 14-A (Proxy), 9-May-1999, pp. 10-12.

⁴⁴ Touch America Holdings Inc., SEC Form Schedule 14-A (Proxy), 31-December-2002, pp. 15-16.

⁴⁵ Montana Power Company, SEC Form Schedule 14-A (Proxy), 26-December-2000, p. 37.

Gannon – a native of Butte who earned his law degree in 1969 from the University of Montana – served two years as an assistant attorney general for the State of Montana and another two-and-a-half years as an assistant U.S. attorney for Montana. On 2-July-2002 Gannon agreed to waive his rights under the change of control agreement in return for a payment of \$2.2 million.⁴⁶ Similar agreements were enacted with three other company executives at a cost of \$3.2 million.⁴⁷ Gannon also entered into a three-year employment agreement that provided for an annual base salary of \$515,000, which may be increased by the board of directors; participation in an annual bonus incentive program with a potential bonus equal to 100% of annual base salary; and an immediate grant of stock options on 400,000 shares of common stock and a grant to purchase 350,000 shares on the first anniversary of the agreement.⁴⁸ Similar employment agreements were also signed with three other executives. (Exhibit 5 provides a summary of the compensation for the CEO and chairman of the board for the years 1991 to 2002.)

The Fallout

Revenues from telecommunications in 2001 increased substantially due to increased network services revenues (wholesale and dedicated business lines) and retail sales revenues (commercial and consumer long distance sales). However, expenses increased more rapidly due to rising costs to access other carriers' networks and higher than expected marketing expenses. In addition, there were write-downs of \$14.8 million and losses of an additional \$15.5 million from unconsolidated telecommunication investments. The result was a net loss of almost \$20 million. (Exhibit 6 contains Touch America Holdings financial data for the telecommunications businesses that continued to operate after the divestiture of all energy-related businesses for the years 2000, 2001, and the first nine months of 2002.) The situation worsened in the first nine months of 2002 as intense price competition in the telecommunication industry and lower than expected demand resulted in significantly lower revenues and a loss of \$66 million.

On 15-April-2003 Touch America announced that it would be late filing its annual report for fiscal year 2002.⁴⁹ The delay was caused by the 27-Mar-2003 announcement that an arbitrator had awarded Quest Communications Corporation \$59.6 million to settle a dispute over various revenue and expense items relating to Touch America's 2000 purchase from Quest of wholesale, private line, long distance, and other telecommunications services businesses in the former US West 14-state region.⁵⁰ The filing delay was necessary to allow Touch America to properly assess the impact of the award. On 15-April-2003 Touch America also announced that it anticipated taking a non-cash charge of about \$800 million for the write down of fiber-optic assets.⁵¹

Whether investors in MPC stock profited from the conversion from a utility to a telecommunication company depended on if or when they sold their stock. MPC stock was selling for more than \$80 per share in the spring of 1999 and in Aug-1999 the stock split 2-for-1. The shares continued to appreciate, hitting a high of \$64 per share (\$128 on a pre-split basis) on 31-Mar-2000. By year-end 2000 the price had declined to \$20.75; at year-end 2001 it sold for \$5.75 per share. MPC stock stopped trading on 13-Feb-2002 when shareholders received stock in Touch America. By year-end 2002 the price of Touch America shares was \$0.39; on the day it announced that it was delaying its annual report filing, the stock sold for \$0.17. Touch America stock was delisted from the New York Stock Exchange on 28-March-2003 because its price had remained below \$1 per share for more than 30 days.⁵²

⁴⁶ Touch America Holdings Inc., SEC Form Schedule 14-A (Proxy), 31-December-2002, pp. 24-25.

⁴⁷ Ibid, p. 25.

⁴⁸ Ibid, pp. 22-23.

⁴⁹ "Touch America Announces Delay in Filing Annual Report," Touch America Holdings Inc. press release, 15-April-2003 and http://psc.wi.gov/pdf/annlrpts/tele/OTH_2002_5936.PDF.

⁵⁰ "Arbitrator Rules on Proceeding Between Touch America and Qwest Communications," Touch America Holdings Inc. press release, 27-March-2003 and <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=105&STORY=/www/story/03-27-2003/0001915621>.

⁵¹ Touch America Holdings Inc., SEC Form 8-K, 16-April-2003.

⁵² Touch America Holdings Inc., SEC Form 8-K, 28-March-2003.

Investors were not the only group harmed by the conversion to a telecommunication company. Utility customers in Montana experienced significant rate increases, with a particularly severe impact on commercial customers. For example, Stedman's Montana Resources saw its cost of electricity go from \$19 per megawatt hour in 1999 to \$26 in 2000 and \$320 in May-2001.⁵³ Faced with such high energy costs, Montana Resources shut down its operations. Deregulation that promised to provide lower energy costs and stronger economic growth instead delivered a devastating economic blow to the state and its citizens.

Montana Power Company's management had intended to strengthen the company through diversification. The fact that specific restructuring strategies failed is significant but may not be as important as the attempt by MPC management to hide critical decisions from its constituencies. Are there ever circumstances when management should restrict stakeholder participation in strategic plans by silencing the voices of potential opponents? What recourse do stakeholders have? How can such catastrophic actions be prevented from recurring in the future?

⁵³ Jim Robbins, "As Power Prices Surge, Montana, Too, Asks Why," *New York Times*, 13-May-2001.

Exhibit 1																		
Montana Power Balance Sheets At 31-December (Figures in Millions of USD)*																		
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Cash	33	29	29	6	4	3	9	9	5	9	12	22	16	32	17	10	595	118
Receivables	64	78	81	109	110	118	120	140	138	143	158	160	152	142	127	200	182	300
Inventory	15	25	27	31	29	31	33	34	41	42	43	48	42	39	39	42	38	16
Other Curr Assets	24	29	31	37	49	67	74	67	53	51	44	65	62	58	60	76	72	183
Total Curr Assets	136	161	168	183	192	219	236	250	237	245	257	295	272	272	243	328	887	619
Net PP&E	1,303	1,343	1,127	1,142	1,169	1,180	1,222	1,189	1,225	1,270	1,371	1,453	1,542	1,986	2,052	2,082	1,705	1,084
Intangibles	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	152
Deferred Charges	29	33	125	166	179	186	139	120	128	281	255	268	288	305	372	368	297	252
Other Investments	223	229	324	345	322	342	348	427	494	490	503	497	483	136	134	150	160	710
Total Assets	1,692	1,765	1,743	1,836	1,863	1,926	1,946	1,985	2,085	2,285	2,386	2,513	2,586	2,698	2,802	2,928	3,049	2,817
Curr Portion Debt	7	7	2	8	3	17	2	8	36	37	26	17	25	69	82	96	59	169
Notes Payable	51	86	74	85	95	83	56	64	57	63	69	114	96	105	134	70	0	75
Accounts Payable	34	24	32	25	22	26	31	39	46	49	56	51	64	62	78	97	116	207
Taxes Payable	35	40	56	39	39	42	40	36	42	55	49	56	53	53	52	77	207	145
Other Curr Assets	62	90	70	71	68	73	87	96	107	123	114	76	99	76	72	76	127	124
Total Current Liab	189	247	235	227	226	242	216	242	288	327	313	313	338	365	417	416	509	720
Total LT Debt	688	706	581	568	562	551	563	600	603	581	572	589	617	698	718	763	684	374
Deferred LT																		
Taxes	102	101	76	129	139	144	137	136	142	288	310	323	321	333	340	324	9	0
Other Liabilities	33	38	124	130	136	163	184	167	168	170	178	231	264	273	257	278	781	558
Total Liabilities	1,011	1,092	1,015	1,054	1,062	1,100	1,100	1,145	1,202	1,367	1,373	1,456	1,539	1,669	1,732	1,782	1,982	1,653
Preferred Stock	99	82	52	52	52	52	52	52	52	52	101	101	101	58	58	58	58	58
Common Equity	582	591	677	730	748	774	794	788	831	867	911	956	945	971	1,012	1,089	1,009	1,106
Total Equity	681	673	728	782	800	826	846	840	883	919	1,013	1,057	1,047	1,029	1,069	1,146	1,066	1,164
Total Liab and Eq	1,692	1,765	1,743	1,836	1,863	1,926	1,946	1,985	2,085	2,285	2,386	2,513	2,586	2,698	2,802	2,928	3,049	2,817

* Source: Research Insights

Exhibit 2																		
Montana Power Income Statements For the Years Ended 31-December (Figures in Millions of USD)*																		
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Sales	352.44	368.72	425.17	447.05	422.48	443.68	451.87	450.34	498.02	504.69	544.89	540.72	542.82	973.21	1023.6	1253.7	1342.3	999.7
Cost of Sales	241.05	254.50	273.54	292.16	299.58	313.85	282.09	293.85	324.97	334.28	355.36	364.99	336.24	648.23	712.43	834.18	999.29	845.08
Gross Profit	111.39	114.22	151.64	154.90	122.91	129.84	169.78	156.49	173.05	170.41	189.53	175.73	206.58	324.98	311.17	419.54	343.02	154.63
Depreciation	23.22	33.70	34.83	35.50	37.05	39.35	40.94	39.65	41.44	43.53	46.06	48.08	50.73	88.74	94.66	114.27	111.15	77.03
EBIT	88.17	80.52	116.80	119.40	85.85	90.48	128.84	116.83	131.60	126.88	143.47	127.65	155.85	236.24	216.50	305.28	231.88	77.61
Interest Expense	67.62	74.91	72.24	52.15	53.98	53.49	59.06	48.70	51.93	49.28	48.82	46.23	49.15	51.66	60.16	66.34	48.50	39.90
Other Income (Expense)	91.03	58.04	111.58	43.83	55.06	67.93	38.69	67.05	76.43	75.10	66.68	86.24	(28.19)	6.78	34.16	4.86	11.03	72.09
Pretax Income	111.58	63.65	156.15	111.08	86.94	104.92	100.36	135.19	156.11	152.70	161.33	167.66	78.51	191.36	190.50	243.79	194.41	109.79
Total Taxes	22.99	12.33	34.58	44.14	24.51	33.06	25.95	40.21	50.39	45.64	54.12	54.07	21.57	71.98	61.87	78.17	44.06	33.60
Net Income	88.59	51.32	121.57	66.94	62.43	71.86	74.41	94.98	105.72	107.07	107.21	113.59	56.94	119.39	128.63	165.62	150.35	76.19

Exhibit 3																		
Montana Power Selected Ratios For the Years Ended 31-December (Dollar Figures in Millions of USD Except Per Share Figures and P/E Ratio)																		
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Year-end Stock Price		19.25	32.38	38.50	31.38	35.75	42.25	20.25	28.25	26.38	25.75	23.00	22.63	21.38	31.75	56.56	36.06	20.75
Earnings Per Share	2.11	1.02	2.62	1.39	1.26	1.42	1.45	1.84	2.03	2.02	1.98	2.00	0.92	2.03	2.29	2.95	1.34	1.84
Dividends Per Share			2.10	2.53	2.68	2.68	2.76	1.78	1.48	1.56	1.58	1.60	1.60	1.60	1.60	1.60	1.40	0.80
Market Capitalization		805	1,412	1,742	1,462	1,712	2,063	1,006	1,421	1,348	1,340	1,222	1,224	1,168	1,735	3,110	3,959	2,188
Market Value Added		132	683	960	661	886	1,217	165	539	430	327	165	178	139	666	1,963	2,893	1,024
Dividend Yield			6.49%	6.6%	8.5%	7.5%	6.5%	8.8%	5.2%	5.9%	6.1%	7.0%	7.1%	7.5%	5.0%	2.8%	3.9%	3.9%
ROE	13.0%	7.6%	16.7%	8.6%	7.8%	8.7%	8.8%	11.3%	12.0%	11.7%	10.6%	10.7%	5.4%	11.6%	12.0%	14.4%	14.1%	6.5%
ROA	5.2%	2.9%	7.0%	3.6%	3.4%	3.7%	3.8%	4.8%	5.1%	4.7%	4.5%	4.5%	2.2%	4.4%	4.6%	5.7%	4.9%	2.7%
Equity Multiplier	2.48	2.62	2.39	2.35	2.33	2.33	2.30	2.36	2.36	2.49	2.36	2.38	2.47	2.62	2.62	2.55	2.86	2.42
P/E Ratio		19	12	28	25	25	29	11	14	13	13	12	25	11	14	19	27	11
ROIC	4.5%	4.0%	5.7%	4.2%	3.6%	3.5%	5.3%	4.5%	4.7%	4.3%	4.4%	3.7%	4.8%	5.9%	5.6%	7.7%	6.9%	2.3%

* Source: Research Insights

Exhibit 4 Board of Directors Compensation*					
Year	Company	Annual Retainer	Payment for Each Committee Meeting Attended [§]	Payment for Each Special Meeting of the Board	Payment for Serving as Committee Chair
1991	Montana Power	\$16,500	\$500	\$850	
1992	Montana Power	18,500	\$500	\$850	
1993	Montana Power	18,500	\$500	\$850	
1994	Montana Power	19,600	\$500	\$850	
1995	Montana Power	19,600	\$500	\$850	
1996	Montana Power	19,600	\$500	\$850	
1997	Montana Power	19,600	\$500	\$850	
1998	Montana Power	19,600	\$500	\$850	
1999	Montana Power	19,600	\$500	\$850	
2000	Montana Power	19,600	\$500	\$850	
2001	Touch America	35,000		\$850	\$5,000
2002	Touch America	NA	NA	NA	NA

[§]Not at a regular meeting of the Board

Exhibit 5 Compensation of CEO and Chairman of the Board*					
Year	Cash Salary	Cash Bonus	Long-term Incentive Plan	Number of Securities Underlying Options Granted	Other Compensation
1991	\$182,549				\$5,933
1992	232,000				6,110
1993	274,100				6,296
1994	305,000			26,800	6,300
1995	322,500				6,468
1996	333,000		\$16,100	31,000	6,650
1997	346,500		32,885		6,654
1998	362,523	\$115,920	51,757	42,000	6,400
1999	408,600	263,671	126,000	214,800	15,054
2000	483,654	272,114	191,100		6,800
2001	500,000	100,000			18,819
2002	515,000	NA	NA	400,000	NA

* Sources: Various Montana Power Company and Touch America Holdings Inc. SEC Form Schedule 14-A

* Sources: Various Montana Power Company and Touch America Holdings Inc. SEC Form Schedule 14-A

Exhibit 6			
Touch America Holdings Income Statements, Balance Sheets, and Selected Ratios			
Highlights For Years Ended 31-December*			
(Dollar Figures in Millions of USD Except Per Share Figures and P/E Ratio)			
	2000	2001	9 months ended Sep 30 2002
Revenues	323.327	549.932	248.807
Operations and Maintenance	179.672	378.726	216.766
Selling, General, and Administrative	79.557	118.585	81.644
Depreciation and Amortization	22.423	44.790	43.609
Operating Income (Loss)	36.312	(3.911)	(104.216)
Income (Loss) From Cont Ops Before Taxes	36.465	(33.259)	(109.147)
Income Taxes (Benefit)	14.134	(13.412)	(42.181)
Net Income (Loss) From Continuing Operations	22.331	(19.847)	(66.966)
Cash and Cash Equivalents	118.417	45.307	44.550
Accounts Receivable	300.298	274.987	313.904
Inventory	16.446	0.947	0
Other Current Assets	89.544	39.329	19.976
Assets of Discontinued Operations	282.350	1,521.054	0
Total Current Assets	807.055	1,881.624	378.430
Net Telecommunication Properties	729.916	1,000.319	1,117.031
Net Utility Properties	1,089.330	0	0
Other Assets	378.974	177.537	112.657
Total Assets	3,005.275	3,059.480	1,608.118
Current Portion of Debt	169.054	255.200	0
Notes Payable	75.000	0	0
Accounts Payable	206.925	270.895	259.943
Other Current Liabilities	269.024	59.205	88.079
Liabilities of Discontinued Operations	188.480	1,115.239	0
Total Current Liabilities	908.483	1,700.539	348.022
Long-Term Debt	374.463	0	0
Other Long-term Liabilities	558.317	182.346	166.984
Preferred Stock	57.654	57.654	35.670
Common Stock	705.157	705.600	499.749
Treasury Stock	(205.656)	(205.656)	0
Unallocated Stock Held by Trustee	(17.227)	(12.762)	(9.692)
Retained Earnings	624.118	633.913	567.821
Total Shareholders' Equity	1,164.012	1,176.595	1,093.112
Total Liabilities and Equity	3,005.275	3,059.480	1,608.118

* Sources: Touch America Holdings Inc. SEC Form 10-K, 31-December-2001 and 10-Q, 30-September-2002.

Stock Price	20.75	5.75	0.62
Earnings Per Share	0.21	(0.19)	(0.65)
Dividends Per Share	0	0	0
Market Capitalization	2,188.108	596.666	64.325
Market Value Added	1,024.096	(579.929)	(1,028.787)
ROE	1.9%	-1.7%	-6.1%
ROA	0.7%	-0.6%	-4.2%
P/E	98	NM	NM
ROIC	0.9%	-0.1%	-5.1%

Appendix A: Time Line of Significant Events*

Time	<i>Event</i>
1871	Montana's first hydroelectric facility is built on the Missouri River's Black Eagle Falls near Great Falls
1912	Amalgamated Copper Company's many small power producers merged and spun-off into Montana Power Company (MPC), both companies remaining interdependent; Amalgamated becomes Anaconda Copper Mining Company in 1915, grows to be the largest customer of any utility in the nation and world's largest copper mining company only to be closed in 1983
1910-15	Progressives carry weight in Montana politics; initiate many reforms, including 1913 creation of Public Service Commission to regulate newly formed Montana Power Co.
1913	Butte, Anaconda, and Pacific Railroad are 100 percent electrified; Montana is home to nation's longest stretch of electric rail
1928	American Power and Light Co. buys almost all outstanding MPC stock to become East Coast holding company
1930s	Montana Power Co. expands into natural gas business
1933	John Ryan dies at his home in New York
1936-37	Anaconda experiences shutdowns at mines and smelters as drought conditions create energy shortages
1950	American Power and Light Co. is dissolved; stockholders again control MPC
1950s	MPC purchases coal leases near Colstrip displaying arrogance toward regulators; came on-line in 1975, 1976, 1984, and 1985
1959	Anaconda Co. sells daily newspapers in Montana; social and political weight of company is diluted by more diversified economy
1960s	Anaconda and MPC begin to split; culminates in 1968 when Anaconda for first time opposes MPC rate hike
1967-68	Longest, costliest mining strike in Montana history closes anaconda operations and reduces MPC rates
1970s	Environmental movement grows in Montana
1971	Chilean government seizes Anaconda's mining properties there; company declares annual net loss of \$357.3 million
1972	Montana voters elect Democrat majority sensitive to environment; Montana passes new state constitution, reflecting environmental concerns, followed by a series of stringent state environmental laws
1972-75	Several laws protecting the environment are passed, including the Strip Mining and Reclamation Act, Water Use Act, and Major Facility Siting Act; at same time, lawmakers enact coal severance tax to create endowment for future when all Colstrip coal is mined
1973	OPEC announces oil boycott, energy crisis spurring interest in new power plant construction; U.S. responds by creating the Department of Energy in 1977 and passing the National Energy Act of 1978 <i>Director/Management Decisions: Coal Tax institutes 30% tax on out of state sales; negative effect on MPC's power purchase agreements</i>
1978	The Public Utility Regulatory Policies Act (PURPA) opens the regulated utility industry to non-regulated suppliers
1970s	Montana Power Co. partners with other West coast utilities to build four coal-fired power plants at Colstrip; arguments over whether the third and fourth plants are necessary drag on for a decade and drain the company financially
1970s	Congress responds to energy crisis by encouraging new, sustainable technologies; orders utilities to buy back power from small, alternative producers

* Sources: Case information; "Generations of Power: History of Montana Power Company," *Missoulian*, 18-February-2001 <http://www.missoulian.com/specials/power/power3.html>; "Here is a chronology of Montana Power Co. and its high-tech successor," *Billings Gazette*, 19-June-2003 <http://www.billingsgazette.com/index.php?display=rednews/2003/06/19/build/local/32-timeline.inc>

Time	Event
1980s	Regional power providers recognize industry over-built in response to 1970s energy crisis; projects are abandoned, resulting in \$2.25 billion bond default
1980s	Montana Power Co. and other utilities experience flat growth; begin to diversify into other areas, including telecommunications
1990	One of MPC's smallest non-regulated companies, Telecommunications Resources, Inc., acquires a small long-distance provider called Touch America, a provider of long distance phone service; adapts the name for its existing telecommunications subsidiary which installs fiber-optic lines; grew rapidly during the 1990s Director/Management Decisions: 1985, Colstrip 3 costs partially disallowed to be included in rate case; Colstrip 4 totally disallowed from rate recovery
Mid-1990s	Montana Power Co. begins consolidating, closing far-flung offices and laying off workers at Colstrip and elsewhere
1992	Congress passes the Energy Policy Act (EPACT), in effect deregulating the wholesale power market; in May, MPC's shareholders approve employee long-term incentive plan Director/Management Decisions: IIPs encouraged by EPA; utilities must purchase energy from IPPs at above-market prices
1994	Towers Perrin evaluate the compensation packages of top 13 MPC executives, concluding they were substantially below competitive practices and not sufficiently objectively related to performance; in response, the Personnel Committee adjusts salaries and awards options based on performance criteria over 1-January-1994 to 31-December-1996
1997	Within months of Montana passing the Electric Utility Industry Restructuring and Consumer Choice Act, MPC offers to sell all of its Montana electric generating facilities worth approximately \$550 million Director/Management Decisions: Outside evaluation of compensation system: Stern Stewart helps implement an EVA financial measurement system containing an executive compensation incentive plan based on 1998-2001 performance
1998	Touch America, formerly a subsidiary of Montana Power Co., is restructured; MPC is made a subsidiary of Touch America; Town of Colstrip incorporates in attempt to distance community from power company; MPC board of directors declines from 15 members in 1994 (11 outsiders) to 12 members (10 outsiders)
1999	MPC sells all of its power producing plants to Pennsylvania-based PPL Resources Inc. for \$759 million but retains its transmission and distribution operations; stock was selling for more than \$80 per share in the spring and in August split 2-for-1; Hewitt Associates evaluates the compensation packages of executives deemed to be critical to the success of the Touch America subsidiary, resulting in performance-based stock options payable in 1999 and 2000 Director/Management Decisions: T&D business still regulated and provides restricted income; performance-based options to increase performance
25-Jan-2000	Goldman Sachs assists in separating Touch America from Montana Power Director/Management Decisions: Telecommunication industry providing attractive growth opportunities
28-March-2000	MPC announces it would begin divesting all of its multiple energy businesses, with shareholders of Montana Power becoming shareholders of Touch America Holdings; the stock hits a high of \$64 per share (\$128 on a pre-split basis) on 31-Mar-2000 Director/Management Decisions: High stock prices indicate shareholder confidence in strategy and management

Time	Event
27-Sep-2000	Touch America subsidiary reorganizes as Touch America Holdings; board of directors consists of 10 members (8 outsiders); enters into change of control agreements with 36 company executives and high-level managers <i>Director/Management Decisions: Executive packages put in place to assure reorganization in a manner not done for personal reasons</i>
Oct-2000 to April-2001	Sells its oil and natural gas operations, Continental Energy Services, and coal operations; by year-end 2000 the stock price declines to \$20.75; begins paying employees for previous years' performance based on the now-terminated EVA bonus plan and adopts Success Sharing 2001 in its place <i>Director/Management Decisions: Several \$M separate regulators and MPC on stranded costs issues; in early 2000, generating plants selling for up to 2x book value; used to defray stranded costs</i>
Aug-2001	Four Montana law firms sue Montana Power Company and its executives for \$3 billion; shareholders claim the asset sale was illegal because they never approved the move as required by state law; more lawsuits follow as deregulation proceeds; at year-end the stock sells for \$5.75 per share
13-Feb-2002	MPC merges with The Montana Power, L.L.C a wholly owned subsidiary of Touch America Holdings, Inc, with MPC shareholders becoming shareholders of Touch America Holdings, Inc; MPC stock closes at \$4.23 per share and stops trading
15-Feb-2002	Utility operations sold to NorthWestern for \$1.3 billion, making the company a stand-alone telecommunications company; by year-end the stock price of Touch America shares is \$0.39
March 2002	Large payments made to executives and accounting firm Arthur Andersen
2-July-2002	CEO and Chairman of the Board Gannon receives \$2.2 million and a three-year employment agreement
Jan 2003	NorthWestern's chief executive Merle Lewis resigns as company stock continues to fall; restructuring plan includes selling all non-utility businesses and re-negotiating debt; most of NorthWestern's stock downgraded to junk status
28-March-2003	Touch America stock delisted from the New York Stock Exchange
15-April-2003	Touch America announces that it would be late filing its annual for fiscal year 2002 and anticipates taking a non-cash charge of about \$800 million for the write down of fiber-optic assets; stock sells for \$0.17
April-2003	Montana Legislature exempts NorthWestern from the \$3 billion lawsuit filed against Montana Power and others for selling assets
14-Sep-2003	NorthWestern files for Chapter 11 bankruptcy protection in Delaware, wiping out nearly 10,000 investors who owned the company's stock
7 Nov-2003	NorthWestern pays 25 key employees \$2.6 million in bonuses
20-Dec-2003	Citing low morale and high stress among employees, NorthWestern asks federal bankruptcy judge to approve a bonus plan for its officers, managers, and employees
10-Feb-2004	Federal bankruptcy judge approves NorthWestern plan to pay up to \$8.6 million in bonuses to executives and other employees over the next year but lets Montana Public Service Commission decide whether ratepayers will foot the bill

Time	<i>Event</i>
11-March-2004	NorthWestern files its reorganization plan and disclosure plan with U.S. Bankruptcy Court, proposing a debt-for-equity swap in which its creditors would be given new stock in the company in exchange for their debts; claims it will be an investment-grade company again listed on a national stock exchange by the final three months of 2004
15-July-2004	Shareholders of Montana Power Co. and Touch America settle class-action lawsuit for up to \$67 mill; the agreement does not affect the shareholders' pending, separate lawsuit against Goldman Sachs

Appendix B: A Brief History of the Utility Industry (1901-1990)*

From 1901 to 1932, the electrification of the country spurred electric utility capacity and generation growth of 12% per year. During this period there was a rapid consolidation of small producers as it became evident that the electric utility industry was a natural monopoly (see below), so that a single vertically integrated company serving a specific geographic area could achieve the lowest unit costs. State regulations developed to ensure that utility monopolies did not take advantage of their monopoly pricing power. In most states, a public service commission established the utility rates that utilities could charge to earn a “fair” rate of return on their investment. Significant legislation was the Federal Power Act (1920) and the Public Utilities Holding Company Act of 1935 (PUHCA).

From 1932 to 1941 electric generation grew at an annual rate of 8% although capacity increased only 2.5% per year. Residential electricity rates averaged 3.7 cents per kilowatt in 1941, one-third less than that in 1932. During the war years 1941-1945, electric generation grew at a 7.5% annual rate, capacity grew at an annual rate of 4.5%, and residential rates declined 2% per year. From 1946 to 1950, electric generation grew at an 8% annual rate, capacity grew at an annual rate of 6.5%, and residential rates declined 3% per year. These trends continued during the 1951-1960 period: electric generation grew at an annual rate of 8.5%, capacity grew at an annual rate of 9.5%, and residential rates declined 1% per year.

During the 1960s, electric generation grew 7.5% per year in response to strong economic growth, continued declines in real energy prices, and growing consumer preference for electric power. However, this growth masked several developing problems. First, environmental mandates – especially those related to clean air – began to add to the costs of electricity generation. Second, the rate of decline in unit costs resulting from increased economies-of-scale began to slow as it was becoming more difficult to reduce unit costs. Third, the East Coast blackout in 1965 raised concerns about the reliability of the wholesale distribution network. Capacity growth matched generation growth of 7.5% per year during the period.

The decade of the 1970s was one of significant change in the industry. The utility industry had been able to increase its efficiency from 1900 through the 1960s, squeezing more generation from each unit of generating capacity. This allowed utilities to reduce unit costs and rates. Lower rates, in turn, stimulated additional demand and led to rapid growth. Due to inflation, rising fuel costs, more stringent environmental regulations, and other factors, costs increased dramatically during the 1970s resulting in annual electricity generation increases of only 4% while rates rose 11% per year. Since capacity grew at an annual rate of 6% per year, the industry was building capacity faster than it was being utilized, resulting in excess capacity.

In January 1960 the annual rate of increase in prices as measured by the consumer price index (CPI) was 1.03%; by January 1970 prices were increasing at a 6.18% annual rate and by January 1980 the rate of increase was 13.91%. As the rate of inflation increased, so did interest rates. The average rate on Baa-rated bonds was 8.86% in January 1970; this rate increased to 13.17% in January 1980 and reached a postwar peak of 17.18% in February 1982. During the 1970s construction times lengthened due to increased technical and regulatory requirements, so the effects of rising financing costs were exacerbated for utilities. The oil crises of 1973 and 1979 led to significant increases in the price of oil, rising at an annual rate of 26% during 1970-1980. Over this same period the prices of natural gas and coal increased 23% and 16%, respectively. The 1970s was also a decade of increased environmental regulation. Passage of the Clean Air Act of 1970, the Federal Water Pollution Control Act of 1972, and the Resource Conservation and Recovery Act of 1976 mandated the installation of expensive new pollution control equipment and the adoption of cleaner waste disposal methods.

The 1970s was also a watershed decade for nuclear power generation. During the 1971 to 1974 period, 131 new nuclear generating plants were ordered; the average size of each plant was 1,100 megawatts, significantly larger than non-nuclear units. The large size of the plants, rising inflation, and higher financing costs combined to increase construction costs from \$150 per megawatt of capacity in 1971 to \$600 per megawatt in 1976 and \$1,200 in the early 1980s. Concerns about nuclear plant safety increased when the Nuclear Regulatory Commission (NRC) shut down five reactors over worries about possible

* Source: Based on http://www.eia.doe.gov/cneaf/electricity/page/electric_kid/append_a.html

earthquakes and the 1979 nuclear accident at one of the Three Mile Island reactors in Pennsylvania. Rising costs, the financial burden on utilities, and weaker demand for electricity slowed the number of new nuclear plants ordered after 1974: 63 orders were cancelled between 1975 and 1980 and no new plants were ordered after 1978.

Utility rates rose by 19% in 1980, 15% in 1981, and 12% in 1982, resulting in a decline in generation for the first time in the industry's history. But since capacity continued to grow, the gap between capacity and generation continued to widen. During the second half of the 1980s, generation grew at moderate rates but the problem of excess capacity remained.

A Primer on "Natural Monopoly"

Some monopolies are created by government, for reasons of health and safety or to protect a favored firm from competition. In contrast, a "natural monopoly" is a situation where the nature of a product or service makes a single supplier more efficient than multiple, competing ones. For instance, several electrical distribution systems covering the same area with redundant infrastructure would require large and wasteful investments. Supply and demand conditions could create an equilibrium price below their average cost to produce, causing losses for all firms. But if one company is large and efficient enough to take advantage of economies of scale relative to the existing demand for the industry's product, it can minimize its average cost of production at a level more than sufficient to supply the entire demand in the relevant market area, making a sole provider more socially beneficial than competitors could.

The term also refers to where there are high barriers to entry into the market. For instance, when there are large initial capital investments to enter the market but only very modest additional outlays to produce additional output, the firm that initially starts out with the largest share of the market is in a position to price its output at a level below its (higher cost) competitors' costs of production and still make a profit. Larger market share begets lower unit costs until a monopoly position is finally obtained. Transportation and telecommunications had fit this model until overtaken by new technologies like the automobile and wireless communications, or by government intervention. Given the possibility of price gouging or restricting supply, regulation of natural monopolies is regarded as essential to protect the interests of captive consumers. Such regulation has been argued as representing instances of "market failure," necessary to ensure a stable price, enable a "fair return" for their shareholders, and reduce risks of competition. Unfortunately, a regulated "natural monopoly" can capture the regulators, thereby creating a favorable regulatory environment.

Critics have argued that instances of true "natural monopoly" situations are extremely rare. The vast majority of actual real world monopolies does not arise from economies of scale but instead have been politically conferred by government at the instigation of formerly dominant firms grown fearful of emerging competition. Regulatory policies, the critics contend, in practice are almost always much more responsive to arbitrary political pressures (especially from the regulated industry itself) than to any burning desire to have price equal marginal cost. In recent years, utilities have been deregulated, often at the request of government regulators, to reduce the burdens of regulation in exchange for accepting some competition.

Appendix C: The Goldman Sachs Group Code of Business Conduct and Ethics*

Introduction

This Code of Business Conduct and Ethics (the “Code”) embodies the commitment of The Goldman Sachs Group, Inc. and its subsidiaries to conduct our business in accordance with all applicable laws, rules and regulations and the highest ethical standards. All employees and members of our Board of Directors are expected to adhere to those principles and procedures set forth in this Code that apply to them. ...

The Code should be read in conjunction with Our Business Principles, which provide in part that, “Integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives.” ...

Section I

A. Compliance and Reporting

Employees and directors should strive to identify and raise potential issues before they lead to problems, and should ask about the application of this Code whenever in doubt. ...

Any questions relating to how these policies should be interpreted or applied should be addressed to an Appropriate Ethics Contact.

B. Personal Conflicts of Interest

A “personal conflict of interest” occurs when an individual’s private interest improperly interferes with the interests of the firm. ... In particular, an employee or director must never use or attempt to use his or her position at the firm to obtain any improper personal benefit for himself or herself, for his or her family members, or for any other person, including loans or guarantees of obligations, from any person or entity.

Service to the firm should never be subordinated to personal gain and advantage. Conflicts of interest should, to the extent possible, be avoided.

Any employee or director who is aware of a material transaction or relationship that could reasonably be expected to give rise to a conflict of interest should discuss the matter promptly with an Appropriate Ethics Contact.

C. Public Disclosure

It is the firm’s policy that the information in its public communications, including SEC filings, be full, fair, accurate, timely and understandable. All employees and directors, who are involved in the company’s disclosure process, including the Senior Financial Officers, are responsible for acting in furtherance of this policy. In particular, these individuals are required to maintain familiarity with the disclosure requirements applicable to the firm and are prohibited from knowingly misrepresenting, omitting, or causing others to misrepresent or omit, material facts about the firm to others, whether within or outside the firm, including the firm’s independent auditors. In addition, any employee or director who has a supervisory role in the firm’s disclosure process has an obligation to discharge his or her responsibilities diligently.

D. Compliance with Laws, Rules and Regulations

It is the firm’s policy to comply with all applicable laws, rules and regulations. It is the personal responsibility of each employee and director to adhere to the standards and restrictions imposed by those laws, rules and regulations. ...

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* Amended and restated as of January 2005. *Source:*

http://www.gs.com/our_firm/investor_relations/corporate_governance/articles/corporate_governance_03022419574_2.html

Section II

A. Corporate Opportunities

Employees and directors owe a duty to the firm to advance the firm's legitimate business interests when the opportunity to do so arises. ... More generally, employees and directors are prohibited from using corporate property, information or position for personal gain or competing with the firm.

* * *

B. Confidentiality

In carrying out the firm's business, employees and directors often learn confidential or proprietary information about the firm, its clients/customers, prospective clients/customers or other third parties. Employees and directors must maintain the confidentiality of all information so entrusted to them, except when disclosure is authorized or legally mandated. ...

C. Fair Dealing

We have a history of succeeding through honest business competition. We do not seek competitive advantages through illegal or unethical business practices. Each employee and director should endeavor to deal fairly with the firm's clients, service providers, suppliers, competitors and employees. No employee or director should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any unfair dealing practice.

D. Equal Employment Opportunity and Harassment

Our focus in personnel decisions is on merit and contribution to the firm's success. ...

E. Protection and Proper Use of Firm Assets

All employees should protect the firm's assets and ensure their efficient use. All firm assets should be used for legitimate business purposes only.

Section III. Waivers of This Code

From time to time, the firm may waive certain provisions of this Code. Any employee or director who believes that a waiver may be called for should discuss the matter with an Appropriate Ethics Contact. Waivers for executive officers (including Senior Financial Officers) or directors of the firm may be made only by the Board of Directors or a committee of the Board.