Benefit Obligation

Following is a reconciliation of the changes in plan benefit obligations and fair value and a statement of the funded status (in thousands):

	Pension Benefits December 31,		Other Postretirement Benefits December 31,	
	2006	2005	2006	2005
Reconciliation of Benefit Obligation				
Obligation at beginning of period	$386,915	$ 373,979	$55,620	$ 52,391
Service cost	9,049	8,531	741	688
Interest cost	20,791	20,174	2,775	2,853
Actuarial (gain) loss	(10,265)	1,236	(2,705)	1,705
Plan amendments	—	2,661	—	—
Fresh-start reporting adjustments	—	—	—	2,561
Gross benefits paid	(18,928)	(19,666)	(3,368)	(4,578)
Benefit obligation at end of period	$387,562	$ 386,915	$53,063	$ 55,620

The total projected benefit obligation and fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets were $387.6 million and $301.1 million, respectively, as of December 31, 2006. The total accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were $385.4 million and $301.1 million, respectively, as of December 31, 2006.

The total projected benefit obligation and fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets were $386.9 million and $271.1 million, respectively, as of December 31, 2005. The total accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were $384.8 million and $271.1 million, respectively, as of December 31, 2005.

The NorthWestern Energy pension plan was amended effective January 1, 2005 to increase the retirement death benefit from 50% to 100% of the accrued benefit. This is reflected in the plan amendment amount above.

Balance Sheet Recognition

The accrued pension and other postretirement benefit obligations recognized in the accompanying Balance Sheets are computed as follows (in thousands):

	Pension Benefits		Other Postretirement Benefits	
	December 31, 2006	December 31, 2005	December 31, 2006	December 31, 2005
Accrued benefit cost	$ (107,700)	$ (117,585)	$ (41,768)	$ (44,333)
Intangible asset		502	—	—
Amounts not yet reflected in net periodic benefit cost:				
Prior service cost	(2,419)	—	—	—
Accumulated gain	23,656	—	2,063	
Net amount recognized	$ (86,463)	$ (117,083)	$ (39,705)	$ (44,333)

Plan Assets and Funded Status

	Pension Benefits		Other Postretirement Benefits	
	December 31,		December 31,	
	2006	2005	2006	2005
Reconciliation of Fair Value of Plan Assets				
Fair value of plan assets at beginning of period	$271,103	$244,643	$10,363	$8,333
Return on plan assets	30,917	14,754	1,041	637
Employer contributions	18,007	31,372	5,322	5,971
Gross benefits paid	(18,927)	(19,666)	(3,368)	(4,578)
Fair value of plan assets at end of period	$301,100	$271,103	$13,358	$10,363
Funded Status	$(86,463)	$(115,812)	$(39,705)	$(45,258)
Unrecognized net actuarial (gain) loss	—	(3,932)	—	925
Unrecognized prior service cost	—	2,661	—	
Accrued benefit cost	$(86,463)	$(117,083)	$(39,705)	$(44,333)

Our investment goals with respect to managing the pension and other postretirement assets is to achieve and maintain a reasonably funded status for the pension plans, improve the status of the health and welfare plan, minimize contribution requirements, and seek long-term growth by placing primary emphasis on capital appreciation and secondary emphasis on income, while minimizing risk.

Our investment policy for fixed income investments are oriented toward risk averse, investment-grade securities rated "A" or higher and are required to be diversified among individual securities and sectors (with the exception of U.S. Government securities, in which the plan may invest the entire fixed income allocation). There is no limit on the maximum maturity of securities held. In addition, the NorthWestern Corporation pension plan assets also includes a participating group annuity contract in the John Hancock General Investment Account, which consists primarily of fixed-income securities, reflected at current market values with a market adjustment.

Equity investments can include convertible securities, and are required to be diversified among industries and economic sectors. Limitations are placed on the overall allocation to any individual security at both cost and market value and international equities investments are diversified by country. In addition, there are limitations on investments in emerging markets.

Our investment policy prohibits short sales, margin purchases, securities lending and similar speculative transactions as well as any transactions that would threaten tax exempt status of the fund, actions that would create a conflict of interest or transactions between fiduciaries and parties in interest as defined under ERISA. With respect to international investments, foreign currency hedging is allowed under the policy for the purpose of hedging currency risk and to effect securities transactions. Permissible investments include foreign currencies in both spot and forward markets, options, futures, and options on futures in foreign currencies.

The current investment strategy provides for the following asset allocation policies, within an allowable range of plus or minus 5%:

	Pension Benefits	Other Benefits
Debt securities	30.0 %	30.0 %
Domestic equity securities	60.0	60.0
International equity securities	10.0	10.0

The percentage of fair value of plan assets held in the following investment types by the NorthWestern Energy pension plan, NorthWestern Corporation pension plan and NorthWestern Energy Health and Welfare Plan as of December 31, 2006 and December 31, 2005, are as follows:

	NorthWestern Energy Pension		**NorthWestern Corporation Pension**		**NorthWestern Energy Health and Welfare**	
	December 31, 2006	**December 31, 2005**	**December 31, 2006**	**December 31, 2005**	**December 31, 2006**	**December 31, 2005**
Cash and cash equivalents	1.9%	2.0%	0.7%	1.1%	—%	—%
Debt securities	30.5	32.3	—	—	28.3	27.2
Domestic equity securities	56.1	55.2	57.0	51.5	71.3	72.3
International equity securities	11.5	10.5	11.6	9.8	0.4	0.5
Participating group annuity contracts	—	—	30.7	37.6	—	—
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

We review the asset mix on a quarterly basis. Generally, the asset mix will be rebalanced to the target mix as individual portfolios approach their minimum or maximum levels.

We continually evaluate the potential for liquidating and reinvesting the assets held in participating group annuity contracts as rebalancing and diversification opportunities are currently limited with respect to this portion of plan assets.

Actuarial Assumptions

The measurement dates used to determine pension and other postretirement benefit measurements for the plans are December 31, 2006 and December 31, 2005. The actuarial assumptions used to compute the net periodic pension cost and postretirement benefit cost are based upon information available as of the beginning of the year, specifically, market interest rates, past experience and management's best estimate of future economic conditions. Changes in these assumptions may impact future benefit costs and obligations. In computing future costs and obligations, we must make assumptions about such things as employee mortality and turnover, expected salary and wage increases, discount rate, expected return on plan assets, and expected future cost increases. Two of these items generally have the most impact on the level of cost: (1) discount rate and (2) expected rate of return on plan assets.

For 2006, we set the discount rate using a yield curve analysis, which projects benefit cash flows into the future and then discounts those cash flows to the measurement date using a yield curve. For our analysis we reviewed both the yield curve of our actuaries and Citigroup. Based on this analysis, we increased our discount rate 0.25% to 5.75%. We previously set the discount rate based upon our review of the Citigroup Pension Index and Moody's Aa bond rate index. The expected long-term rate of return assumption on plan assets for both the NorthWestern Energy and NorthWestern Corporation pension and postretirement plans was determined based on the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension and postretirement portfolios. Over the 15-year period ending December 31, 2003, the returns on these portfolios, assuming they were invested at the current target asset allocation in prior periods, would have been a compound annual average of approximately 10.5%. Considering this information and future expectations for asset returns, we selected an 8.5% long-term rate of return on assets assumption for 2005. We have reduced this assumption to 8.0% for 2006 and 2007.

The health care cost trend rates are established through a review of actual recent cost trends and projected future trends. Our retiree medical trend assumptions are the best estimate of expected inflationary increases to our healthcare costs. Due to the relative size of our retiree population (under 700 members), the assumptions used are based upon both nationally expected trends and our specific expected trends. Our average increase remains consistent with the nationally expected trends.

The weighted-average assumptions used in calculating the preceding information are as follows:

	Pension Benefits Year ended December 31, 2006	Pension Benefits Year ended December 31, 2005	Other Post-retirement Benefits Year Ended December 31, 2006	Other Post-retirement Benefits Year Ended December 31, 2005
Discount rate	5.75 %	5.50%	5.50-5.75 %	5.50%
Expected rate of return on assets	8.00 %	8.50%	8.00 %	8.50%
Long-term rate of increase in compensation levels(nonunion)	3.61 %	3.64%	3.57 %	3.64%
Long-term rate of increase in compensation levels (union)	3.50 %	3.50%	3.50 %	3.50%

The postretirement benefit obligation is calculated assuming that health care costs increased by 8% in 2006 and the rate of increase in the per capita cost of covered health care benefits thereafter was assumed to decrease gradually to 5% by the year 2010.

Net Periodic Cost

The components of the net costs for our pension and other postretirement plans are as follows (in thousands):

	Pension Benefits Year Ended December 31, 2006	Pension Benefits Year Ended December 31, 2005	Other Post-retirement Benefits Year Ended December 31, 2006	Other Post-retirement Benefits Year Ended December 31, 2005
Components of Net Periodic Benefit Cost				
Service cost	$ 9,049	$ 8,531	$ 741	$ 688
Interest cost	20,791	20,174	2,775	2,853
Expected return on plan assets	(21,458)	(20,347)	(829)	(562)
Amortization of transitional obligation		—	—	—
Amortization of prior service cost	242	—	—	—
Recognized actuarial (gain) loss	—	—	117	—
	8,624	8,358	2,804	2,979
Additional (income) or loss recognized:				
Curtailment	—	—	—	—
Special termination benefits	—	—	—	—
Settlement cost	—	—	—	—
Net Periodic Benefit Cost	$ 8,624	$ 8,358	$ 2,804	$ 2,979

We estimate amortizations from regulatory assets into net periodic cost during 2007 will be as follows (in thousands):

	Pension Benefits	Other Postretirement Benefits
Prior service cost	$ 242	$ —
Accumulated gain	—	—

Assumed health care cost trend rates have a significant effect on the amounts reported for the costs each year as well as on the accumulated postretirement benefit obligation. The following table sets forth the sensitivity of retiree welfare results (in thousands):

Effect of a one percentage point increase in assumed health care cost trend	
on total service and interest cost components	$206
on postretirement benefit obligation	2,072
Effect of a one percentage point decrease in assumed health care cost trend	
on total service and interest cost components	$(176)
on postretirement benefit obligation	(1,829)

Cash Flows

On August 17, 2006 the Pension Protection Act of 2006 was signed into law, with changes that impact the funding calculation for benefit plans. We anticipate making contributions of approximately $27.5 million to our pension and other postretirement benefit plans in 2007. Pension funding is based upon annual actuarial studies prepared for each plan. For our postretirement welfare benefits, our policy is to contribute an amount equal to the annual actuarially determined cost that is also recoverable in rates. We generally fund our 401(h) and VEBA trusts monthly, subject to our liquidity needs and the maximum deductible amounts allowed for income tax purposes.

We estimate the plans will make future benefit payments to participants as follows (in thousands):

	Pension Benefits	Other Postretirement Benefits
2007	$19,889	$4,497
2008	20,256	4,400
2009	20,555	4,461
2010	21,342	4,583
2011	22,260	4,503
2012-2016	130,449	23,254

Predecessor Company

The Predecessor Company filed several motions to terminate various nonqualified benefit plans and individual supplemental retirement contracts for former employees. All liabilities associated with these plans were removed from our balance sheet upon emergence based on our expectation that these claims would be settled through the shares from the reserve established for Class 9 claimants. Various claimants objected to the Bankruptcy Court's jurisdiction to terminate such plans and/or contracts. In July 2005, the Bankruptcy Court approved share-based settlements with most of the participants in the various nonqualified plans and supplemental retirement contracts. However, the Bankruptcy Court determined that it did not have jurisdiction to consider a motion to terminate various individual supplemental retirement contracts, therefore in 2005 we reestablished a liability of approximately $2.6 million and have resumed payments on those individual supplemental retirement contracts not covered by the Bankruptcy Court's jurisdiction.

Defined Contribution Plans

Our defined contribution plan permits employees to defer receipt of compensation as provided in Section 401(k) of the Internal Revenue Code. Under the plan, employees may elect to direct a percentage of their gross compensation to be contributed to the plan. We contribute various percentage amounts of the employee's gross compensation contributed to the plan. Matching contributions were $4.3 million for 2006 and $3.4 million for 2005.

(18) Stock-Based Compensation

Restricted Stock Awards

Under our long-term incentive plans administered by the Human Resources Committee of our Board, we have granted service-based restricted stock to all eligible employees and members of our Board. Under these plans, a total of 700,000 shares were set aside for restricted stock grants, in addition to 228,315 shares of restricted stock granted upon our emergence from bankruptcy. We may issue new shares or reuse forfeited shares in order to deliver shares to employees for equity grants. Pursuant to the terms of the Merger Agreement with BBI, which provides that all of the shares available under our long term incentive plans may be awarded before completion of the transaction, 400,025 shares of restricted stock were granted in November 2006. As of December 31, 2006 there were 57,023 shares of common stock of the initial 700,000 shares remaining available for grants under this plan. The stock vests to participants at various times ranging from one to five years if the service requirements are met. Nonvested shares do not receive dividend distributions. The long-term incentive plans provide for accelerated vesting in the event of a change in control. The proposed transaction with BBI would trigger this acceleration.

In accordance with SFAS No. 123R, we account for our service-based restricted stock awards using the fixed accounting method, whereby we amortize the value of the market price of the underlying stock on the date of grant (grant-date fair value) to compensation expense over the service period either ratably or in tranches. We reverse any expense associated with restricted stock that is canceled or forfeited during the performance or service period. Compensation expense recognized for restricted stock awards was $3.6 million for the year ended December 31, 2006 and $4.7 million for the year ended December 31, 2005. The total income tax benefit recognized in the income statement for these restricted stock awards was $1.5 million for the year ended December 31, 2006 and $1.8 million for the year ended December 31, 2005.

Summarized share information for our restricted stock awards is as follows:

	Year Ended December 31, 2006	Weighted-Average Grant-Date Fair Value	Year Ended December 31, 2005	Weighted-Average Grant-Date Fair Value
Beginning nonvested grants	35,164	$ 20.00	114,151	$ 20.00
Granted	503,337	34.42	97,651	30.79
Vested	57,393	29.94	175,558	26.00
Forfeited	5,003	34.39	1,080	20.00
Remaining nonvested grants	476,105	29.54	35,164	20.00

* This amount represents shares forfeited from awards granted upon our emergence from bankruptcy. Forfeited shares from this grant are cancelled. Forfeited shares from all other grants are available to be reissued.

As of December 31, 2006 we had $14.1 million of unrecognized compensation cost related to nonvested portion of outstanding restricted stock awards, which is reflected in other paid-in capital in our Balance Sheet. If the transaction with BBI is not completed, the cost is expected to be recognized over a weighted-average period of 2.5 years. The total fair value of shares vested was $1.7 million for the year ended December 31, 2006 and $4.6 million for the year ended December 31, 2005.

Director's Deferred Compensation

Nonemployee directors may elect to defer up to 100% of any qualified compensation that would be otherwise payable to him or her, subject to compliance with our 2005 Deferred Compensation Plan for Nonemployee Directors and Section 409A of the Internal Revenue Code. The deferred compensation may be invested in NorthWestern stock or in designated investment funds. Compensation deferred in a particular month is recorded as a deferred stock unit (DSU) on the first of the following month based on the closing price of NorthWestern stock or the designated investment fund. A DSU entitles the grantee to receive one share of common stock for each DSU at the end of the deferral period. The value of these DSUs are marked-to-market on a quarterly basis with an adjustment to directors compensation expense. Based on the election of the nonemployee director, following separation from service on the Board, other than on account of death, he or she shall be paid a distribution either in a lump sum or in approximately equal installments over a designated number years (not to exceed 10 years). During the years ended December 31, 2006 and 2005, DSUs issued to members of our Board totaled 22,805 and 20,934, respectively. Total compensation expense attributable to the DSUs during the years ended December 31, 2006 and 2005 was approximately $0.9 million and $0.7 million, respectively.

(19) Regulatory Assets and Liabilities

We prepare our financial statements in accordance with the provisions of SFAS No. 71, as discussed in Note 3 to the Financial Statements. Pursuant to this pronouncement, certain expenses and credits, normally reflected in income as incurred, are deferred and recognized when included in rates and recovered from or refunded to the customers. Regulatory assets and liabilities are recorded based on management's assessment that it is probable that a cost will be recovered or that an obligation has been incurred. Accordingly, we have recorded the following major classifications of regulatory assets and liabilities that will be recognized in expenses and revenues in future periods when the matching revenues are collected or refunded. Of these regulatory assets and liabilities, energy supply costs are the only items earning a rate of return. The remaining regulatory items have corresponding assets and liabilities that will be paid for or refunded in future periods. Because these costs are recovered as paid, they do not earn a return. We have specific orders to cover approximately 91% of our regulatory assets and approximately 95% of our regulatory liabilities.

	Note Ref.	Remaining Amortization Period	December 31, 2006	December 31, 2005
Pension	17	Undetermined	$ 87,397	$ 123,326
SFAS No. 106	17	Undetermined	28,725	33,096
Income taxes	14	Plant Lives	9,453	9,184
State & local taxes & fees		1 Year	5,105	5,697
Other		Various	17,823	13,802
Total regulatory assets			$ 148,503	$ 185,105
Gas storage sales		33 Years	$ 13,774	$ 14,195
Supply costs		1 Year	9,061	7,981
Other		Various	3,462	2,361
Total regulatory liabilities			$ 26,297	$ 24,537

Pension and SFAS No. 106

Through fresh-start reporting in 2004 we adjusted our qualified pension and other postretirement benefit plans to their projected benefit obligation by recognition of all previously unamortized actuarial gains and losses. A pension regulatory asset has been recognized for the obligation that will be included in future cost of service. Historically, the MPSC rates have allowed recovery of pension costs on a cash basis. In 2005, the MPSC authorized the recognition of pension costs based on an average of the funding to be made over a 5-year period for the calendar years 2005 through 2009. The SDPUC allows recovery of pension costs on an accrual basis. A regulatory asset has been recognized for the SFAS No. 106 fair value adjustments resulting from fresh-start reporting. The MPSC allows recovery of SFAS No. 106 costs on an accrual basis.

Income Taxes

Tax assets primarily reflect the effects of plant related temporary differences such as removal costs, capitalized interest and contributions in aid of construction that we will recover or refund in future rates. We amortize these amounts as temporary differences reverse.

State & Local Taxes & Fees

Under Montana law, we are allowed to track the increases in the actual level of state and local taxes and fees and recover these amounts. In 2006, the MPSC authorized recovery of approximately 60% of the estimated increase in our local taxes and fees (primarily property taxes) as compared to the related amount included in rates during our last general rate case in 1999. On December 1, 2006, we filed with the MPSC for an automatic rate adjustment, which reflected 100% of the under recovery for 2006 and estimated amounts for 2007. In January 2007, the MPSC issued an order allowing recovery of the 2006 actual increase and the 2007 estimated increase, reduced by 40% for an income tax deduction. While we have recorded a regulatory asset consistent with the MPSC's authorization, we are disputing the reduction by the MPSC and have filed a Petition for Judicial Review in Montana District Court regarding this issue. We anticipate resolving this matter in 2007; however we cannot currently predict an outcome.

Gas Storage Sales

A gas storage sales regulatory liability was established in 2000 and 2001 based on gains on cushion gas sales in Montana. This gain is being flowed to customers over a period that matches the depreciable life of surface facilities that were added to maintain deliverability from the field after the withdrawal of the gas. This regulatory liability is a reduction of rate base.

(20) Regulatory Matters

The MPSC, the SDPUC, the NPSC, and the FERC approve the rates that we charge our customers for our regulated businesses, as applicable. There have been no significant regulatory matters in South Dakota or Nebraska during the past three years. Current regulatory issues are discussed below.

On September 29, 2006 we submitted an informational filing to the MPSC outlining our cost of providing electric and natural gas delivery service in Montana. The informational filing is based on actual costs in 2005, adjusted for known and measurable cost changes that occurred in 2006 and is a result of a 2004 stipulation and settlement agreement between NorthWestern, the MPSC and the Montana Consumer Counsel. The filing demonstrates a revenue deficiency of approximately $29.1 million in electric rates and $12.3 million in natural gas rates; however, we did not seek a rate adjustment, as we would like the MPSC to give priority to its approval of the transaction with BBI.

On October 17, 2006, we filed an application with the FERC requesting an increase in transmission rates in Montana under the open access transmission tariff. While the request presents a net increase of $28.8 million in overall transmission costs, the rate adjustment pertains only to wholesale transmission and retail choice customers. Therefore, the portion of the requested cost increase pertaining to the remaining Montana retail default supply customer loads, which represents approximately 70% of this increase, is subject to MPSC jurisdictional rates, and will not result in increased revenues. Since the last transmission rate adjustment, which was filed in March 1998, our cost of service has increased and the type of transmission service that we provide has changed as partial retail access has developed in Montana. The overall net effect of this filing for affected customers is expected to be an average rate increase of between 6 – 18%, depending on the type of customer.

(21) Commitments and Contingencies

Qualifying Facilities Liability

In Montana we have certain contracts with Qualifying Facilities, or QFs. The QFs require us to purchase minimum amounts of energy at prices ranging from $65 to $138 per megawatt hour through 2029. Our gross contractual obligation related to the QFs is approximately $1.6 billion through 2029. A portion of the costs incurred to purchase this energy is recoverable through rates, totaling approximately $1.2 billion through 2029. Upon adoption of fresh-start reporting, we computed the fair value of the remaining liability of approximately $367.9 million to be approximately $143.8 million based on the net present value (using a 7.75% discount factor) of the difference between our obligations under the QFs and the related amount recoverable. The following table summarizes the change in the QF liability (in thousands):

	December 31,	
	2006	2005
Beginning QF liability	$ 140,467	$ 143,381
Unrecovered amount	(3,460)	(8,626)
Interest expense	10,886	10,600
Contract amendment	—	(4,888)
Ending QF liability	$ 147,893	$ 140,467

The following summarizes the estimated gross contractual obligation less amounts recoverable through rates (in thousands):

	Gross Obligation	Recoverable Amounts	Net
2007	$58,420	$(52,567)	$5,853
2008	60,574	(53,060)	7,514
2009	62,598	(53,583)	9,015
2010	64,580	(54,086)	10,494
2011	66,067	(54,628)	11,439
Thereafter	1,263,849	(962,297)	301,552
Total	$1,576,088	$(1,230,221)	$345,867

Long Term Supply and Capacity Purchase Obligations

We have entered into various commitments, largely purchased power, coal and natural gas supply and natural gas transportation contracts. These commitments range from one to 24 years. Costs incurred under these contracts were approximately $447.1 million for the year ended December 31, 2006 and $433.9 million for the year ended December 31, 2005. As of December 31, 2006 our commitments under these contracts are $535 million in 2007, $350 million in 2008, $292 million in 2009, $274 million in 2010, $133 million in 2011, and $528 million thereafter. These commitments are not reflected in our Financial Statements.

Environmental Liabilities

Environmental laws and regulations are continually evolving, and, therefore, the character, scope, cost and availability of the measures we may be required to take to ensure compliance with evolving laws or regulations cannot be accurately predicted. The range of exposure for environmental remediation obligations at present is estimated to range between $20.4 million to $56.1 million. As of December 31, 2006, we have a reserve of approximately $34.1 million. We anticipate that as environmental costs become fixed and reliably determinable, we will seek insurance reimbursement and/or authorization to recover these in rates; therefore, we do not expect these costs to have a material adverse effect on our financial position, ongoing operations, or cash flows.

The Clean Air Act Amendments of 1990 and subsequent amendments stipulate limitations on sulfur dioxide and nitrogen oxide emissions from coal-fired power plants. We comply with these existing emission requirements through purchase of sub-bituminous coal, and we believe that we are in compliance with all presently applicable environmental protection requirements and regulations with respect to these plants. Recent legislation has been proposed, which may require further limitations on emissions of these pollutants along with limitations on carbon dioxide, particulate matter, and mercury emissions. The recent regulatory and legislative proposals are subject to normal administrative processes, and we cannot make any prediction as to whether the proposals will pass or the impact of those actions. In November 2006, The Sierra Club sent a Notice of Intent to File a Suit to the owners, including us, of Big Stone I, asserting that it would file a lawsuit in 60 days alleging that the plant failed to obtain permits for certain projects undertaken in 1995, 2001 and 2005 and otherwise failed to comply with the Clean Air Act. The owners intend to vigorously defend against any lawsuit filed by The Sierra Club.

Coal-Fired Plants

Citing its authority under the Clean Air Act, the EPA has finalized Clean Air Mercury Regulations (CAMR) that affect coal-fired plants. These regulations establish a cap-and-trade program to take effect in two phases, with a first phase to begin in January 2010, and a second phase with more stringent caps to begin in January 2018. Under CAMR, each state is allocated a mercury emissions cap and is required to develop regulations to implement the requirements, which can follow the federal requirements or be more restrictive.

Montana has finalized its own, more stringent rules that would require every coal-fired generating plant in the state to achieve by 2010 reduction levels more stringent than CAMR's 2018 cap. Because enhanced chemical injection technologies may not be sufficiently developed to meet this level of reductions by 2010, there is a risk that adsorption/absorption technology with fabric filters at the Colstrip Unit 4 generation facility would be required, which could represent a material cost. We expect the Montana mercury rules to be challenged. If those rules are overturned and we are instead required to comply with CAMR, achievement of the 2010 and 2018 requirements may be possible with more refined chemical injection technology combined with adjustments to boiler/fireball dynamics at a minimal cost. We are continuing to work with the other Colstrip owners to determine the ultimate financial impact of these new rules.

Manufactured Gas Plants

Approximately $28.6 million of our environmental reserve accrual is related to manufactured gas plants. Two formerly operated manufactured gas plants located in Aberdeen and Mitchell, South Dakota, have been identified on the Federal Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS) list as contaminated with coal tar residue. At this time, no material remediation is necessary at the Mitchell location. In January 2007, we received a letter from the South Dakota Department of Environment and Natural Resources (SD DENR) that this location is at a No Further Action Status. We are currently investigating and characterizing the Aberdeen site pursuant to work plans approved by the SD DENR and some remedial activities commenced at the Aberdeen site in 2006. Our current reserve for remediation costs at the Aberdeen site is approximately $15.4 million, and we estimate that approximately $13 million of this amount will be incurred during the next five years. During 2006, we incurred remediation costs of approximately $0.4 million.

We also own sites in North Platte, Kearney and Grand Island, Nebraska on which former manufactured gas facilities were located. During 2005, the Nebraska Department of Environmental Quality (NDEQ) conducted Phase II investigations of soil and groundwater at our Kearney and Grand Island sites. On March 30, 2006 and May 17, 2006, the NDEQ released to us the Phase II Limited Subsurface Assessment performed by the NDEQ's environmental consulting firm for Kearney and Grand Island, respectively, and we are evaluating the results of these reports. We plan to conduct additional site investigation and assessment work at these locations in 2007. At present, we cannot determine with a reasonable degree of certainty the nature and timing of any remediation cleanup at our Nebraska locations.

In addition, we own or have responsibility for sites in Butte, Missoula and Helena, Montana on which former manufactured gas plants were located. An investigation conducted at the Missoula site did not require entry into the Montana Department of Environmental Quality (MDEQ) voluntary remediation program, but required preparation of a groundwater monitoring plan. The Butte and Helena sites, were placed into the MDEQ's voluntary remediation program for cleanup due to the existence of exceedences of regulated pollutants in the groundwater. We conducted additional groundwater monitoring during 2005 at the Butte and Missoula sites and have analyzed the data and presented it to the MDEQ. At this time, we believe that natural attenuation should address the problems at these sites; however, additional groundwater monitoring will be necessary. Closure of the Butte and Missoula sites is expected shortly. Recent monitoring of groundwater at the Helena manufactured gas plant site suggests that groundwater remediation may be necessary to prevent certain contaminants from migrating offsite. We have evaluated the results of a pilot program meant to promote aerobic degradation of certain targeted contaminants. Further data collection is necessary to complete the evaluation and assess other remediation technologies to determine the optimal remedial technology for this site. Monitoring of groundwater at this site will be necessary for an extended time. At this time, we cannot estimate with a reasonable degree of certainty the nature and timing of additional remediation at the Helena site.

Based upon our investigations to date, our current environmental liability reserves, applicable insurance coverage, and the potential to recoup some portion of prudently incurred remediation costs in rates, we do not expect remediation costs at these locations to be materially different from the established reserve.

Milltown Mining Waste

Our subsidiary, Clark Fork and Blackfoot, LLC (CFB), owns the Milltown Dam hydroelectric facility, a three megawatt generation facility located at the confluence of the Clark Fork and Blackfoot Rivers. In April 2003, the Environmental Protection Agency (EPA) announced its proposed remedy to address the mining waste contamination located in the Milltown Reservoir. This remedy proposed partial removal of the contaminated sediments located within the Milltown Reservoir, together with the removal of the Milltown Dam and powerhouse (this remedy was incorporated into the EPA's formal Record of Decision issued on December 20, 2004). In light of this pre-Record of Decision announcement, we entered into a stipulation (Stipulation) with Atlantic Richfield, the EPA, the Department of the Interior, the State of Montana and the Confederated Salish and Kootenai Tribes (collectively the Government Parties), which capped NorthWestern's and CFB's collective liability to Atlantic Richfield and the Government Parties at $11.4 million. In April 2006, we released escrowed amounts of $2.5 million and $7.5 million to the State of Montana and Atlantic Richfield, respectively, in accordance with the terms of the consent decree described below. Pursuant to the terms of the consent decree, the parties expect that the remaining financial obligation of $1.4 million to the State of Montana will be covered through a combination of any refund of premium upon cancellation of the catastrophic release policy described below, and the sale or transfer of land and water rights associated with the Milltown Dam operations.

On July 18, 2005, CFB and we executed the Milltown Reservoir superfund site consent decree, which incorporated the terms set forth in the Stipulation. The consent decree was approved by the Federal District Court for the District of Montana on February 8, 2006 and became effective on April 10, 2006. In light of the material environmental risks associated with the catastrophic failure of the Milltown Dam, we secured a 10-year, $100 million environmental insurance policy, effective May 31, 2002, to mitigate the risk of future environmental liabilities arising from the structural failure of the Milltown Dam caused by an act of God. We are obligated under the settlement to continue to maintain the environmental insurance policy until the Milltown Dam is removed during implementation of the remedy.

Other

We continue to manage polychlorinated biphenyl (PCB)-containing oil and equipment in accordance with the EPA's Toxic Substance Control Act regulations. We, along with other potentially responsible parties, are currently negotiating with EPA over remediation of an oil recycling facility in Oregon to which waste oil had been transported by The Montana Power Company and others. We anticipate that these negotiations will be successfully resolved during 2007. We will continue to use certain PCB-contaminated equipment for its remaining useful life and will, thereafter, dispose of the equipment according to pertinent regulations that govern the use and disposal of such equipment.

We routinely engage the services of a third-party environmental consulting firm to perform a comprehensive evaluation of our environmental reserve. Based upon information available to our consultants at this time, we believe that the current environmental reserve properly reflects our remediation exposure for the sites currently and previously owned by us. The portion of our environmental reserve applicable to site remediation may be subject to change as a result of the following uncertainties:

- We and our third-party consultant may not know all sites for which we are alleged or will be found to be responsible for remediation; and
- Absent performance of certain testing at sites where we have been identified as responsible for remediation, we cannot estimate with a reasonable degree of certainty the total costs of remediation.

Legal Proceedings

Magten/Law Debenture/QUIPS Litigation

On April 16, 2004, Magten Asset Management Corporation (Magten) and Law Debenture Trust Company (Law Debenture) initiated an adversary proceeding, which we refer to as the QUIPS Litigation, against NorthWestern seeking among other things, to void the transfer of certain assets and liabilities of CFB to us. In essence, Magten and Law Debenture are asserting that the transfer of the transmission and distribution assets acquired from the Montana Power Company was a fraudulent conveyance because such transfer allegedly left CFB insolvent and unable to pay certain claims. The plaintiffs also assert that they are creditors of CFB as a result of Magten owning a portion of the Series A 8.5% Quarterly Income Preferred Securities for which Law Debenture serves as the Indenture Trustee. Plaintiffs seek, among other things, the avoidance of the transfer of assets, declaration that the assets were fraudulently transferred and are not property of our bankruptcy estate, the imposition of constructive trusts over the transferred assets and the return of such assets to CFB. On September 29, 2006, the Delaware District Court, which has jurisdiction over this lawsuit, denied NorthWestern's Motion for a Protective Order to limit the scope of discovery sought by plaintiffs. Discovery has commenced and the District Court has scheduled trial, if any, to be held in December 2007. We intend to vigorously defend against the QUIPS litigation.

On April 19, 2004, Magten also filed a complaint against certain former and current officers of CFB in U.S. District Court in Montana, seeking compensatory and punitive damages for alleged breaches of fiduciary duties by such officers in connection with the same transaction described above which is at issue in the QUIPS Litigation, namely the transfer of the transmission and distribution assets acquired from the Montana Power Company to NorthWestern. Those officers have requested CFB to indemnify them for their legal fees and costs in defending against the lawsuit and any settlement and/or judgment in such lawsuit. That lawsuit was transferred to the Federal District Court in Delaware in July 2005 and is consolidated with the QUIPS Litigation for purposes of discovery and pre-trial matters. In February 2007, those officers asked the Federal District Court in Delaware for leave to file a motion to dismiss the complaint and Magten has filed a motion to amend its complaint to add Law Debenture as an additional plaintiff.

In July 2006, Magten served a complaint against The Bank of New York (BNY) in an action filed in New York State court, seeking damages for alleged breach of contract, breach of fiduciary duty and negligence in connection with the same transaction described above which is at issue in the QUIPS Litigation. Specifically, Magten alleges that BNY, as the Indenture Trustee at the time of the 2002 transfer of assets from Montana Power Company to NorthWestern, should have taken steps to protect the QUIPS holders' interests by seeking to set aside the transfer and imposing a constructive trust on the assets. The New York State court is considering BNY's motion to dismiss Magten's complaint. BNY has asserted a right to indemnification by NorthWestern for legal fees and costs incurred in defending against Magten's claims pursuant to the terms of the Indenture governing the QUIPS under which BNY served as Trustee. It is our position that any such recovery should be payable from the disputed claim reserve although the Plan of Reorganization Creditors Committee has objected to this position.

On April 15, 2005, Magten and Law Debenture filed an adversary complaint in the Bankruptcy Court against NorthWestern Corporation, Gary Drook, Michael Hanson, Brian Bird, Thomas Knapp and Roger Schrum seeking to revoke the Confirmation Order on the grounds that it was procured by fraud as a result of the alleged failure to adequately fund the Class 9 Disputed Claims Reserve with enough shares of New Common Stock to satisfy a potential full recovery on all pending claims against NorthWestern's bankruptcy estate which were outstanding at the time the Plan became Effective on November 1, 2004. The plaintiffs also alleged breach of fiduciary duty on the part of certain former and current officers in connection with the alleged under-funding of the Disputed Claims Reserve. NorthWestern filed a motion to dismiss or stay the litigation and on July 26, 2005, the Bankruptcy Court ordered a stay of the litigation pending resolution of Magten's appeal of the Order confirming our Plan of Reorganization. NorthWestern intends to seek dismissal of this action and to the extent such action is not dismissed, NorthWestern intends to vigorously defend this action.

Twice during 2005, Magten, Law Debenture, the Plan Committee and NorthWestern unsuccessfully engaged in mediation to resolve the pending appeals and other pending litigation described above. At this time, we cannot predict the impact or resolution of any of these actions or reasonably estimate a range of possible loss, which could be material. We intend to vigorously defend against the adversary proceedings, lawsuits, appeals and any subsequently filed similar litigation. While we cannot currently predict the impact or resolution of this litigation, the plaintiffs' claims with respect to the QUIPs Litigation will be treated as general unsecured, or Class 9, claims and will be satisfied out of the Class 9 Disputed Claims Reserve established under the Plan.

McGreevey Litigation

We are one of several defendants in a class action lawsuit entitled *McGreevey, et al. v. The Montana Power Company, et al*, now pending in U.S. District Court in Montana. The lawsuit, which was filed by former shareholders of The Montana Power Company (most of whom became shareholders of Touch America Holdings, Inc. as a result of a corporate reorganization of the Montana Power Company), claims that the disposition of various generating and energy-related assets by The Montana Power Company were void because of the failure to obtain shareholder approval for the transactions. Plaintiffs thus seek to reverse those transactions, or receive fair value for their stock as of late 2001, when plaintiffs claim shareholder approval should have been sought. NorthWestern is named as a defendant due to the fact that we purchased The Montana Power L.L.C., which plaintiffs claim is a successor to the Montana Power Company.

In June 2006, we and the McGreevey plaintiffs entered into an agreement to settle the claims brought by the McGreevey plaintiffs in all of the actions stated above through a covenant not to execute by McGreevey plaintiffs against us and by us quit claiming any interest we had in any claims we may or may not have under any applicable directors and officers liability insurance policy, against any insurers for contractual or extracontractual damages, and against certain defendants in the McGreevey lawsuits. This agreement was finally approved by the Bankruptcy Court in November 2006. In February 2007, together with the plaintiffs, we filed a motion to dismiss the claims against us in the McGreevey lawsuits and no objections have been filed. The federal court denied the motions to dismiss on the basis that the plaintiffs' lawyers had not been appointed as class counsel and no class had been certified. We are in discussions with the plaintiffs' lawyers to determine how they will fulfill their obligations under the settlement agreement which was approved by the bankruptcy court.

City of Livonia

In November 2005, we and our directors were named as defendants in a shareholder class action and derivative action entitled *City of Livonia Employee Retirement System v. Draper, et al.*, pending in the U.S. District Court for the District of South Dakota. The plaintiff claims, among other things, that the directors breached their fiduciary duties by not sufficiently negotiating with Montana Public Power Inc. and Black Hills Corporation, two entities that had made public, unsolicited offers to purchase NorthWestern. On April 26, 2006, Livonia amended its complaint to add allegations that our directors had erred in choosing the BBI offer because it was not the most attractive offer they had received for the company. The parties have entered into a settlement agreement which provides that NorthWestern will redeem the existing shareholder rights plan either following shareholder approval of the Merger Agreement with BBI or upon termination of the Merger Agreement with BBI – whichever occurs first. The Board may adopt a new shareholder rights plan if the shareholders approve adoption of such a plan in advance or, in the event that circumstances require timely implementation of such a plan, the Board seeks and receives approval from shareholders within 12 months after adoption. After limited confirmatory discovery, the settlement agreement has been filed. In December 2006 the federal court indicated it would not approve the settlement because it did not provide any benefit to the class members. Based on the federal court's order, the plaintiffs agreed to dismiss the lawsuit with prejudice on the condition that the federal court would retain jurisdiction over any award of attorneys' fees. The plaintiffs' lawyers motion seeking discovery in advance of its motion for an award of attorneys' fees was denied by the federal court which set a briefing schedule for plaintiffs' motion for attorneys' fees. We expect briefing to be completed within the next 30-45 days and a decision by the federal court in the next three months.

Other Litigation

In April 2005, a group of former employees of the Montana Power Company filed a lawsuit in the state court of Montana against us and certain officers styled *Ammondson, et al. v. NorthWestern Corporation, et al.*, Case No. DV-05-97. The former employees have alleged that by moving to terminate their supplemental retirement contracts in our bankruptcy proceeding without having listed them as claimants or giving them notice of the disclosure statement and Plan, that we breached those contracts, and breached a covenant of good faith and fair dealing under Montana law and by virtue of filing a complaint in our Bankruptcy Case against those employees from seeking to prosecute their state court action against NorthWestern, we had engaged in malicious prosecution and should be subject to punitive damages. On May 4, 2005, the Bankruptcy Court found that it did not have jurisdiction over these contracts, dismissed our action against these former employees, and transferred our motion to terminate the contracts to Montana state court where the former employees' lawsuit is pending. We unsuccessfully engaged in mediation of this dispute in November 2005 and September 2006. We recorded a loss of $2.6 million in the third quarter of 2005 to reestablish a liability for the present value of amounts due to these former employees under their supplemental retirement contracts and reestablished monthly payments to these former employees under the terms of their contracts. In February 2007, a jury verdict was rendered against us in Montana state court, which ordered us to pay $17.4 million in compensatory and $4.0 million in punitive damages in a case called *Ammondson, et al. v. NorthWestern Corporation, et al.* Due to the verdict, we recognized a loss of $19.0 million in our 2006 results of operations to increase our recorded liability related to this claim. The Montana state court reviewed the amount of the punitive damages under state law and did not alter the amount of punitive damages. We intend to file post trial motions and post a bond and file an appeal if necessary; however, there can be no assurance that we will prevail in our efforts. In addition, we expect to incur additional legal and court costs related to these proceedings.

In December 2003, the SEC notified NorthWestern that it had issued a formal order of private investigation and subsequently subpoenaed documents from NorthWestern, NorthWestern Communications Solutions, Expanets and Blue Dot. Since December 2003, we have periodically received and continue to receive subpoenas and informal requests from the SEC requesting documents and testimony from former and current employees as well as third parties regarding these matters. In January 2006, the SEC issued Wells Notices to several former officers, a current officer and a then current employee, associated with NorthWestern and NorthWestern Communications Solutions. In July 2006, additional Wells Notices were issued to former officers and directors of NorthWestern and Expanets. A Wells Notice is an indication that the SEC staff has made a preliminary decision to recommend enforcement action that provides recipients with an opportunity to respond to the SEC staff before a formal recommendation is finalized. In December 2006, the SEC filed a complaint alleging securities law violations related to NorthWestern Communications Solutions against the former officers, a current officer and a then current employee. All the individuals agreed to settle the allegations of the complaint against them except our current officer. The current officer has been removed from his officer position pending the outcome of the complaint. There have been no findings or adjudication of the underlying allegations in the Wells Notices, and the SEC's investigation is ongoing and it could issue additional Wells Notices. In addition, certain of our former directors and several former and current employees of NorthWestern and our subsidiary affiliates have been interviewed by representatives of the FBI and IRS concerning certain of the allegations made in the now resolved class action securities and derivative litigation as well as other matters. We have not been advised that NorthWestern is the subject of any FBI or IRS investigation. We are not aware of any other governmental inquiry or investigation related to these matters. On March 7, 2007, the SEC commenced and simultaneously settled an administrative proceeding with NorthWestern and the SEC's investigation into Northwestern's restatement of our first three quarters of quarterly reports in 2002. NorthWestern agreed, without admitting any wrongdoing, to cease-and-desist from future violations of the securities laws. Specifically, NorthWestern agreed to cease-and-desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934, and Rules 12b-20, 13a-11, and 13a-13 promulgated thereunder. NorthWestern will pay no monetary fine, nor be otherwise penalized under the settlement. This settlement ends the SEC investigation regarding us.

Relative to our leasehold interest in Colstrip Unit 4, the Mineral Management Service of the United States Department of Interior (MMS) issued two orders to Western Energy Company (WECO) in 2002 and 2003 to pay additional royalties concerning coal sold to Colstrip Units 3 & 4 owners. The orders assert that additional royalties are owed as a result of WECO not paying royalties in connection with revenue received by WECO from the Colstrip Units 3 & 4 owners under a coal transportation agreement during the period October 1, 1991 through December 31, 2001. On April 28, 2005, the appeals division of the MMS issued an order that reduced the amount claimed due to the application of statute of limitations. The state of Montana issued a demand to WECO in May 2005 consistent with the MMS position outlined above on these transportation revenues. Further, on September 28, 2006, the MMS issued an order to pay additional royalties in the amount of $1.6 million on the basis of an audit of WECO's royalty payments during the three years 2002 to 2004. WECO has appealed these orders and we are monitoring the process. The Colstrip Units 3 & 4 owners and WECO currently dispute the responsibility of the expenses if the MMS position prevails. We believe that the Colstrip Units 3 & 4 owners have reasonable defenses in this matter based on our review. However, if the MMS position prevails and WECO prevails in passing the expense responsibility to the owners, our share of the alleged additional royalties would be 15 percent, or approximately $1.2 million, and ongoing royalty expenses related to coal transportation.

We are also subject to various other legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect our financial position, results of operations, or cash flows.

Disputed Claims Reserve

Upon consummation of our Plan of Reorganization, we established a reserve of approximately 4.4 million shares of common stock from the shares allocated to holders of our trade vendor claims in excess of $20,000 and holders of Class 9 unsecured claims. The shares held in this reserve may be used to resolve various outstanding unsecured claims and unliquidated litigation claims, as these claims were not resolved or deemed allowed upon consummation of our Plan. We have surrendered control over the common stock provided and the shares reserve is administered by our transfer agent; therefore we recognized the issuance of the common stock upon emergence. If excess shares remain in the reserve after satisfaction of all obligations, such amounts would be reallocated pro rata to the allowed Class 7 and 9 claimants. If the BBI transaction is completed, the merger consideration received for these shares will be retained by our transfer agent until resolution of the remaining claims.

(22) Common Stock

Successor Company

The Successor Company is a Delaware corporation and filed a new certificate of incorporation (New Articles). The New Articles authorized 250,000,000 shares consisting of 200,000,000 shares of common stock with a $0.01 par value and 50,000,000 shares of preferred stock with a $0.01 par value. As a result of the Predecessor Company's emergence from bankruptcy, the Successor Company issued 35,500,000 shares of common stock in settlement of claims. Pursuant to the Plan, such stock had an agreed value of $710.0 million. Accordingly, the Successor Company recorded common stock and additional paid-in capital of $355,000 and $709.6 million, respectively, in the Balance Sheet as of October 31, 2004. In addition, the Plan reserved 2,265,957 shares of new common stock for the New Incentive Plan, of which 228,315 shares were granted for Special Recognition Grants (see Note 18).

Concurrent with our emergence from bankruptcy we issued 4,620,333 warrants, each entitling the holder thereof to purchase one share of common stock, to certain holders of class 8(a) and 8(b) claims in settlement of their allowed claim. These warrants are exercisable from November 1, 2004 through November 1, 2007 at a current adjusted strike price of $26.24. We recognized $3.8 million of expense associated with these warrants as a reduction of cancellation of indebtedness income.

Repurchase of Common Stock

On November 8, 2005, our Board of Directors authorized a common stock repurchase program that allowed us to repurchase up to $75 million of common stock under a specific trading plan. This plan was cancelled in May 2006. From the program's inception through December 31, 2005 we repurchased in open market transactions 96,442 shares of common stock for approximately $2.8 million. During 2006, we repurchased in open market transactions 121,306 shares of common stock for approximately $3.7 million.

We also retired 16,664 shares and 95,799 shares of common stock during the years ended December 31, 2006 and 2005, respectively, which were tendered by employees to us to satisfy the employees' tax withholding obligations in connection with the vesting of restricted stock awards. These shares were retired based on their fair market value on the vesting date.