Industry Restructuring:

A Provider's Viewpoint

by Don Kohanski

Electric industry deregulation is coming more slowly to the Tennessee Valley than to other parts of the country. It is not a regular news topic, a major concern for state legislators, or a subject of conversation at cocktail parties. A recent survey of Nashville Electric Service (NES) residential customers indicates only 29 percent are "somewhat" and six percent "very" familiar with the subject.

Electric industry deregulation is not imminent in Tennessee for several reasons: (1) energy rates are below average in the south, so ratepayers do not have the same incentive to push for deregulation as they do in the higher-cost areas; (2) the Tennessee Valley Authority's (TVA) unique presence shields the valley from the effects of competition for the time being; and (3) California's electric problems have caused some states to reconsider the push for deregulation.

However, most consumers, lawmakers, and industry insiders agree nationwide deregulation of the $200 billion electric industry is inevitable. About half of the states have adopted their own deregulation schemes over the last six years that Congress has been debating the issue. The Bush administration is preparing a national deregulation proposal to open wholesale electricity markets and plans to present it to Congress this fall for consideration. Senior Energy Department officials have indicated the bill will not include a deadline for states to open their retail electricity markets to competition but will address transmission issues and the unique TVA situation.

Developing a workable nationwide transmission system is key to successful deregulation of the electric industry. The high-voltage interstate transmission system in place now was not designed for a competitive marketplace with increasing numbers of electricity providers and transactions. The Federal Energy Regulatory Commission (FERC) announced recently that it wants the electricity industry to form four regional transmission organizations (RTOs)—in the northeast, southeast, midwest, and west—to move power across the country, be responsible for ensuring fair and open access to the transmission system, and help mitigate market power. Many other proposals are also being discussed.

It remains to be seen what type of oversight system will ultimately be put in place and what will happen to TVA. Federal lawmakers are discussing options including dismantling TVA, leaving it as it is, and all stops in between. While either extreme is unlikely, changes are inevitable, and TVA's 158 distributors, of which NES is one of the largest, have a keen interest in the outcome. More than 80 percent of every dollar NES takes in goes directly to TVA for purchased power. TVA has always been a low-cost, reliable provider of electricity, and most distributors in the valley are in no rush to completely severe their relationship with TVA. However, as TVA makes business decisions to ensure its own survival in a competitive marketplace, distributors are asking for contract flexibility so they, too, can compete on a sound footing.

NES and other distributors have been negotiating with TVA for several years for contract changes to allow distributors more flexibility and control over rates and power purchases as well as a shorter contract term, specifically:

- To be allowed to purchase at least some portion of overall power requirements on the open market or allow it to come from alternative sources, including co-generation and self generation;
- To change the regulatory structure so distributors have meaningful input on wholesale rates and control over retail rates and prices at the local level; and
- To set reasonable contract term lengths, as some between TVA and distributors today are perpetual unless a 10-year cancellation clause is invoked.

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Some progress has been made, and recently TVA announced a willingness to allow distributors, on two years' notice, to purchase from non-TVA sources or self-generate up to 10 percent of their total power requirements. Further, TVA has stated that all distributors may convert to five-year, rolling-term contracts effective October 2002. Considerable work remains , but the changes are a step in the right direction.

While negotiations with TVA continue, NES is working internally to control costs and improve service in preparation for competition. Employment, NES's largest controllable expense, is being held to about 1,000, with contractors accommodating work overloads. Computer operations have been outsourced, saving approximately $11 million over five years.

Improving customer service and reliability are two major NES undertakings. Focus groups, telephone and written surveys, and pilot programs are used regularly to determine what customers want and to identify specific customer groups' needs. Research shows that while service has become more reliable over the last five years, customer perceptions and expectations have changed. Residential, small business, and large commercial and industrial customers are increas-

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ingly dependent on electricity and expect more reliable power than ever before.

A TVA study reveals electricity consumption in the Tennessee Valley is growing at nearly twice the national rate. In the Nashville area, electricity use has grown 22 percent over the last 10 years, and the number of industrial customers has grown 41 percent since 1997, increasing the demand on the NES electrical system. The annual growth of the system peak is 2.5 percent, almost double the annual increase in customers, and NES has broken its all-time summer peak in four of the last six years.

To be certain the electrical system can meet the increasing customer growth and demand, NES commissioned a study of the system's reliability, focusing on customer expectations, outage prevention, outage restoration, and information needed for reliability improvements. As a result, a comprehensive review of tree trimming and the replacement timetable for aging electrical equipment is underway, and plans are to allocate additional resources in both of these areas to improve overall reliability.

Utilities must provide what the customer wants instead of attempting to force the customer to buy what is good for the utility.

NES spends approximately $10 million annually on tree trimming, and estimates are that $13-15 million must be spent to reduce the number of outages caused by trees. Approximately one-quarter of NES's customers are served by aging 4kV electrical equipment, mainly in established neighborhoods within the city. This 4kV system will exceed its 50-year service life within 20 years (67 percent within 10 years). Estimated cost to replace this system in a 10-to-15-year time frame is $15 million per year.

Meeting growing demand while providing customers with reliable service is a major challenge, but vital to success in a competitive environment. Utilities such as NES have had to make many service improvements over the last few years, including installing new telephone systems and computerized equipment to handle the large volume of phone calls received during outages and to allow faster power restoration following emergencies. New policies make it easier to do business, such as allowing customers to sign up for electric service by phone, fax, mail, or telephone; accepting credit cards; and providing staff to answer customer questions around the clock. The utility guarantees it will perform certain business functions promptly and efficiently (service turn-on/off or accurate billing) or the customer will receive a credit.

Bilingual customer service representatives assist a growing Hispanic population. Written materials are translated into Spanish. A "language line" allows customer service representatives to communicate with speakers of practically any language by linking with an interpreter.

NES is installing equipment to read large commercial and industrial customers' meters automatically each month via telephone and even monitor energy usage. Large commercial customers are assigned key contacts at NES to determine their needs for more efficient operation. An outreach program is being developed to meet the special needs of small businesses.

Accomplishing customer service and reliability goals will be difficult; already narrow profit margins will become even narrower for distribution, or "wires," companies in a competitive environment. Consumer-owned electricity distributors have an advantage. NES is a public, municipally owned utility whose board serves without pay and whose mission has always been to deliver electricity at the lowest reasonable cost to its customer/owners, not to make huge profits or pay investors large dividends. Since NES is not a generator, it does not have expensive generating plants and the associated heavy burden of debt.

It is unlikely that every electric distribution company now in existence will survive deregulation, because competition generally drives companies to merge to take advantage of economies of scale. Some cities are likely to sell municipal utilities to raise capital for needed infrastructure upgrades.

NES's future depends on many factors, not the least of which will be ability to focus on our mission: *to provide reliable, safe, and economical electric power for the comfort, convenience, and security of our customers*. It is likely NES will both deliver power purchased from a number of suppliers and provide full retail service to smaller, non-aggregated customers and those satisfied with the services they receive who see no reason to change suppliers. NES will still serve as the local distributor, even if large industrial customers find cheaper power elsewhere.

For more than 60 years, NES has been an excellent corporate citizen, committed to good financial stewardship and giving back to the community. NES is the largest taxpayer in Metro Nashville, its rates are among the lowest in the nation, and its employees are involved in community betterment programs. We look forward to providing reliable, safe, low-cost power to the Nashville area for many years to come. ■

Don Kohanski is president and CEO of Nashville Electric Service.