



July 2004

Customer Choice

Across the country, customer choice for utility customers is typically limited to selecting among service providers, with no delivery choices. Telephone customers choose long distance and sometimes local service providers, but not which wires deliver that service. Electric customers choose a generation provider, but usually not a wires company. Across the portions of Texas where most customers live, customer choice is usually limited to selecting a retail electric provider (REP) not a wires company. This is not, however, true everywhere.

In the 1970s when territory in Texas was assigned to electric utilities, some rural portions of the state were claimed by more than one provider. The Public Utility Commission of Texas often certified these territories to two providers. Customers in these dually certificated areas can choose whose distribution wires bring service to their homes and businesses. Since that time, some formerly rural areas surrounding cities have become heavily urban.

Cooperatives in Texas may choose to opt-in or stay out of customer choice. All but two have taken a wait-and-see approach and not opted-in. But, because customers in dually certificated areas can change their wires service providers, many cooperatives have faced very real competition with neighboring Investor-Owned Utilities (IOU) for years.

Pat McAlister is the general manager/CEO of Southwest Rural Electric (SWRE), a largely rural 7,200 meter cooperative in North-central Texas. SWRE gained over 100 customers who switched from two competing IOUs over a five year period. These customers range from residences and small commercial businesses to oil

production facilities and a state prison. The largest customer to choose SWRE over an existing service provider was just over one megawatt.

McAlister believes customers are motivated to change wires service primarily because they distrust deregulation.

"Certainly, part of the reason customers give for changing is lower price," McAlister said. "But, I believe a primary motivation is to get back the relationship they used to have with their power supplier. They want live people answering the phone locally. They want line crews dispatched from local offices. They want to talk in person with a company representative who can make decisions. They want their power supplier to support the community. And they are tired of waiting for weeks to receive service."

The SWRE team targeted potential growth areas and literally went door-to-door discussing the advantages of cooperative service.

"Of course, we will work with any customer requesting service, but SWRE has attempted to kill two birds with one stone by building new lines in areas of potential future growth," McAlister said. "We don't advertise. In part this

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Regulatory Update

The compliance dates for Spill Prevention Control and Countermeasures (SPCC) Plans may change again.

In the June 17, 2004 Federal Register, the EPA gives notice it is considering extending compliance dates by 12 months for SPCC Plans.

Proposed compliance dates are Aug. 17, 2005, to amend an existing SPCC Plan, and Feb. 18, 2006, to implement the Plan.

According to the proposed dates, affected facilities starting operations after Aug. 16, 2002, through Feb. 18, 2006, must prepare and implement an SPCC Plan by Feb. 18, 2006. Affected facilities that become operational after Feb. 18, 2006 must prepare and implement an SPCC Plan before starting operations.

Contact Angela Riddles at 405.416.8294 for complete information regarding SPCC compliance dates or visit www.chguernsey.com then click on SPCC Update in the Announcements area.

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Benefits

cont. from page 2.

windfall because Texas retail electric competition rules permit affiliate REPs to increase their total fuel factor by the increase in natural gas prices since 2002, but they are not obligated to reduce those fuel factors when fuel prices decline.

Not surprisingly, TXU Energy's first quarter earnings for 2004 rose by 257 percent over the same quarter last year. Sales to residential and commercial customers outside their territory rose by 34 percent over the previous year.

Nonaffiliated REPs have been very selective of customers they serve and tend to target only the most profitable loads. The success of nonaffiliated REPs to target better loads is revealed in the following statistics. Nonaffiliated REPs serve:

- 15 percent of residential customers, but 17 percent of residential load

- 19 percent of commercial and small industrial customers, but 48 percent of the load

- 57 percent of customers above 1 MW, but 63 percent of the load

Non-Retail Choice Customers

Customers of non-retail choice IOUs, electric cooperatives and municipal-owned utilities continue to enjoy lower electric bills, with only one-third the price increase experienced by Price to Beat customers since 2002. More importantly, these customers have not experienced competition's transition problems. Lastly, electric cooperative members and municipal-owned utility customers still enjoy local service at a lower

rate. Consequently, these customers, particularly residential and small commercial customers, have benefited from not being forced to participate in retail electric competition.

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InFOCUS

Who Really Benefits?

Texas illustrates the answer to who benefits from retail electric competition.

Natural Gas Price Outlook

GUERNSEY's natural gas model provides six-month outlook.

Regulatory Update

SPCC compliance dates may change again.

Customer Choice

Cooperative managers discuss switchovers in dually certificated areas of Texas.

NRECA's Upcoming Seminars

GUERNSEY's Carl Stover, Judy Lambert and David Hedrick are set to present seminars at the 2004 Accounting, Finance and Tax Conference on July 25-28, 2004 in San Diego, Calif.

was because we already have a waiting list of customers desiring to switch and in part we want to target potential customers."

The SWRE staff conducts cost-benefit analysis for each potential load, balancing future revenue from the customer and potential customers to be added from a proposed new line against construction and financing cost.

"The cooperative has taken advantage of pro-growth wholesale rate designs from our power supplier," McAlister added. "These rates phase in demand increases, allowing us to apply additional margins in early years of projects against construction costs."

McAlister mentioned a distinct advantage of adding switched load. "Unlike new construction where usage estimates have to be made, these customers provide copies of actual bills from existing power suppliers. We know exactly what we are going to get."

See Choice on page 3.

Who Really Benefits?

Texas is 2½ years into retail electric competition. During this period, customers have experienced a number of problems related to the start-up of this new, competitive retail market.

Starting Jan. 1, 2005, IOU retail electric providers (REP) affiliated with T&D companies will be permitted to offer non-Price to Beat rates to retail customers in the certificated area of their T&D affiliate if they so choose. Consequently, this is a good time to evaluate how this reportedly competitive market in Texas has worked and who has realized the most benefit.

Residential

The majority of residential customers have not benefited from competition. Most residential customers have seen their bills increase significantly. Although increases in fuel costs affected virtually all Texas customers, bills for residential customers in retail electric competition (competition) experienced substantially larger average increases than those still served by non-competing utilities.

Through April 2004, the average bill for residential customers using 1,000 kWh served by the affiliated REP increased 34 percent. In contrast, the same usage served by an electric cooperative, municipal-owned utility or non-competing IOU has only increased by 11 percent. This differential does not incorporate the 3.4 percent increase implemented in May for customers in the certificated area of TXU Energy, Texas's largest REP, or the 5.7 percent increase they will

implement in late July.

Considering the fact that TXU has not raised customer rates for its SESCO division since January 2002, it is evident how broke the system really is. TXU Energy and TXU SESCO are both deregulated divisions of the same company, with the same affiliated REP. However, TXU has not felt the need to raise the rates for SESCO customers.

Although several REPs are competing in each certificated area, prices offered by competing REPs track any changes to the Price to Beat authorized for the affiliated REPs. The competing REPs tend to offer prices no more

than 10 percent below the Price to Beat and sometimes exceed it. It is not surprising that only 15 percent of eligible residential customers have changed their REP.

Small Commercial
Most small businesses have

not benefited from competition. Commercial customers with average monthly usage less than 15,000 kWh have seen price increases similar to residential customers. However, fewer REPs are really competing to serve these small commercial customers. In addition, because REPs do not publish their prices for commercial customers, these customers do not know if they are receiving a good deal. Many of those who do select a different REP find when they



add all charges their bills are actually higher.

Larger Commercial and Small Industrial

These customers have experienced the largest savings. Although little specific data has been made public, large commercial and industrial customers typically attract proposals offering savings in excess of 20 percent as compared to Price to Beat rates. Now that most affiliate REPs can offer competitive rates to commercial and industrial customers with loads less than one MW, larger commercial and small industrial customers with better load factors can get lower rates from the affiliate REP.

REPs

An estimated 85 percent of residential customers and 65 percent of all retail load in Texas is still served by affiliated REPs. Some affiliated REPs have enjoyed a

See Benefits on page 4.

Choice

cont. from page 1.

McAlister sees change coming in the near term. "I think we must be close to the end of the switching boom, but I thought so last year too. Cooperatives provide excellent electric and customer service and it seems that's a commodity customers still value," McAlister said.

Darryl Schriver is the manager of Taylor Electric, a 13,000 meter cooperative. Taylor serves territory around Abilene — territory that was once extremely rural and is now becoming increasingly urban. Over the past couple of years, Taylor has added over 600 primarily residential customers who chose to switch from their existing IOU supplier. This is in addition to growth from new construction in the area.

"From the board and management to each employee at Taylor, we work as a team to operate our marketing program," Schriver explained. "A key job of our marketing team is communication with members to build understanding about the importance of marketing. As prices inevitably rise, existing members can either all pay more or add more customers to spread those costs."

"When we looked at a map of our service territory, we saw tremendous potential for growth around Abilene — an area where we did not have sufficient electric infrastructure in place at the time to handle growth. In order to get our share of new load coming into the

dually certificated area, we needed to add infrastructure. We saw a window of opportunity when customers of existing IOUs were highly motivated to switch wires suppliers where possible. We decided to market to these customers and use the line extension to capture easement and position ourselves to serve other load in the area." Schriver said.

Taylor used advertising — targeted to zip codes they determined were most likely to see future growth — to explain the advantages of cooperative service.

"Our message was simple: if you are tired of deregulation and want to go back to a bundled service, give us a call. We didn't say we were cheaper, though we usually are," Schriver said.

Schriver agreed with McAlister that electric cooperatives offer significant competitive advantages.

"We feel Texas IOUs made three significant mistakes. First, they lost connectivity with their customers. Customers don't know who to call

and the utility doesn't know anything about them or their community when they do call. Recently, a new customer told me he didn't care what our rates were; he just wanted someone who would return his calls. Second, IOUs have lost local service crews. Repair service must come from a distance. Customers see cooperative crews working immediately after a storm

and know them personally. Third, the IOU is not involved with the local community. They no longer sponsor the local baseball team or change the lights at the ball field. They take money out of the community and return nothing," Schriver said.

Nimbleness and planning are key elements to the Taylor marketing plan. "We want to be able to

rapidly respond to individual customer needs and changes in the industry," Schriver said. "And we are careful to look at the potential impact of any marketing plan in all cooperative areas, from financing and cash flow to engineering and long-range planning."

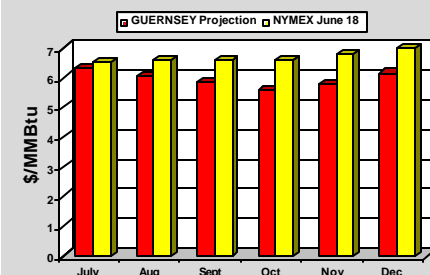
Taylor's approach is working. "We are adding a total of about 500 new members a year, including customers who switch and new construction," Schriver said.

"This is a great time to be an electric cooperative in Texas," Schriver concluded. "We are building the same strong ties we did 60 years ago with a new generation of members who can see real differences that affect their daily lives between how their cooperative does business and how the neighboring IOU does business. They will remember those lessons."

"We are building the same strong ties we did 60 years ago with a new generation of members..."

"Most residential customers have seen their bills increase significantly."

Six-Month Natural Gas Price Outlook



The GUERNSEY forecasts are based on the most recent weather forecasts for the next two weeks and normal weather after that. The price forecasts have a band of +/- \$0.50.

The fact that gas prices are simply tracking oil prices the last several months makes the gas market a treacherous place for physical and financial gas traders.

The relatively healthy storage injections and levels, which are failing to move the gas market, are

shadowed with uncertainty concerning summer weather and the direction of oil markets. Absent an unlikely major downturn in the oil market — given Middle Eastern unrest in the short term — gas prices are predicted to stay high in the short to medium term.

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