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6. Facilities Management
7. Energy Management
8. Construction Management
9. General Management
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11. Library / Research
12. Accounting / Finance
13. Marketing / Sales
14. Communications / Public Relations
15. Purchasing
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8. Accounting / Law Firm
9. Management Consultancy
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11. Investment Banking / Financial Institute
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14. Federal Government / Commission (US)
15. Non-US Entity
16. Industrial / Commercial Energy Customer
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19. Publisher
20. Vendor to power industry
21. Other

3 In which areas do you have purchasing authority or influence purchasing decisions:
(please check all that apply)

A. General

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2. Outsourcing services
3. Safety / security products
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5. Financial & administrative services

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10. Environmental protection & control
11. HVAC equipment & services
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13. Alternative energy systems
14. Distributed generation equipment & services
15. Fuels

C. Information Technology

16. Computer hardware / software
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24. Distribution automation
25. Demand-side management
26. Energy management systems

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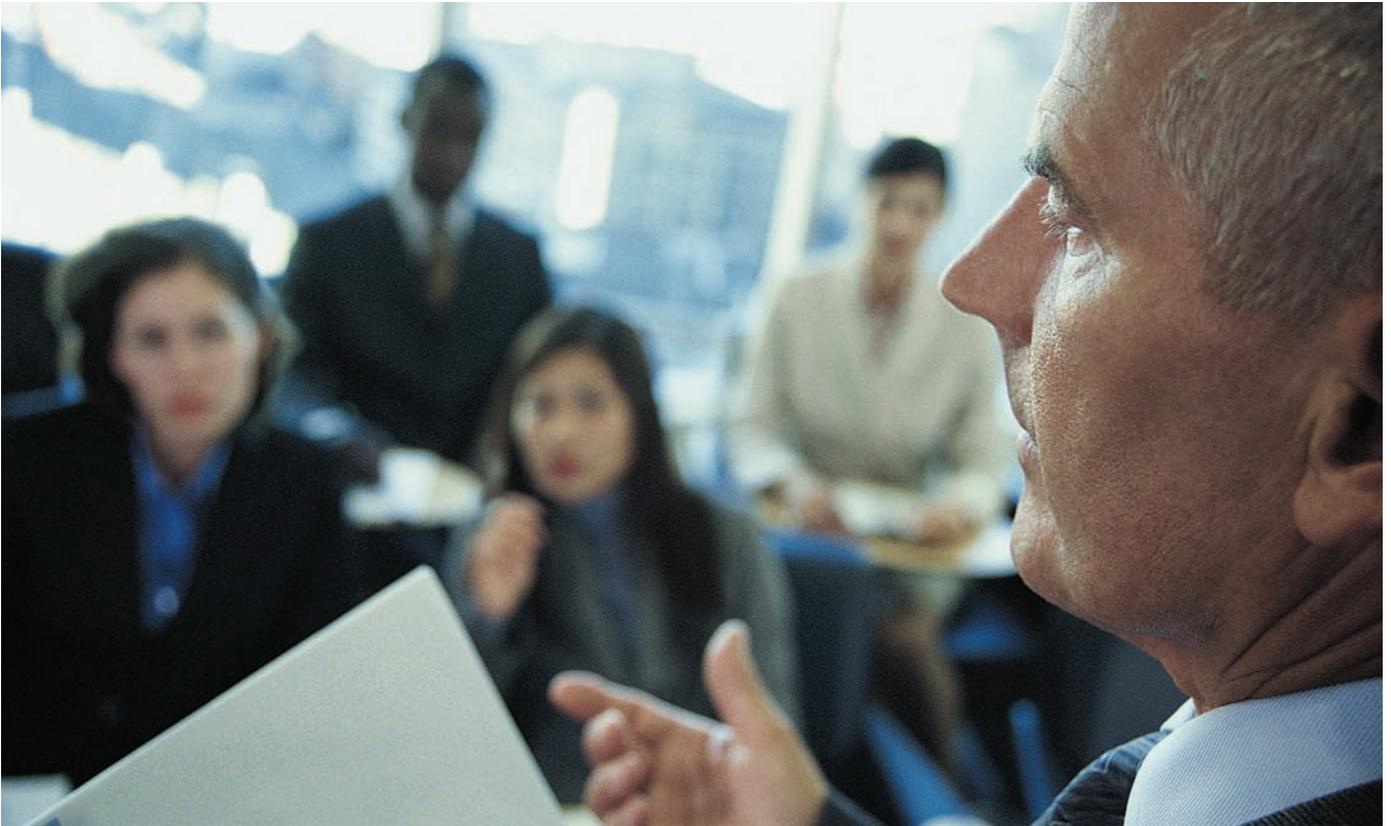
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Our Take

Lessons from the Land of Oz!

A decade ago, David Wittig was summoned to tranquil Topeka, Kan., by John E. Hayes Jr., then chief executive of Western Resources, now Westar, to grow the company. At the time, Wittig was a top player on the merger and acquisition scene. By age 31, his financial feats landed him on the cover of *Fortune magazine*, where he was photographed chomping a cigar.

Shortly after arriving at the utility, Wittig told me his goal was to create one of the largest utilities in the country — one that would serve 10 million customers and generate \$10 billion in annual revenues.

Pursuit of that goal proved messy after he mounted an unsuccessful hostile takeover bid of Kansas City Power & Light. While such efforts were rare in the then-clubby utility world, Wittig was a master of the hostile takeover game, succeeding in 23 out of 25 such deals in a number of industries before landing in Topeka.

Unfortunately for Wittig, the failed attempt to snare KCP&L was just the beginning of his woes. Last summer, a federal grand jury returned a 40-count indictment against Wittig and Douglas Lake, Westar's chief strategic officer, alleging that the pair conspired to defraud their employer. Although their trial ended in a hung jury, federal prosecutors have announced they will retry the men.

The Wittig story is worth pondering on two counts.

First, there are strong signals that M&A is heating up again in the utility world. The Exelon-PSEG announcement in the closing days of 2004 prompted virtually every utility CEO to contact his or her investment bankers for advice. New York writer Gary Stern surveys this topic in the cover story. A leading investment banker expert in utility mergers talks to *EnergyBiz* about where the industry may be headed. The package begins on page 16.

Second, a large number of utilities have tapped new chief executives recently — the result of a spate of retirements and the desire of some boards to head in new strategic directions. West coast writer Arthur O'Donnell examines this trend and its implications in the article beginning on page 30.

The Wittig example reminds us that business leaders must operate in a multi dimensional world. They cannot solely indulge a passion for deal-making to the exclusion of all else. Neither Wittig nor Hayes had spent much time in the energy industry before trying to totally overhaul a sound utility in pursuit of corporate grandeur.

Recently, a number of utilities have looked outside the industry to pick new leaders. The energy industry faces new challenges so why not go with leaders with skills not commonly possessed by traditional utility executives? There is merit in that view — just as there is merit in picking utility veterans to fill leadership roles. However, there is a lesson to be learned from the Wittig case. Not long ago, one utility's executive selection was totally shaped by a desire to win in the M&A sweepstakes. The mess that followed is still being sorted out in federal court. ☹

Martin Rosenberg

Independent Power Awaits Rebound

By Martin Rosenberg

The independent power production landscape remains littered with the dashed dreams of once ardent investors, and the revival may take some time. In fact, it could be as much as 18 months before excess generating capacity is tapped by a more power-hungry country, experts are saying.

"Currently, developers are not positioning themselves to actively develop and build," said A. Michael Schaal, with Energy Ventures Analysis in Arlington, Va. "They simply do not have the signals in the market to indicate capacity is needed."

Independent power producers (IPPs) suddenly arrived on the energy scene around 1998, eager to put a fleet of new power plants in place to facilitate the then-burgeoning business of trading power. At the time, the commonly held vision of the future was that customers would soon enjoy wholesale and retail choice of energy providers. Utilities would shed regulated generation assets and focus on running distribution systems.

IPPs came on fast, going from virtually no installed capacity to a peak level of 120,000 megawatts under construction in late 2001. By the end of 2001, non-utilities accounted for about one-third of total generating capacity in the country. Some estimate that share grew in subsequent years to as much as half of all generation. Between 2000 and 2003, IPPs boosted their combined gas turbine capacity by 179,200 megawatts, according to data compiled by Energy Ventures Analysis. However, last year they added just 18,200 megawatts of gas turbine power. All signs indicate the downward trend could well continue for the next five years – given current power market conditions. Capacity additions are expected to trail off to 17,000 megawatts this year, 12,200 next year, 9,900 in 2007, and 6,000 in 2008, Schaal said.

While as much as 80 percent of added capacity at the height of the building boom was ordered by IPPs, today the dominant share of new projects are being launched by utilities within their service territory. "It's [the trend] roughly reversed itself," Schaal said.

Bob Fishman, senior vice president of development for Calpine, said that hefty reserve margins around the country need to fall before power prices pick up and IPPs elect to build new plants. That could take "18 months – maybe less," he said.

The health of the economy will be a major factor in determining when new generation will be built. For every 1 percent jump in the gross domestic product, energy demand increases 0.6 percent, he said.

To prepare for inevitable economic and power demand growth, Calpine has 11 projects under construction, making it one of the most active IPP players today. Currently, it has 89 plants in 11 states churning out 26,600 megawatts.

Virtually all power plants being built today by IPPs are projects that include a contracted buyer ready to take delivery of the power, Fishman said. Unlike just a few years ago, investors without power sales contracts in hand will not speculate that market forces will lift energy prices and make their investment profitable.

Fishman said Calpine stands ready to make the most of a business environment that is more stable than it has been in the recent past because there is less upside potential and downside risk.

Who are Calpine's main competitors? Utilities that would like to build their own plants, Fishman said. "Our story is we think our proposals are better for ratepayers," he said. "We can do it faster, cheaper and in an environmentally cleaner way."

In addition, Calpine and other players are pursuing a variety of niche opportunities.

A large number of banks, hedge funds, and investors have picked up independent power plants, yet they lack the technical and market skills to make the most of their investments.

Tyr Energy has built a business around commercial management of power plants. Brad Nordholm, president of the Overland Park, Kan.-based company, said that many IPP projects laden with debt have defaulted, are now owned by banks, and need the help of companies with expertise in commercial project management. Tyr manages plants with a combined output of 5,000 megawatts, sufficient to power about 5 million homes.

Meanwhile, new deals are being made, and the generation side of the business is attracting new investors.

"The market for IPPs with long-term contracts is very, very strong," Nordholm said. "There is strong demand from investors who want to own them."

A huge number of deals could well be in the offing. As much as 100,000 megawatts – around 10 percent of total domestic generation – is "in disarray – in play right now," he said.

"For the next year or so, the biggest unanswered question is whether banks will sell the projects they are taking over to hedge funds and others interested in non-contracted plants," Nordholm said.

News Flash >>

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AFRICAN TELECOM

South African electricity companies are ready to jump into the telecommunications business, bringing affordable service to remote regions of the country. City Power Johannesburg could be providing customers powerline communications as early as the second quarter of this year.

ALBERTA POWER LINES

Consumers – not generators – must put up \$1.5 billion to cover the expense of installing new power lines in Alberta, Canada. The province's energy minister agreed that the cost should not be shared by consumers and generators. "It wouldn't be in Albertans' interest to see the generators lose money year after year, or else we'll have no generation, we'll have no electricity at all," he said.

The View from Calpine

Calpine Corp. has a vision of the long-term value of building an industry around independent power production. Despite recent setbacks, IPPs will play an important role in the emerging new power industry, Calpine's top executive maintains.

Peter Cartwright, chairman, president and chief executive of Calpine, is not new to a belief in independent power. He founded Calpine two decades ago to capitalize on opportunities in the generation business. By the end of this year, the company expects to be producing a block of power sufficient to serve 30 million households, qualifying it as one of the largest power producers in the country. Cartwright has labored in the power industry in the United States, Asia, Latin America and Europe for 40 years. His take on the future of his company and IPPs:



energybiz: Calpine has suffered financially as a result of the tumultuous changes affecting the IPP market in recent years. On what do you build your hope for a rebound?

CARTWRIGHT: Over the last several years, electricity prices have been low as a result of a significant increase in new power plants coming on line. But demand for electricity is increasing, and Calpine has the most modern, most efficient, and least polluting fleet of power plants in North America.

energybiz: Does the energy industry and the general business world understand the role and importance of independent power production in America?

CARTWRIGHT: In electricity markets where there is open competition such as Texas, prices are low. This benefits all consumers — industrial, commercial, and residential.

energybiz: Why is it more efficient for IPPs to meet the future power needs of the country, rather than rely on utilities to build their own power plants?

CARTWRIGHT: When an IPP builds a new power plant it must carefully control its cost. Taxpayers and electricity

Russian Power Opportunity

By Robert Ebol

Russia plans to break up its Unified Energy System, the world's largest electric utility, to spur deregulation and court foreign investors. Russia would continue to hold a controlling interest.

Anatoly Chubais, the system's chief executive, said that it will take an infusion of \$50 billion to upgrade Russia's aging electricity system.

Chubais believes the electric power sector of Russia will perform more efficiently if it is deregulated. Undoubtedly, he has observed that the Russian private oil companies have outperformed state-owned oil companies, especially where Western managerial expertise and technology have been applied. In part, state-owned companies lack shareholders demanding better performance and returns on investment.

Chubais will do what he can to "sell" UES to the potential private investor, but he can expect that these investors will take a hard look at Russia's electric power sector, in terms of prospective returns on investment

and political risk. The Yukos affair, with President Putin moving to reassert government control of the oil sector, will convince risk-adverse investors to stay away.

Electric power is not as sexy as oil. Investors, seeking access to new supplies, look longingly at the Russian oil potential. The electric power industry needs a complete make-over. Electric power rates need to be raised, but that is politically difficult. Consumers need to pay their bills on time, which is not always the case today. Meters need to be installed everywhere. Will all this come through deregulation? That is a lot to ask.

Chubais can attempt to court foreign investors, but why would the foreign investor consider the Russian electric power system at this time? Later perhaps, after deregulation is in place and a more reasoned appraisal of the system can be made.

Robert Ebol is chairman of the energy program at The Center for Strategic and International Studies.

consumers are not on the hook for cost overruns. Competition guarantees the lowest cost in the power industry.

energybiz: In addition to Calpine, what kinds of investors remain active in the IPP sector?

CARTWRIGHT: Many IPP companies have dropped out of the business over the last several years including most utilities that had unregulated subsidiaries. Banks and private funds have taken over some of the power plants that were being built. Municipal utilities and a few IPPs are planning new power plants.

energybiz: What will be the greatest single factor shaping the generation business in the coming decade?

CARTWRIGHT: Some of the major issues facing the industry are:

- The need to control power plant emissions including green house gases. This will mean closing down older plants and in particular old coal-fired plants that are highly polluting.
- Bringing in new resources of natural gas including importing liquefied natural gas.
- Increasing competition in the power industry and allowing customers — particularly industrial and large commercial customers — to purchase power on the open market.

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MOSCOW PRICE BOOST

Electric and heating rates in Moscow were boosted effective the beginning of the year. Rates for Mosenergo's consumers were raised by 12.55 percent, on average. The Energy Committee of the Moscow region increased the respective tariffs by 12.23 percent. The cost of gas to power Mosenergo's power plants jumped by 24 percent last year.

- By Martin Rosenberg

To Diversify – Or Not

By Richard Korman

News Flash >>

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FUNDING HURRICANE REPAIRS

Florida Power & Light can begin recouping \$354 million of hurricane-related expenses while it awaits a final regulatory ruling. FPL had a \$350 million storm fund before the 2004 hurricane season, but three devastating storms caused \$710 million in damage.

RAIL SALE

Progress Energy will sell its rail-services business to J.P. Morgan Chase & Co. Progress Energy plans to use the \$405 million from the deal to cut debt.

Boredom is beautiful, at least as far as investors are concerned. The utilities that rewarded investors most over the past five years, Entergy Corp. and Green Mountain Power, both emphasized a back-to-basics approach well before their peers, says the Edison Electric Institute. Among utilities, "The no. 1 priority is to convince investors that utilities again are defensive stocks," says Justin McCann, senior industry analyst with Standard & Poor's.

Yet no industry has fought harder for its freedom to operate in competitive markets than electric and gas utilities. Even now with the new focus on core-regulated businesses, hybrid models prevail at the best-performing investor-owned utilities. Prudent diversification, coupled with a back-to-basics approach, seems like the way to win the hearts of investors.

The conventional wisdom is that utilities are recovering from their ill-conceived romances with debt and risky merchant power production and other ventures. A new study reinforces the idea that, unlike other industries, diversification initially created value in the electric utility business, but over-diversifying squandered it. Part of the proof is in how investors treated utility shares in the 1980s and 1990s. The difference was the degree of regulatory control.

Under stricter regulation for the first 12 years of diversification, roughly 1980 to 1992, investors rewarded shares of diversified electric utilities with a premium, the study says. But after 1992, when the Energy Policy Act loosened restrictions on deregulated investments, diversification premiums disappeared.

In general, diversification destroys. Research shows that diversified companies lose around 13 percent to 15 percent of their value.

"After 1992, the advantage for electric utilities disappeared, suggesting that electrical utilities became similar to other unregulated industries," says Tomas Jandik, assistant professor of finance at the University of Arkansas and co-author of the study.

Diversification hurts in several ways. "It puts too many horses under one roof. Managers go off in different directions, and may lie about information to headquarters," says Jandik, who performed the study with Anil Makhija, a professor at Ohio State University.

A key goal of their research was to discover how regulation affected diversification decisions and why, contrary to the discounts documented for other diversifying firms, diversified electric utilities prior to 1992 traded at a premium. Their research covered the years 1980 to 1997 and examined

investor-owned electric utilities. They counted as a diversified segment only those whose sales, assets or profits exceeded 10 percent of the company's total. The research stopped at 1997 because after that a new financial accounting standard changed the way companies reported financial data.

Since their ability to freely distribute their profits in the form of bigger dividends was limited by worries about how regulators and ratepayers would respond, single-segment utilities tended to plow too much of their spare cash into their electric segments, Jandik says.

The industry's options for spending spare cash opened up after it completed a series of costly nuclear plant construction projects in the 1970s. As demand for electricity slackened and with excess cash in their pockets, electric utilities first began sinking it into non-core ventures. Breathing "the sweet air of opportunity," as one writer put it, utilities tried insurance, banking, airplane leasing and other ventures. One example was Pacific Gas and Electric, who bid to acquire the G.D. Searle subsidiary that made Nutrasweet. Skeptics abounded, but the electric utilities as a whole performed well for investors.

Between 1980 and 1997, electric utilities with unregulated segments increased from 8.3 percent to 34.3 percent, reports Jandik's study. To decide whether diversification helped, Jandik and Makhija estimated the difference between a firm's total value and the sum of the values for its segments as stand-alone firms. Then they looked at the excess value or lost value of the firm. To do that, they considered factors that included the market value of its stock and the book value of its debt.

From 1980 to 1992, diversification into non-electric (non-regulated) businesses added 6.1 percent in value, Jandik and Makhija write. From 1992 to 1997, there is little or no measurable gain. Once the industry was partially deregulated, the benefits of diversification quickly diminished.

The implication for utility industry business models is that diversification must be done with discipline and should not exceed the entrepreneurial skill sets of its managers.

A lot of the risk in a utility stock depends on the nature of its deregulated businesses. Oil and gas production, pipelines, fuels and trading are major sources of revenue. MDU Resources Group, Inc., has a deregulated entity, Knife River Corp., whose revenues have reached \$1 billion. It has extensive operations in mining, asphalt, cement and construction, as well as gas pipelines and independent power production. MDU has been developing some of its



GATHERINGS

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unregulated businesses for more than a decade. Some are riskier than others. Asphalt and construction, for example, may rise and fall depending on Congress' willingness to spend big on highway and transportation public works, analysts say. A much smaller utility, Otter Tail Power, gets more than half its \$418 million in revenues from ventures ranging from health care to plastics. Recently Otter Tail acquired a manufacturer of dehydrated potato products.

So far, the back-to-basics approach flourishing at so many utilities has regained the respect of investors, who have driven up the value of gas and electric utility stocks about 23 percent each of the past two years. With a few notable exceptions, successfully diversified utilities are sticking to fields where they have much experience, such as oil and gas production and mining.

The yearning for competition in deregulated markets remains strong, most analysts agree, and investors are counting on diversified businesses to help drive utility stock returns in the year ahead. Yet many of the five million or so individual investors in utility stocks never understood the risks during the last wave of diversification.

"From World War II until 1993 or 1994, utility investors got total annual returns in dividends plus price appreciation from 9 percent to 11 percent," says Gary F. Hovis, a vice president of Argus Research, New York, and director of Argus' utility research.

Beginning in 1993 and 1994, investors saw utility returns gyrating unpredictably. Finally there was a dramatic fall. "They learned their lesson the hard way," Hovis says.

Now investors are believed to better understand how the industry works. ☺

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MARCH 30 - 31

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ASME Power 2005
ASME
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APRIL 10 - 13

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APRIL 10 - 13

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Las Vegas

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Chicago

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Midwestern/Eastern Coal Power Project Development
Infocast
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APRIL 26 - 27

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MAY 4 - 6

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MAY 10 - 11

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Sempra Challenged, Stakes High

By Arthur O'Donnell

They met at a Phoenix airport hotel room just two days after California enacted its sweeping power-market restructuring bill in September 1996. But the dozen executives of three Western energy firms had more on their minds than the deregulation of electricity.

According to a copy of the sketchy agenda and handwritten notes from one participant, officials of Southern California (SoCal) Gas, San Diego Gas & Electric (SDG&E) and El Paso Natural Gas pipeline discussed possible joint ventures to construct a power plant in Samalayuca, Mexico, which would distribute natural gas in Northern Mexico. The group also contemplated working out a potential realignment of excess pipeline capacity as the gas transportation customer profile for El Paso and the utilities was shifting.

The prospective deals never reached fruition — in part because of disinterest by the Mexican government in joint bids. The later merger of SoCal Gas and SDG&E into Sempra Energy also put a damper on joint deals with El Paso, said the companies.

However, a host of plaintiffs in a pending lawsuit claim that the companies' real agenda that day was to agree not to compete with each other for new or expanded pipeline projects that would increase gas flows into California. According to allegations in *Continental Forge v. Sempra, et al.*, the result was a market-allocation conspiracy that caused the prices of natural gas and electricity to spike upward during the power crisis of 2000-01. They also charge that Sempra manipulated gas prices and storage during the crisis for its own benefit — a claim that has been rejected by state regulators.

Besides alleging violations of California antitrust laws, the broad alliance of plaintiffs in the multiple class-action litigation cite the state's unfair business practices code Section 17,200 to seek treble damages for above market energy costs—estimated at up to \$24 billion.

Despite repeated attempts to have the case summarily dismissed or removed to federal jurisdiction, the Sempra utility defendants, SoCal Gas and SDG&E, face a jury trial later this year in San Diego Superior Court. El Paso is no longer a defendant in the case, having reached a global settlement of energy crisis-related matters in late 2003 — in which it agreed to pay about \$1.7 billion in damages without admitting any guilt for a number of alleged market infractions.

"This is an old-fashioned, horizontal antitrust case," observed Gordon Erspamer, an attorney with Morrison & Foerster. "The allegation is that people got together in a room and carved up the market."

Litigation over unfair competition in the modern utilities business is rare, but not novel, said Max Blecher, an antitrust expert from the Los Angeles firm Blecher and Collins. "Agreements not to compete or to divide up territories are classic antitrust violations dating back to Addyson Pipe & Steel in 1898," Blecher said.

Notwithstanding the massive claims for damages, neither Blecher nor other energy litigators perceive broad implications for the industry. "It's a lot of money," said San Francisco attorney David A. Simpson. "But it doesn't look like anything that has particular importance nationally. This is a standard, garden variety antitrust case."

Although Court TV is unlikely to set up its tripods at the San Diego courthouse, if and when the case goes to trial (Sempra has appealed to the California Supreme Court), the case illustrates that traditional defenses employed by utilities do not hold up well during a period of transition from highly regulated to unregulated markets.

Harvey Reiter, a partner with the Washington, D.C., law firm Stinson Morrison Hecker, LLP, explained that utilities usually rely successfully on two "regulatory shields" — federal preemption of state actions when interstate commerce is involved and application of the federal filed rate doctrine.

"When an industry is regulated, you can take into account the regulatory scheme," Reiter said. In this case, neither defense has worked for Sempra.

San Diego Superior Court Judge J. Richard Haden in a detailed order last September saw no application of federal preemptions against the state suit. "Congress has not shown an intent to preempt the field, and state antitrust and unfair competition causes of action do not conflict with federal law," Haden found.

He reiterated previous rulings in rejecting Sempra's claim that the Federal Energy Regulatory Commission (FERC) holds jurisdiction over the case. "The case at bar is not about regulated rates but rather the unregulated spot market for natural gas at the California border and skyrocketing prices for natural gas and electricity therefrom. There is no filed rate of natural gas spot market prices, and retail electric rates are not FERC regulated."



“The defense is going to be: ‘We didn’t do it.’”

The judge concluded that there is sufficient evidence of gas market manipulations by Sempra to warrant a jury trial, which he set for September 5, 2005.

Erspamer noted that in nearly all the electricity cases emanating from the power crisis, defendants have successfully removed the litigation to federal courts, which tend to side with preemption arguments. “But the filed rate doctrine has been more successful in electricity cases than in natural gas, partly because gas was deregulated early,” he said.

Sempra’s failure to have the case removed to federal court last year may give a slight advantage to the class-action plaintiffs. “State courts are much more political,” Erspamer said. “Judges and juries are much more receptive to claims of harm.”

Blecher believes the case will be relatively straight forward. “The plaintiffs will be required to prove the conspiracy by a preponderance of evidence; just tip the scales ever so slightly in favor of the plaintiffs,” he said. “The defense is going to be: ‘We didn’t do it. We met and discussed and agreed upon legitimate business issues but didn’t agree not to compete.’”



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Coal Captives

GUEST OPINION

By Duane L. Richards

There's a new spirit of rapacity in the air. When it comes to hauling coal — the nation's most abundant and affordable source of energy for generating electricity — electric utilities often find themselves captive to a single railroad either at the point of origin (the mine), destination (power plant), or both. This fact of life for utility executives places them at the mercy of a monopolist.

Twenty years ago, Western Fuels Association, Inc., a cooperative business supplying coal to consumer-owned utilities across the Great Plains, Rocky Mountain, and Southwestern states, negotiated a private contract with the Burlington Northern Santa Fe Railway (BNSF) for coal deliveries from surface mines in Wyoming's Powder River Basin (PRB) to the Laramie River Station (LRS), a three-unit 1,650-megawatt power plant located 175 miles away in Wheatland, Wyo.

The relatively short haul over one of BNSF's two main lines serving the PRB, coupled with the high volume of coal moved (which is more than 8 million tons of coal each year in continuously running, dedicated train sets), made this a highly profitable move for BNSF. Despite receiving significant returns under the longstanding contract, BNSF marketing executives took a curious stance when the contract re-opened late last year. They maintained that Western Fuels had reaped substantial benefit while BNSF had not earned enough revenue. It was payback time.

Today, BNSF insists that Western Fuels must pay more than twice as much as before and be subjected to unfavorable escalation terms that will double the rate again over time. Will the railroad, in turn, guarantee faster cycle times, ease the burden of the power plant owners providing their own rail cars for the move, or improve service? No. In fact, the new BNSF-imposed rates and service terms are worse than before.

Ultimately, neither Western Fuels nor its shareholders will bear this burden because it is a not-for-profit cooperative. Western Fuels passes its actual costs along to its member-owners, who are consumer-owned utilities in the LRS and other areas. The radically inflated cost imposed by BNSF because of its market dominance will be passed along to the 1.8 million people who live in eight northern Great Plains and Rocky Mountain states. But the victims are not simply electricity consumers. The households, farms, ranches, small businesses and rural industries that depend on LRS for electricity actually own a stake in the power plant as taxpayers in communities with municipally-owned utilities or as members of rural electric cooperatives. The excessive profit BNSF intends to extract from the users will



undoubtedly flow into corporate coffers in Ft. Worth, Texas, because BNSF hardly requires the extra revenue.

In January, BNSF President, Chairman and Chief Executive Officer Matt Rose announced that his railroad had experienced "all-time record" demand and revenues for the third consecutive quarter, with 2004's fourth-quarter earnings 49 percent greater than the year before on 40 percent greater operating income. BNSF also reported "all-time record" revenues for its coal business as well, reporting \$551 million in free cash flow in 2004 — a 91 percent increase over 2003 even after paying substantially higher dividends for the year and engaging in significant stock repurchase activities. Nonetheless, Rose is telling utility executives BNSF needs more cash. As a result, customers can expect even higher rates for coal hauls.

Western Fuels could turn to another railroad or mode of transportation and force BNSF to compete for its business. Unfortunately, LRS is captive to BNSF due to the fact that there are no feasible transportation alternatives. Even if Western Fuels could convince the Union Pacific System to originate coal from mines south of Gillette, Wyo., along what is called the "joint line" with BNSF, it still would control the price of delivery into the power plant. Therefore, LRS and Western Fuels have no other economically viable alternative — there is no way to barge coal across the arid plains, and air transportation is out of the question. It is physically and economically impractical to move eight million tons of coal by truck to LRS.

After unsuccessful negotiations over a new private contract for LRS service, and in the face of massive rate increases proposed under tariff by BNSF, Western Fuels and the LRS operator, Basin Electric Power Cooperative of Bismarck, N.D., filed a complaint with the federal Surface Transportation Board (STB) asking that the regulator do what is required under law, which is to set reasonable rates for service for the LRS rail movement. As the law now stands, the STB is the last line of defense against BNSF's price gouging. Western Fuels and Basin believe

we are entitled to significant rate rollbacks under properly applied STB ratemaking standards and will present our argument to the STB later this year.

Following massive industry consolidation, only four major railroads remain in the United States — only two of which are in the West: BNSF and the Union Pacific Railroad. Their increasing resistance to offer reasonable rates and service terms to their customers has stimulated shipper unrest, which is manifest in the work of the Alliance for Rail Competition (ARC) and Consumers United for Rail Equity (CURE). These two shipper coalitions urge Congress to provide meaningful regulatory relief for captive shippers. Coalition participants represent a wide range of industries and include Edison Electric Institute, American Public Power Association, and the National Rural Electric Cooperative Association.

What ARC and CURE intend, claims Association of American Railroads' CEO Ed Hamberger, is nothing less than re-regulation of the railroads — as though railroads operate in a free market devoid of regulation. In actuality, they don't. The railroads have lobbied hard to maintain status quo regulatory protections that allow them to stave off competition and engage in the kind of monopolistic pricing practices that led to the kind of greater than 200 percent rate markup imposed by BNSF on the LRS coal movement. It should be clear that the railroads function as monopolists across a broad sector of their business. In fact, many of the railroads' customers perceive an attitude from the railroads that they do not exist to serve customers' reasonable service needs. Rather, they treat their customers as if their purpose is to serve the railroads' profit-maximizing needs. The railroads all but admit it.

With the advent of railroad deregulation 25 years ago from passage of the Staggers Rail Act, Congress attempted to promote railroad competition where possible and leave backstop rate protections in place for captive shippers. However, the Staggers Act's core principles — the protection of rail customers who are dependent upon a single railroad for service and the promotion of rail-to-rail competition — gradually have been whittled away. A groundswell of railroad customers perceive a fundamental market imbalance on the regulatory playing field. Something clearly needs to be done.

A potential remedy is contained in legislation jointly advocated by ARC and CURE. The "Railroad Competition Act" will be re-introduced in the 109th Congress and is intended to clarify national rail policy by defining primary objectives for the STB. The clearly stated objectives are: (1) ensuring effective competition among rail carriers at origins and destinations; (2) maintaining reasonable rates in the absence of effective competition; and (3) maintaining consistent and efficient rail transportation for rail shippers, including the timely provision of rail cars.

Other major provisions require railroads to quote rates to their customers over so-called "bottleneck" line segments.

It should be clear that the railroads function as monopolists across a broad sector of their business.

Railroads strongly resist this approach for fear of opening up their systems to more competition. The proposed legislation also would remove so-called "paper barriers" that prevent short-line or regional railways from competing with the major railroads that spun them off. It would free up terminal access provisions imposed by statute and rendered unusable by subsequent STB decisions and those of its predecessor, the Interstate Commerce Commission. It also would permit a governor to declare all or part of a state to be an area of inadequate rail competition, triggering special rail customer remedies.

These rather modest legislative remedies do not create a new tier of regulation. Instead, they seek to make more effective laws and legal principles that already are in place. The legislation does not nationalize the railroads or grant a competitor new rights to move its trains over another railroad's tracks. It's neither radical nor re-regulatory. It's simply a remedy well within the bounds of the American free-market system as it has evolved to control anti-competitive behavior.

The Western Fuels Association and its members are threatened by the BNSF's behavior. Circumstances at the LRS appear to be only the first in a chain of contract reopeners Western Fuels' members can experience over the next few years. We intend to fight for our rights under the regulatory system as it exists today. We will do everything we can to make that system more hospitable to the real needs of captive shippers.

Western Fuels, its members, and utilities nationwide rely on coal as the source of more than half of the electricity they generate. Coal-reliant utilities require healthy, profitable railroads as partners in providing electricity, which has become the economy's primary source of energy outside the transportation sector since the mid-1980s. Given railroad business plans that rely upon maximum revenues from coal traffic, it is clear the railroads need utility and coal producer business if they are to survive. The nation needs coal to continue its role as a reliable, affordable and increasingly clean source of energy for electricity generation. Such interdependence cannot thrive in today's anti-competitive environment for coal transportation. ☒



Duane L. Richards is chief executive officer of the Western Fuels Association, which delivers 17 million tons of coal per year to consumer-owned utility.

News Flash >>
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CARBON TRADE LAUNCH

Billions of dollars of carbon credits are expected to be traded in a newly launched European commodity market.

News reports stated that 12,000 facilities on the continent are being told what their allowable emissions levels will be.

Those that come under the limit can sell their credits - one credit per ton of carbon.

Official trading began this year and has grown to roughly 400,000 tons daily.

The procedure is part of the Kyoto Protocol which went into effect in February. Europe is a participant; the United States is not.

M&A TRASH OFF

By Martin Rosenberg

Photos by Metin Oner

News of the \$13 billion mega-deal of the year — the marriage of Exelon and Public Service Enterprise Group to form the nation's largest utility — rocked the utility industry in late December. The new entity, Exelon Electric & Gas, will provide power to 7 million customers and natural gas to 2 million in Illinois, Pennsylvania and New Jersey, serving a territory comprised of 18 million people.

Armed with \$79 billion worth of assets, the new entity commanded attention across the industry, prompting executives and policy makers to question whether this deal signaled the start of a new round of industry consolidation.

Indeed, 2004 was a banner year for M&A in the utility world. All told, \$50 billion worth of unions among electric and natural gas utilities was announced last year, according to data compiled by Thomson Financial. That was the third highest annual amount in the last 15 years — exceeded only by the go-go years of 1998 and 1999.

No one is sure what the coming year will bring. However, the Exelon-PSEG has focused everyone's attention once again on deal-making. CEOs across the industry are huddling with their investment bankers to study their options and the business case for exercising them.

With a global power and utility group made up of a team of 100 led by 20 officers in New York, Morgan Stanley — the financial adviser to PSEG — is considered to be one of the most active investment banks in the arena of utility M&A. *EnergyBiz* recently interviewed Kenneth Marks, one of six managing directors in the Morgan Stanley utility group, to explore the implications of the Exelon-PSEG deal. Our edited conversation follows:



Ken Marks

An interview with Kenneth Marks at Morgan Stanley

energybiz: In light of the renewed interest in utility mergers and acquisitions, how many financial firms advise utilities on M&A?

Marks: There are a number of firms that advise utilities on M&A. A handful of firms are more active than others in this sector, with Morgan Stanley having the leading market share.

energybiz: After the Exelon-PSEG deal, will other utilities in the region consider merging with the new entity?

Marks: Given the time period required for the regulatory approval, it is premature for other companies to focus on a potential combination with the new entity. However, these companies will need to consider whether they have the appropriate characteristics—scale, skill sets, financial strength, etc. — to compete effectively in the future.

energybiz: Who are the likely acquirers in this industry?

Marks: The more likely acquirers are the larger companies —the ones with higher price/earnings ratios and solid credit. Many of the larger companies are considering M&A activity to enhance their platform for earnings growth going forward while investing within their core competencies. In contrast, it's very difficult for utilities to achieve significant growth intrinsically, as underlying growth in the sector is typically less than that of GDP.

energybiz: Are certain key companies on the search right now?

Marks: There are many more than a dozen mid- to large-cap utilities pursuing or considering M&A opportunities. Some are considering acquisitions of smaller companies; others are looking at merger-of-equals transactions with companies relatively the same size. Of course, for every transaction that gets announced, many are studied and assessed, but never come to fruition.

energybiz: Who are the likely target companies?

Marks: It's difficult to generalize, but one category is companies that are experiencing financial or operational challenges but are looking to partner with a bigger company as a way of enhancing their future prospects.

energybiz: Are these companies distressed?

Marks: They don't need to be. Although some are not distressed, they do have a significant amount of debt and recognize the difficulty of reducing debt levels over the next several years while providing earnings growth for their shareholders. Others are looking to partner with other firms to obtain a skill set they don't already have, which would enhance their stand-alone prospects. In other cases, companies are motivated to consider a transaction as a means of achieving an orderly transition in leadership.

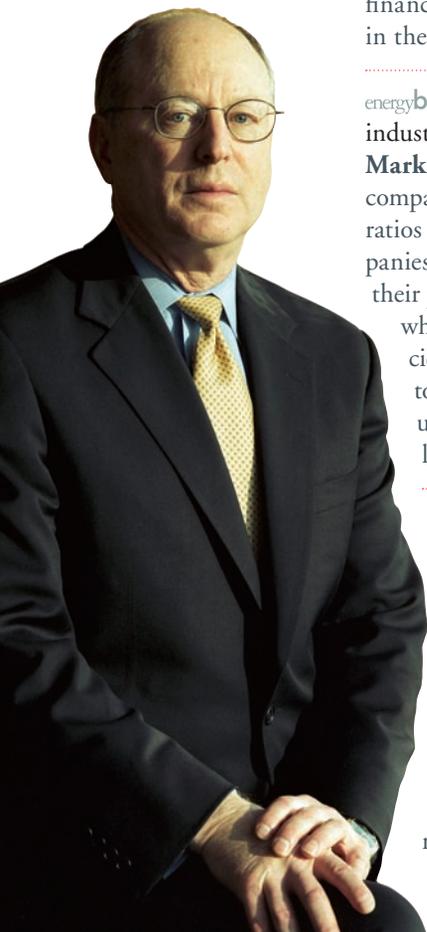
Finally, a target company may have an attractive business plan and strong execution capability to implement it but recognize that a strategic combination provides an effective means of accelerating the enhancement of shareholder value.

energybiz: Can you give me an idea of how large this universe of companies in this target area may be?

Marks: There are approximately 60 utilities with market values in excess of \$1 billion. Except for the largest, any of these could be the target of an acquisition transaction.

energybiz: Why do you feel M&A activity will increase?

Marks: First, there is a strong rationale for utilities' increased interest in M&A transactions, including the objective of achieving earnings growth while mitigating risk in an environment of increasing cost pressures. Second, the current economic and financial market environment is highly supportive of M&A transactions. Third, the increased level of dialog that financial advisors are having with utility decision makers is a leading indicator of increased transaction activity.



energybiz: Can you give me an idea of that? Are CEOs picking up the phone and calling you?

Marks: Yes, we do have very active dialogue with CEOs and other senior utility executives on M&A activity — both as a result of inbound and outbound calls. Not surprisingly, CEOs and other utility officers have asked us for our thoughts about implications of the recent Exelon/PSEG announcement. We also are having more specific conversations about their company’s objectives and issues, and what specific transactions may be available to facilitate their objectives. M&A is an important subject on their minds.

energybiz: Would it be fair to say that the pace, the number, and the drive behind those conversations is up now from a year ago?

Marks: Yes, that’s definitely true.

energybiz: Did Exelon stock take a hit after its PSEG deal was disclosed?

Marks: Actually, it went up on the day of the announcement and has stayed up ever since. The deal is being well received by the financial markets.

energybiz: Will that prompt others to take a fresh look at this?

Marks: Yes. While acquirers assess a number of factors in considering an acquisition, an important consideration is how the stock market will react to an announcement. In the past year, the equity markets have become more receptive to acquisition transactions by both utility and non-utility companies. The positive reaction of the equity markets to the Exelon-PSEG deal — and to other recent utility deals — gives CEOs of other companies increased comfort. That is, if their deal is strategically sound and structured appropriately they will get a favorable response in the marketplace.

energybiz: If Congress should ever repeal the Public Utility Holding Company Act (PUHCA) would more deals flow?

Marks: Yes. A repeal would facilitate the ability of financial investors, foreign utilities and geographically remote domestic utilities to acquire other utilities. However, in my view, PUHCA is not the principal barrier to transactions.

energybiz: That said, what is the principal barrier?

Marks: The principal barrier is the ability to structure a transaction that provides attractive terms to both acquirer and target. Generally, the acquirer that can offer the most attractive financial terms is not a financial investor or an overseas company, but rather a company in the sector that can achieve substantial synergies. These companies generally can structure a transaction that is acceptable to PUHCA, although they may have other regulatory issues as a result of their position in the market.

energybiz: Deals are now picking up. Is this cycle cyclical, or do you think we’re in a paradigm shift?

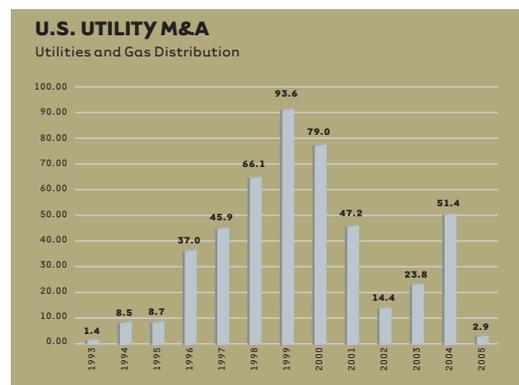
Marks: There are a number of reasons for increased activity now, and I believe there’s a pent-up strategic activity because of the limited number of transactions in 2001-2004. We don’t have enough data at this point to conclude whether or not there’s an overall paradigm shift. However, if the past is any indication, when M&A activity has picked up, it has stayed at high levels for at least several years.

energybiz: If it is a paradigm shift, how many players will be left?

Marks: The utility industry is much more disaggregated than almost all the major industries in the U.S. The top 10 utilities serve only 40 percent of retail customers. Compare this to the telecommunications industry — especially after this recent wave of announced transactions — where a few large players serve a vast majority of the market.

There is room for considerable consolidation. The data shows that there are substantial economies of scale achieved in utility combinations. I believe there will be a decline in the number of utilities over time through consolidation, but it’s going to be a gradual, evolving process. It would be realistic to expect that the current number of mid- to large-cap utilities will decline by 50 percent over the next five to 10 years.

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Source: Thomson Financial as of February 14, 2005

Merger Momentum

By Gary M. Stern

The pendulum for utility mergers seems to be swinging again.

After a sluggish 2002–03 when mergers virtually came to a halt, signs are indicating that acquisition mania could rise again. Fueled by the recent proposed merger of Exelon and PSEG, insider talk is heating up that acquisitive CEOs are hunting for their next target. Not surprisingly, many utility executives are reluctant to show their hand. For example, when *EnergyBiz* recently contacted one leading utility rumored to be in acquisition mode, its director of media relations said the last time its CEO even mentioned the word “merger” in an interview, its stock declined the very next day. Hence, the tight lips.

As reported in a recent edition of *Business Week*, mergers and acquisitions in many U.S. industries were on the uptake in 2004, amounting to \$250 billion in deals for the final quarter.

In the utility sector, Exelon’s announcement in December 2004 that it was acquiring PSEG for \$13 billion seemed to draw a favorable reaction by the stock market early on.

“PSEG has a huge portfolio, domestic and international, including nuclear facilities, gas-fired and coal-fired generation, and electricity transmission and distribution, sprinkled across the U.S., Central America, and Asia,” noted Marlene Motyka, a principal in energy resources at Deloitte & Touche LLP in New York.

The slowdown in utility mergers and acquisitions 2002–03 was due to several factors. Too many utilities carried excessive debt and were concerned about having their credit rating lowered, suggested Motyka. Turmoil in the industry triggered by the business debacles of Enron, Dynegy and El Paso coupled with rising gas prices, created instability that undercuts the demand for expansion. “There was also a dearth of capital,” asserted Dan Revers, managing partner at ArcLight Capital Partners in Boston. Capital markets frowned on investments in the energy sector because many companies were in turmoil and the risk environment had intensified.

At a recent conference attended by 165 utility and financial services executives, the sense was investment in M&A was picking up and that assets would be moved around, said Dean Colucci, a New York-based partner at DLA Piper Rudnick Gray Cary, a firm specializing in the energy market.

As long as interest rates stay low, activity in mergers and acquisitions in the energy field is likely to intensify, noted Stephen Rusmisel, a New York-based partner in Pillsbury Winthrop, a global law firm active in utilities. “We have an improving economy, stable stock market, and fallout from an

energy trading problem — and Enron has been nearly resolved,” he said. “No one likes to buy in a down curve.”

Rusmisl has been a major dealmaker, involved in the Public Service Company of New Mexico’s acquisition of Texas-New Mexico Power for \$1 billion, which is still awaiting regulatory approval. Other long-standing utility M&A powerbrokers include Sheldon Adler from Skadden Arps, Raffiq Nathoo from the Blackstone Group, William Lamb from LeBoeuf, Lamb, Greene & MacRae, Jeff Holzshuf from Morgan Stanley, and Don Kilpatrick, also from Pillsbury Winthrop, who is involved in the Exelon/PSEG merger.

Several aggressive private equity players have also entered the fray, scooping up assets to strengthen their operation and increase the value of their investment. In the energy sector, private capital, hedge funds, buyout funds, and high-yield bond funds started providing capital to buy selected assets or energy companies, often at distressed prices. Major players include ArcLight Capital Partners, Matlin Patterson Asset Management, Texas Pacific Group, and Kohlberg Kravis Roberts & Co. (KKR). While several financial services companies have remained rather low key about their acquisitions, Goldman Sachs has been one of the major acquirers of electricity generation, and Morgan Stanley has been buying natural gas companies.

Mergers and acquisitions bouncing back

Why the bounce back in energy mergers? In 2005, the underlying environment in the energy industry had strengthened and stabilized. Industry leaders are seeing recovery in the marketplace. “If I buy something now, I can buy it on the low side,” Motyka said.

Added Tom Flaherty, senior vice president at Booz Allen Hamilton: “A realization has occurred that the 4 percent consensus growth rate in earnings per share is not easily obtainable. The absence of any silver bullets to fill the gap drives CEOs to merger and acquisitions.”

According to Paul Fremont, a utility analyst for Jefferies and Company investment bank in New York, the utility industry has come to a crossroads — where companies have used cash to fix their balance sheets and shore up their credit positions. “The next logical use of cash historically is to go out and purchase another utility company,” he said. “I wouldn’t be surprised if there were several merger announcements.”

Despite this rosy picture, regulators in the post-Enron era are scrutinizing deals. For example, the Arizona regulatory commission in December 2004 nixed KKR’s acquisition of Unisource Energy Corporation, the parent company of Tucson Electric Power, for \$25 a share, because it believed the risks of the transaction outweighed potential benefits for customers.

After regulators squashed that deal, Stephen Lynn, vice president of communication and government regulations at Unisource Energy, in Tucson, Ariz., paints a dimmer picture of potential mergers on the horizon. After that decision, Lynn maintains that merger activity in Arizona is probably not as ripe as it might be elsewhere. “Regulatory oversight changes the landscape,” he said. “When you not only have to deal with the vagaries of businesses, but also have to deal with other people that control decision-making, mergers are difficult.”

Following in Exelon’s acquisitive footsteps

Who are the likely candidates to follow in Exelon’s acquisitive footsteps? Utilities that want to be national players like Exelon and expand their regional base are looking to snare a competitor, suggested Mark Williams,

former senior vice president at Citizens Power and now a professor at the Boston University School of Management. For example, Florida Power & Light, a force in its fast-growing state, may be poised to expand its geographic marketplace and acquire another utility. Southern Company has shown consistent profits and might benefit from merging with nearby competitor Duke Energy. Other likely targets are companies that have operational issues or a weakened balance sheet but yet still have a stable customer base, noted Colucci, citing the situation with PSEG as an example.

Location may play a major role in future mergers. While several New England and New York utilities have consolidated, many smaller utilities still operate in Ohio, Illinois, Wisconsin and Indiana. "Wisconsin still has six or seven utilities," Colucci said. In Ohio, First Energy, which has had operational problems and was accused of causing the 2003 blackout in the Northeast, could easily be targeted.

Private equity funds playing an increasing role

Private equity funds are making an impact on the utility merger and acquisition landscape. ArcLight Capital Partners, which relies on a \$2.5 billion investment fund, is a buyout fund in which the firm buys utilities for a finite life. "We know how to structure a deal and improve it with near-term economies," Revers said.

For example, ArcLight teamed with Caithness Energy to acquire Aquila's interest in 12 operating power plants for \$300 million in 2004. Those interests, along with three other power plants, were monetized in an IPO of Atlantic Power Corp., which was capitalized at \$600 million. "ArcLight, therefore, generated immediate dividends in its acquisitions in addition to stable, long-term cash flows," Revers said.

Furthermore, several financial service companies and private equity funds, which have experience in M&A in oil, plastics, and other industries, are doing an effective job of bringing that expertise into analyzing a company's operations, noted Michael Sarlitto, president of SummitPoint Management, a Chicago-based firm that has consulted for Goldman Sachs and Taconic Capital Advisors. "Now they're doing the same thing with generation," he said. If a company can run a plant at 92 percent capacity, which had been operating at 82 percent capacity, more profits flow.

Mergers gone awry

Despite this growing appetite for utilities to swallow up their competitors, many past mergers have not lived up to expectations. Though utilities issue glittering press releases about how synergies will increase revenue and cost cutting will eliminate duplication, many mergers result in little additional revenue or enhanced stock price. "AEP failed at international acquisitions, and Edison International took a large right write-off from its acquisitions," Williams noted. "Southern Cal almost went bankrupt."

Unlike other industries, the cost of fuels, natural gas and coal in the utility market is volatile. When utilities face squeezed margins and price volatility, increasing profits for a merged utility can be a difficult proposition. If an unregulated company acquires a utility in a regulated industry, cultural issues can prevail and make merging tough. Hence, utility mergers face more minefields and traps than in other industries.

"There are good deals and bad deals," noted Sheldon Adler, New York-based partner in mergers and acquisitions at Skadden, Arps, Slate, Meagher & Flom, a

“But we’re moving toward a trend of bigger regional players who are more efficient and effective.”

global law firm. He was involved in the acquisition of National Grid, an English utility of New England Electric in 1999. “It’s an example of a good company making an acquisition and having success. A large part was due to the culture being similar and having a well-managed company doing a transaction that makes good business sense,” he said, noting that the acquisition established National Grid as a distribution company in the U.S., and its stock price has appreciated since the deal.

Despite failed mergers, dealmakers can still make a strong business case for them. “It’s a fragmented industry, where levels of scale can be realized, and where regulators would prefer to deal with a reduced number of management groups,” Rusmisl noted. “There are real benefits for private shareholders and rate payers from economies of scale.”

He expects vertically integrated companies that combine transmission, generation and distribution will diminish, and more utilities will specialize in one area and try to merge with another company that complements their specialty.

Regulations limit profits

Unlike in other industries, regulated utilities face rate hike restrictions. “Most of the synergies are routed back to the customers,” Fremont said. “Some deals give customers four to five years to keep saving.”

The atmosphere is so ripe for mergers that even hostile takeovers, which have usually not worked in utilities, may emerge, suggested Rusmisl. “In the past hostile takeovers have been outbid,” he said. “Because returns are regulated, you don’t have the ability to offer premiums and take it out on ratepayers. With more competition from non-traditional acquirers putting more pressure on the available target, that may in turn increase people’s willingness to consider hostiles.”

According to Flaherty, the path to success for mergers now goes through state capitals. Companies must demonstrate “an equitable sharing of benefits to consumers and shareholders,” otherwise the merger or acquisition won’t be approved by state regulators.

Mergers and acquisitions back on track

“I expect a higher rate of deals than in 2004 — much higher than the moribund years of 2002-03. Based on what we hear, people are looking in earnest in ways they didn’t a year ago,” Rusmisl said.

Adler said that there will be an increase in activity, but he doesn’t expect the number of deals to rise to flood level just yet. “But we’re moving toward a trend of bigger regional players who are more efficient and effective,” he said. “Smaller companies could be consolidated into larger ones.”

The pendulum has swung back from a few years ago, when M&A slowed, noted Colucci. “We’re going back to steady progression, where we were in the mid-1990s,” he said. “At that time, there were several consolidations, and we working toward a national marketplace.” ☺

By Al Senia

Dealing *with* Greenhouse GAS

Faced with the growing realization that global warming can no longer be ignored, a number of leading energy company executives are voluntarily taking action to reduce the carbon dioxide and other pollution emissions released from their energy-producing plants.

Some are launching new research projects specifically designed to analyze greenhouse gas limitations. Others are engaging in renewable energy and energy conservation efforts. Still others are looking to new, less-polluting energy sources such as solar, wind, geothermal and even nuclear alternatives. But no matter what their approach may be, most energy industry executives believe it makes good economic and political sense to get behind the greenhouse gas issue now before it becomes even more controversial — and before expected mandated emission curbs arrive.





“We don’t have an alternative energy technology that is cost-effective...”

“It’s hard for an energy company not to take this issue seriously,” says Charles Goodman, senior vice president of research and environmental policy at Southern Company. “We are paying very close attention to it.”

Goodman adds that Southern Company is participating in a variety of efforts to reduce greenhouse gas emissions, ranging from trying to develop cleaner ways of burning coal to utilizing more natural gas and nuclear technology in its energy portfolio.

Business Edge

Eric Kuhn, senior environmental scientist for Cinergy, says that the Ohio utility has committed to spend \$21 million between 2004 and 2009 — about \$3 million annually — on a voluntary program to reduce greenhouse gas emissions to 5 percent below its 2000 emission level between 2010 and 2012. Kuhn says not only is this effort environmentally sound, but it also makes superb business sense because it will push Cinergy ahead of its competitors in an increasingly deregulated industry landscape.

“We’re trying to do a number of things to stay a leg up on the rest of the industry,” Kuhn says. “We are always looking for that advantage over the competition.”

In fact, Kuhn cites competitive reasons in begging off a detailed description of Cinergy’s most effective emission-reducing efforts. Nevertheless, some of those efforts are public, including eight projects to improve the efficiency of its electricity generating units, three renewable energy projects, a carbon sequestration project, and a research project to analyze greenhouse gas emissions limitations and related technology. Last year, the company used allotted program funds for seven heat rate improvement projects at

generating stations that are designed to reduce coal consumption by 142,000 tons annually, reducing carbon dioxide emissions. Cinergy also installed new software at its hydroelectric facility at Markland Dam in Indiana to improve efficiency. The company also purchased trees for a 30-acre reforestation project managed by the Nature Conservancy in Indiana — a program that will sequester an estimated 75,000 tons of carbon dioxide annually.

While such efforts are commendable and widely imitated, it is also clear that Cinergy views its voluntary emissions program as something more: a strategic initiative that positions it to capitalize on developing technologies that could pay big financial dividends down the road.

For example, Kuhn notes that the utility is working on several solar panel and wind generation demonstration projects and is partnering with the Department of Energy in a geologic sequestration project that evaluates safe storage of carbon dioxide in deep rock formations. It is a study of how the carbon dioxide dissipates in the formations, including deep saline aquifers, to determine if the carbon dioxide emissions can be captured and safely stored below ground. Another likely area of study this year involves biomass as a potential viable energy source.

Cinergy is deliberately taking an aggressive posture in carbon dioxide emissions because it believes it needs to position itself now for the future, Kuhn adds. “We expect there is going to be some kind of carbon dioxide regulation,” he says. “There’s no silver bullet out there, but finding ways to manage emissions better will give us a leg up. We believe this program could result in a number of new business ventures. This is a way for Cinergy to step up and be a leader in this area.”

Energy Challenges

Goodman notes that utilities like his face a greater challenge than some because alternative energy sources like wind and solar don't work well in his particular region of the country. Yet, the utility must curb emissions, even while meeting increasing customer demand for energy. In Southern Company's case, that means increasing energy production by 2 to 3 percent annually.

"We don't have an alternative energy technology that is cost-effective," says Goodman, who maintains nuclear power could well emerge as the most effective solution. "Even renewables are expensive, and nuclear energy is very expensive. It's a difficult problem. You don't have the technologies available."

So why does Southern Company bother making the effort to reduce emissions? In part, it's because emission reduction is viewed as not only inevitable but also good business. Like many utility executives, Goodman says global warming has become an issue that resonates with customers and shareholders alike. Furthermore, adding state-of-the-art generation facilities and examining alternative energies makes fiscal sense, putting the utility in a better competitive position down the road, especially if demand keeps growing.

That's one reason Southern Company joined with the Department of Energy to gain funding to build a 285-megawatt IGCC coal burning plant in Florida by 2011. It should provide one-third less in emissions than a traditional coal-burning plant, Goodman says.

Political Uncertainty

Savvy energy industry executives are taking a very forward-thinking approach to greenhouse gas emissions, a position that often puts them out ahead of federal government policy. For example, a National Academy of Sciences (NAS) report released in January concluded that the Bush administration's Clean Skies proposal to rewrite the country's air-quality rules for power plants wouldn't be as effective as simply enforcing existing Clean Air Act regulations. The Clear Skies legislation, currently under consideration by Congress, would set up a national "cap and trade" program for mercury, nitrogen oxides and sulfur dioxide. The proposal aims to reduce emission of those three pollutants by 70 percent over the next 20 years. The NAS report, however, said the proposal is less stringent than the New Source Review rules that have been in effect

Kyoto in Context

The Kyoto Protocol, which went into effect in February, was signed by 140 countries. The United States has not endorsed the effort, saying it does not include energy-hungry China and India.

▶ China, India and the United States are on track to build 850 new coal-burning power plants by 2012 that will emit an additional 2.7 billion tons in carbon dioxide.

▶ The plants will generate a total of 327,000 megawatts — equal to the output of all coal-burning plants in the United States today. They represent 75 percent of the coal-burning units planned for development worldwide.

▶ Countries that have signed the Kyoto Protocol currently plan to cut CO₂ emissions by 483 million tons by 2012.

Source: Christian Science Monitor

since 1977. Those rules require utilities to install costly upgrades to reduce emissions if existing plants are modernized. If Congress rejects Clear Skies, the Environmental Protection Administration is considering its own set of emission rules changes.

Another wild card is the impact of the 1997 Kyoto Protocol, which became effective in mid-February and sets mandatory targets for industrial nations to reduce emissions by 2012. Although the U.S. government has rejected it, other nations have begun establishing emission quotas for carbon dioxide and other greenhouse gases. U.S. energy companies that operate in overseas markets where the treaty applies are already adjusting to it. Among other things, the treaty establishes an international exchange that allows utilities to swap "credits" as they reduce carbon dioxide emissions at coal- and oil-burning power plants. This Clean Development Mechanism (CDM), is overseen by a United Nations office. Some of the energy credits are being sold on European markets, and large players are jumping into the market.

All of this political uncertainty is helping energy executives decide to take the bull by the horns and start searching for their own alternatives to reduce their companies' emissions.

Municipal Utilities Aggressive

in

Fighting Emissions

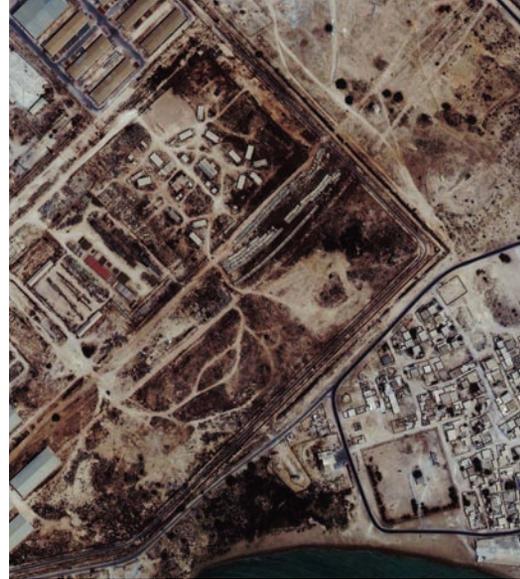
A number of the nation's municipal utilities have taken an aggressive stand in reducing global emissions, typically by investing in alternative and renewable energy projects.

"We believe climate change is an important issue, and it has been on our radar scope for a long time," says Bud Beebe, regulatory affairs coordinator of California's Sacramento Municipal Utility District (SMUD). The utility has studied the greenhouse gas emission issue since 1990 and worked to solve it in three ways:

- Improve the efficiency of current plants by investing in co-generation projects and combined-cycle, natural gas plants,
- Reduce customer demand by launching energy conservation projects in its service area, and
- Switch to less polluting energy, including renewable energy sources such as wind farms, and commit to an aggressive goal of making renewable energy 20 percent of its total energy mix by 2011.

Beebe says SMUD also works closely with alternative providers of wind, solar and geothermal energy to spur the market by agreeing to purchase the energy generated. SMUD may even form a partnership to develop solar thermal electrical generation. "That is an energy technology that is high on the list," he says. "We think we can show that it really works — that it is reliable and cost-effective."

Also on SMUD's energy horizon is non-conventional, direct-burn biomass. "We're committed to the ongoing growth of the renewable energy market," Beebe explains.



“You have to address it, whatever you believe science is telling us.”

"Industry executives realize that the Bush Administration policy may not hold forever," says Barry Worthington, executive director of the U.S. Energy Association. "There are going to be other administrations some day."

Some companies want to position themselves ahead of changes — especially in the area of carbon dioxide emissions that might be mandated in the future. In fact, Worthington believes some executives see the day coming when reductions will be mandatory and monetized. Some would rather see federal mandates arrive before they retire their old polluting plants so they can gain some financial offsets.

Additionally, there is a general growing awareness that global warming is a problem and increasing pressure from shareholders and state regulators for energy and utility companies to do something about it, Worthington notes. In fact, last year a coalition of more than 80 investment funds, environmental organizations and public interest groups brought shareholder pressure on several utility companies to focus on the potential risks to shareholders posed by carbon dioxide emissions. Southern Company and TXU eventually agreed to report publicly on how they are planning for potential emission constraints. Reliant Energy agreed to make plans to improve the measurement and disclosure of the financial impact of its emissions. Last December, the California Public Utility Commission began requiring utilities to account for the future cost of reducing carbon emissions in choosing energy sources.

Worthington says such actions underscore a growing debate over global warming and signal increased industry acceptance that "you have to address it, whatever you believe science is telling us." ☒

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A hand-drawn graph on a white paper napkin. The graph shows a solid curve and a dashed curve below it, with an arrow pointing from the solid curve to the dashed one. The text 'SIT' is written above the curves. Below the graph, the text reads: 'LOWER FUEL CONSUMPTION = LESS CO2'. A yellow pencil with a pink eraser and gold ferrules is positioned vertically to the right of the graph.

Executive

Suite

By Arthur O'Donnell

illustration by Lisa Wharton

Musical

Chairs

Two Dozen Utilities Switch Leaders in Three Years

A new generation of leaders is landing in utility executive suites as the industry struggles to define a vision for itself in a post-Enron environment.



Some are coming from inside the industry. Others are newcomers. Change at some utilities and energy companies is the result of executives reaching retirement age. At others, the changing of the guard has been hastened by board perception that new approaches are needed to shape and deal with a fast-changing business.

The number of new executive arrivals at many companies has gotten the attention of industry experts.

Harry Quarls, a senior vice president at Booz Allen Hamilton, who tracks CEO transitions at the world's largest publicly-traded companies, called the more than two dozen CEO changes since 2002 "a pretty marked increase." In its most recent survey, Booz Allen reported that the annual rate of change at utilities was 14 percent versus 10 percent for companies as a whole.

"The question is, what happens going forward? Does it revert back to the mean or keep going up to a higher level?" Quarls asked.

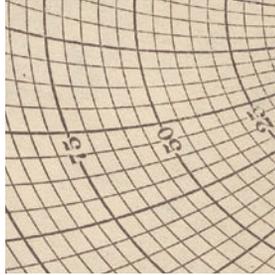
One factor Quarls believes will be crucial going forward is whether energy will see an increase in mergers, such as the recently announced deal between Exelon and Public Service Electric & Gas. "I expect there will be quite a few more mergers," Quarls said. "That will drive succession going forward."





Changing Patterns

Not so long ago, an outside executive stood a better chance of being named chief executive officer at a U.S. energy utility than someone who had worked their way up through the ranks as an operating engineer or regulatory attorney. As the power and gas industry prepared for what was presumed to become a global competitive marketplace for energy services and commodities, new CEOs were being recruited from such disparate fields as banking, telecommunications and consumer product manufacturing. After more than a decade in banking at Deutsche Bank and other financial firms, Mayo Shattuck III, was named CEO of Constellation Energy Group in November 2001 and was considered a harbinger of change for leadership in the utility business.



News Flash >>

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CEOS ON THE MOVE

The pace of turnover in the executive suite is quickening — as is CEO job dissatisfaction.

In January, CEO exits in all industries reached 92, the highest level in four years, according to Challenger Gray & Christmas, an outplacement firm.

The pace of CEO change in January was up 84 percent from the preceding year.

In a related development, Burson-Marsteller reports that executives are not having as much fun as they once did.

The public relations firm said its surveys indicate that 60 percent of chief executive officers do not like their job — up from 27 percent in 2001.

Change certainly arrived, but it took a far different course than many anticipated. The California market failure, subsequent collapse of Enron, and its aftershocks in utility and energy executive suites around the nation threw the entire industry into a “back-to-basics” backlash. What had been a road toward diversification and risk-taking by utilities, merchant generators, and energy trading firms became a route of failed ventures, Chapter 11 bankruptcy filings, investigations, regulatory repercussions, and costly litigation.

Well-respected energy executives, including Bill McCormick at CMS Energy, Chuck Watson at Dynegy and Bill Wise of El Paso, were ushered out while new leaders were brought in to pick up the pieces — all at a pace that was previously unknown to the traditional utility industry.

Will insiders or outsiders be tapped to lead the industry into its future? To a large degree, the answer depends on the circumstances of the CEO transition, said Jeffrey Holzschuh, head of the Global Energy and Utility Group of Morgan Stanley. “The companies that got themselves in financial trouble just needed new leadership, and the companies that got into trouble went outside,” Holzschuh said. “As these companies refocused on their electric and gas assets, it means that their top talent is being groomed from within.”

A head count of CEOs appointed during the past three years shows that most — 15 out of 24 — were promoted from within. In fact, even several of those considered “outsiders” arrived from comparable utility companies. For instance, American Electric Power’s president and CEO Michael Morris had previously been president, chair and CEO of Northeast Utilities. Other recently named CEOs, including Paul Evanson at Allegheny Energy, and

Bruce Williamson of Dynegy, were recruited from the top executive ranks of Florida Power & Light and Duke Energy, respectively.

Technically, someone like John Wilder, now CEO of TXU, might be considered an outsider, having been recruited from his prior position in the executive echelon at Entergy, with prior experience at Royal Dutch/Shell. Also, Michael Chesser, hired as CEO of Great Plains Energy in October 2003 was previously the chair and CEO of United Water, although his résumé included executive stints with Baltimore Gas & Electric, Atlantic Energy, and GPU Energy.

For those who have followed a similar path to the CEO’s chair, the insider/outsider label is a distinction without much differentiation, so long as the past experience is relevant to the energy business. “The energy business is always going to be driven by people who had some exposure to energy,” Williamson said.

Rare indeed is the complete industry outsider, such as Constellation’s Shattuck or Doug Foshee, who took the reins at the struggling El Paso after being chief operating officer at Halliburton — and even that transition showed a commonality of experience in the fossil-fuels business.

“Going back to pre-Enron, we were doing searches for CEOs and COOs and looking broadly at other industries that were capital-intensive, like transportation and telecommunications,” said Bob Shields, an energy executive recruiter with Spencer Stuart’s Chicago office. “That changed a lot when Enron occurred. Companies had to pare back. Naturally, when they did that, they were more inclined to come back to those who know the business.”

In recent years, numerous executive studies have shown that the best performing leaders come from within. “The outsider who comes in to whip a company into shape is more likely to get a thrashing,” found the Booz Allen CEO study in 2004. Similarly, consulting firm Burson-Marsteller reported “businesses are better off hiring insider CEOs than outsider CEOs for long-term success.”

Given that conclusion, it made perfect sense for CMS Energy to promote David Joos as president and CEO last year following the interim appointment of Ken Whipple, formerly an outside board member who stepped in to hold the utility steady after McCormick’s forced departure in 2001. In 1976, Joos joined CMS’ principal subsidiary, Consumers Power, after graduating from Iowa State with a degree in nuclear engineering. Except for a brief period with an architectural/engineering firm, he spent his entire career with the utility.



Southern Company did not face a comparable leadership crisis, but the company acknowledged that the utility industry faces rapid changes by turning to David Ratcliffe, a 34-year veteran of Southern's operating companies.

RATCLIFFE IS INTERVIEWED ON PAGE 80.

Ratcliffe served as CEO of both Georgia Power and Mississippi Power, among many other positions in utility finance, legislative and regulatory affairs, fuel services, plant operations, and marketing. "All of these different experiences gave me a good education on our company and our industry," Ratcliffe said. "The electric utility industry is ever changing, and we have to change along with it."

However, lurking beneath the apparent trend toward reliance on insider promotions is that fact that many members of this new class of utility CEOs actually spent their formative years in fields other than the traditional regulated utilities.

Peter Darbee, recently named CEO of PG&E, was promoted directly from the job of chief financial officer. But prior to joining the utility holding company in 1999, he worked in telecom

and investment banking, with stints at Citibank, Salomon Brothers, Goldman Sachs, AT&T, Pacific Bell, and Advanced Fiber Communications. That stands in contrast to Darbee's predecessor, Bob Glynn, Jr., who represents the quintessential career utility executive who worked his way up the ladder from engineering and operations — following in his father's footsteps, a former PG&E exec.

Darbee characterized his own background as a nice mix of experience — half in competitive industries and half in regulated. "To me, it represents the best of both worlds," he said.

Similarly, Jeff Shaw, named CEO of Southwest Gas in June 2004, has been with the Nevada-based retail gas utility since 1988. But his point of entry was as an auditor for Arthur Anderson, focusing on the manufacturing and retail sectors, until he took a transfer to Las Vegas in 1985. "I had no experience with utilities," Shaw recalled. "I thought I'd be working in gaming."

An assignment with the outside audit team for SW Gas eventually led to an offer to become the utility's director of internal audits. "I feel I've been going to school for the past 17 years," Shaw said.

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What this means for those following the trends of energy company succession is that simply labeling a new hire as an insider or outsider becomes less relevant than understanding the skills each candidate brings to the table.

"To a greater degree, you're going to see people who are fleet of foot and familiar with financial aspects of the market," Shields said. "Because of that experience elsewhere, they've been exposed to and tested by an environment where things move more quickly."

Dynegy's Williamson is a good case in point, combining experience in petroleum at Shell Oil and competitive markets as CEO of Duke Energy Global Markets. "My background is more in exploration and production, with finance and some gas pipeline business at PanEnergy," Williamson said. "I think that fits well in that the power business is going to be a commodity, a volatile commodity just like the oil business. That lets me relate better to the swings in prices up and down. It's not going to shake me up, because I've seen crude oil down to \$9 per barrel and up to \$50."

Exposure to volatility and risk served Williamson well when he stepped into the CEO's job at Dynegy in October 2002. "I walked in when there was an amazing amount of turmoil and change that needed to take place," he said. "Typically, people are brought in from the outside when there's some kind of a problem or a situation that needs to be fixed. At that point, the stock was trading for less than \$1/share, and our bonds were trading at 20 cents on the dollar. When I walked in the door, we had \$1.7 billion in debt that was due in the next six months. We really had to make some fundamental choices."

In his first 100 days, Williamson faced a crucial decision: whether or not to file for Chapter 11 bankruptcy or try and pay back the tremendous amount of debt to creditors. "We went back to our roots in terms of the asset business as a gas midstream marketer and power generator," Williamson recounted. "The hallmark of Dynegy had always been marketing and trading, but more recently we'd gotten into broadband and communications. We shut those down. We shut down trading, wound down broadband, sold off the European assets, and got back to our roots."

He characterized these actions as more tactical than strategic. "I've always said, Dynegy doesn't need a strategy, we need a to-do list," he said. "Now the company can focus more on the future, largely because we've either paid down our debt

or pushed maturities out until after the end of the decade. In 2005, we have \$10 million in debt due, \$13 million next year."

Another CEO who hit the wall of financial disaster is PG&E's Darbee, who was CFO during the company's tumultuous Chapter 11 proceeding. "I'd had experience with workouts at Citibank," Darbee said. "Bankruptcy is not the end of the world."

Still, the company faced what he called an extraordinarily difficult challenge in that not only had the PG&E utility endured Chapter 11, but so had the National Energy Group of non-regulated generation facilities and gas pipeline assets. In the end, PG&E was forced to shed all but the flagship utility. "I perceive PG&E to be a pure-play utility," Darbee said of the pared down corporation.

Despite the ups and downs of their individual fortunes or whether they came from an inside or outside track, the fact that many utilities entered the competitive fray in non-regulated services or international markets means that their next generation of CEOs will be expected to possess a wider array of experiences.

More important for the corporation will be whether or not the CEO transition is forced by circumstances or made under controlled conditions. Some observers believe that the fast pace of CEO change will continue, largely because of early retirements among the current generation of CEOs. "People in their 60s will roll over just because of age," said Morgan Stanley's Jeff Holzschuh.

For example, when Sempra Energy CEO Steve Baum vacates his seat in early 2006, he will take comfort in the fact that his successor is well equipped to handle the challenges of a highly diversified company. Not only was his choice as the new corporate CEO, Don Felsing, formerly president of the San Diego Gas & Electric utility, but he was also chairman of Sempra International and group president of the Sempra Energy Global Enterprises unit, which led the company's expansion into competitive markets.

Baum told *EnergyBiz* that it was his decision to reveal the succession plan well in advance of his own retirement to ensure stability and a smooth transition. "While there are some potential pitfalls in this approach – namely risking 'lame duck' status as the current CEO – I felt the positives far outweighed the negatives," he said. "By naming my successor early, the organization has avoided destructive competition at the top and retained key personnel critical to our success." ☒

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Recent Utility CEO Changes January 2002—January 2005

2005-06	2004	2003	2002
3	10	4	7

Source: Leadership Directories, Inc.

[2005-2006]

SEMPRA (ANNOUNCED FOR 2006)

In: Donald Felsing, Chairman and CEO (Formerly, president and COO, Sempra Energy)
Out: Steven Baum (expected to retire)

PG&E

In: Peter Darbee, president and CEO (Formerly CFO)
Change: Robert Glynn, chairman through 2005

MIRANT

In: Unnamed
Out: Marce Fuller (resignation announced, no timeline for succession revealed)

[2004]

CMS ENERGY

In: David Joos, CEO, (Interim) Kenneth Whipple, chairman (Formerly an outside board member)
Out: William T. McCormick, Jr., (no longer with the company)

SOUTHERN COMPANY

In: David M. Ratcliffe, chairman, CEO and president (formerly president)
Out: H. Allen Franklin (retired)

SOUTHWEST GAS

In: Jeffrey W. Shaw, CEO (Formerly president)
Change: Michael O. Maffie, (remains on the board)

TECO ENERGY

In: Sherrill W. Hudson, chairman and CEO (Formerly an outside board member)
Out: Robert D. Fagan (retired)

WISCONSIN ENERGY

In: Gale E. Klappa, chairman, CEO and president (formerly president)
Out: Richard A. Abdoo (retired)

AMERICAN ELECTRIC POWER

In: Michael G. Morris, chairman, CEO and president (Formerly chairman, president and CEO, Northeast Utilities)
Out: E. Linn Draper (retired)

FIRSTENERGY

In: Anthony J. Alexander, president and CEO (Formerly president, COO and acting CEO)
Out: H. Peter Burg (deceased)

NORTHEAST UTILITIES

In: Charles W. Shivery, CEO
Out: Michael G. Morris (president and CEO, American Electric Power)

PROGRESS ENERGY

In: Robert B. McGehee, chairman, CEO and president (Formerly president and COO)
Out: William Cavanaugh III (retired)

TXU

In: C. John Wilder, president and CEO (Formerly executive vice president and CFO, Entergy)
Change: Erle Nye, chairman

[2003]

DUKE ENERGY

In: Paul M. Anderson, chairman and CEO (Formerly managing director and CEO, BHP Billiton)
Out: Richard B. Priority (no longer with company)

GREAT PLAINS ENERGY

In: Michael Chesser, CEO (formerly CEO GPU Energy, et al)
Out: Bernie Beaudoin (retired)

EL PASO

In: Douglas L. Foshee, president and CEO (Formerly executive vice president and COO, Halliburton Company)
Change: Ronald L. Kuehn, Jr., (was interim chair) chairman
Out: William A. Wise (no longer with the company)

ALLEGHENY ENERGY

In: Paul J. Evanson, chairman, CEO and president (Formerly president, Florida Power & Light)
Out: Jay S. Pifer (formerly interim president and CEO)

[2002]

DYNEGY

In: Bruce A. Williamson, chairman, CEO and president (Formerly president and CEO, Duke Energy Global Markets, Duke Energy Corporation)
Out: Daniel L. Dienstbier, (was interim, retired)
Out: Chuck Watson (no longer with the company)

AES

In: Paul T. Hanrahan, president and CEO (Formerly executive vice president and COO, Growth Distribution)
Out: Dennis W. Bakke (co-founder and emeritus CEO)

PEOPLES ENERGY

In: Thomas M. Patrick, chairman, president and CEO (Formerly president and COO)
Out: Richard E. Terry (retired)

EXELON

In: John W. Rowe, chairman and CEO (Formerly president and co-CEO)
Out: Corbin A. McNeill, Jr. (no longer with the company)

ENRON

In: Stephen F. Cooper, interim CEO and chief restructuring officer (Remains Managing Partner, Zolfo Cooper, LLC)
Out: Kenneth L. Lay (no longer with the company)

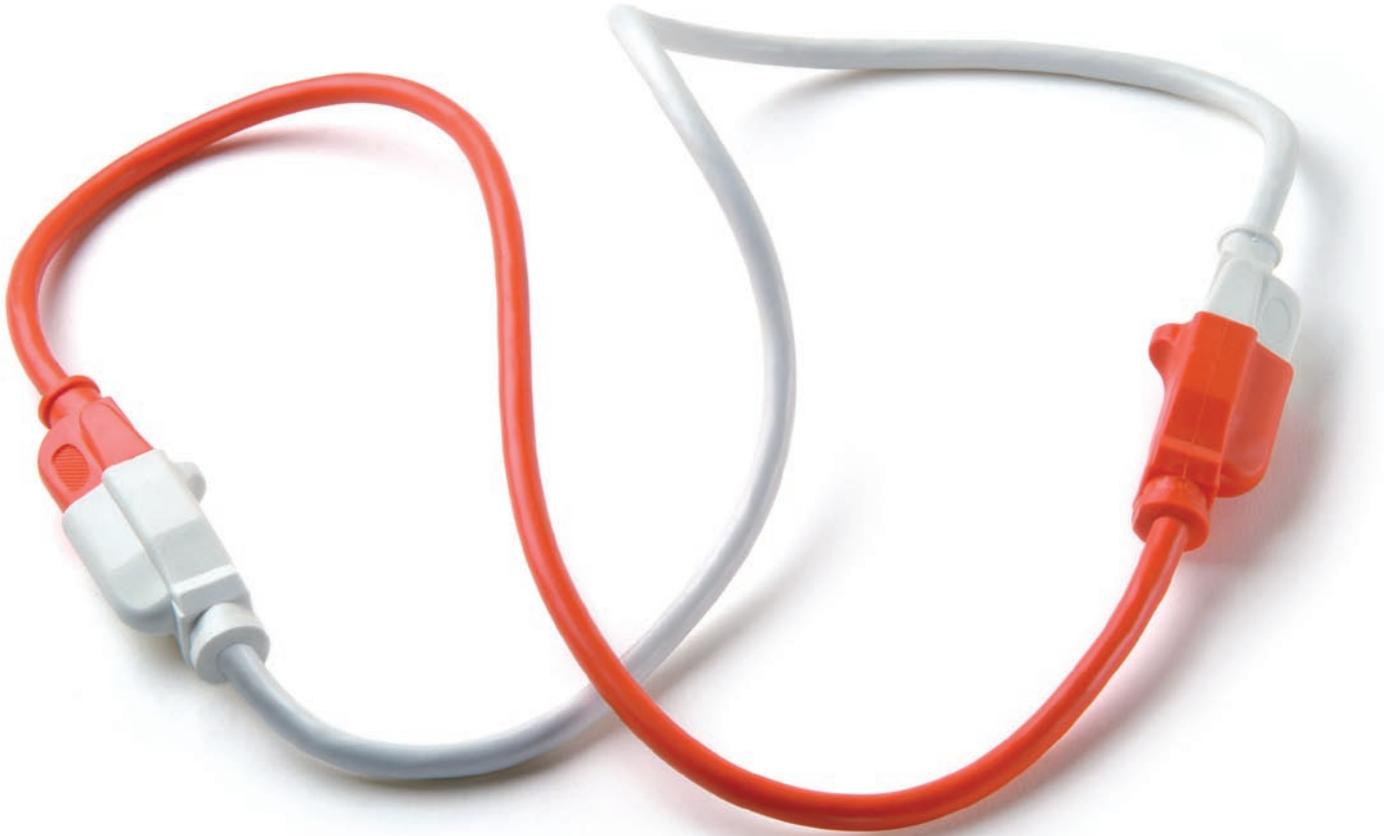
PUGET ENERGY

In: Stephen P. Reynolds, president and CEO (Formerly president and CEO, Reynolds Energy International)
Out: William S. Weaver (no longer with the company)

THE WILLIAMS COMPANIES

In: Steven J. Malcolm, chairman, CEO and president (Formerly president and COO)
Out: Keith E. Bailey (retired) ☹

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The State of Customer Information Systems

By Warren Causey

Have you ever wondered how they get those huge 200-300 ton locomotives back on the tracks after a train wreck? Utilities and the vendors who serve them, especially CIS vendors, have been struggling with a very similar question for the last three years.

The locomotives that drove the great utility IT bubble of the late 1990s went off the tracks in 2001 with the stall of deregulation and competition in most states, plus all the other well-known problems. Those locomotives were primarily deregulation and competition, although utilities also got caught up in the great dot.com euphoria of a new generation of automation. But those locomotives have been lying on their sides beside the tracks for three years now, showing little indication of ever running again.

CIS vendors have been particularly hard hit with major utility CIS installations dropping from five to 10 per year in the late '90s to an average of less than one per year since the turn of the century.

Since mergers and acquisitions among utilities also stalled after 2001, there's another locomotive lying beside the tracks. Utilities also have so many other systems now linked to their CIS (usually between 25 and 100+), they also are reluctant to pull out the roots and start over. "Currently I would say we have literally hundreds [of interfaces to the CIS]," says Mahvash Yazdi, vice president of Business Integration and CIO, Edison International, Rosemead, Calif. "One of the services of the architecture we are trying to put into place is application integration so we can eliminate the number of point-to-point interfaces."

CIS vendors have been scrambling to find a route to survival. Probably the largest in the late 1990s, Andersen Consulting (now Accenture), gave up and left the CIS market. After making a large number of Customer/1 installations throughout the 1990s, Accenture now has stopped support for the 20 or more Customer/1s still in service, including at Florida Power & Light. Now Accenture offers CIS only as an outsourcing option under its Accenture Business Services (ABS) for Utilities after acquiring a Canadian outsourcer to form the basis of ABS.

In the early 2000s, the other major CIS vendors, generally considered to be SPL Worldgroup, San Francisco; Peace Software, Miami; Excelergy, Lexington, Mass.; Lodestar, Peabody, Mass.; and the former SCT Utility Services, Malvern, Pa., all have taken slightly different routes to survival.

SCT was the first of the majors to fall, being acquired in 2003 by Indus International, Atlanta, an enterprise asset management (EAM) vendor. Since then, SCT's Banner CIS, which had dozens of installations across the U.S. and abroad, has been folded into Indus' Service Delivery Management (SDM) initiative, which combines CIS with EAM, field force automation, and other integrated automation software. The SDM initiative also seeks to broaden Indus earnings growth by extending its integration of asset, customer and workforce management applications for the utilities industry into additional markets.

Excelergy and Lodestar also have sought survival in other markets, including load management, forecasting trading and settlement, as well as selling CIS abroad where competition is more established. Lodestar also has had considerable success in the Texas retail market. Excelergy has struggled, replacing its CEO in 2004, along with significant staff reductions.

SPL Worldgroup, probably the largest of the CIS vendors, after Accenture, got out in 2004 and also has sought to broaden its footprint like Indus has done with SCT. In early 2004, SPL acquired CES International, probably the largest vendor of outage management software. Then in late 2004, SPL was acquired by GFI Energy Ventures, LLC, a large venture capital firm formed in 1995 and based in Los Angeles. It also owned Synergen, an EAM vendor, and several other energy vendors, including, coincidentally, Lodestar.

The GFI buyout was engineered primarily by Harry Debes, CEO of SPL, who took over the helm in late 2003 and spearheaded the CES acquisition. Debes, who formerly was with PeopleSoft, announced a strategy to expand SPL's footprint when he took over the company. In the GFI acquisition, Synergen, which earlier had acquired field automation vendor Axiom/Mobility of Atlanta, was folded under SPL and Debes remained as the CEO of the combined firms.

"We're very pleased with how everything has gone to this point," said Debes recently about two months after the GFI deal was completed. "Things couldn't have gone better. We've been very busy making the integrations necessary to make our products compatible and making a solution that looks like it comes from one company. It takes a couple of months to do all those things. We're in that stage right now and are very pleased with where we are."

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Debes is enthusiastic about the prospects for the revised, expanded SPL, including the CIS market. "We're in the proposal stage with several customers now," he says.

SPL also turned abroad when the U.S. market dried up and Debes says that effort has paid off. "We started [this effort] last year, and in the last year we've sold 12 new CIS accounts in the world," he says.

Of the large CIS vendors—those who target mainly large investor-owned utilities in this country—only Peace Software seems to be trying to stay the course as a CIS-only vendor.

"We do not believe in the wider footprint strategy," says Sebastian Gunningham, who replaced company founder Brian Peace as CEO of the firm in 2003. "We believe in a far deeper niche strategy. We primarily build a product around the customer data systems for water, gas, and electricity—around the billing engine.

Gunningham says Peace's strategy is to "go deeper" into the customer management functions at utilities. The primary problem for utilities is the cost to operate these billing systems. That is borne out in surveys and interviews with utility CIOs who report increasing costs in maintain aging CISs is a current worry.

One vendor that usually isn't thought of by most people strictly as a CIS vendor is SAP of Walldorf, Germany. In the late 1990s, SAP brought out a new CIS called its Customer Care System (CCS), which was, of course, tightly integrated with SAP's enterprise system. But after a few installations primarily as test beds, CCS sales also have stalled over the last three years.

Of course there is a whole raft of CIS vendors competing in the smaller U.S. utility markets—for co-ops, smaller municipalities, and even smaller IOUs. Those include such firms as Hansen Information Technologies, Sacramento, Calif., which has built a new headquarters in Rancho Cordova, Calif. Hansen offers a variety of products to municipal governments, including a utility CIS, but does not rely upon CIS sales for survival.

OpenC Solutions, Minneapolis, a spin-off of National Water & Power Corp., Santa Anna, Calif., has made a few installations, including one at Washington Gas Energy Services, a deregulated subsidiary of Washington (D.C.) Gas Co. However, in February, OpenC's parent organization (NWP) announced it was outsourcing its own CIS functions to Accenture Business Services and the deal included Accenture acquiring OpenC. What Accenture will do with another CIS is unclear at this point.

AMX International, Sioux Falls, Idaho, has a CIS called Utiligy that grew out of J.D. Edwards Co., an EAM vendor acquired by Peoplesoft, which now has been acquired by Oracle Corp. Utiligy has been installed at a number of smaller utilities around the country and abroad.

So to say the CIS market is dead is not entirely accurate. But among the large, investor-owned utilities, which represent about 70 percent of all customers in the U.S., and have most of the buying power for large CIS replacements, it

"I don't anticipate a full-scale replacement any time in the near future."

definitely is on life-support. That is because of the engine problem, which means there are currently no drivers for large IOUs to replace CISs.

Even with a slow CIS replacement market, CIS vendors face another threat, the growth of outsourcing. Although no large IOUs have outsourced their CIS directly, several of them have outsourced their entire IT departments, notably Xcel Energy to IBM, Entergy to SAIC and TXU to CapGemini. There are a variety of CIS outsourcers available should they decide to go that route. The largest of these, Alliance Data Systems (ADS), Dallas, has been acquiring its competitors over the last two or three years and now has successfully eliminated most of them. Alliance continues to push the potential savings available to utilities by outsourcing.

"Asset transfer is a proven avenue to both financial and operational recovery," says Tony Johnson, a senior strategic and change management consultant at ADS. "Asset transfer demonstrates what might be necessary to realize a 'step-change' in both cost reductions and improved customer service. Through asset transfer, many utilities are able to transfer risk, right their balance sheet, and win back favor on Wall Street. As we reach the mid-point of the decade, it's time for customers, shareholders, regulators, and utility CFOs to seriously examine this financial tool."

Even though they have no plans for replacing CIS, CIOs at large utilities continue to keep a close watch on the vendor market—some of them with concern, others with more sanguinity.

"I think we'll continue to evolve our system—we have the Andersen Customer/1—but I have no desire to replace it in the near future unless absolutely necessary," says Charles Bremer, vice president-information technology at Ameren Corp., St. Louis. "We want to add functionality to it and put web front-ends and customer self-service on it. We look at how best to manage and process some of the more complex billing structures, whether to do it in the system or external to the system. But I don't anticipate a full-scale replacement any time in the near future."

Necessity is the mother of invention, says Brunson White, vice president and CIO at Energen Corp., Birmingham, Ala. "It's hard to see anything that is going to be a market dynamic that's going to force our industry to be highly innovative in the immediate future," he says.

With no market dynamics for innovation and CIS that spit the bills out as required, there isn't any reason for replacing them. Most utilities are waiting for the smoke to clear before any engines get reassembled, much less put back on the tracks. ❧

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The New CIS Experience

Costly Implementation Woes with Highly Customized Systems Give Way to Increased Standardization and Improved Services

By Arthur O'Donnell

Nobody ever said installing and implementing a modern customer information system (CIS) for energy utility applications was simple, but for Pacific Gas & Electric (PG&E) in the 1990s, the process became a decade-long ordeal of failed efforts and cost overruns. After several false starts, PG&E has finally found satisfaction with SPL WorldGroup's CorDaptix Customer Care and Billing platform that works to improve the processing of accounts for its 6.5 million electric and natural gas customers in Northern California. "It's working great," confirmed Tracy Harizal, PG&E's director of customer information systems. "In two years, we've never missed a billing date or cycle."

Meanwhile, Oneok, Inc., the Oklahoma-based utility company, claims success with the first two phases of a three-utility CIS implementation of Indus International's Banner Advantage platform in combination with several other Indus business applications. With the successful installation of the system for 550,000 gas customers at affiliates Kansas Gas Service and 650,000 accounts at Texas Gas Service, Oneok and Indus are well into the third phase of the project.

"Oklahoma's next," said Charles Moore, vice president and chief information officer for the utility parent company. The company expects that 850,000 customers of Oklahoma Natural Gas (ONG) will be on Indus' interrelated "Customer Suite" of applications by summer of 2006, with the Banner CIS at the core. "We wanted to get our own platform with an ability to grow and to standardize process across all the LDCs," Moore said. "Basically, we can now control our own destiny."

On a smaller scale, rural cooperative CoServ has announced full implementation of the CIS Infinity product from Advanced Utility Systems for its 138,000 electric and gas customers in the Corinth, Texas, vicinity. "CoServ has automated repetitive tasks, put paper-based processes on line and freed up countless hours for customer service representatives, billing staff and field workers," said Stacia Sims, senior vice president of information services.

Taken together, these three utility experiences with CIS implementation illustrate both the challenges and rewards of bringing antiquated customer accounts systems into the 21st century.

Achieving a successful implementation on time and within budget is always the goal for utilities, but for PG&E, the task of replacing a 1964 legacy CIS system seemed an impossible dream. "We made a couple of attempts at replacing it," Harizal said.

According to documents from PG&E's last general rate case at the California Public Utilities Commission, "In the last decade, PG&E has made several attempts, since abandoned, to accomplish major upgrades to its CIS." In 1990, the CPUC reported, the utility received funds for a major rewrite of the legacy system, but "after spending millions of dollars, PG&E abandoned this project. In 1994 and 1995, PG&E undertook development of a non-core CIS (nCIS) to meet the needs of PG&E's 200 largest customers using a client server technology. PG&E terminated the nCIS project in 1995, after completing the system analysis and design programming phases and beginning system testing."

Difficulties continued. After issuing an RFP that led to a contract with IBM to purchase and modify an off-the-shelf system called IBM Integrity, PG&E spent \$44.2 million, but terminated the project in 1997. Then, with the restructuring of electric service markets in California looming, the utility began a crash conversion of its existing patchwork CIS at the same time it contracted with SPL to install the wholly new CorDaptix system — at a cost exceeding \$200 million. PG&E also spent up to \$50 million annually on CIS operations and maintenance, although that figure is decreasing each year.

"Restructuring forced our hand to make extraordinarily expensive adjustments to our old system," recalled Roger Gray, the former chief information officer for PG&E. "People worried if it would be compatible with the future." In all, he estimated that the two projects cost PG&E over \$330 million, in addition to what had been previously spent in the aborted attempts.

At the time California was creating an entirely new market structure, featuring competition for retail electric services — called direct access — as well as the functional separation of utility operations, divestiture of generation and the "unbundling" of associated rates on customer bills for distribution, transmission and power supplies. In

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addition, a complex mechanism of accounting for utility recovery or stranded costs on generation infrastructure and a legislatively mandated retail rate freeze and 10 percent rate reduction for households, meant that bills would take on an entirely new look and level of complexity.

This necessitated changes in all of the business processes related to customer accounts, including demands for more accurate and timely meter-data collections and billing, sometimes on behalf of a new class of energy service providers. In short, everything was changing at the same time and in ways that the 35-year-old legacy CIS simply could not handle.

Key for PG&E's vendor selection was the need for a system that could handle the huge volume of customer information that was compatible with modern computing technologies and Web-based interfaces. "We made a strategic decision not to build a homegrown system, and to go with a custom solution," Gray said.

Originally, SPL was hired to "bolt on" a customized customer accounts program called CIS-Plus to the legacy system to account for direct-access customer accounts, but leave all the inherent system data intact. "That's way different than a conversion of the data base to CorDaptix," Harizal explained. But after running the two vintages of CIS simultaneously, PG&E realized it needed a thoroughly modern CIS.

"We could not make many more structural changes and still meet our processing window. This is a full-scale replacement," she said. The utility's positive working experience with SPL gave the company an edge in vendor selection against other major CIS providers like SAP.

Also underlying the selection was executive-level and regulatory intolerance for further failures. "SPL has a 100 percent success rate," Harizal said.

The successful project, still considered the most extensive CIS installation in the utility industry, hit its budget targets and was online by early December 2002. Harizal admitted that was the latest of three projected installation dates called for in the update plan, with the slight delay caused by a regulatory decision to reintroduce the 20/20 Program of customers' rebates for energy conservation in the wake of the California power crisis.

"We had thought the program was over," Harizal said. But it was easy to insert the 20/20 Program back into the CIS because CorDaptix featured "soft table maintenance" to accommodate changes. "The rules inherent to the legacy system were hard-coded," she said. "Now, we can manage changes and it doesn't require changing the functionality of the system. This minimizes the cost and impact on applications."

Besides improving data accuracy and turnaround times, PG&E's new system allows for customer migration without needing to assign new account numbers or create new files. The account numbers in the legacy system were tied to a

specific location, Harizal said. "If the customer moved, we'd have to change the account. Now, we can track the customer. You can move across the city or in and out of the service territory, and the information doesn't have to be re-input."

That's an invaluable feature in a highly mobile place like California, where nearly half of the population moves every five years.

The CorDaptix Customer Care and Billing platform also allows for real-time changes to account balances when customers pay on-line or at a PG&E service center. And, most importantly, the meter collection and billing cycle can be accomplished within PG&E's goal of a 24-hour window. "The meter is read today, the data is processed tonight, and the bill goes out tomorrow," Harizal said.

Although PG&E has taken much criticism from regulators, consumer groups and the news media for early problems with delayed bills and its continued use of estimated bills — up to \$60,000 per month in mid-2003 but significantly less currently — the fault does not lie with CorDaptix, Gray said. "Delayed bills are a business process problem, but there's no doubt that the problem becomes manifest in CorDaptix." He cited a 99.7 percent rate of being able to process account changes overnight, compared to figures as low as 90 percent at some other utilities using a new CIS system.

THE ONEOK STORY

In contrast to PG&E's arduous history with CIS implementation, Oneok faced the relatively straightforward task of introducing a whole new set of customers into its systems when it acquired gas utilities in Texas and Kansas. According to CIO Moore, the plan in 2003 was to standardize the CIS systems for ONG and Kansas Gas Service, but when the company bought Texas Gas Service, it moved implementation of a new CIS for that utility to the front of the line.

Each utility has its own complications, he noted. In Kansas, the gas utility had been part of Western Resources (Westar Energy), did co-billing with the electric utility and shared customer service centers. "Even now, we combine meter reading," Moore explained. "A single meter reader still collects the data."

The challenge in Texas is that the utility operates in multiple jurisdictions, each with its own tariff and tax structures. And in Oklahoma, there were a multitude of technology changes. "We are automating a lot of processes," he added.

This situation called for a CIS system that could be both standardized across the company while accounting for the particular needs of the three utilities, such as billing flexibility and rate monitoring for the different jurisdictions. "We picked SCT two years ago," Moore said. "At the time we were putting in our system, we knew SCT/Banner was going through some product changes, and we wanted to be a part of that. Also, we didn't want to do it with anyone who couldn't do it on the scale we needed."

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The firm had been developing a good track record for its Banner Advantage system with medium-sized utilities such as Nevada Power and Public Service New Mexico and in the public-power market, where excellent customer service and flexibility are critical components of a vendor/utility relationship. Then, midway through the first two Oneok company installations, SCT was purchased by Indus.

That introduced another level of system integration to the project, and Indus now touts Banner as a core component of its Service Delivery Management suite of customer solutions. Moore called it a “connect to everything approach” that’s particularly well suited to Oneok’s varied circumstances.

Oneok says it is highly pleased with the results. In Texas, the system went live by Memorial Day 2004, and Kansas Gas’ CIS was on-line the following Labor Day. Besides meeting targeted deadlines and staying within a budget estimated at \$30 million to \$40 million, there were few of the usual problems with code conversions. “The code that we got was of a higher quality than what I expected Indus to provide, even though we had a high level of customization,” Moore said.

Still, change is never easy for accounts and billing staff, he acknowledged. “The old legacy system was mainframe-based, so we have a total technology upgrade and different end-user experience,” he said. “These people had been using the same system for 20 years.”

While the system is working well, the staff acceptance level has been a challenge. “We’re still getting people up to speed,” he said. “In Texas, we trained users on a moving target. Basically, we gave them a parachute and threw them out of the plane.”

DOWN ON THE CO-OP

While Oneok needed to find a flexible system to accommodate different companies, the CoServ organization found it needed to combine accounts, data, workflow and business processes for its two affiliates — the CoServ Electric Co-op and CoServ Gas, Ltd.

The electric co-op was founded in 1937 while the gas utility was added in 1998. The North Texas companies experienced tremendous load growth in 2004, adding 16,000 new accounts – a more than 13 percent increase.

The CIS Infinity product turned out to be ideal for the co-op’s needs by giving the utility the ability to integrate membership tracking with billing, in real time and via the Internet. It also allows for a single point of customer contact for those who take both gas and electric services while minimizing custom programming and eliminating much of the manual labor previously used for keeping accounts current.

Sims, CoServ Electric’s vice president of information services, credits the vendor, Advanced Utility Systems, for its thorough training and partnership with utility staff. “Because of the preparation and training, implementation was one of the best I’ve ever seen,” she stated.

The CIS industry has taken its fair share of criticism for costly and problematic implementations in the past, and many utilities have avoided changing out nearly obsolete legacy systems until it becomes absolutely necessary. Given the experiences at PG&E, Oneok, and CoServ; however, it appears that the newest generation of products are bridging the performance gap between completely customized applications and standardized but flexible solutions.

Harizal said she considers the SPL CorDaptix platform to be as close to “off-the-shelf” as is possible for such a complex task. “It’s similar to a Microsoft product,” she said. “It’s not unique to us. We like the fact that we get the benefit of other clients’ use and as SPL refines the product, we can incorporate those changes.”

Moore sees things a little differently, while still praising the flexibility of the Indus applications. “It’s a panacea to say that CIS is going to be completely off-the-shelf,” Moore said. “In utilities, CIS is the system that gets customized the most.” ❧

CIS Roundtable

By Warren Causey

Roundtable



Dr. Raymond E. Gogel is vice president and chief information officer at Xcel Energy



Dennis M. Klinger is vice president and chief information officer at Florida Power & Light Co.



Margaret E. McDermid is senior vice president-information technology and chief information officer at Dominion Resources-Virginia Power

Utilities historically have been very reluctant to replace customer information systems (CIS). To gain insight on what utility chief information officers (CIOs) in the utility industry think about CIS today, we interviewed six of them — five in the United States and one in Canada.

Centering around issues currently facing the CIS market at utilities, we asked the experts about vendor consolidation, the availability of customer information for business intelligence strategies, interfaces to CIS (which are a major expense and deterrent to replacing a system), planning for CIS replacement, and cost trends associated with customer care.

energybiz: With the stall of deregulation and competition, most utilities have stopped replacing CIS and really never got started in the industry. What do you see as the future of customer care in your utility and the IT systems that support it? What is your take on the consolidation now taking place among CIS vendors? Is that good or bad for your utility?

GOGEL: CIS is where the richness of our interactions with our customers is driven. If there are fewer opportunities to select there, I don't think it's a good thing as we go forward. It's probably too early to tell right now. Most CIS engines are driven as transactional engines, but part of the richness that could come is when we start understanding what dynamics are embedded in a process that a utility can really drive to influence customer satisfaction. I'm hopeful there will still be research dollars going into that particular domain as opposed to just funds going into swallowing up and standardizing the architectural solutions that are on the marketplace today.

KLINGER: There will be more than one CIS vendor anyway, so I don't have a concern about it at this point. To the extent that they also try to connect with other third-party providers, it might be good.

I wouldn't be interested in going with small companies anyway, where we might be at risk for non-support. I believe there will be consolidation. I believe there will be only a few suppliers. I am not overly concerned with that. I don't know who I would pick right now if I had to pick one. But as far as I'm concerned, as long as I'm here, this company will never do another big CIS install. The people I talk to, including SAP, all are trying to recognize that and modularize their offerings so they can offer them in smaller pieces you can mix and match. That's the way I think the business has to go, and it's the way we will go.

MCDERMID: We're ambivalent at this point. We know there are other areas we have to focus on. We have two big CIS systems — one on the gas side and one on the electric side and have resigned ourselves to the fact that we're going to have to learn to live with those and optimize that investment. We don't plan on replacing them anytime soon. However, we are building things around them to optimize the situation, such as Web front ends, call centers, certainly the whole business intelligence initiative, and getting customer information out of those systems and into places where people can use it.

TICKLES: In my opinion consolidation is

good. I don't see a billing system as necessarily a strategic IT investment as much as it is a commodity kind of investment. Of course I'm speaking in terms of a regulated utility business. Having more fixed technologies and being able to provide standards within the application, with a variety of billing options, is good. CIS is such a huge part of an IT infrastructure within a utility. Integration of that back to service, to work orders, wireless, back to all the technologies and applications across the company is a point of success for a CIS system. And having all that integration sitting there waiting for us is a good point. Now what starts driving you away from it is the thought that you're going to buy best-of-breed applications. But I think with today's technology, they're building that type of integration back to their tool sets. They're probably doing it in standard tool sets so you can still attach a best-of-breed off the edge of it, so I think it's good.

WOO: In Ontario there have been some implementations of CIS in the last two or

three years, brought about by our market opening. All the utilities in Ontario are considering consolidating their back offices, including CIS. We're in discussions about that now, so we will be interested in what's available when those decisions are made. All the utilities will consolidate on one CIS.

YAZDI: We built our own CIS at the time there really weren't any players that could scale up to four or five million customers. Now that we have made the investments, we are maintaining that investment by doing technology upgrades as much as possible. We've added a lot of capabilities to our home-grown system, particularly in the area of call center automation. Those are off the shelf, but the main engine of our customer information system is designed and developed and maintained by us. Frankly, I don't see us revisiting that in the foreseeable future.

energybiz: Are you currently able to "mine" your CIS for business-intelligence (BI) data? Is this done on a regular basis? How

high in the organization is this BI disseminated?

GOGEL: Since we are focused solely on getting ready to do our cut over next month from an existing Andersen/Accenture Customer/1 to a new Peace system which will replace our last CIS system, we're not focusing on the BI component, although we are sensitive to it and know what we are going to do once we have that cut over done.

KLINGER: We have had a database for many years and applied tools to that database to mine all the customer information that we do collect. It tends to be more around what utilities do and not much what the household is doing otherwise. But if we did know that information, we could put it somewhere and mine it. So I would say the answer is yes. It's one of our more mature data warehouses.

MCDERMID: We do a little of both data warehouse mirroring and actual run-time sourcing depending on what the data is used for and how real-time it has to be. But primarily we are building warehouses

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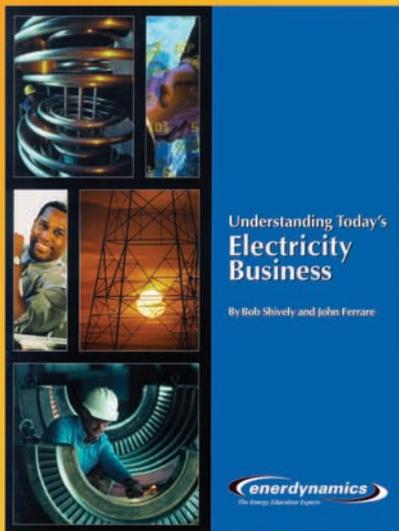
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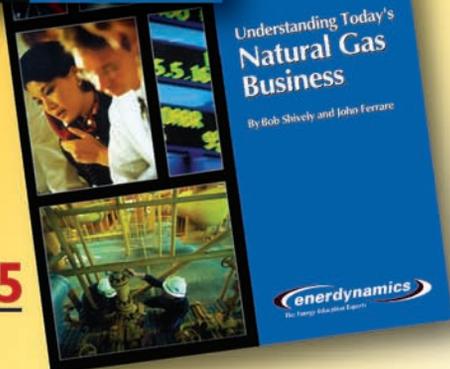
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or data marts to provide that reporting capability and analytical capability to our users. The CEOs of two of our business units get next-day information about production. The one bit of real-time information that goes to our delivery business executives is customers out-of-service. So we do have a real-time view built so that at any time anyone in the organization can go in and see geographically how many customers are out.

TICKLES: We're able to extract the data out of it and use it in other tools if we need to, but I don't think having it as an operational system and a data warehouse is an effective use of it. We have a minor outboard data warehouse, but we're probably not using it as effectively as we should be. But we have the infrastructure there to build upon.

WOO: We do not do a lot of business intelligence because we are a distribution company. We are unable to sell to our customers for energy-related products. We are a separate company so we can't mine our CIS for selling energy services. Basically we don't do any of that.

YAZDI: We have an entire strategy around customers, and we are segmenting the customers using different criteria to try to determine how we serve them better, how do we reduce the cost of service, how do we anticipate their needs. That initiative is fairly comprehensive. It is tied to our business process integration initiative. It clearly requires segmentation of the customer information in our data warehousing capability. We have built some of those data warehouses, we need to build more to enable this initiative, but we have some in place.

energybiz: Approximately how many other systems are interfaced to your CIS?

GOGEL: I can tell you what the interfaces changed to. They went from 165 to 21. That's the basis of doing a simplification, and I'm pleased with how far we've been able to drive that. There are significant dollar savings in that alone.

KLINGER: It's a high number around 50. It's big chunks of finance, all the operating systems, especially for distribution, for outage management, all those things, and a lot of the marketing systems. Part

of it depends on what you call a system.

MCDERMID: Probably 25.

TICKLES: I don't know the exact answer. Anecdotally it seems there are about 30 interface points there.

WOO: Definitely our GIS and finance systems are the two major ones. Finance consists of general ledger and several other items. We have not gotten into too much field service automation, but will be looking at that this year or next.

YAZDI: I would say literally hundreds. One of the services of the architecture we are trying to put into place is application integration so we can eliminate the number of point-to-point interfaces.

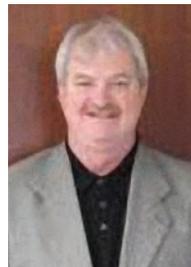
energybiz: Do you think there will be a need to replace your CIS sometime in the future? If so, how far in the future? Are any studies currently under way? What has been your main disappointment with the CIS you now have? What are the most rewarding aspects of it?

GOGEL: Not on my watch!

KLINGER: The only thing that would make us replace CIS—and we look at it every couple of years—is growing operating costs there. Although I'd love to do it, when I look at the investment, and I don't mean just dollars but also resources and distraction of management, it isn't the place where we get the biggest bang for our buck. Consequently, we aren't doing it. What would force us to do it is some kind of business change in Florida or some kind of acquisition or merger where we wanted to normalize our systems across a larger portfolio. At this particular point, our strategy is not to invest and get ready for that merger. If and when the merger comes we'll see if we get something better from whoever we do it with, or the acquisition, or we make the upgraded systems part of the acquisition and we invest in it that way. There's going to have to be some kind of external force to drive us to change our CIS, because in Florida doing the business we do, I don't think anything out there is better than what we have.

MCDERMID: The good thing about them is they are functional, they're stable, and they get the bills out every month. They do the job they're intended to do and we have no plans to replace them. The

Roundtable



Chuck Tickles is Director of Information Technology for Great Plains Energy Services.



Connie Woo is vice president of information technology and chief information officer at Toronto Hydro.



Mahvash Yazdi is senior vice president of Business Integration and chief information officer at Edison International.

challenging thing about them is that they are still very expensive to maintain and because they touch so many parts of our business, any business change or any business process change touches the CIS. So we have to keep a fairly large staff to maintain and enhance those two systems. We've had to develop in-house support. In fact, we had to hire some Andersen (now Accenture) and Price-Waterhouse people to come in and help.

TICKLES: CIS is one thing we cancelled maintenance on and moved that total support in-house. We don't have any plans for major upgrades to the core CIS. We'll do enhancements around it to the peripherals and interfaces to it. The advantage over our previous CIS is the ability to make rate changes much simpler — the capabilities it has for interfacing back to bill print. There are several advantages to it over our previous one, but it's not as flexible as we thought it was going to be when we first put it in.

WOO: We definitely are looking at centralizing all the back offices of various utilities in Ontario, and all of us will be converting to one centralized CIS. We will not be going to

different CISs; we will have to agree on one.

YAZDI: I think our disappointments are behind us because our system has been in place for about five years. If you had asked this question four or five years ago when we were in the initial stages of implementation, there was all kinds of noise in the system. But most of that is gone now, and we're pretty happy with its functionality. The salient capability of our CIS system is that it is structured in such a way that it allows us to add rates and capabilities in a modular fashion. Its design is far more modular than the traditional monolithic type of CIS.

energybiz: How much do you anticipate spending on customer care management in 2005? How does that compare with one year ago, five years ago?

GOGEL: I never comment on actual dollar figures. It's going to go down from the significant capital spending we've had in the last two years. I don't know what the five-year number was, but it's scaling down significantly.

KLINGER: Incremental costs are going up in maintaining the system, but overall they will

remain about the same.

MCDERMID: Our spending has probably increased by 10 to 15 percent over the last couple of years because we have not spent enough on things like call center technology or core systems information. After going through Hurricane Isabelle and having many discussions with emergency response people, what we found out there was that they need better information. We're working on that.

TICKLES: My IT spending as it relates to customer care system and environment, billing systems, and service orders probably still represents about 50 percent of the entire IT budget. I don't think that has changed over the last five years.

WOO: I think we are staying flat with our mandate to keep our costs flat. It's not going up or down.

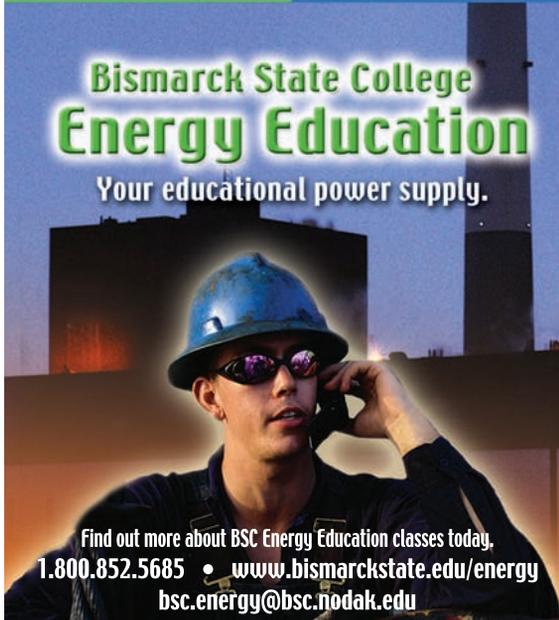
YAZDI: I don't have a specific number, but we anticipate we will be spending about the same as in prior years. In our business process initiative, we will be looking at customer care in a more innovative way, and decisions on what system capability would be required are yet to come. ❏

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Revealing Attitudes on Recurring Payments



CONSUMER RESEARCH TO BENEFIT THE UTILITIES INDUSTRY

With a commitment to helping service providers capitalize on new opportunities and emerging trends, MasterCard International has been conducting research on recurring payments since 1997, completing our latest survey in April 2003.

Since the research was previously completed in 2000, debit card usage appears to have grown significantly. To better understand the unique attitudes and behavior of debit cardholders, this survey is the first attempt by MasterCard® to segment both debit and credit cardholders.

What are Recurring Payments?

Recurring payments (RP) are when a customer agrees to have a service provider bill against a specific account at a predetermined date. The amount debited can always be the same, or it can fluctuate from one payment to another.

CURRENTLY, THERE ARE SEVERAL WAYS TO USE RECURRING PAYMENTS:

- By credit card (CCRP), in which recurring bills are automatically charged to a credit card;
- By debit/check card (DCRP), in which recurring bills are automatically deducted from a debit/check card;
- By direct payroll deduction, in which regular recurring bills are deducted from an employee's paycheck automatically;
- By direct checking account deduction, in which funds are transferred regularly by ACH or direct debit.

Note: Automatic recurring payment is defined as any RP made automatically via the above methods, online or by telephone.

Recurring Payments Benefit Service Providers With Increased Revenue and Boosted Loyalty

VIRTUALLY EVERY CONSUMER HAS A RECURRING BILL.

Every time a consumer decides to have that bill paid regularly and automatically, the service provider benefits. Why?

- Payment assurance: Payments are made in full and on time. No repeat billing, no collections, no problems.
- Better cash flow: Settlement is fast and easy.
- Increased customer loyalty and retention: When customers enjoy the ease and convenience of paying bills automatically, they may be less likely to inconvenience themselves by seeking alternative service providers.

Providers enjoy improved customer relationships that offer numerous ways for them to boost new and incremental revenue streams.

Automatic recurring payments have become well entrenched in the marketplace, with two-thirds of our surveyed consumers (67 percent) now paying bills automatically. Cardholders are still attracted to the ease and convenience of automatic bill payment; however, the financial ease and security is becoming increasingly important for debit/check card users.

Many payment card owners surveyed say they would consider switching service providers if they were offered an automatic bill payment option on their card — all other factors being equal.

The growth in this payment method represents a tremendous opportunity for utilities providers. By providing unique insight into the ever-changing attitudes and behavior of today's consumer, this research demonstrates clearly that motivating customers to use the credit card recurring payment (CCRP) or debit card recurring payment (DCRP) option could boost customer loyalty and fuel revenue.

HOW RECURRING BILLS ARE PAID

Two-thirds of households in our survey report using some type of automatic bill payment, and the method by which they pay these bills is changing.

In the years since our 2000 research, a growing number of households surveyed have enjoyed the benefits of using automatic payments, with DCRP growing 30 percent. In the same time period, use of automatic payroll deductions has declined 28 percent. Check writing, though still prominent, is declining — down 8 percent from 2000 as of April 2003. As the benefits of automatic bill payment linked to a payment card become apparent to users, CCRP/DCRP gains ground as a payment option.

Convenience, the relief of knowing bills are paid on time without worry, savings on postage and late fees, and the potential to earn reward points all motivate consumer usage and point toward a bright future for this payment option.

Automatic recurring bill payment linked to a CCRP continues to be the most common type of autopay, currently used by 37 percent of all surveyed consumers. Those who use CCRPs also report using it for a growing number of their bills, up 14 percent since the 2000 study.

DCRPs have grown noticeably. Since the last study in 2000, more than one in four of our surveyed households (26 percent) are using debit/check cards to pay recurring bills.

HOW MOST COMMON RECURRING BILLS ARE PAID

Our results suggest that not only are more consumers using CCRP/DCRP, but the number of times they use these payment options is also on the rise. **SEE FIGURE 1.**

Automatic bill payment users participating in our research average 3.4 charges or deductions on their payment cards, or nearly half (43 percent) of their total recurring bills. The number of bills they pay in this manner is also on the rise, up 10 percent between 2000 and 2003.

FIGURE 1: RECURRING BILL PAYMENT BY TYPE

	Total Random (%)		CCRP Users (%)		DCRP Users (%)	
	(750) 2000*	(757) 2003	(277) 2000	(280) 2003	(149) 2000*	(195) 2003
RECURRING PAYMENTS						
Any Auto RP (net)	69	67	100	100	100	100
CCRP	37	37	100	100	56	44
Checking RP	25	27	29	30	32	46
DCRP	20	26	30	31	100	100
Paycheck RP	25	18	23	20	24	27
Online RP	10	11	15	16	22	23
ONE TIME PAYMENTS						
Pay cash	28	28	25	20	24	23
Write Check	74	68	58	54	63	55
Use debit/check card	7	13	8	11	11	21
Use credit card	13	12	18	15	14	10
Pay by phone	7	9	10	11	10	15
Pay online	6	7	7	11	9	12

*Excludes exclusive debit users

As consumers pay more of their bills automatically, other forms of bill payment are likely to decline. In 2000, surveyed consumers paid an average of 4.4 bills by check; participants now pay an average of 3.3 by check.

In Short: Customers seem to be paying more of their recurring bills automatically, and linking them to credit and debit cards.

CARD-BASED RECURRING PAYMENTS: A WIN-WIN FOR CONSUMERS AND UTILITIES PROVIDERS

Results indicate that there is an opportunity for further growth in automatic bill payment linked to credit and debit cards.

- More than two of every five participating credit card owners say they would consider adopting or using additional CCRPs.
- Almost half (48 percent) of the surveyed debit/check card owners feel similarly about DCRPs.
- Among the surveyed households reporting some type of automatic bill payment, the number of bills paid automatically has increased significantly from 2000 to 2003, up 10% to 3.4 bills per household.

CONSUMERS STATED THEY BENEFIT FROM CONVENIENCE, STRESS RELIEF AND COST-SAVINGS.

Consumers using recurring payments appear to be attracted to its convenience features. They are also responding to the relief that comes from knowing bills are paid on time without worry. Additionally, our surveyed users cited savings on postage and late fees, in addition to rewards points offered by many issuers, as increasingly important benefits of using CCRP/DCRP. **SEE FIGURE 2.**

FIGURE 2: REASONS FOR CONTINUED USE OF RPs

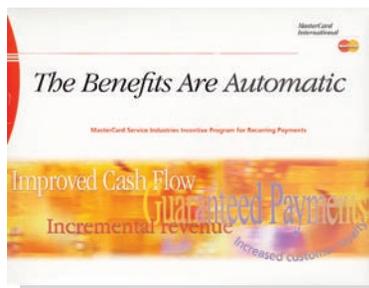
	Reasons for initial use (%)		Reasons for use (%)		Benefits/Advantages (%)	
	CCRPs	DCRPs	CCRPs	DCRPs	CCRPs	DCRPs
Convenience	50	59	66	63	53	62
Stress Relief	18	23	22	29	45	46
Financial Benefits	13	11	13	13	20	18
Only Option Offered	12	7	10	5	4	8

Base: CCRP = 280, DCRP = 195



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MasterCard Recurring Payments. It's nice to know when you're getting paid.

In short: When your customers reap the benefits of paying their bills automatically, you could benefit from increased loyalty and retention, guaranteed payment and improved cash flow. With CCRP/DCRP, everybody wins.

Utilities Industry

SMALL PENETRATION AND AWARENESS CREATE BIG OPPORTUNITY

While three-quarters of Americans pay a recurring utility bill, only 39 percent of those researched were aware of the CCRP opportunity in the utility industry, and only 40 percent know they can pay their utility bills with DCRP.

DEMOGRAPHICS

Research indicates that these customers are most likely to be younger and have larger households. They are more likely to rent than own. Those more likely to be employed are also positive to using DCRP for utility services.

ATTITUDE

Among those surveyed who currently use, or would consider using CCRP/DCRP for their utility bills, money management benefits far outweigh other opportunities. More than in any other industry, surveyed utility customers enjoy the ease of carrying and using payment cards (67 percent for credit cards and 49 percent for debit/bank cards). Some 88 percent (CCRP) and 87 percent (DCRP) of our respondents do not like borrowing money. The speed of paying with a payment card is also an attractive benefit for these users.

With 31 percent of surveyed utility bill payers using, or receptive to using, automatic recurring payments, and a 74 percent rate of occurrence of these bills, nearly one-quarter of all utility bill payers appear to be candidates for CCRP/DCRP. With a current industry penetration of only 10 percent for CCRP and 6 percent for DCRP, the opportunity among utility consumers is substantial. Twenty-one percent of those participants paying recurring bills say they would consider using CCRP, and 24 percent would consider DCRP.

More than one in four (26 percent) participating utility customers would consider switching to a different service provider if the RP option were offered and all else was equal. Therefore, making CCRP/DCRP readily available could be an effective marketing tool for providers looking to attract new customers. **SEE FIGURE 3.**

FIGURE 3	Utilities (%)
BASE:	(560)
CCRP Opportunity	31
Currently use CCRP for Utilities	10
Additional would consider	21
DCRP Opportunity	30
Currently use DCRP for Utilities	6
Additional would consider	24
Other Current Practices	
Check	59
Cash	12
Checking account RP (ACH)	5

In short: Research suggests that a good percentage of young users in large households may switch to a new provider if their utility offers a recurring payment program. This audience seems to respond very positively to the ease and convenience of using debit cards.

After Seven Years of Research, Some Facts Remain the Same

Comparing the results of our 2003 research to our first study in 1997 and to our 2000 study, several trends and opportunities emerge. **SEE FIGURE 4, PAGE 64.**

LINKING AUTOMATIC PAYMENTS TO A PAYMENT CARD IS A GROWING TREND

- Though check writing continues to be the most common method of paying recurring bills, fewer households are now writing checks.
- While the proportion of surveyed households with automatic bill payments has remained relatively unchanged, the number of bills in those households has increased significantly.
- Automatic payments linked to a credit card continue to be the most common type of autopay, and those who use CCRP pay more of their bills in this way.
- Based on survey results, automatic debit card payments appear to have grown noticeably since 2000, reflecting more widespread use of debit/check cards in the marketplace.
- Use of automatic paycheck deductions has declined.

FIGURE 4: COMPARISON OF RESEARCH RESULTS OVER SEVEN YEARS

	1997 (%)	2000 (%)	2003 (%)
HOW DO CONSUMERS PAY RECURRING BILLS?			
Write checks	93	74	68
Use any automatic payment method	36	69	67
Use automatic checking account debit (ACH)	17	25	27
Use automatic credit card payments (CCRP)	11	37	37
Use automatic debit card payments (DCRP)	—	—	26
WHAT MOTIVATES RECURRING PAYMENT BY CREDIT CARD USE?			
Convenience	42	53	66
Required by service provider	35	11	10
WHAT MOTIVATES RECURRING PAYMENT BY DEBIT CARD USE?			
Convenience	—	—	63
Required by service provider	—	—	5
WHAT MAKES CONSUMERS RESISTANT TO CREDIT CARD USE?			
Don't want to lose control	31	22	12
Don't want to pay interest	23	19	19
WHAT MAKES CONSUMERS RESISTANT TO DEBIT CARD USE?			
Don't want to lose control	—	—	12
WHAT PERCENTAGE OF CONSUMERS WILL SWITCH SERVICE PROVIDERS FOR RECURRING PAYMENT BY CREDIT CARD?			
Will switch service providers with all else equal	24	55	41
WHAT PERCENTAGE OF CONSUMERS WILL SWITCH SERVICE PROVIDERS FOR RECURRING PAYMENT BY DEBIT CARD?			
Will switch service providers with all else equal	—	—	44

Note: Applicable base differs by question.

RP'S LINKED TO PAYMENT CARDS DELIVER CONSISTENT, RELEVANT BENEFITS TO END USERS

- Throughout years of research, our surveyed consumers continue to be attracted to the convenience of paying bills automatically with a payment card. This convenience, coupled with not needing to worry about paying bills on time, motivates continued use for a majority of these consumers, with 66 percent of credit card users describing it as a reason to pay bills automatically (compared to 53 percent in 2000 and 42 percent in 1997).
- On the other hand, the primary reasons for participants not considering CCRPs are a desire to remain in control of payments and a concern for accuracy, which may be relieved by utility providers who precede automatic payments with paper bills.

In comparing research conducted over the previous years, it should be noted that our methodologies have changed. In 1997, information was garnered through a mix of focus groups and telephone interviews. In the 2000 study, only personal interviews were used. For this study, in-person interviews were conducted with distinct groups of CCRP and DCRP owners/users.

While methodologies have changed, certain trends remain significant.

- Surveyed consumers appreciate the benefits of RP and exhibit enhanced loyalty and a preference for those service providers that offer the CCRP/DCRP opportunity.
- Educating consumers about the opportunities to use CCRP/DCRP for their monthly payments would appear to be critical since up to one-third of our participants, depending on industry, would consider switching service providers to take advantage of automatic payments.
- Non-user participants still have concerns about the accuracy or variability of charges, high interest charges (CCRP only) and a preference to control their own payments, but itemized paper statements help to increase acceptance of RPs.

There's still work to be done to further enhance recurring payment receptivity, but the chance to make it work for both utilities providers and consumers appears to be greater than ever.

RESEARCH METHODOLOGY

An independent research firm, on behalf of MasterCard International, conducted a total of 757 in-person interviews in April, 2003. Respondents were credit and debit/check card owners between the ages of 21-64 who had most or all of the bill paying responsibility in their households. They represented 25 geographically dispersed markets, and were divided evenly among the sexes. Of the 757 interviewees, 280 were CCRP users, 195 were DCRP users, 30 used another method of recurring payment, and 252 were non-users of any automatic recurring payment method. The research results have a sampling error of +/- 4 percent at the 95 percent confidence level based on 757 total interviews.

A Conversation with MasterCard International

Given that it represents a \$109 billion opportunity, MasterCard® views the use of a payment card to automatically pay a recurring utility bill (recurring payments) as an extraordinary growth opportunity. MasterCard research shows that utility customers enjoy the convenience and benefits of paying their monthly bills with a credit or debit card*. Recently, Donna Johnson, vice president, acceptance development, at Purchase, N.Y.-based MasterCard International discussed with *EnergyBiz* the organization's perception of the marketplace it's courting.

ENERGYBIZ How long has MasterCard been involved with utilities, specifically energy utilities?

JOHNSON MasterCard has been involved with the utilities industry and recurring payments since 1998.

EBIZ What is your objective?

JOHNSON Our objective is twofold. First, we want to increase the number of merchants who accept MasterCard as part of their payment mix. Second, we want to increase recurring payments.

EBIZ Which electric and natural gas companies have you successfully courted?

JOHNSON Due to the fragmented nature of this industry, most of them are smaller in size. However, we have been successful in gaining critical mass by working with cooperatives and associations that are interested in bringing added value to their members.

EBIZ Have insurance, electric companies, and gas companies been your most successful niche?

JOHNSON Yes. These industries have not traditionally accepted payment cards, and we have been able to help them realize their business objectives. By introducing this payment option, they can enjoy payment assurance, better cash flow, and increased customer loyalty and retention.

EBIZ How fast is MasterCard's business growing?

JOHNSON For MasterCard, the utilities industry is growing at more than 35 percent per year in transactions. But when we look at the percent of volume that's still available in the utility category there is still room for growth. Currently, card acceptance penetration is about 3 percent. In other words, 3 percent of all monthly utility bills are now paid via payment card.

EBIZ What's MasterCard's ambition here?

JOHNSON Recurring payments is a \$1.1 trillion opportunity. It is MasterCard's vision to become the global payments leader. To achieve this, MasterCard must continue to displace competitive payment methods and find new acceptance opportunities.

EBIZ What has been your main challenge in convincing utilities that the program has merit?

JOHNSON The cost of acceptance is generally viewed negatively by utilities. The value proposition is complicated by the notion that unlike other industries, consumers will not spend more as a result of the ability to make payment with a credit or debit card. In other words, the utility will not enjoy incremental income to help offset the cost of accepting a card for payment.

EBIZ When you encounter this challenge, what's your response?

JOHNSON We have put together a financial model that we are sharing with utility companies around the country. This model is designed to help dimensionalize where some of the savings might be incurred if the service provider were to accept payment cards. For example, there may be cost savings associated with getting a customer to pay with a payment card and receive their bill via the internet vs. mail. Self care and paper turn-off of statements are increasingly important strategic priorities for utilities.

EBIZ There are obvious advantages to this when the energy business becomes more competitive.

JOHNSON Yes, these companies are able to keep their overall costs down while providing better and more efficient customer service.

EBIZ Your competitors are Visa, American Express and Discover, correct?

JOHNSON These are our most obvious competitors; but to become the global payments leader, MasterCard seeks to displace all other payment types, including checks and cash.

EBIZ Tell us about MasterCard successes.

JOHNSON The Service Industries Incentive Program has allowed MasterCard to successfully penetrate this category by offering a reduced consumer transaction rate in return for marketing preference. This program has helped MasterCard attract a large number of electric, oil, and natural gas service providers, who are seeking to provide their customers with payment choice and convenience. At the same time, the service provider is able to collect payments in a more efficient manner.

EBIZ What is your approach to large utilities?

JOHNSON Recurring Payments is a corporate initiative for MasterCard. As a result, we have dedicated industry specialists and made business tools available to help any size utility determine the cost/benefit of accepting cards and processing recurring payments. In addition, MasterCard continues to leverage venues such as Energy Central, association memberships, trade shows, and advertising in key publications to communicate and support this all-important industry segment.

For more information about MasterCard International and the programs available to the Utility industry, visit www.mastercardmerchant.com or send an e-mail to recurring_payments@mastercard.com

* *Recurring Payments – Awareness, Behavior and Attitude Study - 2003*



DONNA JOHNSON

The View From Lansing

"The customer is No. 1" is not just a slogan at The Lansing Board of Water and Light (BWL). It's exemplified in the many billing options they offer to their 150,000 customers who rely on them for drinking water, electricity, steam and related services in the Greater Lansing area of Michigan. Since 1997, the utility has been teamed up with MasterCard International, to offer their customers the ability to pay monthly bills via credit card (CCRP) without invoking extra fees.

BWL's altruism has paid off. The company has 4,400 customers who pay their monthly bills by credit card, ensuring them guaranteed cash flow, reduced call center volume and increased customer satisfaction. These customers have their utility bills automatically charged to their credit cards rather than writing and mailing checks every month.

"It has worked very well. We prefer these types of payments because it represents guaranteed cash and we don't have much trouble with rejection," said Karen Burdick, customer account supervisor at BWL. "Once everything was set up, receiving monthly credit card payments has been good for the customer and good for us. The system runs very smoothly; it's easily maintained. Most importantly, it's a convenience for the customer."

"The decision to offer CCRP is customer-driven for many of the utilities that we work with," said Henry Zorn, Recurring Payments at MasterCard International. "Many customers are contacting the call centers and asking to pay their utility bills by recurring credit card payment to get their air miles, for example," said Zorn. "And, utilities are concerned about keeping the customer complaint ratio low."

Frequent flier miles or percentage cash back bonus awards are just a few of the incentives of paying by credit card. "Senior citizens or retirees like it because they don't have to worry about getting a bill and paying it, if they are away for the winter in Florida or Arizona," said Burdick. "Also, they may not feel comfortable making payments via the Internet but with a credit card, it's automatically taken care of for them."

According to a recent study by MasterCard, 41 percent of consumers that use credit cards for recurring payments would switch to a service provider that offered them the option of paying bills automatically on their credit card (all other factors being equal).

This same overriding concern to increase customer loyalty and satisfaction drives BWL's business initiatives. "We're trying to make it as easy as possible for the customer to pay their bill," said David Kus, manager of customer service at BWL. "We do have competition on the fringe areas of our service area. Surrounding us is a large investor-owned utility (IOU) so as each new development becomes available, we compete with the IOU for that area. We want to have the lowest price to compete."

Customers' requests for paying monthly bills by credit card are rising. Consumers like the fact that they can more easily track what they are spending on a monthly basis and those with in-home businesses can use that tracking information for end-of-year tax preparation. Many others like the security of knowing that their payment is paid on time and without extra postage costs.

As identity theft increases nationally, CCRP also helps with fraud protection. Rather than writing a check each month, the money is charged against a credit card that offers customers theft protection against unauthorized charges. "Even the CSRs that talk to

MasterCard offers its utility customers like BWL a promotional program to help them market their recurring credit card payments to their customers. MasterCard's Service Industries Incentive Program (SIIP) is specifically designed to help utilities promote the benefits of CCRP to its customers through persuasive marketing materials while saving on transaction fees.

"For the utilities to receive a reduced MasterCard interchange rate on all qualifying transactions, they agree to do a marketing program with us that includes four marketing initiatives over a 12-month period," said Henry Zorn, Recurring Payments at MasterCard International. "Utilities can save as much as 40 percent per transaction through our SIIP program. And, we assist them in promoting their auto pay program with our turnkey marketing tool kit, 'Selling Recurring Payments to your Customers.'"

In addition, the MasterCard Automatic Billing Updater is a tool that allows participating



utilities to receive card account updates (account number and expiration date) to reduce the number of authorization declines due to a change in the customer's information. This is also a customer service benefit as customers will not have an interruption in service if they forget to update their recurring billers with this new information.

To begin the program, the utility and MasterCard negotiate and sign a participation agreement, detailing the marketing communications program that has been selected. The utility then provides merchant certification and registration to ensure that the recurring payment indicator can be placed in the authorization message.

"A typical marketing program may include statement inserts (camera-ready art), customer service training tips and best practices, banner ad copy, on-hold message scripts and call prompts, newsletter articles, advertisements, pre-authorization forms and billing statement messages, all designed to sell the customer

customers can't see the credit card account information listed for the account, so folks can feel secure that their information isn't public," Burdick said.

Although BWL, as a municipality, is not regulated by the Public Service Commission, they made the decision to absorb the service fees associated with credit card payments, offering it free to their customers. "Many businesses today feel that they can move enough people from paper and call center to automated payments where offering CCRP will eventually pay for itself," Zorn said. "This has worked especially well for municipalities and utility co-operatives."

"IOUs are a bit different when deciding on what payment options to offer their customers. They can't just pass the CCRP service fee along to their customers without permission from Public Utility Compliance, if they decide not to absorb them internally," Zorn said.

For those companies, they can contract with a third-party vendor to process the payments for their customers, collect any fees and remit the original payment amount back to the utility.

"While there are service fees associated with offering this convenient service to your customers, many, if not all, charges can be offset by the benefits to a utility company," Zorn said. "Utilities can benefit from improved labor and operational efficiencies with CCRP by automating fee collection via telephone VRUs, self-service kiosks and the Internet."

Automated transactions may also reduce customer traffic in field offices, reducing labor and real estate costs. Additionally, credit cards lack many of the expenses associated with cash, checks and money orders. Cash, which is normally counted several times before it reaches your depository bank, may have extra expenses, including armored car services and bank deposit fees.

Payment by check also includes handling and data entry costs, as well as armored car service and deposit or lockbox fees. While checks can take time to clear, credit card payments result in rapid deposit of funds into the utility's account, providing them

with quicker accumulation of interest. "Mail float," the interest foregone while checks are being moved in-between accounts, is usually also eliminated when payments are made by credit card.

Finally, when customers choose to pay by recurring credit card transactions rather than by personal check, the percentage of checks returned for non-sufficient funds (NSF) and their associated fees, penalties and collection costs are reduced. Utilities benefit from avoiding redeposit fees, as well as the cost of processing additional transactions related to non-payment.

To set up recurring payments, BWL requires on-file, written pre-authorization from the customer for credit card transactions so customers fill out and return the form on the back of their utility bill, to initialize the service. BWL is also required to provide at least 10-day notification to the customer of all pending charges. "Since BWL produces our bills 15 days before they are due, we're allowed to use our bill as notification to the customer," said Burdick. "They also can set up CCRPs through eBill Presentation and Payment, where they receive their billing information online," added Burdick.

Most payment arrangements can be offered through monthly MasterCard payments, because the written authorization is received up-front and because BWL sends a bill notification prior to each transaction. For example, BWL offers "levelized" payments that average a customer's bill throughout the year and these payments can be charged to a customer's credit card. "For those customers, the system will calculate a levelized payment, based on their average use, and they will be billed that amount per month. At the end of the year, the customer is issued a 'shore-up' payment, again charged to their MasterCard card, to balance the account," Burdick said.

A customer utilizing CCRP should also avoid late charges at BWL. "We know that those customers' payments are going to be in on-time so we inhibit the systems' ability to assign late charges to their accounts," Burdick said. "A disconnection is not going to occur with this type of customer because it's a cash flow that you can count on. That's always helpful to the business."

Burdick explained that the company handles credit card rejections a little bit differently than any other kind of NSF because they actually verify funds in real time. "If the funds are not available, we know almost immediately, and the request doesn't actually process on the card," Burdick said. "For example, if a customer was over their spending limit on that particular card, or they may have given us an initially incorrect card number, the request is rejected. In most instances we will then call the customer to resolve the issue."

Adjustments are handled swiftly and easily with CCRP. "If a customer has an adjustment to their billing, our system notifies us that the original statement that went out to the customer has now changed, and then we call the customer to inform them that the amount charged to their credit card is going to be different than the initial statement they received," Burdick said.

Customers are driving the need for more convenient payment methods, but marketing is also key. BWL has promoted this program to their customers in several ways. All payment methods are listed clearly on their website, with access to appropriate forms and customer service information. Periodically, these convenient methods are also highlighted in their monthly "Connections" customer newsletter. BWL also sends out a "Welcome" packet to new customers that includes a recurring payment by credit card authorization form.

Currently, BWL's CCRP participants are usually the better paying customers. However, offering CCRP could represent a future solution to non-pay or late-pay customers. "There are those customers who forgot to make a payment or who have received a disconnect notice who call in and make a one-time credit card payment," Burdick said. "It gives them an extra 30 days to make the payment."

If BWL could convert these customers who call in to the service center to CCRP customers, they could reduce call volume, possible late fees and disconnects and ensure a more consistent payment history. To date, BWL has about 2,500 customers monthly who call in to make one-time credit card payments. ❖

Continued from page 69

on the benefits of CCRP through that specific utility," Zorn said. MasterCard and its issuing banks offer co-branded credit cards which can combine the utility's logo with the MasterCard logo on the card. Every time a customer uses the card to make purchases, they are reminded of the utility (creating brand awareness) and its commitment to customer service excellence.

Paying monthly bills by credit card is a way of life for many consumers, who already pay other recurring account charges for their telephone, cable or satellite TV, insurance, newspaper/magazine subscriptions, home security monitoring, and other services.

By encouraging customers to pay with MasterCard cards, utilities have the promotional expertise of MasterCard at their fingertips, to service their customers and enhance customer loyalty. And MasterCard offers a Financial Model tool, designed to help utilities analyze the financial impact of MasterCard acceptance so companies know exactly what to expect and can plan accordingly.

It's recommended that a statement insert is dropped within six months of processing the first CCRP transaction. The utility can then choose three other promotions during the balance of the 12-month period.

Increased cash flow and meeting customer demand are just two of the many benefits mentioned above, in promoting the CCRP program. Other benefits include improved operational efficiencies, increased bank and settlement options, stronger brand recognition and having operational and marketing support to promote your programs. Customers are demanding competitive differentiation between service providers and offering expanded payment methods designed to make these consumers' lives a bit easier is a step in the right direction. Recurring credit card payments through MasterCard, with its SIPP program, is a win-win situation for the customer, the utility company and the credit card provider.

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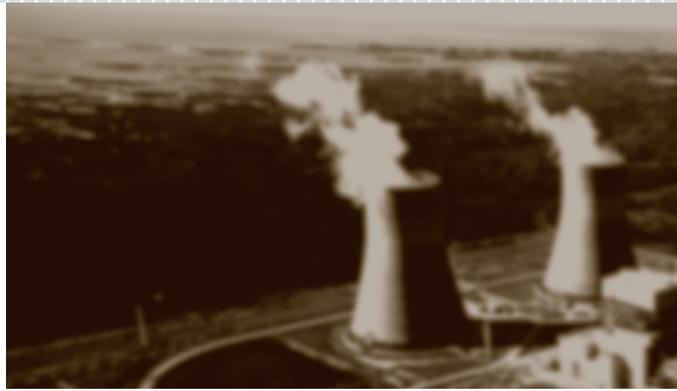


Technology Frontier

Get Nuclear

GUEST OPINION

By Marilyn Kray



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DUKE

NUCLEAR BUILD
Duke Power Co. is looking to plant a brand new nuclear generating plant in the Carolinas.

"It is not a commitment to build," a company spokesman said. "It is a commitment to maintain new nuclear capacity as a meaningful option for our customers."

ENERGY

NUCLEAR BUY

Energy, the second largest domestic nuclear generator, is pondering whether to buy the Duane Arnold nuclear plant in Iowa.

Alliant Energy and other others have signaled an interest to strike a deal to sell the 580-megawatt plant by the end of June.

Electricity was first produced from uranium fuel more than half a century ago, when power from an experimental nuclear reactor lit four light bulbs. That was Dec. 20, 1951. Compare that to Dec. 20, 2004, when at any given moment, electricity from U.S. nuclear reactors lit the equivalent of more than 1 billion light bulbs. That's progress — but it may not be enough.

A great believer in the promise of nuclear power, former president John F. Kennedy once said that the United States has to move very fast even to stand still. For those who believe nuclear energy holds the best and brightest promise of all large-scale generating technologies, nothing could be more true.

Nuclear power deserves a prominent place in our national generating portfolio, and its growth as a source of electricity since 1951 serves as the most persuasive evidence. This is a technology that powers great industries with no carbon emissions. While the ultimate disposal of nuclear waste remains an unresolved political issue, other attributes of the nuclear waste stream should be acknowledged. Management of the nuclear waste stream is so meticulous that every ounce of its byproduct is inventoried, numbered, contained, and stored — never to reach the environment. No other industry in the world can make such a claim. This is a technology that can also produce electricity safely — in massive amounts with stunning 90-percent-or-better reliability at prices that are, at worst, very competitive with other sources. On its best days, nuclear power is less expensive than every other form of large-scale generation that exists today, except hydroelectric power.

This is not to say that nuclear power should dominate America's sources of electricity in the future. The fact is, energy diversity is good. Every time America has put its energy eggs in too few baskets, we have paid a huge price. Remember the gasoline lines of the early 1970s? At the time, scarce petroleum was second only to coal as a fuel for electrical generation. Even today, the intense price volatility we've experienced with natural gas since 2000 has been fed in large part by an unsustainable demand for natural gas in the generating sector (90 percent of all new generation coming online in the past decade was fired by natural gas).

The U.S. Energy Information Agency predicts electricity demand in America will grow by 50 percent in the next 20 years. Nuclear power can and should serve as part of a diverse portfolio of generation sources to meet that demand. But unless we increase nuclear capacity by developing new,

better, and less expensive nuclear technology, nuclear energy's share of the national generation portfolio will diminish as rising demand is met by other fuel sources — primarily natural gas and coal. The result would be continued price volatility on the gas side and an increase in carbon emissions to the environment on the coal side. It is hoped that the coal industry will be successful in its efforts to develop clean coal technology and to sequester carbon from entering the atmosphere. Despite government subsidies, this rising demand cannot be fully met by using wind or solar alternatives because of their inherently low availability and low capacity factors. That means that every megawatt of alternative energy that comes online must be backed up by a megawatt of base-load generation.

Consider this for a moment: At the time of the first oil crisis in 1973, oil represented 20 percent of the nation's generating capacity and nuclear represented a mere 5 percent. Over the ensuing 30 years, those roles reversed: New nuclear power plants that came online mostly in the '70s and '80s generate 20 percent of our electricity today while oil represents only 3 percent.

Over the next several decades, nuclear generation can have a similar impact on natural gas, long considered the "bridge fuel" that will get us through the first half of this century until new generating technologies can be developed. That is to say, by expanding the use of nuclear power using next-generation nuclear technology, we can conserve and stretch our limited and increasingly expensive-to-extract natural gas reserves. At the same time, we would improve the environment by reducing carbon emissions and maybe even give ourselves a break from the rollercoaster natural gas price ride that continues to jolt the American public.

Here is the simple truth: If we want energy independence, if we want energy price stability and predictability, if we want cleaner air and even a chance of avoiding what many experts believe will eventually be catastrophic effects of global warming, then we must make nuclear power part of our future.

To that end, in April 2004 Exelon helped establish NuStart Energy Development, LLC, which is part of a consortium of U.S. nuclear operators and vendors that have joined forces with the U.S. Department of Energy to develop and, hopefully, deploy the next generation of nuclear technology. While none of the nine NuStart power company participants has committed to build a new nuclear energy plant, plans are in the works so that when the time comes for the utility industry to make decisions on new generation, nuclear is an economically viable alternative.



Unfortunately, we're not there yet, despite the admirable record of the nation's nuclear energy fleet. The 103 existing nuclear generating units in America produce safe, highly reliable and inexpensive electricity — about 5 percent less expensive than coal and two-thirds less than natural gas. That's because much of the capital costs of these plants have been retired through amortization, write-offs, and other means. Under today's conditions, it's difficult to evaluate the cost of a new nuclear plant. In large part, this is due to the uncertainties associated with many of the fundamental cost factors of such an investment.

The NuStart project is designed to address these uncertainties through the following objectives:

- **Complete the design engineering work for the next generation of nuclear technologies, and create standard plant designs that can be built by any licensed power generator. The best-suited technologies are the 'advanced light-water reactor' designs. NuStart has selected the Westinghouse Advanced Passive AP1000 and the General Electric Economic Simplified Boiling Water Reactor (ESBWR) designs. These two designs are an evolution of the existing designs, but employ passive safety features, which refer to the reliance on natural laws of physics, such as gravity and natural circulation, rather than complex systems of pumps and valves. For example, the safety systems of the AP1000 advanced reactor, which is under review by the government for design certification, has half the number of valves, 80 percent less piping, 35 percent fewer pumps, 85 percent less cable, and 45 percent less building volume than current light water reactors.**
- **Demonstrate that the U.S. Nuclear Regulatory Commission's (NRC) new streamlined licensing process works effectively by providing full federal oversight and public participation while eliminating the artificial and economically debilitating delays that characterized the previous licensing process. The new, two-step process allows a company like Exelon to designate a potential site for a potential new reactor. It requires the site owner to analyze the environmental and safety characteristics of the site in advance. The NRC then reviews these comprehensive analyses in support of issuance of an Early Site Permit (ESP). The ESP does not authorize construction, but enables the site owner to "bank" the site for future consideration. The site analyses can then be incorporated into a subsequent combined Construction and Operating License (COL) application that seeks NRC approval for construction and operation of a nuclear facility. To gain an understanding of the first part of the new process, Exelon has applied for an ESP for property in central Illinois adjacent to its existing Clinton Power Station, a single unit nuclear station that began commercial operation in 1987. The company's involvement in NuStart will help to develop the second step in the process, the COL.**

APRIL 10 – 12

The 2005 International Conference of Doble Clients Industry Expo
Doble Engineering
Boston

APRIL 11 – 15

International Hydrogen + Fuel Cells Group Exhibit, Hannover Fair
Arno A. Evers FAIR-PR
Hannover, Germany

APRIL 11 – 15

World of Coal Ash
Univ. of Kentucky CAER, American Coal Ash Assoc., US Dept. of Energy NETL, US Office of Surface Mining
Lexington, Ky.

APRIL 17 – 20

Engineering & Operations Technical Conference
APPA
Memphis, Tenn.

APRIL 18 – 20

IASTED International Conference on Energy and Power Systems
IASTED
Krabi, Thailand

APRIL 26 – 28

Distribution Europe 2005
Synergy
Berlin

MAY 5 – 7

Clean Energy Technology & Investment Show
LBP Events
London

MAY 9 – 11

North American T&D Conference & Expo
Electric Energy T&D
Toronto

MAY 11 – 12

Industrial Energy Technology Conference
Texas A&M University
New Orleans

MAY 15 – 18

WINDPOWER 2005 Conference & Exhibition
American Wind Energy Association
Denver

MAY 17 – 20

CIS Conference 29—Blazing New Trails
CIS
Phoenix

MAY 22 – 24

World Renewable Energy Conference 2005
World Renewable Energy Congress
Aberdeen, Scotland

MAY 23 – 25

15th Annual Meeting of the Electricity Storage Association
Electricity Storage Association, Kinetrics
Toronto

MAY 23 – 25

3rd International Conference on Fuel Cell Science, Engineering and Technology
ASME
Ypsilanti, Mich.



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These two objectives represent the significant actions needed by the industry for new nuclear investments. By successfully completing these tasks, the industry will be able to significantly reduce the time to market for a new plant.

While NuStart has taken responsibility to address the challenges of regulatory unpredictability and completing the advanced designs, additional challenges remain. First among them is the disposition of used nuclear fuel. Yucca Mountain, Nev., the intended home for most U.S. commercial used fuel, is more than 10 years behind schedule. The arid, isolated repository site is already the most scientifically investigated piece of real estate in history (more than two decades of intense and often redundant research costing more than \$8 billion - so far), yet Nevada political forces and anti-nuclear groups across the country have mounted challenges that have pushed any possibility of opening the site as a permanent storage facility well into the next decade. It was supposed to have opened in 1998.

No company is likely to invest the kind of capital required for a new nuclear energy plant without assurances that the Energy Department will move its used fuel to a central storage site, as the Nuclear Waste Policy Act of 1982 requires. While storing used fuel at existing nuclear generating sites is acceptable from a safety perspective, those sites cannot be fully decommissioned until all used fuel is removed. A more compelling argument may be that the public will ultimately never accept 70 or 80 independent, permanent used-fuel storage facilities scattered about the country as an alternative to a single underground storage facility on a massive federal reserve in the Nevada desert that is arid, barren, geologically stable, and has already been used for decades as a testing ground for various nuclear technologies, including weapons.

The second challenge is the re-establishment of the nuclear infrastructure. Some predict if you build it, they will come. That may be the case, but we need to have assurance that we will have the adequate personnel to build and operate the next fleet of plants. We are all aware of the aging demographics of our industry and the fact that we have not built a new nuclear plant in this country for many years. This challenge also includes the global market's ability to handle the manufacturing demands for the large components for the next fleet.

The third challenge is acceptable financial returns. A nuclear investment must look attractive on an absolute basis as well as superior to other fuel investment alternatives. For any generation investment, there must be a demonstrated need for base load power with a reasonable prediction of expected market price. The outcomes of all of the nuclear challenges discussed above feed into the overall economic viability of a new nuclear investment. It is becoming evident that the first movers of nuclear investments will need financial incentives, including production tax credits, loan guarantees or investment

tax credits, given the perceived financial risks associated with the initial nuclear investments. Financial incentives similar to those already in place for other generation technologies should be used to encourage needed nuclear investments.

The final challenge is broad public and political acceptance of nuclear power as a long-term solution to America's energy and environmental needs. It is interesting to note that much of the world has already come to the conclusion that the earth's energy future lies in nuclear power, at least in part. Nine nations, including China, Taiwan, Japan and India, had 25 nuclear generating units under construction in January.

Even in the United States, public acceptance of nuclear power has grown steadily over the past 20 years. In the most recent polls commissioned by the nuclear industry and conducted in 2004, seven in 10 Americans consider nuclear power plants reliable, and even more — three-fourths — support the federal-industry collaboration on new reactors embodied by the Energy Department's 2010 initiative. What's more, nearly two-thirds of Americans (65 percent) say they favor nuclear power remaining part of the nation's energy mix, and a similar percentage (64 percent) said they would accept a new nuclear plant on the site of the nearest existing plant if more electricity were needed.

The challenge is in maintaining and further expanding this high level of support for nuclear, which is often surprising to those who don't regularly follow industry issues. This increasingly positive feeling toward nuclear energy is based largely on the confidence engendered by the consistently high level of safe operations the nuclear industry has demonstrated since the 1979 accident at Three Mile Island, when public opinion of nuclear power reached an all-time low. Since then, ongoing improvements in safety, security, capacity factors, and production costs have helped convince Americans that nuclear power is indeed worth another look.

Continuing to improve that high-level performance is the ultimate challenge faced by the nuclear industry, not so much because it is difficult to do but because all other progress within the industry depends on doing it successfully. Our challenge is the diligence with which we pursue self assessment and self criticism, the rigor with which we meet the self-imposed standards that are higher than those imposed by regulators, and the consistency with which we practice the safe production of electricity as our highest calling. These will do more to determine the future of nuclear energy in American than any other factor.



Marilyn Kray is vice president, nuclear project development, Exelon Corp. and president of NuStart, a consortium of power companies and reactor vendors formed to address challenges facing new nuclear investments.

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COAL VS NUCLEAR

Coal-fired generating plants release 100 times as much radioactivity into the atmosphere as nuclear power plants, reports an article in a recent issue of *Wired* magazine.

STORING CARBON DIOXIDE

BP and its partners are injecting carbon dioxide one mile underground at a natural gas processing plant in Algeria's Sahara Desert.

The project, which cost \$100 million, is viewed as a significant test to combat global warming.

CHINESE WAVE POWER

Chinese scientists recently completed tests of a six kilowatt system.

They want to develop a 50-kilowatt plant that could provide power to 240 families in a coastal village.

The Promise of Wave Power

GUEST OPINION

By Annette von Jouanne

The solutions to today's energy challenges need to be found through increased electricity generation using alternative, renewable and clean energy sources. An extremely abundant and promising source of energy exists in the world's oceans. It is estimated that if 0.2 percent of the ocean's untapped energy could be harnessed, it could provide enough power for the entire world. Ocean energy exists in many forms including wave, tidal, thermal, and salinity. Of these forms, researchers at Oregon State University (OSU) have identified significant opportunities and benefits from wave energy extraction.

Research conducted by OSU (using data from the National Oceanic & Atmospheric Administration ocean monitoring buoys), as well as studies by the Electric Power Research Institute (EPRI), has shown that the Oregon coastline presents some of the richest ocean wave energy potentials in the nation. This has prompted the formation of an engineering team at OSU investigating novel direct-drive ocean wave energy extraction devices. OSU is the prime location to conduct ocean energy research, noting the following strategic facilities:

➤ OSU is the home of the nation's highest power university-based energy systems laboratory, with a 750kVA dedicated power supply and full capabilities to regenerate back onto the grid.

➤ OSU is the home of the O. H. Hinsdale Wave Research Lab (WRL) with world-class wave tank facilities, including a 342-foot wave flume.

The combination of key facilities at OSU, ongoing successful wave energy research, and the tremendous wave potentials off the Oregon coast has led researchers at OSU to pursue the formation of a U.S. Ocean Energy Research and Demonstration Center in Oregon. The center would be strategically located at OSU for research and development with a demonstration site off Reedsport, Ore. Reedsport has been identified by EPRI and the Bonneville Power Administration (BPA) as an optimal location for wave energy extraction demonstration — not only from the standpoint of the nature and magnitude of the wave energy source, but also based on other key features such as coastline geometries and access to the electrical transmission grid. A link to the significance of Reedsport is the use of the electrical substations primarily installed to provide power to a now-disused paper mill and an existing effluent pipe to serve as a conduit in the ocean for power take-off cables.



Photo courtesy of: Oregon State University

▲ Testing is performed at Oregon State University's O.H. Hinsdale Wave Research Lab.

Currently, OSU's team is engaged in the nation's only university research program funded from federal resources in ocean wave energy extraction. Several novel wave energy buoy concepts are arising from this research focused on a more direct conversion of processes.

Understanding the processes requires advanced modeling techniques, which are also being developed through this work including advanced fluid structure interaction modeling in both 2D and 3D.

BACKGROUND

The world's first wave energy device patent was registered in 1799 by Girard in Paris. After more than 200 years of development, there are currently more than 1,500 wave energy device patents. Historically, there have been two booms of interest in the research of wave energy, corresponding to the 1970's oil crisis and pollution concerns as well as concerns regarding natural resource reserves since the mid-1990s. Ocean energy extraction technology is currently in a very preliminary state of development — where wind turbines were approximately 15 years ago, with no clearly superior engineering solutions yet established. The OSU team is engaged in research, development and demonstration preparation stages to move toward optimal wave energy topologies (similar to the wind turbine research process which led to the predominant horizontal-axis, three-blade turbine designs). Ocean wave energy has advantages over wind energy in

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KCP&L LINE REBUILT LIVE

Two years ago, Kansas City Power & Light Co. was starring at a serious bottleneck in its transmission system. A major 345-kilovolt line needed to carry more power to serve the regional wholesale electric market.

KCP&L turned to Quanta Services, whose crews replaced the conductors one at a time while power was diverted from the line being worked on to a temporary line. This reduced the needed outage time and did not require the rebuilding of the existing structures.

Work, which began in February 2003, was completed in four months at a cost of less than \$7.1 million while boosting the capacity of the line by 40 percent.



Technology Frontier

that it is more predictable, with forecast times in the range of several hours, less variable, and offers higher available energy densities.

Depending on the distance between the conversion devices and the shoreline, wave energy systems can be classified as shoreline, near-shore and offshore extraction systems.

Shoreline devices are devices fixed to or embedded in the shoreline. Examples include the Oscillating Water Column (OWC), which is the most developed of the shoreline devices. An OWC system has a partially submerged hollow air chamber, which opens to the sea under the water line. A wave enters the air chamber and forces the air in the column to pass through a turbine. When the wave retreats, the air will be drawn back and pass through the turbine again.

Near-shore devices are in between the shoreline devices and offshore devices. Near-shore devices are characterized by being used to extract the power directly from the breaker zone and the waters immediately beyond the breaker zone.

Offshore devices are the farthest out to sea; they extend beyond the breaker lines and utilize the high-energy densities and higher power wave profiles available in the deep-water waves and surges. For utility grid support applications, submersible electrical cables are needed to transmit the generated power onto land where they can be interconnected to the grid. The devices (e.g. buoys) can be placed in such a way that they have little visible impact and would be connected in arrays of several buoys depending on the desired overall generating capacity.

DEVELOPING WAVE ENERGY GENERATOR BUOYS

OSU researchers are currently developing three novel prototype wave energy generator buoys to directly convert the linear motion of the waves to electrical energy. The research and development goals are driven by the important issues of survivability, reliability and maintainability — in addition to efficient and high-quality power take-off systems. The OSU wave energy team is focusing on “direct drive” approaches that allow generators to respond directly to the movement of the ocean, with coupling by magnetic fields for contact-less mechanical energy transmission. Note: This is in contrast to using intermediate hydraulic or pneumatic systems. The extracted energy is then processed through advanced power electronics for efficient transmission through sub-sea cable along the sea floor to land, and interconnection to the grid.

OSU's three direct-drive prototypes include a Permanent Magnet Linear Generator Buoy, a Permanent Magnet Rack and Pinion Generator Buoy, and a Contact-less Direct Drive Generator Buoy. These buoys are designed to be anchored one to two miles offshore in typical water depths of greater than 100 feet — where the buoys will experience gradual, repetitive ocean swells.

Inside the Permanent Magnet Linear Generator Buoy, the wave motion causes electrical coils to move through a magnetic field, inducing voltages and generating electricity. In the Permanent Magnet Rack and Pinion Generator Buoy, linear to rotary conversion is being developed as an extension of the concept of permanent magnet gears. In this device the rotary speed of the magnet gears are greater than the linear speed of the rack (which moves up and down with the ocean swells) making the output more effective for rotary generators. The Contact-less Direct Drive Generator Buoy exhibits linear force transmission using large, high-strength permanent magnets configured in a “piston.” The motion of the piston is then transformed to rotation using a ball screw to drive a permanent magnet rotary generator.

LOOKING TO THE FUTURE

Pioneering developments in ocean wave energy extraction devices are taking place at OSU to best take advantage of wave power in ways that are reliable, maintainable and able to survive a hostile ocean environment. The developing prototype generator buoys are being designed so that they can be “winched down,” or pulled beneath the ocean surface during severe storm or tsunami conditions. Just like wind energy, wave energy systems will be more expensive at first, and then the cost will come down — becoming very competitive due to the advantages of increased energy densities, availability and predictability. While wave energy is about 15 years behind wind, several factors promise that the “catch-up” time can be much less, including advanced technologies and materials as well as the lessons learned from offshore wind installations. Initial wave generator rating estimates are that buoys of approximately 12 foot diameters and heights could produce power on the order of 250kW per unit. Thus, a network of 200 such buoys could power the business district of downtown Portland, Ore. Fortunately for the Pacific Northwest, the winter period of highest wave energy potentials coincides with peak electricity demands. OSU researchers are also investigating small-scale wave energy generators, which could be integrated into water craft anchor systems to power a variety of electronic devices and enable ocean data collection/monitoring buoys to become self powered.

There is reason to hope that advancements being made in ocean wave power may enable a major new, reliable and flexible source of affordable renewable energy. ☞



Annette von Jouanne is professor of electrical engineering and computer science at Oregon State University.

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Trends In Utility Rate Case Filings

By Robert L. Schain

A growing number of electric and gas utilities are seeking approval of retail rate increases from their state regulators.

At the end of last year, electric utilities had \$2.2 billion in rate cases pending; at the end of 2003, \$2.4 billion in cases were pending. Gas utilities had \$662 million in filings pending the end of last year and \$971 million the end of 2003.

By far, the filings of both electric and natural gas utilities in the past two years dwarf the filings in any two-year period going back a decade.

Last year, regulators ratified a total of \$1.1 billion worth of electric rate hikes — the highest amount of the past decade. Gas utilities were granted a combined \$304 million in increases — the second highest total in 10 years.

In the early to mid-1990s, utilities were nearing the end of a very large construction cycle, in which numerous generating facilities were placed into service. Many of these plants were nuclear, which were relatively costly to construct. The number of cases, both filed and decided, was relatively high, given the utilities' needs to have their plant investments reflected in rates.

In the mid-to late-1990s the number of cases subsided given the completion of the large-scale construction and the fall in interest rates. The latter had a significant impact on the number of cases. As interest rates fell, the companies actively refinanced their high-cost debt. If they initiated a rate case, the lower interest costs would be flowed through in the form of lower rates. By staying out, the companies were able to retain the benefits from the lower costs. Additionally, lower interest rates meant lower allowed ROEs. By not coming in for a rate case, many a company retained the relatively high authorized ROE that it was awarded a few years back.

Also around that time, the term "competition" became popular. Companies tried to avoid rate filings, on

the premise that raising their rates would not be ideal from a competitive standpoint. Also, most companies began severe cost-cutting efforts, which also kept them out of the rate case arena.

Today, the rate case count is still affected by the low interest rates — the average authorized ROE is currently at the lowest in recent memory. However, competition is no longer affecting the rate case count. For those states that have restructured, generation is now priced outside of rate cases (e.g. competitive bid, or contract). Distribution rates remain fully regulated and many companies that have not had a rate case in several years now have the need to file, despite the low interest rate environment. As these tables show, the number of cases decided is on the rise, as are the number of filings.

NUMBER OF RATE CASE FILINGS Aggregate Amount Requested (\$ mil.)				
As of Dec. 1	Electric	Gas	Electric	Gas
2004	21	21	2,171.8	661.8
2003	20	23	2,400.3	970.5
2002	16	20	1,692.7	351.4
2001	21	12	1,816.8	560.4
2000	12	8	1,003.1	161.7
1999	10	13	759	562.9
1998	14	8	894.8	546.1
1997	13	11	624.9	161.9
1996	16	18	429.8	266.7
1995	26	14	INF	108.8

AVERAGE EQUITY RETURNS AUTHORIZED JANUARY 1994 - DECEMBER 2004						
Period	Electric Utilities	Gas Utilities	Total Cases Decided	Aggregate Amount Electric	Authorized Gas	
2004	10.73 (30)	10.59 (31)	61	1,092.2	303.5	
2003	10.97 (22)	10.99 (30)	52	313.8	260.1	
2002	11.16 (24)	11.03 (26)	50	-475.4	303.6	
2001	11.09 (21)	10.95 (11)	32	14.2	114	
2000	11.43 (34)	11.39 (20)	54	-291.4	135.9	
1999	10.77 (30)	10.66 (14)	44	-1,683.8	51	
1998	11.66 (31)	11.51 (20)	51	-429.3	93.9	
1997	11.40 (33)	11.29 (21)	54	-553.3	-82.5	
1996	11.39 (38)	11.19 (34)	72	-5.6	193.4	
1995	11.55 (43)	11.43 (31)	74	455.7	-61.5	

Source: Regulatory Research Associates



Robert L. Schain is president of Regulatory Research Associates, Inc.

Ticker Takes

A handful of utility stocks in the past 12 months have reversed significant price retreats, much to the delight of their investors.

TXU share prices have about tripled in the 12 months ended Feb. 1, according to data compiled by SNL Energy.

On the gas side, Williams Cos.' shares have jumped more than 67 percent in that period.



TOP 20 PRICE LEADERS as of last market close (2/1/2005)

Company	(%) Price Change	Closing Price (\$)	High (\$)	Low (\$)
TXU Corp	188.88	69.33	69.85	23.35
Sthwstrn Energy Co	162.32	54.17	55.45	19.32
NRG Energy Inc	76.65	35.33	36.18	18.1
Williams Cos Inc	67.26	16.96	17.18	8.49
Reliant Energy	62.11	12.58	13.94	6.61
Crosstex Energy	58.31	34.75	35.25	21.38
Allegheny Energy	53.96	19.43	20.2	11.75
Edison Intl	46.45	32.22	32.98	21.24
AES Corp	46.41	14.29	14.37	7.56
Crosstex Energy	46.26	41.1	45	27.85
Questar Corp	44.69	50.83	52.12	33.82
El Paso Elctrc Co	41.06	19.72	19.84	13.07
Energen Corp	39.65	60.05	60.59	39.87
Southern Union Co	37.68	23.55	24.97	16.9
Exelon Corp	35.11	45.25	45.28	30.92
S Jersey Indstrs	31.51	54.13	54.55	39.36
Equitable Resource	31.44	57.69	61.18	42.1
UGI Corp	30.64	42.13	42.2	29.85
PG&E Corp	30.24	34.97	35.3	25.9
El Paso Corp	28.47	10.92	11.85	6.57

Based on stock prices as of market close on 2/1/2005

TOP 20 PRICE LOSERS as of last market close (2/1/2005)

Company	(%) Price Change	Closing Price (\$)	High (\$)	Low (\$)
ALLETE Inc	-57.91	41.35	110.13	30.76
US Enrgy Systems	-43.88	0.78	1.85	0.65
Calpine Corp	-41.92	3.38	6.42	2.24
Envmntl Power Corp	-29.5	6.44	9.87	5.6
ME & Maritimes	-24.36	25.15	34.5	24.6
Cap Rock Energy	-22.74	24.8	32.91	23.4
Great Plains	-9.09	30.2	35.69	27.86
Cascade Ntrl Gas	-6.04	20.55	22.61	19.1
Otter Tail Corp	-5.88	24.99	27.36	23.77
Aquila Inc	-4.42	3.68	4.86	2.25
NE Utilities	-3.12	18.65	20.09	17.17
IDACORP Inc	-2.24	30.11	32.95	25.3
Kinder Morgan	-2.14	45.8	47.7	37.65
Central VT Public	-2.02	23.27	24.03	18.45
Avista Corp	-1.06	17.66	19.43	15.35
SEMCO Energy Inc	-1.06	5.58	6.38	4.5
Delta Natural Gas	-0.96	25.85	28.75	22.02
Duquesne Light	-0.95	18.86	20.5	16.93
BayCorp Hldgs Ltd	-0.23	13.16	13.31	11.4
Black Hills Corp	-0.1	29.77	32.49	26.52

Based on stock prices as of market close on 2/1/2005

POWER, GAS PRODUCTION FLAT

Natural gas and power production has exhibited little growth in recent years, according to the modest recent figures available.

PRODUCTION FLAT	
Electric Production	
2001	3,736,644 Gwh
2002	3,858,452
2003	3,847,990
Nat Gas Production (US)	
2001	19,616 Bcf (Net Imports-3,604)
2002	18,964 (3,499)
2003	19,106 (3,236)

Source: SNL Energy and U.S. Energy Information Administration

Source: SNL Energy

Renewable Energy Rankings

The United States is a close third to the United Kingdom and Spain in deployment of renewable energy technology, according to a new report by Ernst & Young.

The report weighs national efforts to use wind, solar, biomass and other renewable technologies.

The study is forward looking. Ernst & Young predicts that renewable energy growth will be more robust this year than last.

China is expected to step up its development of renewable

energy as "the necessary support for a renewable energy economy is becoming established," the authors write.

Domestically, the situation is complex. "The U.S. renewable energy market continues to suffer from a lack of long-term political commitment," the authors write. "Foreign energy companies, including Shell, Scottish Power and AES have undertaken to challenge Florida Power & Light's traditional dominance in U.S. wind energy production. ☒

RENEWABLE ENERGY RANKINGS

December 2004	
UK	67
Spain	67
USA	66
Germany	61
Portugal	59
France	58
Italy	58
Greece	56
Sweden	56
Netherlands	56
Ireland	56
Denmark	56
Australia	52
India	49

Source: Ernst & Young



Introducing

The Biologist at Southern's Helm

CHALLENGED TO GROW AN INDUSTRY GIANT

By Martin Rosenberg

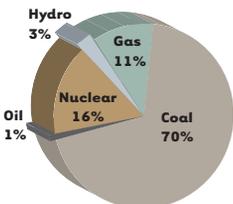
SOUTHERN COMPANY

Territory: 120,000 square miles



Generating capacity: 39,000 megawatts from 79 generating units

Fuel source: 71 percent coal; 16 percent nuclear; 4 percent hydro; and 9 percent oil and gas



2004 revenues: \$11.9 billion

2004 earnings: \$1.5 billion

Customers
➤ Residential — 3,552,000

➤ Commercial — 564,000

➤ Industrial — 14,000

➤ Other — 6,000

➤ Total — 4,136,000

David Ratcliffe knows his term at the helm of the Southern Company comes at a time when the power industry has entered choppy waters. He is one of a number of executives around the country tapped in the past few years to steer their utilities on the eve of what may be a period of epochal industry changes.

New energy legislation and environmental policies as well as a round of industry consolidation are just a few of the challenges Ratcliffe is preparing to tackle. The 56-year-old executive became president in April and chief executive and chairman in July. Ratcliffe and *EnergyBiz* recently discussed his company and industry. His edited comments follow:

energybiz: How does a biologist become a utility executive?

RATCLIFFE: You have to be extremely lucky. I started out with The Georgia Power Co. in 1971 when we were doing the first round of clean air and clean water projects around power plants. I grew up on a power plant operation inside of the business, had to ask a lot of questions, and try to learn as much as I could.

energybiz: How did you get interested in biology?

RATCLIFFE: My dad had a degree in plant physiology and worked with the State Department of Agriculture. I grew up working in an agricultural experiment station in south Georgia during the summer. That was where my interest in biology was born. If I had it to do over again, I'd probably go to medical school. I have always been fascinated with what a wonderful machine the human body is.

energybiz: A lot of biological and environmental issues are going to be facing utilities in the years ahead.

RATCLIFFE: Having grown up in that side of the business is giving me a unique perspective.

energybiz: A.W. "Bill" Dahlberg held the top job at Southern for about seven years, and Allen Franklin, your predecessor, had it for three. Why do you think the pace of turnover has quickened?

RATCLIFFE: Bill made a hard decision to spin off Mirant, the competitive generating company, and let Allen take over the Southern Company. Allen is a fairly unique individual in that he has never been carried away with position or title. He made a commitment to the board that he would stabilize Southern, and he felt like he has done that.

energybiz: There is a changing of the guard at a number of utilities. What kind of executives are now assuming leadership roles?

RATCLIFFE: It's a mixed bag. They are coming from different backgrounds. The industry is much more diverse than it has ever been. Ten years ago, this was a very homogenous industry. We all pretty much looked alike as vertically integrated businesses. We had differences in size and geographic challenges, but we were all trying to do the same things more efficiently and meet growing demand. Now we face different regional issues — some companies are more integrated than others; some are disaggregated. So it should not surprise us if we see a lot of new players emerging. This business has always been complicated. It's always been a much more complex business than the general public realizes.

energybiz: You remain pretty much a traditional, integrated utility. You serve a number of states, and are one of the largest generators with 39,000 megawatts. How does that position you going forward?

RATCLIFFE: Well, we have a very good company, and we're fortunate to live in and operate a business in a part of a country where there's continued economic expansion. So that bodes well for the growth of our business. Look at the generation mix that we have: It's primarily coal, some nuclear and a growing gas component. When you look at how our plants are operating and how our transmission and distribution system are operating, we're achieving record reliability goals. The franchise that we operate is in really outstanding shape. I think the Wall Street folks have recognized that and rewarded us.

As for the competitive wholesale generation business, we've built a very good business around that model, and we will continue to expand that. So I am very optimistic.

energybiz: Given the planned merger of Exelon and PSEG, will Southern have to get larger?

RATCLIFFE: No. We are already big enough. Look at the metrics. We're certainly in the top five if not the top three. John Rowe, the head of Exelon, may become number one if he completes this merger, but I suspect AEP and Southern are right there behind him.



Photos by: Rick Ward/Southern Company

energybiz: Is the power industry headed toward further consolidation?

RATCLIFFE: Yes, we've been talking about that for 10 years. Size will help folks succeed in the long term. You've got to find the right match. There's still a fair amount of concern about things like the Public Utility Holding Company Act. If that were to get repealed, it might facilitate more mergers and acquisitions and attract some new entrants into the industry – like oil companies.

energybiz: Southern supports PUHCA repeal?

RATCLIFFE: Yes.

energybiz: How has Southern been affected by the hurricanes that recently swept through the Southeast?

RATCLIFFE: We did okay. Our folks responded magnificently, and we were able to get most of our customers back online within a week. We lost about 5,000 accounts in the panhandle of Florida that don't exist anymore, but we're seeing folks begin to build that back. We weathered the worst storm that we've had in our history – Hurricane Ivan — and seemed to do okay.

energybiz: A large number of utilities see their workforce aging. Is that a problem at Southern?

RATCLIFFE: We have exactly the same problem. We're actively looking at opportunities to develop all of our folks — particularly our younger ones. We have a very active workforce planning process. We look at functional responsibilities and critical jobs and make certain that we know workers' retirement intentions. Then we plan accordingly.

We may hire additional folks or move people around to get them the best experienced-based knowledge.

energybiz: What constraints will utilities contend with as a result of global warming?

RATCLIFFE: Well you touched a very complex subject, and as you know there are differences of opinion. Most folks would agree that the signs seem to indicate a strong link between greenhouse reactions and climate change. There are still a lot of unknowns, and I don't want to move too quickly. There's a tremendous amount that we've got to continue to work on to understand global climate models and the long term implications of what we see.

We need a long-term glide path to achieve the technology that is necessary to capture carbon. While we know how to capture carbon to some degree, we've never done it on the scale that some people anticipate. It's clear that it will cost a lot.

If we are successful in developing the technology to capture carbon, we still have to decide what we're going to do with it. We've either got to store it in underground caverns or dump it in the ocean — and we don't know what the environmental consequences of that are. There are lots of unknowns. That is not a reason for us not to move forward, and we've been very active in supporting voluntary measures to reduce CO₂ emissions. In our own operations we've improved efficiencies and avoided the creation of about 100 million tons of CO₂ in the last several years. We are one of the major sponsors of developing new technology to burn coal cleaner.

We have to support the next generation nuclear capacity in this country. That's the best technology we have when it comes to zero greenhouse gas emission. We know that technology, we



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> Reduced, avoided or sequestered more than 74 million metric tons of carbon dioxide.

> Reduced emissions of sulfur hexafluoride, a highly potent greenhouse gas, more than 80 percent.

> Testing advanced mercury control technology, conducting research into fuel cells and renewable energy.

know how to operate it, but we haven't built new nuclear plants in 25 years.

energybiz: The Kyoto Accord, ratified by 141 nations, went into effect in February – without the participation of the United States. Your thoughts?

RATCLIFFE: All the folks run to embrace things like the Kyoto Accord. The Japanese, the Canadians, and the Europeans are now very quietly admitting that there's no way they can achieve their objectives. There's not much publicity about that. The fact that we as a nation didn't sign up because we knew we couldn't do it – we shouldn't be criticized for that. The contribution to global warming made by the United States is very small when you look at the expected contribution of China and India. Those folks are not in this discussion. Nothing that we do in the United States will make much of a difference if that is the case.

energybiz: Given Southern's prominence in the power industry, do you believe your company should be a key player in shaping national energy policy?

RATCLIFFE: We certainly will be in those policy discussions. My intention is for us to be a key player. Given our footprint from a generation standpoint, we have to be a player in those discussions — and we are.

energybiz: Vice President Cheney was the top architect of the energy proposals put forth by the Bush administration four years ago. Will he play a similar role this year?

RATCLIFFE: I would expect he will remain involved in it. He is one of the most knowledgeable folks in the administration.

energybiz: Will we get meaningful energy legislation passed by Congress?

RATCLIFFE: There's no question that the energy bill seems to be getting some traction. The indication that we have is that it is one of the top 10 items of this administration.

energybiz: Do we need generation?

RATCLIFFE: With the economy continuing to grow, we will require significant new generating resources as a nation going forward. We've got to get on the path of building additional generation. Several companies around the country are doing that. In the Southeast, we've been overbuilt in the wholesale market and will work out of that capacity probably in the next three or four years.



energybiz: Do you think independent power producers will remain important?

RATCLIFFE: Yes. There are companies purely in that business. We are in the competitive wholesale generation business. You'll see people build independent power facilities in a competitive marketplace.

energybiz: Where do you think we're headed in terms of competition nationally?

RATCLIFFE: People are in a wait-and-see mode to determine whether the expected benefits of retail competition actually accrue to the customer. The reality is that when given the opportunity to choose at a retail level, very few residential and commercial customers actually choose to switch. Most of this effort was driven by large industrial and commercial customers who wanted the opportunity to choose and have the ability to choose.

energybiz: The push for retail competition is not strong in your part of the country, correct?

RATCLIFFE: In the Southeast, our power costs are about 15 percent below the national average. There's not much of an incentive to move down this road until we see a significant benefit for the customer. The best model is wholesale competition – making those markets efficient.

energybiz: What happened with Mirant, the Southern spin-off involved in the competitive generation business?

RATCLIFFE: Our business decision to spin off Mirant was exactly the right one. Like many companies, Mirant was a victim of the Enron fallout and all that has transpired since then. We just have to wait and see what happens to Mirant as it comes through the bankruptcy process.

energybiz: What do you hope to achieve while you're CEO of Southern Company?

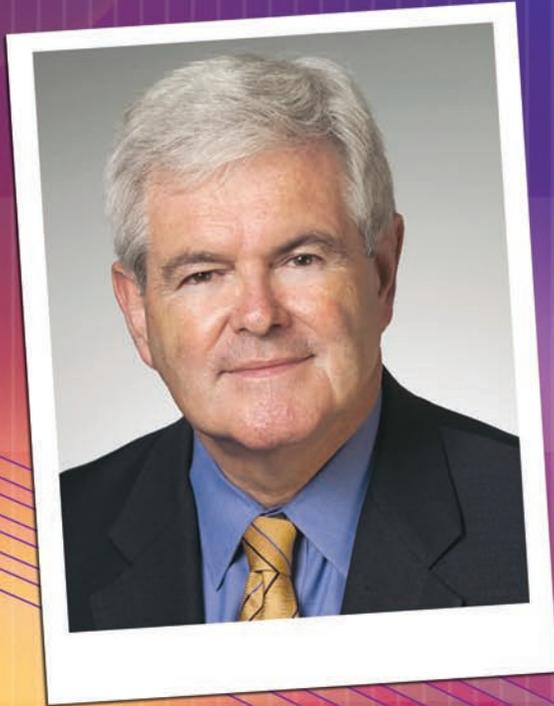
RATCLIFFE: I want to maintain Southern's position as a leader in this industry. This is a very good franchise, and my job is to maintain its viability and leadership position. Secondly, the job of any leader is to raise the next generation of leadership and to leave the company a little better than he found it. ☺



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Top Energy Employer

VALERO CLIMBS FORTUNE'S LIST

By Bill Greehey



Obviously, we don't know why Valero was the only energy company on Fortune magazine's list of the 100 Best Companies to Work For but we do know why Valero was listed and what distinguishes us from other companies.

All companies say their employees are their number one asset but at Valero we say it with our actions. We have the best pay and benefits in the industry. This year was a record year for Valero so all our employees were rewarded with a 200 percent bonus - one month's pay. Valero also gives stock options to more employees than most companies. At Valero, all exempt employees are eligible to receive stock options. And in an age of mergers and acquisitions where most companies merge to look for ways to reduce people as a way of reducing costs, we pride ourselves in the fact that Valero has never had a layoff. In fact, we successfully merged two Fortune 500 companies in the same town (Valero & UDS in 2001) without a single layoff.

We've weathered bad times through the years but we have always counted on our employees to see us through — and they have. In 1998, I think we were the ONLY energy company that did not have layoffs. Instead, we asked our employees to cut costs in everything but safety and environmental efforts and they came up with \$46 million in expense savings that year. A layoff would not have saved as much and would have destroyed morale. Instead, our employees pulled together and were more motivated than ever. Then, when margins improved, we were in a position to take off running. And we did so by acquiring Ultramar Diamond Shamrock Corp. in 2001 — a company that was actually larger than Valero at the time.

Another thing that distinguishes Valero from other companies is its unique caring and sharing spirit. When we founded the company, we said in our mission statement that we wanted to be a company known for giving back to the communities in which we had business operations. We also said we wanted to hire caring people because people who care about the community typically care more about the company and their co-workers. This strategy has worked well for Valero because our employees take a great deal of pride in all that the company does for the community, which results in great employee morale and camaraderie.

Valero used to be in a regulated business. At one time we owned the largest intrastate pipeline in Texas. But we have always had the same philosophy about treating our employees as our number one asset.



Photo courtesy of: Valero Energy

At Valero, we firmly believe that our dedication to our employees is the root of all our success. We believe that if you take care of the employees, they'll take care of the community and the share holders. And, I'm happy to say that our numbers back up this belief. We've had record earnings, a record stock price, record total shareholder return and much more. In fact, Valero's total shareholder return has been 380 percent over the last five years compared to the S&P 500 Index's 11 percent loss over that same period. Last year Valero's total shareholder return was 98 percent and year-to-date it is about 60 percent. Valero just completed the best year in its history and has attracted national attention after receiving a string of honors.

We were ranked No. 1 by Forbes Magazine on their annual listing of America's 400 Best Big Companies for our 2004 earnings growth and shareholder return; We were ranked 3rd among the large employers on Fortune Magazine's listing of the "100 Best Companies to Work For." As you know, Valero also rose to No. 23 on this year's list of the nation's best employers — up from its No. 32 ranking in 2004.

It is a tremendous testament to Valero's unique culture to be recognized for our commitment to the community and to our employees and to our shareholders — all in the same year.

We believe Valero is living proof that a company can successfully look out for ALL of its stakeholders. ☺

Bill Greehey is chairman and chief executive officer of Valero Energy Co., which is based in San Antonio, Texas, has annual revenues of \$55 billion and employs 20,000.

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Enterprise Asset & Work Management

Addresses full asset lifecycles, from design/estimating, construction, operations, and maintenance to salvage/retirement. Optimizes repair/replacement decisions while improving asset reliability, service levels, and regulatory compliance.

Mobile Workforce Management

Ensures resource availability and automates field-force operations with state-of-the-market mobile workforce dispatch, resource scheduling and routing, and automatic vehicle location.

Outage Management

Reduces service restoration time, improves operational efficiency, safeguards workers and the public, and offers the only comprehensive real-time outage management solution.

Distribution Management

Helps distribution utilities create new sources of revenue, decrease costs, defer capital investments, and provides tools required for proactive operations and network management.

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