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# **Report of the Tennessee Valley Electric System Advisory Committee**

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March 31, 1998

# Tennessee Valley Electric System Advisory Committee Membership

**The Honorable Butler Derrick, Chairman**  
Williams and Jensen, P.C., Washington, DC

*Member of the Secretary of Energy Advisory Board*

**Mr. George Blaylock**

International Representative, International Brotherhood of Teamsters, Fort Oglethorpe, Georgia

*International Brotherhood of Teamsters represents 30,000 members in the power service area of TVA and approximately 800 TVA and TVA contractor employees.*

**Mr. C. Terry Callender**

Vice President, Government Affairs, NGC Corporation, Houston, Texas

*NGC Corporation is a leading gatherer, processor, transporter and marketer of energy products and services in North America and the United Kingdom. Through its Energy Store<sup>sm</sup>, NGC offers a multicommodity energy-product and -services resource that provides natural gas, natural gas liquids, electric power and crude oil.*

**Mr. Don Collette**

Tennessee Valley Public Power Association

President/CEO, McMinnville Electric System, McMinnville, Tennessee

*Tennessee Valley Public Power Association (TVPPA) represents 110 municipal electric systems and 50 rural electric cooperatives, all of which purchase their power from TVA. TVPPA members serve eight million electric consumers across the seven-state TVA service area.*

**Ms. Michelle Neal Conlon**

Natural Resources Chair, Knox County League of Women Voters, Knoxville, Tennessee

*League of Women Voters is a nonpartisan, political organization that encourages the informed and active participation of citizens in government and influences public policy through education and advocacy.*

**Mr. Joe Fisher**

Tennessee Valley Industrial Committee

Account Executive, Dye, Van Mol and Lawrence, Inc., Nashville, Tennessee

*Tennessee Valley Industrial Committee (TVIC) is made up of 33 large, energy-intensive companies that purchase electricity directly from TVA. TVIC member companies have 47 Tennessee Valley plant locations and operating sites providing approximately 35,000 jobs. TVIC members have a combined annual electric bill of approximately \$600 million.*

**Mr. Ronald Fogel**

Executive Director, Associated Valley Industries, Incorporated, Columbia, Tennessee

*Associated Valley Industries (AVI) represents 63 member companies who provide jobs for over 76,000 employees at 118 plant locations all across the Tennessee Valley. These companies purchase their power from distributors supplied by TVA.*

**Mr. Joseph Hartsoe**

Vice President, Enron Corporation, Washington, DC

*Enron Corporation is the world's leading integrated natural gas and electricity company. The company owns approximately \$23 billion in energy-related assets and delivers physical commodities and risk management and financial services to provide energy solutions to customers around the world.*

**Mr. Carl Lansden**

International Vice President, 12th District, International Brotherhood of Electrical Workers, Chattanooga, Tennessee

*International Brotherhood of Electrical Workers (IBEW) represents 4,500 employees of TVA and approximately 26,000 workers within the current TVA service area.*

**Mr. Neil McBride**

Director, Rural Legal Services of Tennessee, Oak Ridge, Tennessee

*Rural Legal Services of Tennessee is a publicly funded law firm that provides free legal aid to low-income people who live in 19 counties in the Appalachian coal fields of East Tennessee.*

**Mr. William Museler**

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*Tennessee Valley Authority (TVA) is a government-owned corporation, created by the TVA Act of 1933, with responsibility to provide electric power, flood control, navigational control, agricultural and industrial development, and other services to a region including all of Tennessee and parts of six surrounding states.*

**Mr. Kenneth Nemeth**

Executive Director, Southern States Energy Board, Norcross, Georgia

*Southern States Energy Board (SSEB) is an interstate compact of 16 States and 2 territories. The Board is composed of the governor and 2 legislators from each member jurisdiction. A Federal representative is appointed by the President. The Board's mission is to embrace economic development and the quality of life in the South through innovations in energy and environmental programs and technologies.*

**Mr. David Ratcliffe**

TVA Watch

Executive Vice President and Treasurer, Georgia Power Company, Atlanta, Georgia

*TVA Watch is made up of investor-owned utilities operating in markets that border the TVA service area. Members include Southern Company, Entergy, American Electric Power, Duke, Kentucky Utilities, Carolina Power & Light, and SCANA.*

**Dr. Stephen Smith**

Executive Director, Tennessee Valley Energy Reform Coalition, Knoxville, Tennessee

*Tennessee Valley Energy Reform Coalition (TVERC) is a coalition of 19 environmental, consumer, and advocacy groups throughout the seven-State TVA service area. The combined organizational membership is about 10,000.*

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# Introduction

In November 1997, Secretary of Energy Federico Peña requested that a subcommittee of the Secretary of Energy Advisory Board be created to advise him specifically on what provisions related to the Tennessee Valley Authority (TVA) should be included in the Administration's legislative proposal to bring competition to the electric utility industry. He made this request in response to interest in the initiation of a regional consensus building process. As a result, the Tennessee Valley Electric System Advisory Committee was created. This is the report of that Committee.

The Committee is made up of representatives from organizations with a wide range of interests in TVA issues, including TVA itself, retail distributors of the region, industrial retail customers served by TVA, industrial customers served by TVA's wholesale customers, surrounding utilities, independent power producers, marketers, environmentalists, advocates for low-income consumers, unions, and affected State governments.

This introduction to the report contains a brief history of trends in the industry that have resulted in the Administration's preparation of a comprehensive plan for competition in the electric industry, a short discussion of TVA, and a summary of the proceedings of the Committee. The nine sections that follow present discussions of and recommendation on the issues that the Committee decided are unique to the Tennessee Valley and that must be dealt with in order to bring the benefits of a competitive electric industry to the citizens of the Tennessee Valley.

## The National Background

There are many changes going on in the electricity industry. States are taking a hard look at electricity monopolies and deciding that a competitive industry where customers can choose their own suppliers can provide electric service with the same or greater reliability, at a lower price, and with less impact on the environment. At the Federal level, the Administration and key leaders in Congress are committed to allowing customer choice.

Since the early 1980s, there has been a growing competitive wholesale sector in the electricity supply business. The Public Utility Regulatory Policies Act of 1978 encouraged cogeneration and renewable power generators that were not owned by utility monopolies.

The Energy Policy Act of 1992 expanded the role of independent power producers by allowing nonutility companies to build powerplants and sell exclusively at wholesale, and by authorizing the Federal Energy Regulatory Commission (FERC) to order utilities that own transmission lines to allow competitors to use those lines for wholesale sales of electricity.

More than half of the new generation that has come on line in the United States since the middle 1980s has been built by independent power producers and not by traditional utility monopolies.

A number of States have passed legislation allowing customers to choose their own electric suppliers. (These states include California, Rhode Island, New Hampshire, Oklahoma, Nevada, Montana, Illinois, Massachusetts, Pennsylvania.) Others, such as New York, have issued regulatory orders doing the same. Many States have trial programs under way. In almost every State in the Nation, some kind of proceeding is under way that will likely result in the institution of retail competition in the electricity industry.

At least thirteen bills have been introduced in Congress to do the same, with sponsors ranging from Representatives Dan Schaeffer, Chairman of the House Energy and Power Subcommittee and Tom Bliley, Chairman of the House Commerce Committee, Tom Delay (R-TX), and Ed Markey (D-MA) in the House to Senators

Dale Bumpers, Slade Gorton, Jim Jeffords, and Jeff Bingaman in the Senate.

On March 25, 1998, the Administration transmitted the Comprehensive Electricity Competition Plan to Congress. The Plan contains detailed specifications for Federal legislation to allow customers to choose their electricity suppliers. This Plan does not contain specifications for a TVA title. It does acknowledge the work of this Advisory Committee and anticipates that the report will be of great help in preparing such a TVA title.

## Why Is This Happening?

Regulated monopolies are created for businesses where a competitive industry would be less efficient. Businesses that depend on networks, such as telephones, gas, and electricity are classic cases of the natural monopoly. Early in the development of the electricity industry it became clear that building multiple transmission and distribution systems would be a waste of resources. Economies of scale for generation meant that bigger plants were more efficient than smaller ones, and so, cheaper. Newer technologies, however, have developed that can allow many competitors to use the same network. Furthermore, economies of scale for generation have changed: New smaller generators, particularly combined-cycle gas combustion turbines, are more efficient and require less capital investment. These two facts suggest that a vertically integrated regulated monopoly may not be the most efficient way to get power to customers. Hence, a competitive industry is possible and will ensure that efficiencies are passed on to customers, since customers can shop for the most efficient supplier. A more efficient industry also is cleaner, using less fuel to provide the same amount of electricity.

Department of Energy economists, using conservative assumptions, have projected that a restructured, competitive industry could save Americans as much as \$20 billion per year by 2010.

The Department believes that customers will make better decisions for themselves than monopolists and regulators will make in their behalf.

## TVA Background

The Tennessee Valley Authority is a government-owned corporation created by the TVA Act of 1933 with a warrant to provide electric power, flood control, navigational control, agricultural and industrial development, and other services to a region including all of Tennessee and parts of six surrounding States.

Originally, the nonpower components of TVA's mission were of greater importance than the power program. Dams were built primarily for flood control and navigation, with power production as a third priority. In the early years, one of the most important projects was the manufacture of fertilizer at two plants in the Tennessee Valley, in order to encourage modern agricultural techniques. As time went on, however, power production became increasingly important.

In the 1940s, TVA's hydroelectric dams began to be augmented by coal-fired power plants. In the 1960s, TVA began a huge nuclear power construction program, planning and beginning work on seventeen reactors. In fiscal year 1997, TVA's generation mix was 54 percent coal, 20 percent nuclear, 17 percent hydro, and 9 percent gas.

In 1959, Congress amended the TVA Act to require TVA to fund power programs out of electricity revenues entirely. The Act also limits TVA to sales of electricity only to its own wholesale requirements and industrial retail customers inside its service territory, and to economy exchanges with the fourteen surrounding utilities with whom it already did business. This limitation created what is now called the fence. The amendments also authorized TVA to borrow money to finance the power program under a Congressionally set debt cap. The cap has been raised a number of times over the years and now is \$30 billion.

Until the beginning of the nuclear program, TVA's rates were stable and very low. The nuclear program, however was based on forecasts of demand that later did not develop, like those of many utilities in that era. TVA acquired land and began design work and construction on the plants. When demand did not emerge, TVA was forced to cancel a number of the plants. Construction was completed on five of the units in the 1960s and early 1970s. Work continued on four others. As a result of management and safety concerns, the Nuclear Regulatory Commission halted operation and construction of all TVA nuclear plants from 1985 until 1988.

Currently TVA has a total generating capacity of 27,694 megawatts. Peak loads in recent years have been at or above 26,600 megawatts. Revenues for fiscal year 1997 were \$5.5 billion. The debt is more than \$27 billion. Wholesale rates in 1996 were \$0.042 per kilowatthour.

TVA is governed by a three-member board of directors, appointed by the President and confirmed by the Senate to 9-year terms. The board is accountable to the President, and to Congress for annual appropriations to the nonpower programs. TVA is not subject to either Federal or State regulatory commission jurisdiction, except to the limited extent that the agency is subject to FERC under sections 211 and 212 of the Federal Power Act for transmission through TVA service territory but not to existing customers.

The board manages TVA, both as to power programs and nonpower programs. It is self-regulating as to planning and rates for the power programs. TVA also argues that it has the authority to regulate the retail rates of its distributors.

TVA supplies full power requirements to 159 retail distributors in its service territory. The distributors are all either municipal or cooperative utilities. The five largest distributors are the municipally owned utilities for Memphis, Nashville, Knoxville and Chattanooga, in Tennessee, and Huntsville, Alabama. All but one of the distributors are members of the Tennessee Valley Public Power Association (TVPPA).

The distributors purchase power from TVA under wholesale contracts. These are full requirements contracts that do not allow distributors to acquire power from sources other than TVA. They give TVA the right to set retail rates. The contracts also provide

for industrial incentive rates for industrial customers served by the distributors. Until recently the contracts were essentially evergreen with ten year notice provisions for termination. Some distributors have entered into contracts that shorten these notice provisions.

TVA sells to industrial customers directly and through the distributors. There are 67 large industrial and Federal customers who buy directly from TVA at retail.

## The Tennessee Valley Electric System Advisory Committee

The Advisory Committee was asked by the Secretary to complete its work and report to him by March 31, 1998. This allowed four months for the Advisory Committee to address a complex and often contentious set of issues. The short time frame limited the number of issues the Advisory Committee could consider, therefore its report is not intended to offer recommendations on *all* questions related to TVA and the transition to a competitive electric market.

The terms of reference that guided the Advisory Committee's work are provided in Appendix A.

At the first public meeting in Nashville on December 3, 1997, members of the Advisory Committee, at the request of the Chair, presented lists of issues that they thought were important for resolution in Federal legislation. These issues were then divided into three categories:

- Issues that will be dealt with in Federal legislation on a national basis and that do not need individual treatment for the TVA region.
- Issues that will be dealt with on a national basis, but that have such significance for the valley that they must be addressed individually.
- Issues that are unique to the TVA region.

The first category, issues that will be dealt with on a national basis and that are not in need of individual treatment for the Tennessee Valley, are in many ways the most controversial and difficult, but do not raise concerns for the TVA region that are different from the concerns that they raise in other regions. As a consequence, the Committee did not attempt to reach agreement on resolution of these issues. These issues are:

- A Federal mandate for customer choice.
- Market power controls.
- Universal service.
- Public benefits funding.
- Reliability.
- Environmental issues.
- Employee protections.
- Public information and disclosure.
- Renewable resources.

These issues are of tremendous importance and are all under discussion for resolution in comprehensive Federal legislation. The Committee decided that they did not need special treatment for the TVA region, but that the national resolution of these concerns should apply in the TVA region. This agreement does not commit any member of the Committee to any particular position on any of these issues, or even to support for Federal legislation.

For example, reliability is one of the most important issues facing us. Major blackouts have already occurred and many are arguing that the structures for assuring the reliability of the system must be strengthened. Others would argue that competition will put new stresses on the reliability of the system and that Federal legislation should not be passed to restructure the electricity industry unless reliability concerns are dealt with in a meaningful way. The Department of Energy has attached so much importance to this issue that it has convened a Secretary of Energy Advisory Board panel to make recommendations to the Secretary. That

panel has issued reports recommending Federal legislation to clarify FERC authority and responsibility for reliability; implement and enforce mandatory reliability standards applicable to all entities using or operating the bulk-power system; and require greater regulatory oversight of reliability standards, policies, and the organization and governance of reliability organizations.

The North American Electric Reliability Council has convened a blue ribbon task force to address these same issues. Most of the members of the Advisory Committee are represented in some manner on one or both of these panels. The Committee agreed that it is not necessary to duplicate these national efforts in this proceeding.

The other issues listed above are also undergoing serious scrutiny and are under debate at the national level. Many members of the Advisory Committee hold the position that Congress should not pass legislation without dealing with these issues.

## The Working Groups

The Advisory Committee divided itself into three working groups to address the issues that are unique to TVA or that are national in scope but have significant impact on the TVA region. Those groups were:

- A. The Regulation and Jurisdiction Working Group
- B. The Mission Working Group
- C. The Competition Working Group

Group A addressed transmission and rate jurisdiction, applicability of anti-trust and labor laws, tax status and retail regulatory jurisdiction.

Group B addressed the mission of TVA and its role as an integrated river management agency.

Group C addressed the fence and anti-cherry picking provisions, the contracts, TVA's role as a retail/wholesale supplier of electricity, and stranded cost issues that are unique to the valley.

The Advisory Committee further designated drafting groups composed of two or three members, to prepare proposals for discussion on each of the sub-issues under the larger scope of the three working groups. The drafting groups presented their initial position papers to the larger Working Groups, who discussed and further refined the proposals. The results of these discussions were presented to the full Advisory Committee at the public meeting in Nashville, on January 20 and March 24, 1998.

The nine issues the Advisory Committee addressed are set forth in sections that summarize the Committee's discussions and contain recommendations for treatment of these matters.

# Issue 1: *Transmission and Wholesale Rate Jurisdiction*

The question addressed by this section is whether TVA should be subject to FERC's transmission and wholesale rate jurisdiction.

Currently TVA and other public power entities (that is, municipal and cooperative utilities and Federal power agencies) are not subject to sections 205 and 206 of the Federal Power Act. These sections give FERC the authority to regulate investor-owned utilities (IOUs) to determine that rates, charges, practices, etc., for wholesale sales and transmission are "just and reasonable and not unduly discriminatory or preferential."

It is also under this authority that FERC issued its regulations for transmission of electricity, Orders 888 and 889.

These orders require that investor-owned utilities file tariffs that provide the rates, terms and conditions for use of their transmission systems by competing sellers of electricity. In order to help prevent discrimination that could stem from ownership of transmission facilities, FERC requires that rates, terms, and conditions for use by transmission customers are comparable to the rates, terms, and conditions that the utilities apply to their own use of their systems.

Because public power entities are not required to file tariffs, FERC instead has imposed a reciprocity requirement on their use of other utilities' tariffs. In order to make use of a transmission tariff, public power utilities must offer service to the utilities whose tariffs they intend to use that is comparable to the service that they are seeking. This constitutes a far less comprehensive requirement for open access transmission than that for private utilities.

In Order 888, FERC has required public and Federal power entities to comply with the reciprocity provisions. Removal of the TVA fence, therefore, might allow FERC to order TVA (on a

case-by-case basis) to offer wheeling services comparable to those services requested by TVA. Unfortunately, however, the existing reciprocity provision in Order 888, do not give FERC the authority to order a TVA tariff to be filed.

With regard to the question of transmission jurisdiction, agreement was reached by all members of the Advisory Committee that TVA, and all public power entities within the TVA territory should be subject to FERC jurisdiction comparable to that imposed on such entities elsewhere for purposes of transmission. The members also agreed that under full retail and wholesale open access, the rates, terms and conditions of transmission service to be provided by all transmission-owning and/or operating entities in the United States, including TVA, should be subject to FERC regulation and jurisdiction.

If all transmission owners and operators do not become subject to FERC jurisdiction and regulation, then the views of the Committee diverge.

NGC, Enron, TVA Watch, the League and TVERC agreed that they would not be opposed to applying FERC jurisdiction initially only to TVA and the TVA region, rather than the entire country if that limitation would expedite the passage of this recommended legislation. These members believe that being subject to FERC jurisdiction would not place TVA or the TVA region distributors at a competitive disadvantage in the wholesale power market.

TVA, TVPPA, TVIC, AVI, and the Teamsters disagree. These members believe that it is inconsistent with the purpose of the legislation, which is to promote full wholesale and retail competition on a national basis, to single out the TVA region.

The Advisory Committee's discussions of wholesale rate jurisdiction were not quite as clear-cut. It was recognized by many members, that, if the TVA fence comes down, some level of regulatory oversight would be necessary. Much like the FERC decision-making process when evaluating whether to permit market-based rates, a TVA wholesale power marketing arm within the utility would need oversight to ensure that no "captive-territory" cross-subsidy of marketing efforts occurs. There was some discussion of whether a modified Bonneville Power Administration "energy model" might be an approach with some merit. Under this approach, FERC has the ability to review

wholesale rates which then “become effective upon confirmation and approval thereof by the [FERC].”

## Recommendations

### Transmission

Agreement was reached by all members of the Advisory Committee that:

- TVA, and all public power entities within the TVA territory should be subject to FERC transmission jurisdiction comparable to that imposed on other transmitting utilities. The Committee recommends that under full retail and wholesale competition, the rates, terms, and conditions of transmission service to be provided by all transmission-owning and/or operating entities in the United States, including TVA, should be subject to FERC regulation and jurisdiction.

If all transmission owners and operators do not become subject to FERC jurisdiction and regulation, then the views of the Committee members diverge.

- NGC, Enron, TVA Watch, TVERC and the League agreed to the following: It is our position that the rates, terms and conditions of transmission service provided by all transmission-owning and/or operating entities in the United States should be subject to FERC jurisdiction. TVA should not be excused from FERC jurisdiction, regardless of whether or not other entities are excused. Such jurisdiction should be effective with the passage of this subject legislation and should not be delayed until any future date certain for retail access, which may also be addressed in this subject legislation.
- TVA, TVPPA, TVIC, AVI, IBEW, and the Teamsters disagree. These members believe that it is inconsistent with the purpose of the legislation, which is to promote full wholesale and retail competition on a national basis, to single out the TVA region.

## Wholesale Rate Jurisdiction

The following position is recommended by TVPPA and supported by TVERC and the League.

Historically, TVA has been subject to Congressional oversight. This oversight afforded the distributors an avenue of general, but not specific, relief should there be concern by distributors about the rates and rate-related programs as covered by TVA's existing wholesale power contracts. Specifically, the existing long-term contracts allow TVA to unilaterally raise rates without any forum for appeal except for Congressional hearings. If circumstances arising from the hearing suggest corrective action, then legislative proposals, may or may not be adopted by Congress. As the electric industry becomes more complex, the increasing demands placed upon Congress consequently makes it burdensome for them to devote either the time or staff resources required to adequately address specific TVA-distributor rate-related issues.

To provide distributors an additional recourse from rate decisions that one or more distributors believe is adverse, it is recommended that additional legislation be enacted as a section to any Federal restructuring legislation to provide for judicial review to be available as to the rate and rate-related actions of TVA. This would be in addition to, not a replacement for, Congressional oversight.

Therefore, it is proposed that the following section be included in Federal restructuring legislation in a title relating to TVA:

Section \_\_\_\_\_. Relationships between TVA and Distributors. Judicial Review.

- (a) In TVA's relationship with those Distributors with whom it had a contract as of October 1, 1997, in any contract or subsequent contract for the sale of electric power by TVA to a Distributor of TVA power, in which TVA has reserved for itself the unilateral right to change the rate at which that power is sold, to establish a rate for electric power service or program made available under that contract, or to change terms and conditions of the contract in such a way as to have a direct impact on such rates, TVA may take such action only after providing the Distributors affected with notice and opportunity for comment. Such notice and comment period shall not be less than 90 days for a rate adjustment and not less than 180 days for a rate change.

Any rate or charge made by TVA for electric service to a Distributor or Distributor customer or the availability, rate, or charge for a rate-related

program shall be just and reasonable and not unduly discriminatory among Distributors or Distributors customers, taking into consideration the duration of contract, the amount of power purchased, the percentage of Distributor's requirements purchased from TVA, and the requirements of the TVA Act of 1933, as amended.

- (b) Any Distributor aggrieved by the decision of the TVA Board of Directors as determined in accordance with Paragraph (a), shall be entitled to judicial review by bringing an action in the United States District Court in the district in which the distributor's principal office is located or in the United States District Court for the Eastern District of Tennessee.
  - (i) On any action brought under Paragraph (b) hereof, the Court shall conduct a trial *de novo* without the intervention of a jury, and may hold unlawful or set aside the actions of TVA and order such relief as the Court shall determine appropriate.
  - (ii) Any action brought in a United States District Court under Paragraph (b) hereof shall be initiated by filing a summons and complaint within one year from the date of the final action of the TVA Board of Directors that is the basis for the claim.
- (c) Any amount paid by a distributor in the form of a rate, charge or cost to TVA, and that is subsequently determined in a proceeding under Paragraph (b) hereof to be in excess of that amount that is just and reasonable, shall be refunded by TVA with interest at the rate allowed for monetary judgments under Federal law, with interest to be paid from the date the excess amount was paid by Distributor through the date the refund is paid by TVA.

TVA, the Teamsters, AVI, and TVIC support the following position:

- Since this legislation promotes full wholesale and retail competition with reduced rate regulation, TVA believes that the TVA Board should retain the authority to establish TVA prices for power sold to any entity. A third party review of TVA Board price setting conditions would have a negative effect on TVA's bond rating, which would ultimately increase the power price to TVA's customers. Additionally, as the country moves toward market-based power prices, IOUs would have the ability to use market-based power prices to attract customers, and TVA should have the same freedom to set its own rates for the sale of power. TVA already is required by Federal Law and its bond covenants to recover its costs and provide nondiscriminatory service; and TVA, as a public nonprofit entity with no shareholders, needs no rate regulation to ensure it does not earn an unreasonable profit.

TVA Watch, NGC, and IBEW support the following position:

- The vastness of TVA's transmission system and the magnitude of its generating capabilities result in TVA's interaction on a daily basis with all physical entities in the Eastern Interconnection, as well as the energy and capacity transactions of numerous parties that are subject to FERC jurisdiction. TVA, likewise, should be subject to the regulatory oversight of the FERC for sales of energy and capacity. As with transmission rates, FERC jurisdiction over wholesale rates should be effective with the date of this subject legislation.

Additionally, where no state regulatory body asserts jurisdiction, FERC should regulate the rates for transmission, distribution and sales made at retail by TVA.

Also according to TVA Watch, a second issue within the broader wholesale rate regulation controversy relates to FERC and antitrust oversight of TVA sales outside the traditional TVA territory. In this area, Federal Power Act jurisdiction over TVA is necessary to ensure that FERC has jurisdiction and power to evaluate the appropriateness of allowing TVA to make market-based sales to off-system purchasers.

## Issue 2: *Antitrust and Labor Law Status*

The question addressed in this section is, should TVA be subject to Federal antitrust laws and the National Labor Relations Act? Consideration of the two issues raised by this question were discussed separately and are presented separately in this report.

### **Antitrust Status**

The purpose of U.S. antitrust laws is to prohibit collusive conduct that restrains trade such as monopolization, attempted monopolization, price fixing, bid rigging, etc.

The premise underlying antitrust laws as the Supreme Court explained in *Northern Pac. Ry. v. United States* is as follows: “Unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.”

TVPPA supports the following position:

The antitrust laws are designed principally to avoid economic injury through the use of anticompetitive means and to avoid the creation of illegal monopolies. Historically electric utilities have been provided well-defined service territories and have had lawful monopolies for the sale of electric power. These lawful monopolies were necessary, among other reasons, from the early development of electricity to help assure the provision of electric service to all. Safeguards were developed in the form of a regulatory process so that electricity was priced in a manner that established prices at a level affordable to the customer while at the same time assuring the investor-owned electric utilities that they would earn enough for a reasonable return on investments in

the electric plant assets together with their cost of service plus a reasonable profit. No regulatory oversight was required for the public power utilities, on the other hand, since they operated only as a public service and without a profit motive.

In the upcoming era of deregulation, it appears that methods will be developed to diminish the need for monopoly public service in some segments of the industry and to allow electricity to be sold in competitive markets. Therefore, antitrust laws will become more important to assure fair competition among all.

The antitrust laws are designed so that one who violates them will be subject to not only damages, but treble damages, attorneys' fees, and in some instances injunctive relief. In the Tennessee Valley region the distributors and TVA have historically operated on a nonprofit basis. This has essentially eliminated the temptation that could otherwise be present for a private-sector participant to try to use economic power to secure either unreasonable profits or achieve a monopoly status other than through lawful means with fair and open competition.

Because the economic incentives are different for private sector participants than for public sector entities, Congress recognized in 1984 that treble damages and attorneys' fees are not an appropriate source of relief under the antitrust laws and enacted the Local Government Antitrust Act of 1984. This law provided that although local governments are to follow the basic principles of the antitrust laws in their conduct, they cannot be held liable for damages, treble damages or attorneys' fees. Municipal electric systems in the TVA region are currently covered by this law, as are all units of local government throughout the United States. Because they, along with the electric cooperatives and TVA, operate without profit and only with the goal of serving the public with electric power at the lowest possible cost, it appears appropriate to include TVA under the provisions of this law.

## Labor Law Status

The Advisory Committee sought to identify how TVA's existing statutory requirements related to labor issues differ from those imposed on private utilities by the National Labor Relations Act.

The chart below sets forth the major differences between the requirements.

### *Current Situation—Comparison of TVA and Private Utilities*

	TVA	Private Utilities
General Labor Legislation—covering recognition, bargaining units, subjects of bargaining, unfair labor practices (ULPs), etc.	No—these matters are established by contract	Yes—primarily the National Labor Relations Act. The NLRB decides representation issues, as well as ULP's against both management and unions
Wage Rates Governed by Legislation	Yes—a statutory requirement that TVA and its contractors pay “prevailing rates” to their trades and labor employees, with disputed rates determined by DOL	No—the parties set wages by contract
Right to Strike	No—prohibited by Federal law	Yes—but restrictions may be established by contract
Federal Leave and Workers Compensation Laws	Yes—leave provisions are mandated by Federal law; Federal workers' compensation laws govern	No—leave may be covered by contract provisions; State workers' compensation laws govern

The Advisory Committee members concluded that if changes are to be made, they should be made on a basis that would maintain an appropriate balance between the interests of TVA and those of the unions representing its employees, similar to the balance that exists in private utilities.

## Recommendations

### ***Antitrust***

The antitrust laws are the “charter of economic liberty” in the United States and should be applied uniformly to all market participants in order to eliminate distortions resulting from violations of basic rules prohibiting anticompetitive behavior. All members agree that the requirements and behavioral restrictions of the antitrust laws should be applicable to TVA. However, there is divergence on remedies to be applied.

TVA, TVPPA, IBEW, the Teamsters, AVI, and TVIC proposed that the following be included in Federal restructuring legislation in a title relating to TVA:

- TVA would be subject to the principles of the antitrust laws by coming within the coverage of the Local Government Antitrust Act of 1984. This means that TVA would:
  - Be subject to injunctive relief for violation of antitrust law.
  - Not be subject to damages, treble damages, or attorneys’ fees under the Federal antitrust laws.
- Distributors would continue to retain immunity from antitrust liability for their collective dealings with TVA as an agency and instrumentality of the Federal government.

TVA Watch, TVERC, and the League support the following position:

- TVA should be fully and completely subject to the antitrust laws in a manner comparable to that of any other competitor in the marketplace.
- Potential victims of anticompetitive activities on the part of TVA should be able to obtain the same compensation that

they could obtain from any other power supplier, provided TVA not be permitted to pass through the cost of such penalty to any ratepayer and should be required to pay such fines out of retained earnings.

### **Labor Law**

TVA, TVPPA, TVIC, AVI, and the Teamsters support the following position:

- The current structure has worked well for both TVA and its employees for more than 50 years and this structure is not inconsistent with the balance of interests (between company interests and employee interests) that exists in private utilities today. Additional regulatory requirements would not be constructive or fair, therefore, we see no reason to change the current structure.

IBEW, TVA Watch, TVERC, and the League support the following position:

- TVA purports that wage rates are governed by legislation. Such a paradoxical statement is devoid of many realities. While the Congress put provisions in Section 3 of the TVA Act that prohibited the exploitation of labor by TVA, it did not set or govern wage rates. It merely put provisions that prohibited TVA from exploiting laborers and mechanics as it relates to wage rates. As it relates to the right to strike, TVA's position is agreed to. As it relates to Federal leave and workers' compensation, TVA's position is rather shallow when placed in perspective in that all leave provided in the industry is not covered by Federal leave regulations and compensation, whether it is mandated for employees, whether it be Federal or state.

Based upon the foregoing, the IBEW respectfully requests the Congress review the recommendation of the General Accounting Office in September of 1991 relative to labor-management relations at TVA and provide the employees of TVA a protection commensurate with that which exists in the private sector for employees of the Tennessee Valley Authority. It should be recognized that other Federal agencies of the United States Government have access to collective bargaining and a body of regulations equivalent to that of the National Labor Relations Board.

Based upon these Federal employees being in a “no-man’s land” and precluded from using either the National Labor Relations Board or the Federal Labor Relations Authority for redress, it is respectfully requested that legislation include employee protection by applying the labor laws and/or regulations of this country enjoyed by other employees throughout the Utility industry.

As noted by the IBEW, TVA is exempt from requirements under 5 U.S.C. Sec. 7101 and Executive Order No. 11491 (1969), providing that employees of the executive branch of the Federal government may participate in labor unions. Investor-owned public utilities and other competitors and potential competitors in the electric utility industry do not benefit from such an exemption. TVA should have to live by the same labor rules as everyone else.

## **Issue 3: *Tax Status For Public and Federal Power Entities***

The issue addressed in this section is that present Federal, state and local tax structures treat investor-owned and public power providers differently. These differences potentially could cause disparities that would reduce or eliminate the economic benefits of competition. In order to create fair markets for wholesale and retail competition and to protect significant revenue bases for state and local governments, Congress, State legislators and regulators will need to consider the implications of existing tax structures and the changes necessary for a competitive environment.

Some of the most difficult tax issues relate to the tax-exempt status of Federal and public electric power systems. Municipalities, State and/or Federal agencies and rural electric cooperatives provide a large amount of electricity in the market. If retail electric competition occurs in the states, tax status issues raise numerous and complex policy questions for Congress and the states to address.

Based upon these concerns, several types of taxes have been identified as potential problem areas for creating a fair market for wholesale competition and retail choice in a competitive environment. These types of taxes present specific concerns for the restructuring of the electric power system in the Tennessee Valley. Several categories of taxes and the potential disparities among the electric power entities they may cause are listed below. The listing does not reflect any priority order.

## **Gross Receipts Taxes, Property Taxes and Payments “in lieu of taxes”**

### **Gross Receipts Taxes**

A majority of states impose a gross receipts tax on electric utility revenues that is a portion of their corporate franchise tax structures. The revenue yield of these taxes is greater than the yield from a net income tax would be in many States. Usually, gross receipts taxes apply only to sales to customers within the taxing state, not to out-of-State customers. Sales of electricity by municipals and other public power entities are generally exempt from utility gross receipts taxes. Public power providers pay tax on the basis of net income in the majority of States resulting in a lower tax burden than the gross receipts tax.

### **Property Taxes**

Often property owned by a utility is taxed at a higher effective rate than property owned by non-utility businesses. Some states tax real property but not personal property which raises questions regarding property owned by regulated utilities vs. other business property.

### **Payments “in lieu of taxes”**

Certain entities make payments to state or local jurisdictions to compensate them for loss of tax revenues from exemptions due to tax status or tax incentives. Often these payments in lieu of taxes are not required to be shared with other jurisdictions. The TVA Act authorizes and directs the TVA Board to pay state and local government specific payments at a specific rate in lieu of taxation in order to render financial assistance to the state and local governments in the jurisdiction it serves and in which it operates.

## **Income Taxes, Deferred Income Taxes, and Related Issues**

### **Income Taxes**

Investor-owned electric utility companies, independent power producers and some rural electric cooperatives, are subject to the Federal income tax imposed on corporations by the Internal Revenue Service (IRS). Municipals, state-owned utilities, most rural electric cooperatives and Federal power producers are not subject to Federal income taxes due to nonprofit, tax-exempt status.

### **Deferred Income Taxes and Related Issues**

Investor-owned utilities are subject to unique tax provisions including normalization rules for depreciation, nuclear decommissioning costs, and other unique IRS rules.

## **Private Use Restriction in Municipal Power Funding**

Municipal power programs will not allow use of the power facilities by taxpaying entities for fear of violating the IRS Code on the treatment of tax-exempt bond funding which is hindering the formation of open market mechanisms such as independent system operators, etc.

## **Recommendations**

The Advisory Committee members considered and reached conclusions for each of the separate types of taxes. The following sets forth their recommendations:

## **Gross Receipts Taxes, Property Taxes, and Payments in Lieu of Taxes**

The Advisory Committee members agreed on the following recommendation:

- Taxes on gross receipts or in lieu of tax payments *by the producer* should be eliminated in favor of some form of public utility excise tax on electric distribution companies or their customers.
- Reduce taxes or in lieu of tax payments and equalize or make consistent property assessments between business ownership types in favor of some form of public utility excise tax as discussed above so as to not create a disadvantage for in-State generation with out-of-State supplies.

## **Income Taxes, Deferred Income Taxes and Related Issues**

TVA, TVPPA, TVIC, AVI, TVERC, the League, Teamsters, and SSEB support the following position:

- Defer to national legislation. Not unique to TVA.
- Public, nonprofit entities, including TVA, should not be subject to Federal or State income taxes (see Appendix B for details).

TVA Watch and NGC support the following position:

- Exemption from tax obligations, including Federal, state and local taxes, provides an economic advantage to TVA that is not enjoyed by its competitors. Any proposed legislation should remedy this concern to ensure that TVA is not able to use this benefit to the detriment of others.

## **Private Use Restriction in Municipal Power Funding**

The Advisory Committee members reached agreement on the following position:

- Tax treatment of existing public power bonds should not change because of retail open access. Tax favored treatment

for future public power funding in facilities that are by nature monopolies (such as transmission, distribution, etc.) should be continued. Tax treatment of new debt in non-monopolistic activities such as generation should not receive favorable tax treatment over all other entities in the industry.

## Issue 4: *Retail Regulation*

The question addressed in this section is, who should regulate retail sales in the TVA region.

TVA currently regulates the retail rates of its distributors. TVA argues that its regulatory authority preempts that of the states for its distributors. While some may disagree, at this time TVA has the right to regulate retail rates in its contracts with its distributors.

All members of the Advisory Committee, including TVA, concluded that it would not be appropriate for TVA to maintain its role as retail regulator in a circumstance where it could be a retail competitor with its distributors. As a consequence, the group reached agreement that TVA should relinquish its role as retail regulator. Most of the discussion focused on how to carry out this shift in responsibility for TVA

If TVA relinquished that role without further Federal action, the states would have the authority to regulate the retail distributors as to rates, distribution facilities, investments, and for any other purpose not reserved to the Federal government by Federal law that the state legislature has approved. Most States do not regulate municipal or cooperative utilities. In fact, none of the states in the TVA region do so. In all but a few instances, States allow municipal and cooperative utilities to regulate themselves.

TVPPA suggested that distributors in the TVA region be assured in Federal law that regulatory authority be exercised by the local governing bodies of municipal electric utilities and rural electric cooperatives. TVPPA asserted that such distributors have exercised effective regulation in the past, and that they are close and responsive to the needs of local electric customers.

Rural Legal Services of Tennessee suggested that a regional regulatory body should be created in Federal law to regulate TVA's retail distributors. Rural Legal Services and the League argued that distributors cannot function effectively as both providers and regulators for the same reason that TVA cannot serve as a producer and regulator. Further, Rural Legal Services contended that municipalities do not have appropriate expertise to negotiate and regulate complex agreements involving the purchase and distribution of power from non-TVA sources.

Rural Legal Services also argued that the state of Tennessee, which consumes the bulk of power produced by TVA, lacks institutions or expertise to regulate effectively the sale and distribution of retail power. SSEB responded that the state of Tennessee does have a Tennessee Regulatory Authority that has limited experience in the regulation of electricity in the sense that it has regulated only one city which has been supplied by private power utilities for seventy years. While the Tennessee Regulatory Authority's regulatory experience in the electric area is limited to Kingsport, it does have considerable experience in rate making matters related to telephone, trucking, railroad, etc.

TVA Watch concluded that it would be a mistake to create a multi-state, regional authority to regulate the sale and distribution of retail power by municipal electric utilities and rural electric cooperatives that have traditionally received power from TVA. TVA Watch argued that creating such an authority would require a congressionally approved, multi-State compact. By their very nature such compacts are complicated to design, fraught with political problems at every turn and difficult to manage.

SSEB has concern with the self regulation of TVA with little or no customer recourse. However, SSEB's position is not to create a new level of regulation below the Federal level and in lieu of state and local jurisdiction. Creating a new layer of governmental oversight is not in line with the diligent efforts being undertaken at both the Federal and State levels to reduce, not increase, their size and scope.

SSEB further argued that while TVA may operate in seven states, its circumstances are not unlike those of existing utility holding companies and numerous individual electric utilities that currently serve wholesale and retail customers in multiple states. Electric industry restructuring efforts to date indicate that those holding companies and utilities will transition to competition

state by state, and that they will remain, to some degree, subject to state and local regulation. Meanwhile, Federal legislation is intended to remove barriers to competition. Any Federal legislation should ensure that public power does not enjoy an advantage in a competitive market over other market participants. SSEB was joined by the League in agreeing that all competitors choosing to participate at the retail level, including TVA, should be subject to oversight by the same state and local regulators.

## Recommendations

The Advisory Committee members reached agreement that TVA should relinquish its role as a retail regulator. There were differences, however, as to who should replace TVA in that role, as expressed below:

- TVPPA recommends that regulatory authority should be assured at the local level in Federal legislation. TVA and AVI concur.
- Rural Legal Services recommends that a regional body should regulate retail distributors.
- Rural Legal Services, TVERC, and the League recommend that, if there is no regional authority, legislation should include authority to offer funding and technical expertise to state regulatory commissions, where necessary.
- The Southern States Energy Board, TVA Watch, NGC, and Enron recommend that states should have the right to make their own determinations as to whether they will regulate retail distributors, as they do in the rest of the country.

## Issue 5: *TVA's Mission*

The questions addressed in this section are, should TVA's mission be modified? Does the current mission statement contain the proper purposes and priorities for TVA in the future?

In addition, the Advisory Committee decided to consider issues related to TVA and the addition of generating capacity. A summary of that discussion and the associated conclusions is included at the end of this section.

How these questions were discussed by the Advisory Committee members reflected to a great extent their views on the future of TVA's mission. Since the nature of the discussion and the positions of members are so closely associated it is difficult to characterize the discussion without imparting views not necessarily held by all the Advisory Committee members. Instead, the views on TVA's mission held by TVA, TVPPA, TVIC, TVERC, AVI, IBEW, the League, SSEB, and the Teamsters are included in Appendix C.

### **Mission**

TVA's definition of its mission follows:

- TVA's mission is to develop and operate the Tennessee River system to minimize flood damage and improve navigation, and to provide energy and related products and services safely, reliably, and at the lowest feasible cost to residents and businesses in the multi-State Tennessee Valley region.

## Recommendations

TVA, TVPPA, TVIC, AVI, Teamsters, IBEW, the League, SSEB, and TVERC reached agreement on the following positions:

- TVA's mission is important to the region and the Nation and the integrated nature of TVA's natural resource stewardship and power production activities should be continued.
- TVA was created as a regional agency charged with developing and managing a national resource—the entire Tennessee River watershed—and ensuring that it promotes local, regional, and national economic interests. TVA's earliest proponents recognized that the Tennessee River, properly developed and managed, would be the center of the Valley's economy, and that the benefits of flood control, navigation, stewardship of the land and water resources, power generation, economic development and recreation across the entire region could only be optimized through an integrated system, rather than through a number of individual projects designed to provide limited benefits for specific portions of the region.
- Thanks to Congress' integrated design of TVA, the Tennessee River system is effectively managed to minimize flooding, maintain a safe navigation channel, ensure adequate water quality, generate electricity and provide recreation. While these benefits primarily accrue to the eight million residents of the Tennessee Valley, residents of surrounding regions and the Nation as a whole also directly benefit from flood control and navigation on the Tennessee River, from low-cost electricity exchanges when their own systems are in short supply, and from a highly developed regional tourist industry.
- Because TVA was designed to function as an integrated system, reassigning some of TVA's responsibilities would significantly degrade the efficiency and effectiveness of the overall system, resulting in fewer benefits, higher costs, and greater environmental impacts for the region and the Nation. TVA can best continue to provide public benefits to the Tennessee Valley and the Nation as a whole as a Federal agency.

In order to integrate TVA's power operations into a restructured industry in a manner that is fair to both TVA customers and other marketplace participants, the terms and conditions under which TVA participates in a competitive market are being reviewed and considered more fully by the other two working groups of the Advisory Committee.

TVA, TVPPA, TVERC, AVI, IBEW, the League, the Teamsters and TVIC agree that an appropriate level of funding for nonpower programs should continue.

TVPPA, TVIC and AVI also recommend that, should congressional appropriations for nonpower programs cease, those programs should not be paid for out of power revenues.

TVERC and the League recommend that in the case of such cessation of funding, an identifiable stream of revenue, such as the hydro-plant revenue, be made transparent and dedicated to the river management and nonpower programs and that Congress assure oversight of continued maintenance of the multi-purpose programs, through creation of a new body or other mechanism.

TVA Watch and NGC's position with regard to TVA's mission is as follows:

- As has been pointed out in various other comments TVA was created to perform a unique and vital mission for the Tennessee Valley and river system. Given its history of accomplishment and the current evolution of the electricity markets in the United States, TVA Watch and NGC believe that it is appropriate for Congress, as the body that formed TVA, to review and reconsider its mission. Whether and how TVA should continue its mission is properly the subject of rigorous public debate that only Congress is empowered to undertake. Many of the functions performed by TVA are and can be provided by the private sector or other government agencies. This was not the case when TVA was formed. Whether this should change is a matter of public policy and should include input from all stakeholders.

As has been stated in other areas TVA Watch fundamentally believes that TVA, because of its unique nature, should not be allowed to participate in competitive electricity markets without substantive change.

TVA Watch also believes that TVA should not participate in foreign or domestic markets as a provider of consulting, any other services in competition with private enterprises. In addition, TVA Watch believes that TVA should be required to fund from power revenues any hydroelectric-related programs or activities that private utilities are currently required to fund through power revenues.

TVA's mission does not and should not involve competing with other private enterprises for the sale of power at wholesale or retail outside of the Tennessee River Valley Region. TVA's mission does not and should not include competing with other private enterprises for the sale of natural gas, fuel oil, coal or other energy products and services in any capacity in any jurisdiction. As a Federal corporation, TVA should be required to request competitive bids for future generation required to serve load in its historical territory. TVA should have little or no role in building new generation capacity in a competitive environment.

## Generation

As part of the discussion of TVA's mission, there was interest in addressing the question of whether or not TVA should be allowed to build new generation capacity. The following section covers the discussion of this question and conclusions reached by the Advisory Committee members.

The views of the committee range from restricting the addition of any new generation to building new generation in accordance with the TVA Act.

## Recommendations

The positions of organizations represented on the Committee are presented below.

TVA, TVPPA, TVERC, IBEW, the Teamsters, TVIC, AVI, and the League support the following position:

- Any new TVA generation (capacity) would be built to meet the needs of the electric power consumers in the Tennessee Valley region as defined in the TVA Act as amended.
- Preferences for the sale of TVA power to public power entities in the Tennessee Valley (as defined in the TVA Act) should be maintained.
- TVA should be able to sell surplus power on the wholesale market with no restrictions, including any capacity that becomes surplus as a result of lost wholesale and retail load due to future competition.
- After Retail Choice/Fence Down/Contract Modifications, power distributor's obligations relative to TVA should be limited to the contract terms of the power agreement with TVA. Therefore, distributors will have no stranded investment obligations for any new TVA generation unless specifically agreed to by contract with the distributors.

The following is supported by Enron, NGC and TVA Watch:

- TVA should not have the ability to build new generation due to unfair competitive advantages associated with being a Federal corporation.
- Should TVA need additional capacity to replace retired units or to serve increasing load growth, TVA should acquire these resources from the market, IPPs, other utilities, and so forth. As a Federal corporation, TVA should be required to request competitive bids for future generation required to serve load in its historical territory.

TVERC supports the following position:

- TVERC believes that TVA as a Federal corporation is primarily a watershed management agency and instrument of the Federal government. As such should not be allowed to

expand generation except where it meets the goals of the Federal government in meeting national and international environmental protection commitments and treaties, and/or assists in the development or market stimulation of new technologies having national and international significance.

TVA Watch and NGC support the following position:

- TVA Watch and NGC are concerned about possible future expansion of federally supported generation facilities and strongly believe that TVA, as a Federal corporation, should have little or no role in building new generation capacity in the southeast. As originally created, TVA was to manage flood control, navigation, rehabilitation and conservation of agricultural lands, regional planning of natural resources and agricultural and economic development. In connection with that mission, TVA was authorized to sell surplus electricity generated at its dams. It was not until 1945 that TVA placed in service its first steam electric generating plant. Electric operations, which were seen by President Roosevelt as a “side function,” now encompass 97 percent of TVA’s total budget. Given its historical mission, it is no longer necessary, prudent, or wise to permit a government agency to continue to build and finance facilities that the private sector can build and operate efficiently.

## Issue 6: *The Fence and Anti-Cherry Picking Provision*

The basic questions addressed in this section include, should the TVA fence and the anti-cherry picking provision be removed? If so, at what time?

There is an emerging consensus that electric utility exclusive service territories should be eliminated. As applied to TVA, this would mean lifting the territorial barrier, known as the fence, that shelters TVA's neighbors from competition from TVA by barring TVA from selling outside its historic service territory. It also would mean repealing the provision of the Energy Policy Act of 1992, known as the anti-cherry picking provision, that protects TVA from competition by barring competitors of TVA from obtaining transmission into TVA's service territory. Legislation to remove these barriers to competition could be relatively straightforward and may be joined in the near term with Federal legislation promoting retail competition.

The timing and sequence of the elimination of these market-access restrictions will be determined in large measure by the resolution of issues being addressed by other working groups. Assuming satisfactory resolution of those other issues, the Advisory Committee concluded that legislation can and should be enacted to lift the fence and repeal the cherry picking prohibition, subject to qualifications as noted below.

The introduction of retail competition in the southeast will increase and make more immediate the need to lift the fence and eliminate the cherry picking prohibition. If retail access is implemented soon and throughout the southeast, then Advisory Committee members agreed that the fence and cherry picking prohibition should be terminated concurrently. If retail access is implemented in the near term in some, but not all, states within the southeast, then elimination of the cherry picking prohibition could be made on a reciprocal basis.

The Advisory Committee members' views diverge in the case that retail competition is delayed.<sup>1</sup> Enron and NGC believe that elimination of both market access restrictions can proceed immediately and need not await the introduction of retail competition. If introduction of retail competition is delayed for any reason, then action on the fence and cherry picking prohibition can proceed in two phases. The first would remove both fence and cherry picking restrictions within the wholesale market. The second would lift the fence entirely when and if retail competition is introduced. In short, policy makers need to recognize that, outside of TVA's historical service territory, open-access and competition in wholesale power markets is the current reality. That reality can and should be extended into the TVA historical service territory irrespective of changes in existing barriers to retail competition.

TVA, on the other hand, views differently the relationship between retail competition and elimination of market access restrictions. In TVA's opinion, the anti-cherry picking prohibition that protects it from competitors wheeling power into its historical service territory should not be eliminated until retail competition is fully implemented throughout the southeast. TVA takes this position because its exposure to competition is unique in that it is predominantly a wholesaler. Approximately 85 percent of its existing load is wholesale whereas the loads of neighboring utilities are predominantly retail in nearly inverse proportions. Eliminating TVA's anti-cherry picking protection before implementation of retail competition, in TVA's view, would expose it to competition for the lion's share of its loads without opening to TVA comparable new, competitive opportunities within the service territories of its predominantly

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<sup>1</sup> It should be noted that until Federal legislation is enacted to provide retail customer choice, TVA through contract re-negotiations with their wholesale distributors could provide transmission access on a fair pricing basis, allowing distributors to purchase power from non-TVA entities (see Issue No. 7 Wholesale Power Contracts). This could be accomplished without Federal legislative intervention to change TVA's exclusive service territory or the anti-cherry picking provision of the Energy Policy Act. This partial voluntary one-way removal of the TVA service territory protection would allow wholesale competition to proceed for those interested TVA distributors while protecting the interests of other distributors and posing no threat to other electric power supply entities outside the TVA service territory.

retail-selling neighbors. TVA submits that this would be unfair to its existing customers and to the taxpayers. Accordingly, TVA would eliminate the cherry picking prohibition only as neighboring southeastern utilities open their markets to full retail competition from TVA.

While the Advisory Committee members' views diverge on the sequence of retail competition and removing market entry barriers, the members are all in agreement that simply lifting the fence or repealing the cherry picking prohibition will not make competition occur at wholesale or at retail. Entry barriers erected by the fence and the cherry picking prohibition are projected into the future for the duration of potentially many pre-existing contracts that were entered into when those barriers were in effect. Accordingly, the Advisory Committee recommends that the effectiveness of legislation to lift the fence and repeal the cherry picking prohibition be postponed until such time as wholesale power purchase contracts that were entered into during the effectiveness of the cherry picking prohibition may be reopened at the request of the purchaser.

## Recommendations

The following is supported by the full Advisory Committee:

- The fence and anti-cherry picking provisions should be removed concurrently with the implementation of retail competition.

In addition, Enron and NGC support the following:

- If retail competition is delayed, the fence and anti-cherry picking provision should be removed immediately.

TVA, TVPPA, TVIC, AVI, IBEW, and the Teamsters strongly disagree with Enron and NGC's position calling for the immediate removal of the fence and anti-cherry picking provisions if retail competition is delayed. Allowing competitors to serve TVA's wholesale customers while TVA and its distributors are effectively prohibited from serving retail customers outside the fence would be patently unfair, place TVA's

remaining customers at considerable risk of increased prices and ultimately lead to TVA's financial collapse.

TVA Watch supports the following:

- As discussed in the Report, under Section 15d(a) of the Tennessee Valley Authority Act of 1933, as amended, TVA is prohibited from making contracts for the sale or delivery of power that have the direct or indirect effect of making it a source of power supply outside a statutorily defined area. This provision of law is generally referred to in the electric utility industry as the "fence" and applies with limited exceptions to affirmatively prohibit the direct or indirect marketing of TVA generated power outside the Tennessee Valley region. The Supreme Court of the United States has recognized that the fence was erected to protect utilities from having to compete against TVA power because of the privileges, benefits and artificial competitive advantages TVA possesses as a government corporation. If TVA power is to be made available outside the confines of the fence, a number of changes to Federal law must be considered by the Department of Energy to ensure fairness and to prevent economic distortions in competitive markets:

**(1) Payment to Federal Treasury for Equity Support:**

TVA has been afforded an AAA rating on its bonds by Moody's Investment Service and Standard & Poor and as explained by Moody's, the rating is due to the implied promise by the Federal government to come to TVA's rescue in times of fiscal difficulty. The Federal government is thus providing the equity backstop for TVA's credit rating and its ability to borrow money at 'risk-free' rates of interest. Moreover, certain bond issues by TVA are guaranteed by the U.S. Treasury. See 16 U.S.C. §§ 831n through 831n-3. Under 16 U.S.C. § 831n-4 (the power operations bond authorization), bonds are not guaranteed by the U.S. Treasury, but the TVA can require the U.S. Treasury to buy its bonds during times that the market is not receptive to issuance of bonds by TVA under the terms and conditions needed by TVA. The Department, as a Federal agency, should consider whether TVA should pay the Federal Treasury for this equity support in an amount each year equal to the difference between TVA's annual cost of

money and the average cost of money for all utilities subject to FERC's jurisdiction.

- (2) **Payment for Southeastern Power Administration (SEPA) Power:** The practice of SEPA to date has been to sell power from facilities it controls on the Cumberland River system to TVA at a price well below market prices that could be obtained for such power. This power source should be sold to TVA (or others) at its true market value so as to maximize the revenue to the Federal Treasury. It has been estimated that the foregone revenue to the Federal Treasury as a result of the current practice is almost \$130 million per year. One possible solution for this problem could take the form of an amendment to the Rivers and Harbors Act of 1945, which authorizes the sale of electric generation from Corps of Engineers facilities, to require competitive bids for the acquisition of power from these facilities, with a right of first-refusal provided to current TVA preference customers.
- (3) **Application of Federal and State Regulation:** Under current law, TVA is exempt from regulation of all state authorities and from regulation of many of the Federal authorities that oversee investor-owned utilities. This exemption from the law that applies to its competitors, if allowed to continue, will distort competitive marketplaces. Exemption from equal regulation destroys parity and symmetry with investor-owned utilities with whom TVA would compete. TVA should be subject to the same regulation applicable to private competitors—both at the Federal and state level. Congress and the courts have recognized the important interest that states have in the regulation of the suppliers of electric service. TVA should not be exempt from application of those regulatory oversights. The regulation that would provide equity in this area includes the following:
- (1) FERC regulation of rates for electric service and transmission services in the same manner as investor-owned utilities;
  - (2) FERC regulation of hydroelectric activities of TVA;
  - (3) state regulation over the retail service provided by TVA as well as over the siting and construction of transmission and distribution facilities;
  - (4) state regulation over territories in which electric suppliers render electric service; and
  - (5) state regulation

over environmental matters; and (4) FERC regulation of TVA's accounting system consistent with the requirements imposed on other electric utilities.

- (4) **Elimination of TVA Exemption From Mandatory Wheeling Under 1992 Energy Policy Act:** As noted in the principal Report, Section 211 of the Energy Policy Act of 1992 imposed mandatory wheeling requirements on all owners of transmission owners—all except TVA. TVA persuaded Congress to exempt it by reminding members that the “fence” prohibits it from marketing its power outside a specified area, so fairness and equity required that it be protected from competition within its boundaries. As a result of Section 212(j), TVA is exempted from any requirement to transport power into its service area in competition with power it generates. TVA's current announced strategy to become a market force outside the fence vitiates the underlying policy basis for granting TVA and exemption from Section 211. If as the result of an Administration bill TVA is permitted to market power, directly or indirectly, outside the fence, it should be subject to meaningful competition within the fence. Any other result permits TVA an unfair statutory advantage, as only they will have the privilege of seeking new loads and customers outside their historical area, while being protected from competition within the fence.
- (5) **Civil Liability:** TVA employees currently enjoy Federal tort immunity. See 16 U.S.C. § 831c-2. This means that TVA is not liable for the wrongful actions of its employees that take place in the course of business. Moreover, TVA is exempt from any requirement to pay prejudgment interest or to pay punitive damages. See 28 U.S.C. § 2674. TVA's potential competitors in the electric power industry do not receive such benefits—their employees do not receive Federal tort immunity and they are not exempt from requirements to pay prejudgment interest or punitive damages. This exemption should be ended.
- (6) **Federal Procurement:** TVA, as a Federal corporation, currently enjoys the right to make purchases of goods and services as a Federal entity, a significant

competitive advantage with respect to the procurement of production inputs and other materials. Accordingly, the Secretary should consider the question of whether TVA should be required to surrender its right to make tax exempt purchases.

- (7) **Environmental Regulation:** TVA is exempt from Federal laws for the protection of game, fur-bearing animals, and fish resulting from the impoundment, diversion or controlling of waters. TVA also is exempt from investigations by the Secretary of the Interior to determine the effects of domestic sewage, petroleum and industrial waste, and other pollutants on wildlife. TVA should be subject to the same environmental regulations as its potential competitors.

TVA believes that a number of issues TVA Watch and NGC raised above are outside the “Fence” issue. Nevertheless, TVA believes it is important to respond to these TVA Watch/NGC recommendations, which would unfairly burden TVA and would raise power costs in the Tennessee Valley.

- (1) **Payments to Federal Treasury for Equity Support:** TVA bonds are, by law, neither obligations of nor guaranteed by the United States. They are secured only by future TVA power revenue. Taxpayers are not responsible for their payment. Nevertheless, TVA bonds do receive AAA ratings and those ratings are based, in part, on that U.S. ownership. This is the same thing that happens when the strength of a financially healthy parent company in a utility holding company system is reflected in the bond ratings of its operating subsidiaries. There is nothing “unfair” here. The *same rule* is being applied to TVA as to private utilities. For example, Moody’s ratings make the following statements about these private power companies:

*“As a member of The Southern Company system, Georgia Power Company also benefits from the support of a financially and operationally strong parent.”*

*“System Energy Resources, Inc., secured debt rating of Baa3 is based on the strength of the Entergy support agreement.”*

“Ohio Power Company’s A3 senior secured rating reflects...the strength derived from membership in the American Electric Power system.”

“Kentucky Power’s membership in the AEP system provides sufficient resources to maintain current credit quality.”

TVA Watch identifies four sections of the TVA Act (16 U.S.C §§831n-831n-3) which provide for Treasury guarantees of TVA bonds. They neglect to note, however, that these sections have not been in effect for decades. The last loans to TVA under these sections were paid off in 1960.

- (2) **Payment for SEPA Power:** SEPA is obligated under section 5 of the Flood Control Act of 1944 to sell that power at cost to “preference customers.” TVA’s municipal and cooperative distributors are among the preference customers entitled to power from the Cumberland River projects. In carrying out its legal obligation to TVA distributors, SEPA has elected to provide their allocated share of that power by passing it through TVA because this is the most efficient distribution mechanism.

Objections to these arrangements are part of a larger, nationwide effort by the private electric power industry to force a change in the Flood Control Act. They would require SEPA power, and other power marketing administration power nationally, to be sold “at its true market value so as to maximize the revenue to the Federal Treasury.” This is another way of saying that the Federal government should charge its citizens the highest price the market will bear and should use its hydro projects, like those on the Cumberland River, as a cash cow for the U.S. Treasury. It is radical departure from how the Federal government has operated for 200 years.

- (3) **Application of State and Federal Regulations:** The chief function of utility regulation is to ensure that the private utility companies do not charge customers too high a rate to make too large a profit for their stockholders. This is the reason few States regulate nonprofit electric systems, like municipal and cooperative systems. TVA has no incentive to overcharge its customers or abuse its market power. Consequently, calls for rate regulation or increased

regulatory review of TVA actions by another governmental body serves no public purpose and achieves only the private purposes of reducing TVA's flexibility, increasing its administrative costs, and increasing its borrowing costs.

The standards that govern TVA rates are far more stringent than those that either FERC or State public service commissions administer. Their basis is Federal statute, the same source that provides FERC its authority. No public purpose is served by requiring one set of Presidential appointees (FERC) to review decisions made by another set of Presidential appointees (TVA Board) which are already obligated by Federal law (the TVA Act) to keep rates as low as possible and otherwise use its Federal property only in certain ways.

TVA's AAA bond rating is based, in part, on TVA's statutory obligation to meet certain financial tests and on its authority to set rates to obtain sufficient revenues without the intervention of a utility regulatory commission. If TVA were to lose its AAA rating on account of rate regulation being imposed on it, TVA's annual interest cost could increase by about \$270 million. These extra costs would be borne directly by the very consumers rate regulation is supposed to protect.

Licensing by the United States of TVA hydroelectric facilities, which already belong to the United States and were built to comply with a Federal law, simply does not make sense. The nation's waterways are public resources. TVA, as a Federal instrumentality, has been directed by Congress to develop a portion of these public resources for the public's benefit, and has been provided its own set of rules for doing so—the TVA Act. Placing TVA hydro licensing under FERC would authorize an administrative agency to override the laws of Congress.

Finally, it is difficult to understand the concern over TVA's "off-system" sales and the reasons why FERC regulation of those sales "is absolutely necessary." First, TVA can make only those off-system sales it is by law authorized to make. No new regulatory requirements are necessary to ensure that TVA does not act beyond the scope of its authority any more than it is necessary to have some other Federal agency review and regulate the actions of FERC. Second, the new

competitive market should be sufficient to regulate TVA's off-system sales. If TVA asks too high a rate for its power, it will simply not make the sale. The potential purchasers of such power need no further protection. TVA cannot force them to buy the power. Further, TVA could not "load up" its costs on its traditional customers. It is required by law to provide those customers with the lowest possible rate, and with competition they, too, could simply begin to buy power from elsewhere.

- (4) Elimination of TVA Exemption From Mandatory Wheeling under 1992 Energy Policy Act:** This concern is without merit, since the "Anti-Cherry Picking" provision becomes inoperative by its own terms once the Fence is eliminated, and TVA has already proposed its simultaneous repeal with Fence removal.
- (5) Civil Liability:** TVA is generally subject to suit in State courts for violations of State rules against tortuous conduct, putting TVA on a par with private power companies. The provision of law cited by TVA Watch as insulating TVA from liability for the wrongful actions of its employees has just the opposite result. While protecting TVA employees from personal liability when they are acting within the scope of their employment, it ensures that the action can be brought against TVA. This helps to ensure the recovery of damages by a successful plaintiff.
- (6) Federal Procurement:** The only significant advantage of Federal procurement arises out of the volume of purchases, a circumstance as potentially available to large private electric utilities as to a Federal agency, like TVA. The fact is, however, that TVA's procurement needs have little in common with those of other Federal agencies and, thus, TVA seldom procures significant amounts of material through joint Federal procurements. Coal is by far TVA's largest procurement item. At about \$1.2 billion each year, it accounts for almost one third of TVA's total operating expense. TVA uses the same kind of procurement methods available to private power companies to keep coal costs as low as possible. TVA's relatively low coal costs are a function of the volume it buys, not its Federal agency status. In fact, Federal procurement laws can impose large, extra costs on acquisitions, which are not experienced by private power companies, such as special procurement preferences, and

heavy paperwork burdens on contractors the costs of which are passed back to the agency.

- (7) **Environmental Regulation:** TVA is subject to virtually all the same Federal and State environmental laws and administrative regulations as are private power companies—including the costly Clean Air Act and Federal Water Pollution Control Act. For example, the TVA power system will have spent in the aggregate more than \$4 billion on pollution control protection by the time it finishes implementing the Clean Air Act's present requirements. In addition, TVA is subject to the National Environmental Policy Act, which applies unique constraints to Federal agency actions, and, as a Federal agency, is also required to give special consideration to impacts of its actions on historical and archeological resources, wetlands, floodplains, and prime farmland.

## Issue 7: Wholesale Power Contracts

The question addressed in this section is, how should restructuring affect wholesale power contracts?

Long term, all-requirements, wholesale electric power contracts may not in some cases be consistent with nor supportive of the transition to retail customer choice initiatives in electric power supply. In transitioning from a regulated monopoly market environment to one that is open and competitive, many wholesale customers might remain captive well beyond a reasonable period to enter the new market place.

TVA is not unique in negotiating and entering into long-term contracts. Such bilateral arrangements are typical in this country and are essential for the management of intricate transactions. The certainty provided by long term contracts is necessary for the proper planning, operation, and administration of complex markets, in which entities need some certainty about future arrangements to properly forecast and commit to future needs. The ability to negotiate more advanced contractual agreements also allows parties to pursue innovation, growth, and system improvements. Such long-term arrangements are necessary so that entities, such as TVA, may plan and invest in future growth and improvements.

Particularly in the utility industry, long-term contracts are essential for comprehensive planning and operation. For example, FERC Order No. 888 clearly places the responsibility for recovering future investments squarely on the parties to a power sales contract, and such investment recovery is dependent on long term contracts. If long-term contracts are invalidated, or prohibited, in the restructuring legislation, no entity will be able to justify the risk of large capital expenditures for a market that may disappear quickly. Furthermore, any such elimination of existing contracts will destroy the certainty, previously provided

by the long-term contracts, that TVA, or any other energy producer, will recover existing debt; the legislation thus may create new stranded costs.

Under certain suggested legislation, TVA may be entitled to claim stranded cost relief from FERC or other regulatory or administrative process. The Bumpers Bill, for example, proposes that any party may terminate its power supply contract with TVA on one year's notice, notwithstanding any contractual provisions to the contrary, provided that the party pay TVA any stranded costs that FERC determines are the responsibility of that party. This proposed legislation, however, only provides for the possibility of recovery and therefore does not solve the stranded cost problem while it puts the Federal government and taxpayer at risk. Congress should not belatedly declare that the contractual commitments upon which the parties agreed are meaningless; TVA relied on those provisions when it planned its electric system, which serves millions of customers, and obtained necessary financing, which extends into billions. Congress cannot adequately substitute these provisions with the mere chance that TVA may someday recover its costs through the administrative process.

TVA and the power distributors currently are discussing new offerings of term length that still covers stranded cost so that it does not become a burden on the tax payers or the distributors that choose not to change their contracts. TVA and wholesale distributors will have to accommodate retail open access mandates through negotiated adjustments in their contracts, as was necessary during the restructuring of the natural gas industry. Congress, however, should not attempt to manage this issue through restrictive termination requirements or other legislative mandates concerning the notice provisions of the contracts.

Congress must not interfere with contracts if it wishes to allow smooth transition to retail and wholesale competition in the utility industry. TVA will be unable to pay for past investments, much less pursue capital improvements in the power system to meet the region's future power needs. A termination limitation also will prevent wholesale power distributors and directly-served customers from freely negotiating the provisions of their contract with power suppliers. Some parties may prefer a longer notice provision in exchange for other benefits, such as reduced price, additional transmission, or guaranteed supply. At the very least, such legislative constraints will place TVA at a competitive

disadvantage because other entities will have much greater negotiating flexibility, thus putting the \$27 billion TVA debt at risk. Ultimately, any legislative limitation on TVA's contracts will preclude the possibility of a smooth transition to normal competition in the utility industry.

Legislative language could be crafted to facilitate a contract re-negotiation process without dictating specific contract terms and conditions. A suggestion was made that if the legislative intent of congress is to encourage contract re-negotiation for all wholesale power contracts, not just TVA's wholesale contracts, then a window of time might be designated for the wholesale customer to request opening the contract. A guiding restriction in this directive without defining terms and conditions might be to require retention of the inherent "value" of the contract for both parties using potential stranded investment cost (as proposed by drafting team No. 9) as a reasonable proxy for the value of the contract. In the event that negotiations fail to produce agreement between the parties concerning the contract value within 12 months of enactment of Federal legislation establishing retail customer choice, then, FERC would be authorized to adjudicate complaints brought by either party, taking into consideration the stranded-investment rules established to facilitate transition of the electric utility industry to a new competitive market environment. Establishment of an appropriate stranded cost amount by FERC would include mitigation efforts and consideration of a true-up mechanisms to correct differences between projected and actual market rates used in the stranded cost determinations.

## Recommendations

TVPPA, the Teamsters, IBEW, and TVA support the following position:

- The sanctity of contracts between parties should not be overturned by Federal legislation, regardless of whether or not one or more parties are government entities (TVA/Distributor contracts). However, all-requirements contracts that prevent access to competitive open markets, should be subject to re-negotiation, as a customer choice, to provide

flexibility options (terms which are shorter or longer and permit less than all-requirements) while still protecting outstanding financial obligations of the parties (generation, transmission and distribution investments that may be stranded). Federal legislation may be needed to facilitate this process for the entire industry including TVA and the distributors. Legislation should not dictate the terms and conditions, but should require the unbundling of rates and services for all requirements contracts consistent with standards promulgated under authority delegated to FERC. This unbundling requirement ensures uniform dissemination of information so wholesale customers can make informed decisions.

- Wholesale contract issues are not unique to the TVA service area, but also apply to private and other publicly owned power systems. There are, however, certain Federal constraints imposed singularly on TVA and distributors of TVA power which prevent their fair entry into a wholesale and retail customer choice environment (the fence and anti-cherry picking restrictions). Federal legislation should provide for removal of those TVA regional constraints to allow a smooth transition to a restructured electric utility industry consistent with completion of contract flexibility negotiations.
- A specific performance date should be established for completing contract flexibility negotiations. A performance date could be set to complete contract re-negotiations 12 months before the effective date of federally mandated retail competition, but not less than 12 months after federally mandated legislation is enacted. The same performance date for completion of contract negotiations would apply to TVA.
- TVA wholesale customers should be given the option, but not be required, to re-negotiate wholesale electric power contracts with TVA.

TVA Watch supports the following position:

- The notion of a “federally implied” requirement to renegotiate all non-TVA wholesale contracts upon implementation of federally mandated retail competition is not universally supported. As has been pointed out in the

discussion on this issue, sanctity of contracts is a doctrine fundamental to effective markets. Additionally the IOUs have been involved in a competitive marketplace for several years during which discussions with customers over contract terms have already resulted in re-negotiation of contracts. It makes no sense to impose an implied federally mandated re-opener on these contracts.

NGC and TVA Watch support the following position:

- The wholesale power contracts that TVA has entered into with its distributors, in light of the lack of state regulatory oversight, should be subject to review and approval by the FERC. This is appropriate because, as the wholesale contracts are being renegotiated, the terms will have a direct impact on stranded cost determination and recovery.

## Issue 8: *The Retail/Wholesale Nature of TVA*

The question addressed in this section is, should national legislation on retail competition that will give retail customers the right to choose their electric energy suppliers allow any retail customer in the country to choose TVA as a supplier of electricity, or should TVA remain basically a wholesale supplier only?

The origin of TVA as a Federal entity has defined its evolution as a power supplier. Its power operations have been focused on the generation and transmission of electrical energy to distributors of power for resale and to a few very large consumers of electricity including some owned by the Department of Defense and the Department of Energy. The move toward retail consumers choice of their electrical suppliers without regard to the territorial limitations associated with the previously regulated electric utility industry is counter to the original concept of TVA. This breakdown in monopoly service territory and the proposed rights of retail customers to choose across these boundaries raises the question of whether the new retail open access rules should allow retail customers both inside and outside the current TVA service territory, as defined by the TVA Act, to be able to choose TVA as their source of supply in the future.

There also is some question as to whether TVA can enter the retail business and remain the retail regulator of distribution companies who sell TVA power at retail. Also, if TVA power distributors lose retail load to other suppliers, TVA would lose the associated wholesale load and would need to find new wholesale markets for that power. In addition, TVA's original mission was to focus on the economic development and environmental protection for the Tennessee River system and TVA's Federal status afforded certain benefits to allow this mission to be successful. There is some concern that the benefits of Federal status will now be used to compete unfairly in the retail market

outside the Tennessee River Valley. Although these issues of regulation and Federal benefits could probably be satisfied by appropriate legislative guidelines, many could be avoided altogether or at least mitigated by not changing the basic nature of TVA.

One solution would be to permit TVA to sell wholesale power to any entity purchasing power for resale (wholesale buyers), consistent with guidelines established by Federal legislation, however, the citizens of the Tennessee Valley should not bear harm from the construction of any additional generation sources as a result of this activity. In other words, TVA's all-requirements customers must not carry the expense of generation and transmission facilities (beyond the needs of existing TVA wholesale customers) and thereby allow TVA to create a lower-cost offering to new wholesale customers. TVA would be limited to power generation necessary to satisfy the demands of the consumers of energy in the Tennessee River valley and those within an economic transmission distance from the Tennessee River similar to the original intent of the TVA Act. Such a limitation would perhaps lessen concerns over the possibility of additional stranded investment in the future.

TVA would continue to serve its current retail customers if those customers chose TVA as a supplier. However, if distributor customers have the option of obtaining electricity from other suppliers, distributors should then have the opportunity to be chosen by retail customers outside the "fence."

Within the TVA service territory, TVA could be permitted to serve additional retail customers in an existing power distributor's territory if that distributor's customers collectively take less than 51 percent of their requirements from TVA. TVA could also be permitted to pick up those loads distributors are unwilling to serve either solely or in alliance with one or more other distributors.

Unless otherwise agreed to by distributors in the Tennessee Valley, TVA should not offer long-term, all-requirements power to distributors in the Tennessee Valley at wholesale rates less favorable than firm, all-requirements power offered to wholesale customers who are not currently municipal or cooperative distributors in the TVA service area. Exceptions would be permitted if distributors in the Tennessee Valley having firm, all-requirements contracts with TVA agree that a different arrangement would clearly benefit existing customers. However,

the League believes that TVA and its distributors should not be able to agree to firm, all-requirements wholesale rates for any other entity that are less than the rates available in the Tennessee Valley, unless the public is duly notified.

## Recommendations

The Advisory Committee members reached agreement on these positions:

- TVA is to remain basically in the wholesale business.
- TVA should be allowed to sell at wholesale outside the fence consistent with guidelines established by Federal legislation.
- TVA's existing retail customers should have the option of remaining TVA direct served customers if they so choose.

TVA, TVPPA, TVIC, the Teamsters, IBEW, and AVI support the following:

- TVA should be able to sell at retail inside the fence under conditions mutually agreed to between TVA and its existing distributors.
- TVA should be able to sell outside the fence at retail in order to mitigate stranded cost, as approved by the FERC.

TVERC and the League support the following:

- TVA should be only a wholesale provider and should not be allowed to compete in the retail market inside or outside the current fence. Current direct served customers contracts can be extended. New large power customers within the current TVA fence should be served through distributors of TVA power.

TVA Watch and NGC support the following:

- TVA is currently engaged primarily as a wholesale supplier of energy. The small component of retail load that TVA serves is larger industrial customers. As a government agency, TVA

has been authorized to sell surplus power only at wholesale. In the future, it runs counter to good national policy to endorse TVA's role as a competitor against private enterprises to serve additional retail load. It runs counter to good business policy for TVA to expand the scope of its operations into an area in which it has little or no expertise, that being smaller retail customers geographically located outside the region. This expansion of effort by TVA would be at great expense, would require funds that should be used to retire TVA's debt, and would potentially be subsidized by TVA's captive customers.

## Issue 9: Stranded Cost

The question addressed in this section is, how should TVA's stranded costs be determined and recovered?

Typically, stranded costs are defined as those costs incurred by a utility to meet its legal or contractual obligations that become unrecoverable as a result of the transition to competition. In the case of TVA, stranded costs could occur if the competitive market price for power sold by TVA or the volume of power sold by TVA does not result in sufficient revenues to TVA to cover all of its ongoing and debt service costs.

This potential for stranded costs results from the fact that TVA, as is the case with most utilities, has had an obligation to meet the needs of its wholesale distributors (including their retail customers) and TVA's direct-serve retail customers as a result of the TVA Act. If Congress decides that customers within TVA's geographic service area should have a choice of supplier, TVA's wholesale distributors will wish to shop for the lowest cost source of wholesale power so that they can offer the lowest possible rates to their retail customers and retail customers will also shop for the lowest rates. As a result, TVA and distributors of TVA power may lose customers to competitors. Thus, Congressional action to require TVA and the distributors to provide choice to their customers will likely result in stranded costs to TVA.

TVA has unique stranded cost issues in several respects. First, while TVA's debt is not explicitly backed by the Federal government, TVA is a Federal corporation. In the event that TVA cannot generate sufficient revenue to meet its cash needs, the Federal government, like any owner, may be forced to contribute additional capital to avoid a default. Thus if TVA's stranded costs are not dealt with appropriately, the costs may fall on the American taxpayer. This would mean that consumers in other regions of the country would bear a portion of TVA's stranded costs.

There are six *major* categories of costs which could become stranded with a transition to competition:

- Nonperforming assets (i.e., the costs of investments by TVA in plants or facilities which have little or no value in the competitive marketplace, such as uncompleted nuclear plants)
- Above-market generating costs
- Above-market purchased power or fixed fuel contract costs
- Costs that continue to be incurred to fulfill mandated public policy obligations and that are not otherwise paid for by Federal appropriations
- Costs of any current or future utility obligations that are not fully reflected in current rates (e.g., the costs of nuclear decommissioning)
- Costs of transmission and distribution facilities to the extent that they are no longer used by a departing customer

This list is not meant to be all inclusive. The types of transition costs incurred could be highly dependent on the market structure adopted for competition and the length of the transition period. Changing environmental rules and/or state or Federal regulations could possibly impose additional types of stranded costs during the transition to competition. TVA should have the right to request the recovery from the appropriate regulatory body of any costs that fit within the generic definition of transition costs discussed above.

While FERC and many States have limited stranded cost recovery to legitimate, prudently incurred costs, such a standard is not applicable to TVA. TVA's investments have not been subject to any substantive review of legitimacy and prudence, and we do not suggest that such an inquiry be conducted in the future. Furthermore, even if some of TVA's costs were found to be imprudent, it again would be taxpayers who would likely bear the brunt of any stranded cost disallowance. Thus, TVA should be allowed to recover its full stranded costs as determined by the regulator, without consideration to the legitimacy and prudence of past TVA expenditures.

With regard to calculation of stranded costs, the Advisory Committee members concluded that the revenues-lost type of approach adopted by FERC in Order 888 could be appropriate to apply to TVA. An up-front estimate of these stranded costs might be made for planning purposes and the actual amount could be trueed up each year to ensure that TVA neither under-recovers or over-recovers its true stranded cost.

Alternatively, to prevent a potentially adverse effect on competition in the future, Enron, the League and TVERC would prefer that the amount of stranded cost owed to TVA should be determined and established up front by the FERC or other appropriate Federal authority. Once the amount of stranded cost owed to TVA is established, Enron, the League and TVERC would not oppose implementation of a true-up mechanism to ensure that (1) only the amount fixed for stranded costs in the beginning has been collected; and (2) only the amount of stranded costs owed by each distributor has been collected.

Stranded investment should be recovered via a non-by passable surcharge on the bills of TVA's direct serve customers and an equivalent surcharge on the bills of other retail customers as a result of this stranded investment calculation. The amount paid by each customer subject to stranded investment should be allocated to those customers in a nondiscriminatory manner. Congressional action may be required to mandate the imposition of such a surcharge on all customers. If a customer is paying the stranded cost surcharge, the customer should be eligible to shop for a new power supplier where consistent with state law.

## Recommendations

The Advisory Committee members reached agreement on this position:

- Any stranded costs resulting from Congressional action to mandate competition should be borne by those TVA or distributor customers for whom TVA incurred those costs (that is, direct or indirect customers that TVA had a reasonable expectation of serving when investments were made).

- TVA's recovery of stranded costs should not be unbounded. Because of the potential for TVA to discriminate in stranded cost recovery and use its market power to gain competitive advantage, certain restrictions should be placed on cost recovery by TVA. These include:
  - FERC or some other *Federal* authority should be required to review and approve any costs for which TVA seeks recovery after receiving input from State authorities when appropriate;
  - The time period for recovery should not extend beyond October 1, 2007, unless terms to extend the recovery period are mutually agreed upon by the parties;
  - All stranded cost recovery revenues received by TVA should be used to pay down its debt; TVA should be required to collect stranded costs via a non-by passable mechanism from all customers on a basis which does not discriminate against any particular customer or group of customers. Customers leaving TVA or the distributors should not have any more exposure than customers remaining with TVA or the distributors;
  - TVA should be required to collect stranded costs from all customers for whom TVA had a reasonable expectation of serving, either as a direct-serve customer or through a distributor. Whether or not a reasonable expectation exists or existed should be determined by the appropriate regulatory body. Exemptions should not be allowed;
  - TVA should be required to use its best efforts to mitigate stranded costs. This could include selling its power at auction to the highest bidder to ensure revenue optimization, possibly selling nonperforming assets, and if approved by FERC, making retail sales outside the fence in addition to wholesale sales.

TVA Watch and NGC's position in response to TVA being able to make retail sales outside the Tennessee Valley in order to mitigate stranded cost (item 5 above) is:

- Permitting TVA to make wholesale sales, inside and outside the fence, will provide an adequate means for TVA to mitigate its remaining stranded investment. Permitting a Federal agency to become a major force in what will undoubtedly prove to be a very competitive retail market makes little policy sense and requires TVA to begin building a new infrastructure within the agency to replicate sophisticated marketing efforts better left to private parties. The loss of current wholesale customers by TVA does not lead logically to the conclusion that TVA must be permitted to enter retail markets. Obviously, the overall amount of power demanded in the region will determine the demand for supplies of TVA generation. Private retail aggregators will be able to signal TVA as to the value and use of its wholesale generation resources. The demand portion of the market equation will not be affected by whether TVA potential sales are wholesale or retail. Moreover, at a minimum, any decision to permit TVA to become a retail market participant should be left to the Congress, not the FERC.

NGC and the League support the following position:

- TVA is in the Process of negotiating stranded costs responsibilities with its distributors. In this process, the distributors, who own the rights to energy and capacity, have an opportunity to exert influence on their economic destiny. Furthermore, once stranded costs are clearly associated with individual customers, the customers should have an active role in mitigating these costs. In other words, TVA should not be the only party responsible for stranded cost recovery. TVA and the distributors should align themselves with other market participants who could, through innovation and broader market exposure, provide creative solutions to recovering these costs faster and in a greater proportion to the total.

# Appendix A

## Tennessee Valley Electric System Advisory Committee Terms of Reference

### Objectives and Scope of Activities

To provide advice, information and recommendations to the Secretary of Energy Advisory Board on a legislative proposal to establish the role of the Tennessee Valley Authority (TVA) in a restructured competitive electric industry.

### Background

The President has announced his intention to pursue a bold plan for electricity restructuring legislation. Several bills have been introduced in Congress to restructure the electric industry. Several states have passed legislation or regulatory initiatives to institute competition in the electric industry at the retail level. Proposals to restructure TVA raise unique issues because of its statutory status as a government-owned corporation.

The purpose of the Tennessee Valley Electric System Advisory Committee is to encourage citizens of the region to develop a consensus-based proposal that would define the role of TVA in a restructured electric industry. This process will provide information to the Secretary of Energy Advisory Board and will be valuable to the Administration and Congress for use in development of legislative proposals to restructure TVA to assure residents and businesses of the Tennessee Valley the right to choose their own electric service suppliers.

### Description of the Committee's Duties

The Committee will prepare a report that will include a proposal for TVA restructuring legislation and will identify areas of agreement, and disagreement (if any), among stakeholders.

### **Reporting**

The Committee shall report to the Secretary of Energy Advisory Board.

### **Estimated Number and Frequency of Meetings**

The Committee is expected to meet two to three times. Meetings will be scheduled as the Committee chair deems necessary for the Committee to accomplish its duties and purposes.

### **Members**

The Committee's membership will reflect a balance of expertise and viewpoints from the Tennessee Valley region. Members will include a representative from the Secretary of Energy Advisory Board, as well as representatives from TVA, municipal and cooperative distributors, regional industrial customers, retail and residential consumers, public interest groups, surrounding utilities, independent power producers, electricity marketers and state government representatives.

### **Chairperson**

The Secretary of Energy shall designate a chair for the Committee.

### **Working Groups**

To facilitate the functioning of the Committee, the Committee may establish working groups on its own initiative. The objective of a working group would be to undertake fact findings, drafting and analysis of matters within the scope of the Committee.

### **Duration and Termination Date**

This Charter will expire five months from the date of the Committee's establishment, subject to extension or dissolution by the Chairman of the Secretary of Energy Advisory Board.

# Appendix B

## Issue 3—Tax Status for Public and Federal Power Entities

### **Position of TVA, TVPPA, AVI, TVERC, the League, the Teamsters, IBEW, TVIC, and SSEB**

The proposed restructuring of the electric power industry has highlighted the problems of tax laws enacted in a previous regulatory era and the unprecedented tax consequences of retail choice in a new competitive environment. It appears necessary that Congress, the Administration and the States will be required to take corrective action to realign tax policies with the new energy policies. State tax situations in particular must be carefully considered since local and State revenues may be significantly affected.

Any realignment in tax policies should specifically take into consideration the differing missions of public and private power. Public power is not just another way of delivering electricity. Public power's market strength is its mission of providing communities and consumers with reliable power at a reasonable cost, its local control, its public service ethic and its nonprofit status. Public power's nonprofit status is in recognition of the right of consumers, communities, States, etc., to organize for the purpose of providing for themselves without the requirement of making a profit. By not making a profit, nonprofit organizations have not been subject to Federal income taxation. The electric utility industry is not unique in having some nonprofit organizations participating in the market and should not be singled out for different tax treatment. If consideration is being given to change the Federal income tax status of nonprofit organizations, such a change should be included in a total review of the IRS tax code and not limited solely to the electric industry.

As the electric utility industry is restructured and retail competition begins, there may be a need to modify State and local tax laws (and tax equivalent laws) to ensure that electricity

consumers all bear their fair share of those taxes which are typically assessed against gross business activity, regardless of the nature of the supplier from whom they buy their electric power. For example, it may no longer be fair to levy a business excise tax against one kind of supplier, in cases where the tax has been routinely passed on to its consumers as a cost of power supply, unless competing suppliers and their consumers also bear the same tax or its equivalent. On the other hand, taxes like income taxes are based on profit accruing to the owners of the supplier. The assessment of such taxes should continue to be based on the nature of the entity.

In many instances where public or Federal power entities are exempt from the payment of local and state business assessment taxes, payments in lieu of these taxes are made as a tax equivalent.

TVA and its municipal and cooperative distributions systems believe that they pay more to local and state governments in tax and tax equivalent payments than do many private power companies. In 1995, TVA and the distributors of TVA power paid 5.7 percent of their revenue to state and local governments, whereas TVA's private power neighbors paid only 4.7 percent, excluding income taxes. For years TVA has been Tennessee's largest "taxpayer" and in many instances, TVA distributors are also the largest local "taxpayer." This method of state and local "taxation" of public and Federal power entities appears to have worked well in the past without requiring a change in tax status.

### **Recommendations**

The relative tax situations of all sectors of the electric utility industry should be considered as a result of industry restructuring legislation. TVA should not be singled out for a change in tax status in national legislation.

TVA and distributors of TVA power already make substantial payments to state and local governments and should not be required to pay more in tax and tax equivalent payments. That is, there should be no increase in TVA's 5 percent of gross power revenues or in the distributor's payments.

Unless the Federal tax status of all nonprofit organizations in the IRS tax code is amended to reflect different treatment, taxes on income should continue to be based on the nature of the entity,

thereby exempting nonprofits, TVA, and municipal distributors from Federal income taxation.

### Position of TVA Watch

- First, TVA Watch believes that the tax treatment of existing power bonds should change because of retail open access if the facilities financed by those bonds are used to compete against private enterprises with comparable facilities.
- Second, if TVA power is to be made available outside the confines of the fence and the tax laws are not otherwise changed as discussed in the report, a number of changes in law should be made to ensure fairness and to prevent economic distortions. For example, TVA could be asked to make payments in lieu of Federal income taxes in light of the fact that TVA avoids more than \$500 million annually in Federal and state income taxes that would be paid by a comparable-sized investor-owned utility. In order to achieve parity and symmetry among competitors, Congress could adopt a provision that requires TVA to pay an amount equal to the Federal income taxes that other potential competitors pay to help bear the cost of the Federal government.

Likewise, TVA's exemption from state income taxes could also be remedied through a payment in lieu of state income taxes. In order for TVA to pay its fair share of the cost of government that must be borne by TVA's competitors, Congress could require TVA to pay the States the otherwise foregone taxes by requiring the Corporation to pay to each state in which it sells power and energy an amount equal to its total operating revenue from within that State times the average amount of State income taxes incurred per dollar of operating revenue to such State by utilities subject to the jurisdiction of FERC. The average amount of State income taxes incurred by such utilities could be determined from the annual reports of operations and costs prescribed by the FERC.

Similar to the income taxes TVA avoids by virtue of its Federal status, the agency also escapes more than \$400 million annually in State and local ad valorem and other taxes. This lost tax revenue is over and above the "payments-in-lieu-of-taxes" that TVA currently pays.

Requiring such payments would establish parity and symmetry among all competitors by furnishing to state and local governments needed revenue that currently is not paid by TVA and not included in the cost of electric services supplied by TVA.

Finally, to extent revenues are derived by TVA through participation in sales of electricity and other services in direct competition with private entities, such revenues should be subject to the same taxation as revenues of private entities.

# Appendix C

## Issue 5—TVA's Mission

### **Position of TVA, TVPPA, TVIC, TVERC, AVI, IBEW, the Teamsters, and the League**

TVA's integrated management of the entire Tennessee River watershed optimizes the benefits of the water resource. Major functions of the corporation include:

- Management of the Tennessee River system for multiple purposes including (in order of priority) flood control, navigation, power generation, water quality, recreation, and economic development
- Generation of electricity
- Sale and transmission of electricity to wholesale and large industrial customers
- Investment in economic development activities that generate a higher standard of living for citizens of the Tennessee Valley;
- Stewardship of TVA assets and provision of recreation opportunities on Federal lands entrusted to the corporation
- Research and technology development that addresses environmental problems related to TVA's statutory responsibilities for river and land management and power generation

TVA was created as a regional agency charged with developing and managing a national resource—the entire Tennessee River watershed—and ensuring that it promotes local, regional, and national economic interests.

TVA's earliest proponents recognized that the Tennessee River, properly developed and managed, would be the center of the Valley's economy, and that the benefits of flood control, navigation, power generation, economic development and recreation across the entire region could only be optimized through an integrated system, rather than through a number of individual projects designed to provide limited benefits for specific portions of the region.

Thanks to Congress' integrated design of TVA, the Tennessee River system is effectively managed to minimize flooding, maintain a safe navigation channel, ensure adequate water quality, generate electricity and provide recreation. While these benefits primarily accrue to the eight million residents of the Tennessee Valley, residents of surrounding regions and the Nation as a whole also directly benefit from flood control and navigation on the Tennessee River, from low-cost electricity exchanges when their own systems are in short supply, and from a highly developed regional tourist industry.

Because TVA was designed to function as an integrated system, reassigning some of TVA's responsibilities would significantly degrade the efficiency and effectiveness of the overall system, resulting in fewer benefits, higher costs, and greater environmental impacts for the region and the Nation. For example:

- An isolated decision to maintain high water levels on a tributary reservoir to improve recreation for a small area would cause problems for residents downstream with flood control, navigation and power production.
- Reduced cooperation and coordination in managing the river's cooling water would increase the costs of generating electricity and cause some power plants to reduce their output—in some cases resulting in the loss of entire fossil units on summer days when they are most critical to meeting heavy electricity demands.
- If the operation of the river system and the power system are not closely linked, there would be less electricity produced from TVA's low cost, pollution-free hydro units and correspondingly increased use of more expensive, less environmentally-friendly fossil plants.

- Dismantling the unified agency structure would require the reassignment of TVA's nonpower functions to other agencies—a process that would inevitably result in operational dislocations and, more importantly, budgetary increases.

Over the past 65 years, TVA's fundamental mission has been to serve the public interest. When TVA built dams on the Tennessee River system, the character and ecosystem of the river basin were forever changed, which necessitates TVA's ongoing role as a regional resource management and public power agency. TVA has also played a major role in many of this Nation's greatest struggles, including providing munitions and aluminum during wartime, providing electrical power for the development of the United States' nuclear deterrence, and developing most of the fertilizer formulas in use today throughout the world.

These historical and ongoing contributions to the public interest—and TVA's ability to contribute in the future—demonstrate that there is a continuing role for a Federal presence in the electric utility industry.

There are compelling reasons for TVA to remain an agency of the Federal government. TVA is uniquely qualified to continue to serve the national interest through the integration of electric power generation and natural resource stewardship. The agency's economies of scale provide unique opportunities for the development and market implementation of cost effective, clean, efficient generation technologies. The Federal government has the stated goals and commitments to clean air, energy efficiency, renewable energy development and resource management. TVA, as an instrument of the Federal government, could and should serve to further these national public interest goals and commitments. These activities should not result in services or products offered in competitive markets that are funded or subsidized by Federal tax incentives or appropriated funds not equally available to all market participants.

TVA's experience, unique structure, and mission will allow it to continue to make powerful contributions to the national interest, such as:

- Continuing to ensure that affordable electric power is available to all classes of customers and providing leadership to the public power commitment in this area;

- Continuing to conduct national demonstrations of new, cleaner fossil fuel and renewable technologies and hydro technologies that improve air and water quality.

TVA has a wealth of experience with these issues and others—such as renewable fuels, the demonstration of environmentally-friendly technologies, and the non-wasteful uses of electricity—all of which are likely to be increasingly critical in a restructured industry.

TVA's energy mission in a restructured industry should be much as it has been in the past. TVA should primarily be a wholesaler of electricity to residents and businesses in the Tennessee Valley and—after retail open access becomes effective in the TVA region—to areas within economic transmission distance of TVA's existing territory, subject to the management needs of the Tennessee River watershed as a whole. TVA recognizes that this mission will have to be carried out in a fashion that adapts to a fundamentally changed energy marketplace promoting competition and customer choice. The ground rules governing competition will be discussed elsewhere, but TVA looks forward to helping to set them in ways that promote the public interest.

# Appendix D

## Governance of TVA

### Position of TVERC, the League, and SSEB

- Many of the recommendations of this report will require changes to the TVA Act. It would be appropriate to address the issue of TVA's Board structure and governance at this time. Over the past twenty years several recommendations have been set forward by representatives and panels for the restructuring of TVA's Board. Most have centered around expanding the number of board members and making board selection more accountable to the citizens of the Tennessee Valley. TVERC, the League, and SSEB anticipate a growing need for these and other changes in TVA's governance structure in a restructured electric power market and would recommend these changes be undertaken concurrently.

