THE WIRE

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CoBank

Co-ops and Digital Transformation: Key Topics for 2019

The National Rural Electric Cooperative Association's Regional Meetings offer an excellent chance for co-op leaders to meet with one another, learn from experts and candidly discuss some of the most important issues the industry faces, and the recently completed meeting series for this year was no exception.

Few topics are attracting more attention than the ways that data and technology are reshaping the power industry. At one such gathering recently, CoBank had the opportunity to facilitate a workshop for CEOs titled "Designing Your Co-op's Future: Unlocking the Value in Data."

While such discussions always elicit diverse opinions and perspectives, a few overriding themes emerged – ones that seem likely to take center stage in 2019.

Co-op Partnerships and Third-Party Support for Cloud-Hosted Services

Many co-ops lack the resources to build in-house cloud computing systems, which are increasingly vital in order to store, retrieve and manage ever larger and more complex data. In

continued on page 6

Nevada Votes NO on Energy Choice

On November 6, 2018, Nevada voters rejected a proposition that would have fully liberalized the state's electricity market. The Energy Choice Initiative would have required the Nevada legislature to establish an open, competitive retail market for electricity, reduce energy market regulation and prohibit monopolies by energy companies. It was defeated with 67 percent of ballots cast against the measure after opponents spent millions of dollars campaigning against it.

The initiative had attracted attention from the rural electric cooperative community across the country. Passage would have made Nevada the first state to implement retail electricity choice through an amendment to its constitution, and the only one that did not exempt cooperatives from competition. Indeed, passage had seemed likely, after the same question, on the ballot in 2016, won with 72 percent of the vote. (Nevada requires constitutional amendments adopted by initiative to be voted on twice.)

Yet while the Energy Choice Initiative did not become law, the issue is by no means settled on a national scale. "Progress toward retail choice is likely to slow, but commercial

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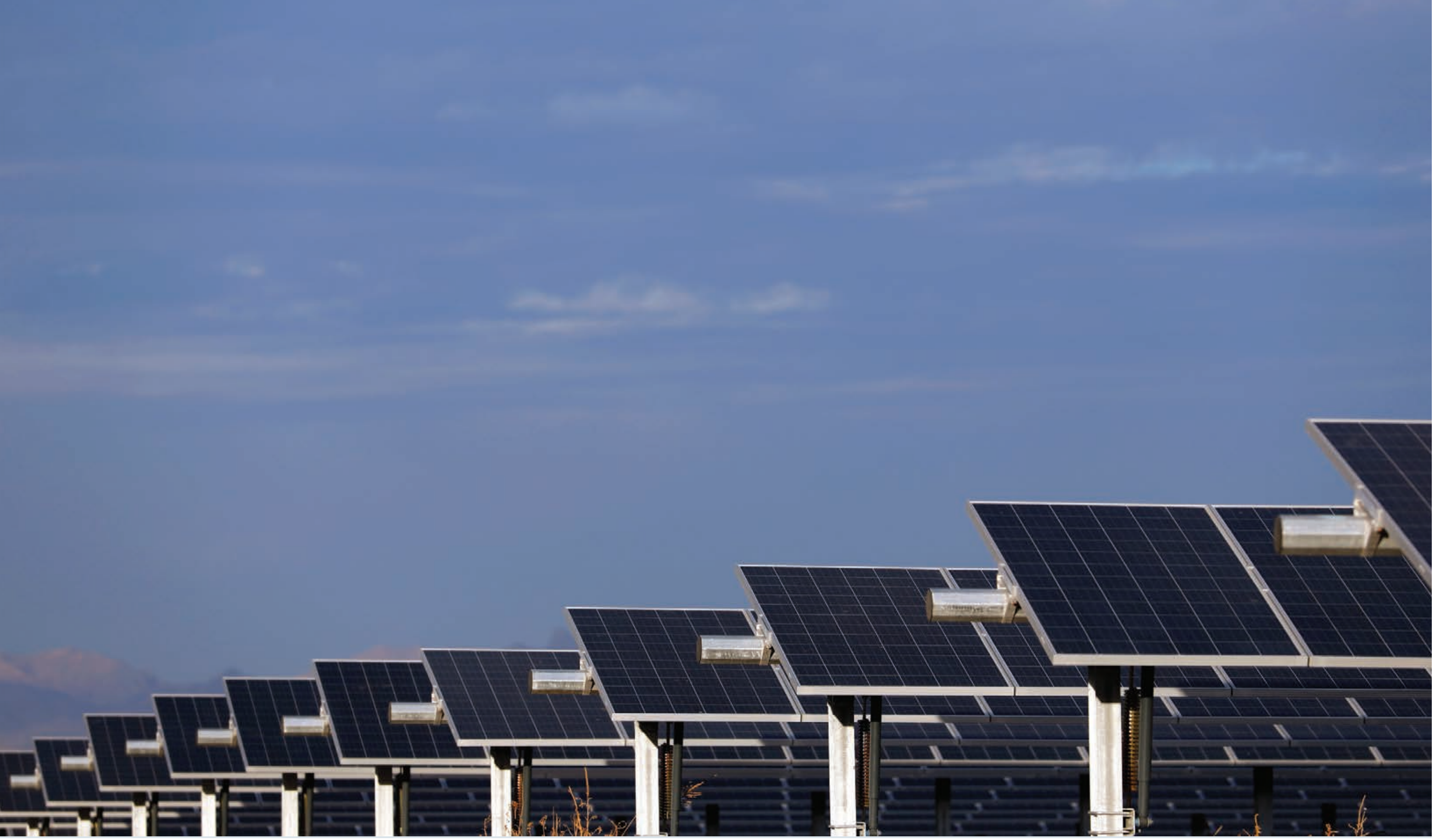

NEVADA VOTES NO, from page 1

and industrial (C&I) customers continue to want alternative options for procuring their energy," says Taylor Gunn, lead economist for power, energy and water at CoBank. "Those interests pushed for passage in Nevada and they'll continue that push in other states."

That could mean ongoing risks from energy choice for electric co-ops nationwide, which may face a shrinking customer base and other issues should similar measures pass in their states, Gunn notes. A close examination of what was at stake in Nevada could help cooperatives elsewhere understand and prepare for what may still be ahead. In Nevada "the divestiture of NV Energy's power supply assets could have resulted in billions of dollars of stranded costs and higher electricity bills for Nevada consumers," says Gunn. The initiative, along with a second Nevada referendum, could also have reduced co-ops' access to affordable federal hydroelectric power, which has long been a key resource for them.

Progress toward retail choice is likely to slow, but commercial and industrial customers continue to want alternative options for procuring their energy.

– TAYLOR GUNN, Lead Economist for Power, Energy and Water, CoBank

C&I Customers Pushing for Choice

"A growing divergence between wholesale electricity prices and retail rates could embolden customers in other states, particularly large C&I customers, to embrace retail choice as a way to pay lower electricity rates," says Gunn. Adding to the push for retail choice are a growing number of companies around the country that have decided to fill most or all of their energy needs from renewable sources.

States in which the generation mix is dominated by fossil fuels and where wholesale energy is cheaper than retail rates will face growing pressure for deregulation. The Midwest and West, which generally lack dominant investor-owned utilities that might oppose retail choice, could see a wave of change.

"Historically, electric cooperatives have been exempt from competition under deregulation," says Gunn. "Even though Nevada voters rejected the initiative, an ever-louder call for choice could weaken this longstanding pact in other states."

What's the True Cost of Retail Choice?

Under the Energy Choice Initiative, power generation and energy supply would have been established as competitive services, with utilities required to divest assets related to the supply of electricity. NV

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NEVADA VOTES NO, from page 2

Energy and its affiliates—the dominant energy suppliers in the state—would have been forced to leave the power-generation side of their businesses, divesting all of their power generation assets before 2023, when the law, had it been passed, was set to go into effect.

Because many of NV Energy's long-term electricity contracts have prices above the cost of new generation, those contracts would have been unlikely to be purchased by new retail electricity providers entering the market. Whether NV Energy could have divested its power generation fleet and covered the book value of those assets remains a large unknown. Combined, these issues could have resulted in stranded costs of $4.074 billion dollars,[1] according to an estimate by the Public Utility Commission of Nevada.

Spreading these costs across Nevada ratepayers would likely have increased monthly electricity bills, including electric co-op member-owners. However, Nevada electric co-ops do no rely on NV Energy for energy supply services. The Nevada Rural Electric Association argued that electric co-op customers shouldn't have to shoulder any costs associated with the divestiture of NV Energy's power generation assets.

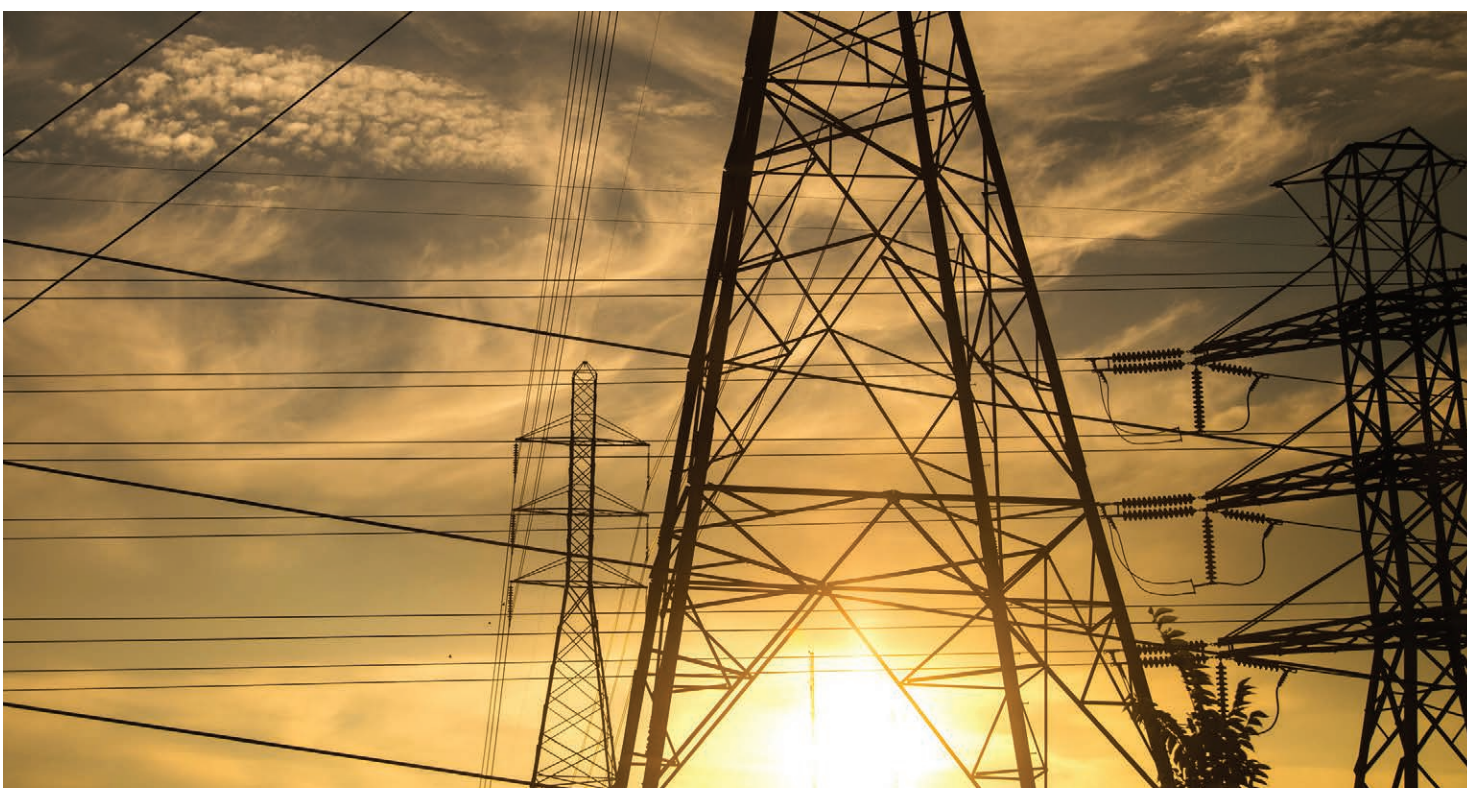
Historically, electric cooperatives have been exempt from competition under deregulation. Even though Nevada voters rejected the initiative, an ever-louder call for choice could weaken this longstanding pact in other states.

Keeping Customers Under Retail Choice

If Energy Choice had become law, customers would have been automatically assigned to a retail electricity provider unless they chose to stay with their existing providers, which would have been responsible for notifying customers of the change and convincing them to remain customers. Inevitably, some customers would have taken no action, regardless of notifications, says Gunn, thus remaining with their assigned provider. "If similar requirements become parts of initiatives in other states, even in the best-case scenario, co-ops could be left with fewer customers."

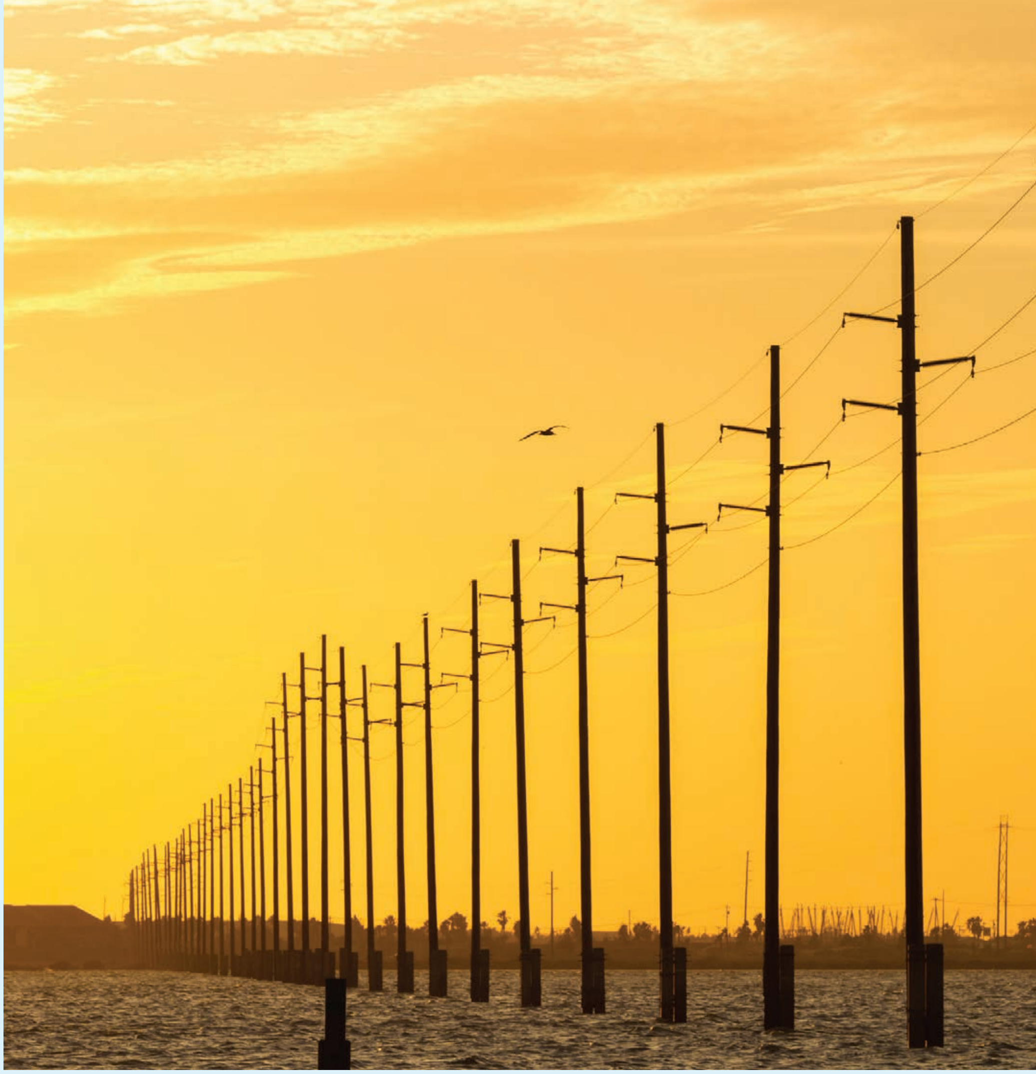
If retail choice is enacted in other states, rural electric co-ops could face rising electricity costs for delivering power to fewer customers, as well as significant uncertainty about the future. ■

[1] *Public Utilities Commission of Nevada, Energy Choice Initiative Final Draft Report, Investigatory Docket 17-10001, April 2018.*



CASE STUDY:

Nueces Electric Cooperative – Making Energy Choice Work in Texas



For cooperatives wondering how energy choice could affect their businesses and membership, Nueces Electric Cooperative (NEC) in South Texas has some answers. A distribution co-op serving eight counties along the Texas Coastal Bend, NEC has offered choice to its customers for nearly 15 years. Assistant GM and Chief Compliance Officer Sarah Fisher was there from the start. We asked her about the challenges and benefits of offering choice and what the transition involves.

***THE WIRE:* When and why did NEC introduce choice for its customers?**

Sarah Fisher: The Texas Electric Choice Act of 1999 made choice mandatory for investor-owned utilities (IOUs) in Texas and optional for municipal power companies and co-ops such as ours. Eighty-five percent of members surveyed at our 2000 annual meeting favored choice. Initially, though, our management and board determined that the costs outweighed the benefits and we didn't move forward.

> *Since we first opted in, our number of meters-served has grown by 239 percent, mostly due to customer choice.*
>
> – SARAH FISHER, Assistant GM and Chief Compliance Officer Nueces Electric Cooperative

In 2004, as part of a territory settlement agreement, we acquired 6,000 customers who had previously been with a local IOU. Because those customers already had electric choice, regulators required us to adopt choice as part of the agreement. We were the first and are still the only Texas co-op to do so.

***THE WIRE:* How many providers can customers in your area choose from, and how has that affected NEC's market share?**

SF: Commercial customers have 19 potential providers and residential customers have two, including NEC's affiliate, NEC Co-op Energy. Commercial customers pushed for choice in Texas. Our affiliate serves 70 percent of the commercial and industrial market in our area while 30 percent have chosen other providers. Residential consumers have shown less interest in choice, and other providers have to be really motivated to pursue our small, rural population. Our affiliate continues to serve 95 percent of that market. Homes and businesses combined, our affiliate serves 91 percent of NEC's area.

***THE WIRE:* What did adopting choice involve from a practical standpoint?**

SF: Among other changes, we unbundled our rates and created a competitive retailer relations program to ensure open access for retail providers. We developed member protection rules, trained our employees not to engage in anticompetitive behaviors, and developed educational materials to help

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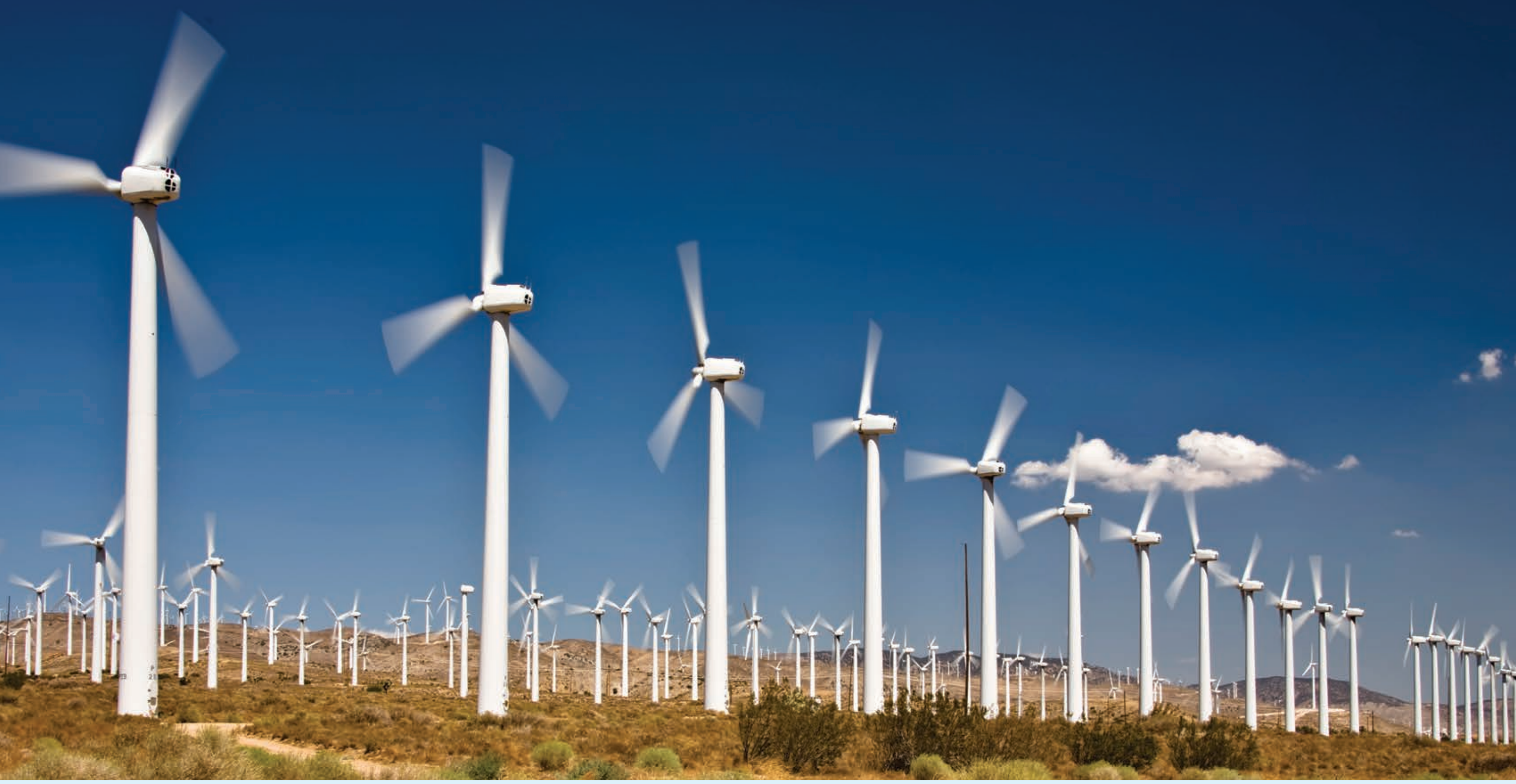

NUECES ELECTRIC, from page 4

members understand choice. We modified our computer information system to process billing for multiple providers and to handle electronic data transactions. We also formed our affiliate, NEC Co-op Energy, to sell power to new consumers in competitive areas across Texas.

THE WIRE: What was the biggest risk?

SF: We knew that no matter how many consumers we might lose to other providers, we were still going to have to pay our share of the generation and transmission (G&T) resources we'd already contracted for. Covering that obligation could have required big increases in our remaining members' rates to cover stranded assets. The statewide competitive affiliate supports a revenue stream that ensures we satisfy our debt obligation to our G&T.

THE WIRE: How successful has the affiliate been in attracting new customers?

SF: We've experienced significant growth. Since we first opted in, our number of meters-served has grown by 239 percent, mostly due to customer choice. Today, the number of non-wires members and meters is larger than those served in our wires area. Non-wires members offer the advantage of revenue and sales growth without a large capital investment. But they have a much higher turnover rate, which makes forecasting demand more complex. Our G&T has been supportive in this process and eventually incorporated our non-wires members into their forecasting and planning.

THE WIRE: What challenges has the affiliate experienced?

SF: Serving two very different customer bases creates challenges. Because regulations differ, we had to create all new customer disclosure information. There were accounting, IT and communications challenges. We have a second website for our competitive affiliate, two monthly membership magazines, separate billing processes, twice as many social media sites, and significantly more advertising for the affiliate. In other words, our communications efforts have more than doubled.

THE WIRE: What advice would you offer other co-ops considering choice?

SF: Consider your power supply arrangements carefully, especially if you plan to seek customers outside your traditional area. Are you going to use a power broker to connect you to new suppliers, or is your existing wholesale G&T going to provide the power? Examine your existing wholesale power and other contracts – what they say now and if contract renegotiation is allowed if you offer choice.

Finally, while choice can be a means of growth, think about why you want to grow. Is it just because growth looks good for the co-op, or because it's good for the members? The decision with the greatest benefit to members is always best. ■

Sarah Fisher is assistant general manager and chief compliance officer for Nueces Electric Cooperative, where she's worked for 21 years. She earned a bachelor's degree from the University of Oklahoma and an MBA from Texas A&M Corpus Christi.

CO-OPS AND DIGITAL TRANSFORMATION, from page 1

order to meet growing consumer demand, look for co-ops to form partnerships, pooling their efforts and resources to create, manage and upgrade their cloud capabilities. Leaders also cited the need for co-ops to consider and communicate the value of credible third-party vendors for cloud-hosted services. Reliable vendors may offer a level of capacity, expertise and cost-effectiveness that will enable co-ops to focus on their core businesses.

Using Big Data to Improve Efficiency

One key topic was data analytics and the ways that co-ops can collect and interpret information to improve customer engagement, increase reliability, reduce costs through operational efficiencies, generate more robust financial forecasting and planning, and create tailored rate structures.

Broadband as a Necessity

Increasingly, electricity and broadband internet services are converging. In our last issue of THE WIRE, we spoke with Rural Utilities Service Administrator Kenneth Johnson, who noted that broadband has become as important to rural life and success in the early twenty-first century as electricity was in the early twentieth. Just as the need for electricity gave rise to the rural electric cooperative industry, co-ops today have a central role to play in delivering broadband to their communities.

Customer-Centric Thinking

Though data-crunching is sometimes thought of as impersonal, there was widespread agreement at the meeting that for co-ops, the data they collect can be just the opposite, helping co-ops develop two-way conversations with customers and improve their overall experience. Thanks to the rapid pace of technological advances, customer expectations are constantly evolving. Here are some questions co-ops can ask themselves to ensure they keep pace:

- *How do we rely on data, research and analytics to develop a consistent, holistic view of our customers?*
- *How do we apply customer-centric design principles that ensure we are putting customers first and getting their feedback in the beginning?*
- *How do we make sure our decisions are unbiased and objective, and are not overly influenced by our own opinions?*

These are just a few of the issues that co-op leaders will contend with in 2019 and beyond. The solutions won't be simple, but if the past is any indication, cooperatives will adapt to each development and continue to provide vital services to their memberships. And, as the NRECA Regional Meetings show, keeping the conversation going is essential to that process. ■

CoBank 2018 Webinar Series

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Beyond dependable credit and financial services, CoBank seeks to help our customer-owners by providing thought leadership, high-quality information and timely insights on a number of energy-related topics that may impact you and your organization.

Don't miss the final webinar in our 2018 series:

- *Tuesday, November 13, 11:00 a.m. EST*

BATTERY STORAGE

- *Taylor Gunn, CoBank Lead Energy Analyst*

For more information or to register, please contact your CoBank Relationship Manager.

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