CONSULTANT REPORT

Report on the Development and Organization of the

CALIFORNIA ELECTRIC USERS COOPERATIVE

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CALIFORNIA ENERGY COMMISSION

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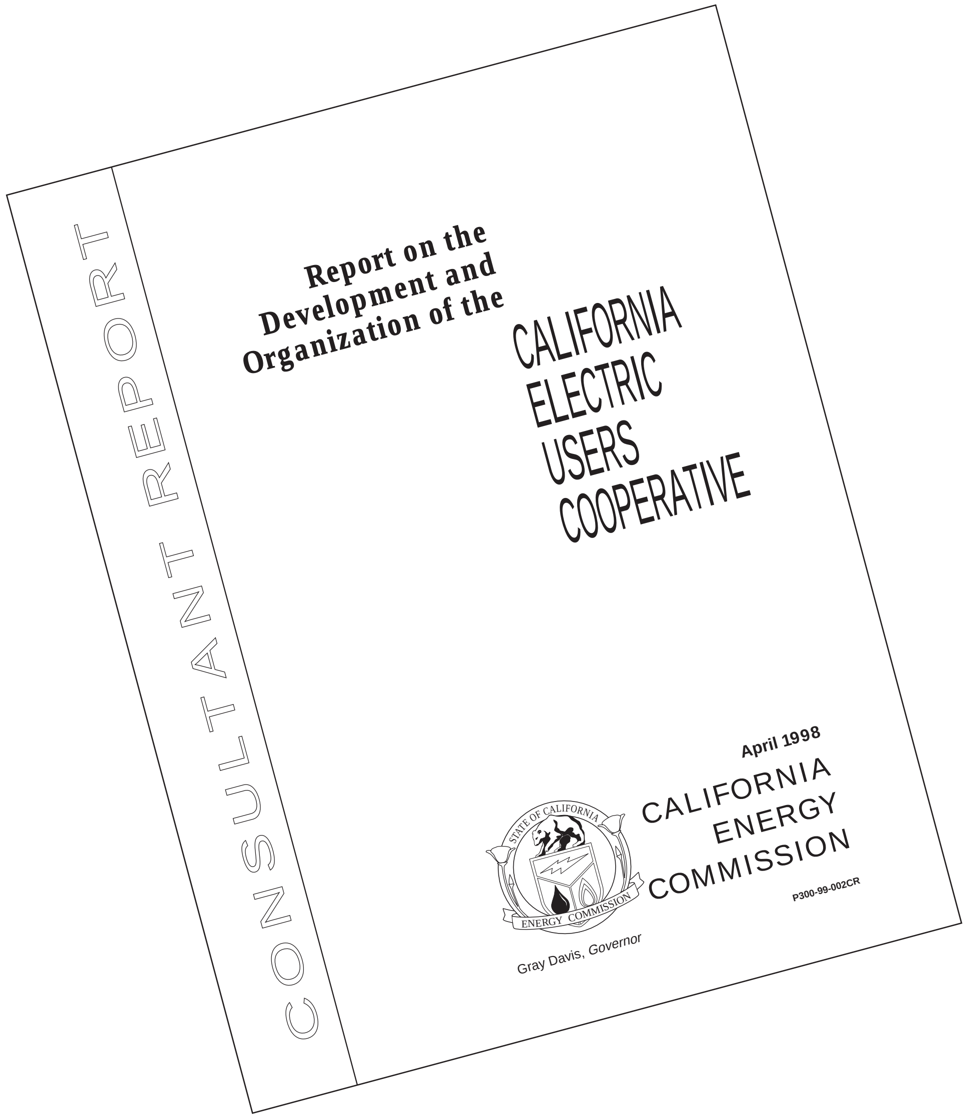

CALIFORNIA ENERGY COMMISSION

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REPORT ON THE
DEVELOPMENT AND ORGANIZATION
OF THE
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Executive Summary

The California Electric Users Cooperative (CEUC) is an electric cooperative without wires, the first organized under the new regime of California's electric industry restructuring. It aggregates the electric loads of small farmers and processors who are organized into agricultural cooperatives under the provisions of the California Food and Agricultural Code. The product of over a year of grass-roots organizing and an extensive collaboration among private organizations and public agencies, it provides a model for consumer-initiated and consumer-owned and -controlled entities attempting to function in California's new electric marketplace.

The CEUC is a cooperative whose members are agricultural cooperatives. Such cooperatives must agree to purchase their electric energy through the CEUC. Individual farmers and processing entities who are members of the CEUC-member cooperatives are also entitled to purchase energy through the CEUC. CEUC has negotiated a master agreement for power supply that guarantees CEUC members and their farmer members a reduction in their annual electric bill.

Cooperatives are incorporated entities of private persons and businesses. They have distinctive organization principles and tax treatment under state and federal law. They are owned by their consumer-members, are governed on the basis of one member/one vote, and operate on a non-profit basis. These features make it possible for consumers to purchase an essential service like electricity at the lowest possible cost, assuming effective and prudent management. The CEUC represents an attempt, apparently successful, to adapt the cooperative model to the needs of consumers in the new restructured electric market in California.

The California restructuring experiment is predicated on individual customer choice. The unfolding process of articulating the initial set of rules and procedures for exercising customer choice during 1997 made the parallel process of organizing the CEUC, the first consumer-initiated cooperative intended to benefit small consumers specifically, more difficult than similar efforts will be in the future. However, there are features of the California restructuring effort that pose significant issues and challenges for any group of consumers seeking to be proactive in the new market. The CEUC organizing process provides insight into these issues and challenges.

First, the California electric market restructuring is focused on individual customer choice stimulated by seller activity. A seller-driven market means that customers with especially attractive loads will be singled out for attractive pricing, while small customers -- such as farmers -- will be neglected or ignored, i.e., will have no choices. The CEUC manages to combine large, attractive industrial -type loads with small customer loads by emphasizing the community of interest that exists between the farmers who own the cooperatives which in turn provide the large processing loads, and by appealing to the solidarity of the agricultural cooperative movement. The distinctive mix of organization making up the CEUC -- dairies, avocado growers, citrus packing and marketing entities, cotton-seed marketers, farm supply companies -- reflects this sense of solidarity.

Second, the structure of choice resting on individual customer decisions means that extensive persuasion activities will be required. In the case of the CEUC, individuals and institutions with tremendous personal reputations and personal contacts throughout the agricultural industry spent substantial time meeting with agricultural cooperative boards and members. The creation of the initial CEUC steering committee and the furnishing of start-up-capital would not have occurred without the involvement and the personal credibility of these individuals and institutions. Their continued involvement is being supported both by cooperative capital and government grants.

Third, the creation of a sound business plan informed by sophisticated technical insight, experience in the utility business and good business judgment is essential. The California electric restructuring is premised on creating competition through disaggregation of the geographic-based aggregated electric loads and re-aggregation based on different premises and principles. The economic implications of re-aggregation for the specific customers group seeking to organize and participate in the market must be analyzed and understood. These studies are a development cost that can be significant. In the case of the CEUC the analytical process was made all the more difficult by the fact that the market did not exist at the time the analytical work was being done, so that the analysts had to rely on forecasts and assumptions that were inherently uncertain and constantly changing. The ultimate decision on a power supply relationship was based on an informed business judgment that the cooperative should proceed, while minimizing risk in this climate of extreme uncertainty.

Finally, the positive, proactive approach to consumer self-organization reflected in the CEUC was facilitated by the collaboration of many partners -- the member cooperatives, Cal-AgriCivics, the Northern California Power Agency, the Plumas-Sierra Rural Electric Cooperative , the California Energy Commission, the National Rural Electric Cooperative Association, the Center for Cooperatives at the University of California, the National Rural Utilities Cooperative Finance Corporation and numerous individuals. Recognizing the importance of creating a forum where consumers can come together and such collaborations can occur is another important lesson.

I. THE HISTORY OF THE DEVELOPMENT OF THE CALIFORNIA ELECTRIC USERS COOPERATIVE

A. The California Experiment - An Overview

California has embarked on a grandiose experiment that redefines the terms and conditions of how and from whom electric energy is purchased for private and public use. The basic elements of this experiment involve both deconstruction and deregulation and reconstruction and re-regulation. The premise of the California Experiment is that individual users are better off if they have the opportunity to purchase electric energy from competing providers on terms which are freely negotiated between the parties rather than specified by regulatory command.

Over the past 100 years, electricity has become an essential service for modern life. Recognizing this, governments have provided consumers of electricity with substantial protections against the uncertainties associated with the free market. Suppliers have been granted exclusive territorial franchises within which to provide service and have been permitted to achieve a high degree of vertical integration in providing all levels of electric service. Consumers have been protected against abuse from vertically integrated monopolies by regulation that assured that they would be provided with reliable service without discrimination, at "just and reasonable prices" subject to periodic public review and approval. Suppliers were protected against overly aggressive regulation by bedrock constitutional guarantees against confiscation of dedicated property. The "regulatory compact" provided for an obligation to serve at reasonable rates and an opportunity to recover costs plus a reasonable profit under conditions of prudent management without facing competitive pressure and uncertainty. The California Experiment changes all of this in fundamental ways.

First, the California Experiment abrogates the exclusive territorial franchise and permits customers and new electricity providers to contract directly for electric energy. Second, the vertically integrated monopoly is deconstructed (unbundled) into competing generation providers, transmission providers and distribution providers. Customers will have the choice of purchasing energy directly from an electric service provider (ESP) or continuing with their current utility, the default provider. Transmission will be managed by the newly created Independent System Operator (ISO) who will convey electricity from a generation source to a local substation. The local delivery of electricity on wires and poles to homes will still be provided by the current utility, but it will now be known as the utility distribution company (UDC). Electric energy will be provided on a competitive basis with pricing set through bilateral relations between buyer and seller. The market, not the government, will determine the cost of energy at whatever price the traffic will bear. The UDC remains subject to regulation on a traditional cost-of-service basis and continues to have an obligation to serve without discrimination, as well as an opportunity to recover costs and profits under the condition of prudent management without meaningful competition. The transmission function is provided at cost (including cost of ownership) under regulation by the Federal Energy Regulatory Commission (FERC).

The physical facilities used to generate, transmit and distribute electricity have not changed. What has changed are the commercial relationships between buyers and sellers. Instead of a single bill for integrated service presented by the utility, consumers will now have multiple relationships (perhaps coordinated by a single ESP). At a minimum, those relationships will involve payments to the UDC for distribution service; to the ISO for transmission service; to a generation supplier for electric energy; and to a schedule coordinator for matching-up the consumer's electric demand with a generator's electric energy supply. The disintegration of the electric utility may result in scale dis-economies; for smaller consumers, the re-integration of their loads into large scale blocks of demand may be more costly than the aggregation by the formerly integrated monopoly utility. Similarly, matching up of the dis-integrated and re-integrated demand with suppliers while assuring supply reliability might be more expensive than the formerly integrated utility service. These costs may be incurred both on the customer side (transaction cost associated with shopping the competitive market, costs associated with a failure to arrange for appropriate supply, costs for "insurance" to assure reliability under conditions of uncertainty) and on the supplier side.

B. The Cooperative Option

A collective response on the part of small players in the market to gross disparities in size and power of their counter-parties in the market has a long tradition in American economic life. Labor unions were organized as collections of laborers facing corporations which were collections of capital. Cooperatives were organized by small farmers to gain market power parity with corporate entities such as railroads and packing houses which had great advantages in terms of size and power over individual farmers. In the 1930's, farmer cooperatives were formed to provide electric and telephone service in rural areas where private corporate interests were unwilling or unable to economically justify providing that service on the usual terms. The application of the cooperative model to empower small consumers in the new electricity market dominated by former monopolists and large scale power suppliers is thus a logical development in the California Experiment.

The traditional rural electric cooperative is a distribution entity that operates on an exclusive franchise basis in a rural area to provide distribution service and to aggregate customer load to procure electricity on favorable terms. In the California Electricity Experiment, all geographic areas in the state are already served by distribution facilities whose monopoly status may not be readily subject to competitive challenge. However, the fundamental meaning of the California Experiment is that these customers served by distribution facilities no longer can rely on anyone other than themselves to find a “good deal” for the purchase and procurement of the electric energy they will actually use in their homes, offices, factories, etc. For the small consumer, the classic problem of having no scale economies, market leverage or power, and in most cases lacking expertise, means that these consumers are potentially vulnerable to exploitation or abuse. The essential nature of electricity in modern life means that they must find a way of dealing with that vulnerability. Adapting the cooperative model to the purchase of electricity is potentially a way of addressing that vulnerability. But the cooperative model developed by the rural electric coops is not applicable, because the electric purchase cooperative will be a cooperative without wires. Its infrastructure will be organizational and commercial relationships, not the hard wiring of distribution poles, lines and transformers.

The organizers of the CEUC started out from this recognition. The initial concept document (Appendix A) focused on the benefits that could accrue from collective action initiated by the consumer in the new electric market.

C. Cooperative Development as an Organizing Process

The California Electricity Experiment was not initiated by consumers. Small consumers in particular, have for the last 100 years been encouraged to maintain a passive relationship with their electricity provider. The basic relationship can be characterized as consumers flipping a switch, expecting and receiving instantaneous delivery of electric service, and paying a monthly bill for the service they have used. Communicating the necessity of shopping for electricity and paying a price offered by a competitive provider requires a fundamental change of attitude on the part of the consumer. A second level of attitude change required for small consumers is that they must join with others similarly situated to enhance their power and position in this new market. Under these circumstances, the place to begin organizing a cooperative is with entities and consumers who are already familiar with the benefits associated with joint or cooperative action.

The organizing process involves both educating potential members and, in the case of the California Electricity Experiment, tracking the evolving competitive market and mechanisms. By doing this, the interests of potential members can be identified and concrete strategies can be developed to advance their interests. Ideally, the cooperative movement and entities interested in utilizing the cooperative forum would have actively participated in shaping the initial rules of the California Experiment, but that was not the case. Educating potential members of the CEUC on the benefits available to them, if organized correctly, was a primary organization emphasis. As a result, it may be necessary to proactively address issues and institutions developed during 1997 by the California Public Utilities Commission (CPUC) and the Legislature so that they can be ideally adapted to facilitate the self-organization of consumers into consumer-owned and controlled cooperatives.

The organization of the CEUC has also highlighted the importance of viewing benefits in the long term as well as the short term. The California Experiment provides for electric rates to be frozen during a transition period, during which utility default customers will pay an energy price based on the results of the spot market auction conducted hourly by the Power Exchange (PX). Customers that chose direct access will pay their contract energy price and will save money only if the contract energy price is less than the PX price. During the transition period, the PX price is likely to be relatively low because of the existence of excess capacity throughout the western United States. Under these conditions, savings will be small and the inclination to do nothing and to avoid the effort of organizing and developing market expertise will be very great.

At the end of the transition, overall bills will drop substantially because the IOUs will no longer be able to collect Competitive Transition Costs (CTCs) associated with their generation assets. At that time, the cost of electric energy for all IOU customers will be set exclusively by market forces, a market in which buyers will be largely unprepared unless they have used the transition period to develop a market strategy informed by strength and size, as well as expertise. One of the most important factors in organizing the CEUC as a viable entity has been the efforts of the organizers to communicate and the members to understand the need to become positioned for the end of the transition period and to accept moderate to small savings in the near term in order to reduce the risk of exploitation and abuse post transition.

D. Development of the CEUC Business Plan

The CEUC’s goal is to represent agricultural cooperatives' interest in the California deregulated electric utility business. The CEUC eventually aspires to be a not-for-profit power marketer established specifically to purchase electricity for its member cooperatives. This will require that the CEUC be an ESP, responsible for managing the members' interfaces with electricity generators, with the Independent System Operator (ISO) and with the incumbent utility (UDC) which will remain responsible for local delivery. The CEUC has no plan to own any generation of its own. As an ESP, CEUC may, potentially, offer unbundled revenue cycle services (metering, billing, collections and data management) currently being provided by utilities as part of the current bundled utility service rate to its members.

These responsibilities will require the expertise of two experienced utility managers. Additionally, office space and support will be required. In order to assure continued capital growth, member development must continue and be funded.

In order to develop financial projections to evaluate the capital requirements of this plan, the CEUC hired Management Consulting Services (MCS) to do a Business Plan. Capital to operate the CEUC was assumed to come from gross savings available to all cooperative members. Generally, larger users of electricity like member processing plants will save more than a small grower who uses less energy and faces a large amount of demand or "stand-by" costs. These financial projections were developed from CEUC members’ billing data provided by the customer to MCS or requested from the local utility. Each member's savings were calculated by using the difference between the Market Clear Price (MCP) and the Direct Access Price and multiplying that difference by the customer's yearly demand. This calculation yields the individual gross savings for the member. Individual gross savings were added together to arrive at the CEUC gross savings. Once this was completed, the estimate of CEUC Operating Costs, as described above, were subtracted resulting in the net market savings available to all cooperative members. These projections were done for 1998 through 2002, the end of the transitions period.

To get a feel for how sensitive estimates of net margins were to changes in the Direct Access Price, MCS developed three cases based on their recent experience with similar direct access proposals that were available. An "Optimistic" case was run using the lowest direct access price, a "Moderate" case used an intermediate direct access price, and finally, a "Conservative" case in which the direct access price was very close to the MCP estimate. This allowed CEUC members to evaluate how sensitive the net margins were to changes in the direct access price. The optimistic scenario ($18/MWh) produced large positive net margins. The moderate scenario ($20 per MWh) also produced positive net margins whereas the conservative scenario ($24 per MWh) produced annual losses for each forecast year.

E. The Inter-relationship Between Regulatory Change and Cooperative Development

During 1997, the CEUC organizing process moved from a simple concept paper (the cooperative without wires) to a fully developed incorporated entity capable of contracting for power for the loads of its members, estimated to be fifteen (15) megawatts on average (peak twenty-five (25) megawatts) as well as developing contacts for the loads of the grower/packer/producer members of the constituent coops who make up the membership of CEUC. While the CEUC was developing its unique internal corporate structure and procedures, the CPUC and the Legislature were elaborating on the relationship between consumers, UDCs and ESPs; and potential ESPs were assessing the market and developing electric service proposals for a wide variety of potential customers.

The adventual form that the CEUC took was profoundly affected by regulatory change, tariffs, regulations and evolving product offerings by ESPs. Initially, the CEUC planned to be the agent operating in the market place for its members, providing electric and delivery service at the lowest possible price. To provide these competitive services, the following contractual arrangements had to be negotiated and put into place: an ESP/customer contract, an ESP/UDC contract, an ESP/schedule coordinator contract, along with the need for substantive power supply contracts. As the group struggled to develop a corporate structure and business plan, organizers had to continually check the changing status of regulatory reform . At the same time potential ESPs were observing reduced opportunities for wholesale margins on which their livelihood depended, so many of them held back offering only minimal savings, if any, to potential customers.

F. Evolution of Market Mechanisms at the CPUC

The primary objective of the California Experiment is to provide the opportunity for individual consumers to purchase power directly from completing providers. In order to achieve this objective, AB 1890 was passed into law in September of 1996 and directed the CPUC to authorize direct access transactions and establish the mechanisms to make such transactions possible. In spite of the complex nature of this transformation, the California legislature decreed that the new competitive market should open on January 1, 1998, just fifteen months away. This very short timeframe put pressure on all parties working to create the Western Power Exchange (WEPEX) which makes direct transactions between ESPs and end-use customers possible and establish protocols, programs and tariffs for use in the new competitive market. Following is a brief background and description of the multitude of decisions that were being considered at the CPUC during the time the CEUC was struggling to organize and become an independent participant.

During 1997, in workshops and at hearings at the CPUC, industry representatives, small consumer representatives, the investor-owned utilities (IOU), meter companies and government officials met to discuss the wide range of issues and problems that had to be addressed before direct access could become a reality. During these talks, the complexity of the task became apparent. Parties struggled to develop formats and mechanisms to allow an accurate and nondiscriminatory process of direct access applications. IOUs had to file charges for meters and billing. Discussions about meters and who should have them occupied significant amounts of time. After months of workshops and hearings, the CPUC finally made a decision that modified the phased-in schedule suggested in AB 1890 and allowed all IOU customers to enter into direct access agreements when the market opened in 1998.

The CPUC, by removing the initial access restrictions, made it possible for the CEUC and other organizations to have the opportunity to represent their members and participate in the new marketplace on the first day of operation. This decision also expanded the potential pool of new customers to whom ESPs could offer services as soon as the market opened.

At the same time hearings concerning direct access issues were being conducted in 1997, the CPUC was also reviewing the applications of the three IOUs for approval and evaluation of sunk costs eligible for recovery in the CTC. Estimates of these costs are considerable, and although the possibility that these costs will be paid off early exists, some market participants believe this will not happen. This fact led may ESPs to conclude that until the CTC charge is substantially paid off at the end of the transition period, the small potential savings on the commodity portion of a customer's bill will not be enough to get them to switch energy providers. For this reason, some ESPs have decided not to participate in the California market during the transition period.

Proceedings to change or modify the terms of tariffs continued during 1997, as well as hearings to determine how Public Purpose Programs will continue and be funded during the transition period.

G. Evolution of the Market Clearing Price at the California Energy Commission

Another variable important to electric market participants, including the CEUC, is the Market Clearing Price (MCP). Every ESP must estimate what the MCP is before making a power purchase offer to potential customers. The California Power Exchange is anticipated to be a competitive market whose daily and hourly market clearing prices will be used as a benchmark by other electric generators and suppliers to gauge the competitiveness of their electricity prices. Because knowledge of these future prices is so central to business decisions to buy or sell power in California, there has been a high level of interest in forecasts that will provide any clue about the range of the price.

Since early 1996, the California Energy Commission has been studying and evaluating models that purport to forecast many market variables including the MCP. Many complex factors influence and make modeling the competitive market complex, challenging and unpredictable. Following are just a few of the factors that can influence the MCP and must be accounted for in any modeling exercise. In the short term, hourly or daily, the MCP can spike unexpectedly because supply is suddenly reduced or demand increases. This can result from extremely hot temperatures over the whole state, plants shut down unexpectedly due to mechanical problems, seasonally reduced transmission capability somewhere in the system or a host of other short duration events. These unexpected events may drive the hourly or daily MCP price up for a short period of time, but it will not have a market affect on the average annual MCP.

In December 1997, an Interim Staff Market Clearing Price Forecast for the California Energy Market: Forecast Methodology and Analytical Issues, was done by the California Energy Commission. Simulations from four different models were used to calculate the average annual MCP forecast for 10 years. Table 1 below presents the Energy Commission Staff's MCP forecast in both nominal (current) and real (constant) 1998 dollars.

TABLE 1

	MCP ($MWh)	
YEAR	**NOMINAL**	**1998$**
1998	27.2	27.2
1999	25.9	25.3
2000	26.6	25.3
2001	27.3	25.3
2002	29.3	26.3
2003	30.3	26.4
2004	31.6	26.7
2005	32.8	26.8
2006	34.3	27.1
2007	35.7	27.2
2008	37.3	27.4

When looking at long term forecasts of the MCP, two assumptions were identified as particularly influencing the average MCP produced by these models. The first is the role of must-run contracts with the Independent System Operator and second is the forecast of natural gas prices. A generator who enters into a must-run contract with the ISO, to the extent that its cost are recovered through these contracts, will not have to recover these costs from the MCP. This generator then can afford to bid at lower levels. In the early years of market operation, most thermal plants in California will be operating with some type of must-run contract. Finally, new forecasts of natural gas prices are lower because extensive reserves in the Gulf of Mexico are expected to enter the market in the near future when transportation facilities are complete. While these two assumptions have been identified as being influential, other assumptions not mentioned here could also influence the MCP generated by these models.

The above discussion about variables that influence any estimate or forecast of the MCP should be kept in mind by all parties who use these estimates. The average MCP is the benchmark for all potential direct access customers and other power marketers to beat, and this being the case, it is a number about which there is constant speculation. Forecasts of the MCP, like the one above from the California Energy Commission, are meant to be informative. The vulnerability of these forecasts and their underlying assumptions should be kept in mind when ever any decisions are based on these forecasts.

H. The Decision To Contract For Services

In late summer, after completing the initial business plan, representatives of the CEUC began making some initial inquires about direct access prices. Instead of finding prices in the range of $18 per MWh that had been offered to others in the spring, what they found instead were prices around $27 per MWh, approaching the level of CEUC's business plans estimate of the MCP. This was bad news for the CEUC because the key variable that has the greatest affect on the CEUC's profitability is the direct access price. The relationship between the direct access price and the MCP is the key driver of the CEUC's margins. The difference between the two must result in enough capital to cover the operating costs of the organization and return some benefits to members. As an example, if the MCP, is assumed to be $28 per MWh in 1998, and the direct access or purchase power price offered is $18 per MWh, the difference between the two would be $10. This $10 savings is multiplied by the sales volume of all the members to calculate the gross capital. Operating costs must then be subtracted to get the net benefits to be allocated amongst the cooperative members. Clearly, if direct access prices are rising, capital available to pay operating costs and benefits to members will be reduced proportionately. As suppliers continued to withdrew from the California market, and began offering more cost sharing deals rather than straight percentage discounts, organizers were forced to reassess the original goals of the organization and consider alternate options.

As the CEUC struggled with the above financial realities and the continuing regulatory uncertainty and increasing complexity, others were observing the same developments. The CEUC's target community, agricultural producers and processors, were hearing from organizations in the agricultural community, notably California League of Food Processors, California Farm Bureau and the Agricultural Energy Consumer Association that they should retain the default/provider relationship with the UDC for the foreseeable future, citing the uncertainty of concrete benefits to be achieved in the near term from forming an aggregation and trying direct access. The CEUC organizers came to the conclusion that if they were to go forward, they would have to, for the time being, postpone becoming an ESP serving members. Hence, the decision to contract with a third party for all services. They also decided to seek guaranteed percentage savings as opposed to a riskier "split the savings" approach and structured a Request for Proposal in December 1997 accordingly. This approach was successful in achieving a contract between CEUC and New West Energy that provides for guaranteed savings of three percent (3%) of the CEUC member's bill, with savings paid to CEUC to defray its expenses, and the net accruing to the benefit of the CEUC member.

II. THE CALIFORNIA ELECTRIC USERS COOPERATIVE ORGANIZING PROCESS

A. Chronology

In November 1996, Mahlon Lang, Director of the Center for Cooperatives, U.C. Davis, was asked by John Gaucci, Director of CLUSA Institute for Cooperative Development to bring together an exploratory group for the purpose of evaluating the interest in and feasibility of establishing an electric users cooperative in California.

In attendance at the exploratory meeting were: Mahlon Lang, Director of the Center for Cooperatives; Bob Marshall, General Manager; Plumas- Sierra Rural Electric Cooperative; Bob McDonald, Board Member, Plumas-Sierra Rural Electric Cooperative; Robert Church, President, Management Consulting Services, Inc.; Stephen Piecara, Mgr., Tax, Financial and Accounting Policy, National Rural Electric Association; John Gaucci, Director, CLUSA Institute for Cooperative Development - National Cooperative Business Association; David Thompson, Thompson Consulting, and Lee Ruth, Principal, Cal-AgriCivics.

The exploratory group concluded that the idea had merit and that a larger group of potentially interested parties should come together to analyze the potential for an electric users cooperative to service consumer needs in California. Mahlon Lang, Director of the Center for Cooperatives, agreed to work with the industry in organizing such a meeting and scheduled it for April 17, 1997 in Sacramento.

The Exploratory Committee, recognizing that the agricultural cooperative community was the most likely to recognize the potential for such a cooperative, asked Lee Ruth, President Emeritus of the Agricultural Council of California, to present the concept to a meeting of the delegates of the Agricultural Council of California at its Annual Meeting, March 4, 1997 in Dana Point, California. Lee Ruth made the presentation to the delegates under the auspices of Cal-AgriCivics assisted by associate Terry Witzel. Rob Church, Management Consulting Services, Inc.; Bob Marshall, Sierra Rural Electric Cooperative; John Rogers, National Rural Utilities Finance Corporation; and Mahlon Lang were in attendance serving as technical resource people.

Ruth's objective was to provide an overview of how deregulation would impact the agricultural community and to ask for the Agricultural Council's support and assistance in securing attendance for the April 17 workshop. The delegates approved the Council's involvement and pledged assistance in securing attendance for the workshop.

During the month of March, Cal-AgriCivics took the lead in working with the Center for Cooperatives and the industry in putting together the meeting format and getting word out to the cooperative community and other interested parties.

On April 17, 1997, there were 53 people in attendance at the Workshop sponsored by the Center for Cooperatives at the Red Lion Inn in Sacramento. The audience represented a broad cross section of potential electric users.

The agenda included --

- Overview of Deregulation;
- Economic Opportunity of a Utility Without Wires;
- Why a Cooperative;
- Lobbying and Trade Associations;
- Financial Resources;
- Wholesale Supply;
- Regulatory and Government Liaison; and
- State Agency Support.

Potential next steps were discussed with Lee Ruth and Terry Witzel of Cal-AgriCivics being asked to organize the next meeting limiting invitations to representatives of agricultural cooperatives and selected technical support people.

Messrs Ruth and Witzel of Cal-AgriCivics, worked with Rob Church, Bill Julian, and Bob Marshall in laying out the format of an 'exploratory Meeting" held June 11, 1997 at the University Extension, U.C. Davis Classrooms, Sutter Square Galleria, Sacramento. Attendance was restricted to agricultural cooperatives and other potential users of services. Organization expenses were covered by a fee of $100 per participant. Representatives from 17 cooperatives were in attendance.

The Exploratory Meeting was called to order by Acting Chairman George Beitzel, Blue Anchor, inc. An Interim Steering Committee was selected with Fielding Thompson of Fruit Growers Supply as Interim Chair and Glen Janzen of Ranchers Cotton Oil as Interim ViceChair. It was estimated it would take $97,000 to finance the activities of CEUC until August 19, 1997. These funds would be used for market research and analysis, financial projections, a business plan, a cooperatives operational model, project coordination, member development and education, and technical consulting.

It was determined that $20,000 in seed money would be needed by July 1, 1997. This was obtained by an initial $2,000 assessment per participant. The remaining $77,000 was to be acquired by July 15, 1997. To secure this amount, each participant paid an additional assessment based on a formula related to actual dollars spent yearly on electrical usage.

Cal-AgriCivics, with Lee Ruth acting as the Principal Project Manager, assisted by Associates Terence Witzel, Curtis Anderson and Henry Wallace, was selected by the Steering Committee to manage the day-to-day operation of the project. Rob Church, Management Consulting Services, was selected to do the preliminary research and develop the Business Plan. Bill Julian, Government Affairs Consulting, agreed to provide regulatory liaison and monitoring to assure the Business Plan was consistent with developing policies and procedures in the regulatory arena.

The Steering Committee met again on August 28, 1997 under the leadership of Interim Chairman Fielding Thompson. By this date twelve cooperatives were involved and a total of $79,850 had been raised to support the effort. At this point Fruit Growers Supply Company/Sunkist Growers, Inc., secured the services of Larry Larson and Ed Sienkiewicz, both experts in power marketing. These individuals served as direct advisors to the named cooperatives and gave general guidance as needed to the overall project.

At this meeting Rob Church presented a preliminary Business Plan. Lee Ruth was authorized to contact legal firms and present an estimate at the next meeting of the legal fees necessary to form CEUC. The Steering Committee agreed to meet again on Wednesday, September 24, 1997 to consider the completed Business Plan and a financial model for CEUC. Cal-AgriCivics was authorized to continue as overall project coordinator.

On September 23, 1997 Bill Julian arranged a meeting with Bob Taylor and Robert Shuler of Tuttle and Taylor and Dennis DeCuir of DeCuir & Somach, for the purpose of discussing the legal ramifications of the type of cooperative under discussion and a preferred legal structure. It was determined in this session that the cooperative should be an agricultural cooperative formed under the provisions of the California Agricultural Code and the firm of Tuttle and Taylor would take the lead. Others in attendance at this meeting were: Bill Julian, Lee Ruth, Mahlon Lang, Terry Witzel and Curt Anderson.

On September 24, 1997 Rob Church and John Grant, Management Consulting Services, presented the Business Plan, including a five year forecast of operations, capitalization requirements as an ESP, and anticipated annual average gross savings. The Operational Model and Capital Requirements for CEUC became a major item of discussion. Questions arose as to whether there were sufficient savings to support a viable cooperative ESP. Reports were made on initial discussions with power suppliers. These discussions were based upon sketchy descriptions of CEUC's requirements and inadequate reports from members as to their own electrical usage.

The firm of Tuttle & Taylor was retained to develop the Articles of Incorporation and Bylaws. It was decided that the CEUC should adopt an organizational structure that would make it eligible for 501c(12) tax status. Alan Edwards offered the technical assistance of NRECA in accomplishing this objective.

Linda Kelly, Electricity Specialist for the California Energy Commission, described her agency's interest in the project and how they could be of technical assistance. The CEUC proposed a non-voting membership for the Commission in the CEUC Steering Committee. The understanding was that this membership would carry forward when the CEUC was organized as a legal entity.

Bill Julian was authorized to meet with investor-owned utilities PG&E and SCE to discuss various issues related to a cooperative electric service provider including expediting the electronic transfer and usage information from cooperative members to Management Consulting, Inc. and non-standard aspects of the ESP/UDC relationship presented by a cooperative.

It was determined that pre-incorporation contributions would be repaid, with interest, to Steering Committee members. The timing and procedure for repayment was to be subject to a decision by the CEUC Board of Directors.

Lee Ruth was authorized to brief CoBank and the National Rural Utilities Cooperative Finance Corporation (CFC) as to the status of the formation of CEUC.

At the October 24, 1997 meeting a major presentation on tax issues was made by Jason Reschly, Stinson & Fitzell. Discussion continued on the role of co-op lending institutions, reducing start-up capital requirements, and the content of the Articles of Incorporation and the Bylaws.

Discussion started on the desirability of exploring alternative methods for the CEUC to purchase electric services. The Committee decided to look at a "full service package" with an electric service provider. Interviews were conducted with Northern California Power Agency and PG&E Energy Services.

Lee Ruth was authorized to contact CoBank and the National Rural Utilities Cooperative Finance Corporation to determine what financial services they would offer to assist in the formation of the CEUC

The language of the Articles of Incorporation was approved and subsequently filed with the Secretary of State on November 14, 1997. The Bylaws were also finalized and approved.

On November 21, 1997, CEUC held its "Organizational Meeting." The Interim Steering Committee was dissolved and officers of the new corporation were elected. A bank account Employer ID, Tax Status Application, and all other legal steps necessary to prepare for operational status were authorized.

Separate lending institution briefings were held, with CoBank and the Cooperative Finance Corporation (CFC) making presentations.

Discussion continued on an operational model for CEUC. Focus centered on a Utility Unit and a Co-op Unit. Other items included CEUC's first year budget and administrative needs

The Board, recognizing the fact that the initial funds had been exhausted, approved an additional assessment of an amount equal to 5 percent of each cooperatives' prior contribution. The money was to fund the project management effort until the organization could become operationally functional.

The newly elected Board agreed at this time to issue a "Request for Electrical Power and Management Services" required to operate the CEUC. It was agreed at this time that CEUC would negotiate with the Northern California Power Agency (NCPA) for either wholesale electricity or assistance in obtaining a full service package.

Lee Ruth was authorized to initiate the application process for a line of credit from the cooperative lending institutions (CFC and CoBank), and report back at the next meeting which was set for December 17, 1997.

The purpose of the December meeting was to consider the bids solicited by the Northern California Power Agency for both electric power service and full electric service. The intention was to decide which approach to take alter seeing the bid results.

On December 17, 1997, Don Dame, NCPA, came back to the Board with a presentation that provided CEUC with the following options: gross discount percentage; fixed commodity price; power exchange minus contract; and two weeks free electricity. The consensus was that none of these options were in the best interest of CEUC at this time. They directed NCPA to pursue a plan which would allow the CEUC to begin operations as soon as possible at the lowest cost with the least risk. They asked NCPA to go back to the ESP's with a letter soliciting bids for a "full service contract." Essentially the decision was made to initially operate as an aggregator but structure the organization so that it could, over time, become an ESP.

At this time Cal-AgriCivics was asked to develop a projected overhead budget for the first year of operation under a "full service contract." The budget was to be presented for consideration at the January 9, 1998 meeting. Preliminary discussions also took place regarding the type of membership agreement that would be needed.

On January 9, 1998 the Board came together to review the results of the RFP's. RFP letters had been sent to approximately 35 power/marketing entities. Two ESPs responded and indicated an interest in being a full service provider. One offered a combined fixed/shared savings, the other offered a fixed discount off the retail price. Presentations were made to the Board by New Energy Ventures (NEV) and New West Energy (NWE).

At this time the officers of the CEUC were authorized to continue working with NCPA in the specifics of a contract that would provide CEUC with a guaranteed savings and a Special Meeting of the Board was set for January 21, 1998 for the purpose of finalizing the specifics of the contract.

Due to the need to conserve funds it was agreed at this meeting that the Board of Directors of CEUC would immediately assume responsibility for the administration and management of CEUC. The Chairman, Fielding Thompson, became the "clearinghouse" for all future activities. All remaining funds held by Cal-AgriCivics were transferred into the CEUC checking account.

Extensive discussions took place between NCPA, NWE and the CEUC officers over the next twelve day period. On January 21, 1998 the Board met in Sherman Oaks to review the results of the negotiations and give the negotiators further direction.

Chairman Fielding was authorized to complete the negotiations and sign a contract providing it met the agreed upon guidelines. A contract was signed with NWE on February 6, 1998.

The Board agreed to request a line of credit from the National Rural Electric Cooperative Finance Corporation, adopted a by-law amendment authorizing the establishment of a revolving fund, reviewed the wording of a Charter Membership Agreement, and took action authorizing the foundation of a second tier CEUC grower cooperative to service the needs of CEUC grower members.

The February 19, 1998 meeting was set in Sacramento, at which time the Board finalized its line of credit, continued work on CEUC Grower Cooperative formation status, reviewed member contracts status, and further refined organization and staffing.

Full operational status was achieved on March 31, 1998, and new membership will be open until May 3l, 1998.

The essentials of the working arrangement with NCPA are still in the discussion stage. Pursuant to the CEUC/NWE power supply agreement, the members of CEUC and the CEUC Grower Cooperative will pay the bill they would have paid to their former utility energy supplier to NWE. The CEUC will receive 3 percent of that amount in any month in which the member purchases energy. This 3 percent savings will defray the costs of the co-op, with the remainder being allocated to the members as patronage dividends. Co-op expenses, in no case, are to exceed one percent of gross billings.

B. Member Recruitment Program

The organizers of CEUC recognized from the beginning that they needed the market power of a large aggregation of electric users to negotiate favorable supply contracts. They also realized that they had to keep the administrative overhead of the cooperative at the lowest level possible if they hoped to offer a significant savings to members. This could only be accomplished with participation from a significant number of agricultural cooperatives.

The initial Steering Committee dedicated 25 % of its original budget to Member Development and Education. Cal-AgriCivics associate Curt Anderson played a lead role in this effort supported by Terry Witzel, Lee Ruth and Hank Wallace. Each person used his own knowledge of the industry and contacts to get the word out as to what kind of organization was planned and how they might benefit by being part of it.

Over a five month period, contacts were made statewide trying to ascertain interest and following up with meetings with management and boards of directors of cooperatives. In addition to the work done by Cal-AgriCivics, members of the Steering Committee were also making contacts with their peers in the co-op Community.

Organizational activity during the summer and fall of 1997 was dampened severely by the fact that CEUC potential targets (cooperatives) were being advised by several of the major farm and trade organizations that they should not commit to any new program because of the uncertainty of the benefits that might be achieved.

This was further complicated by the fact that some new power marketers were making promises of savings that were far above what CEUC was willing to say were possible. CEUC's estimated savings were moderate in comparison to what was on the street.

On top of all this the news media continued to present the whole process of deregulation as a gamble. This further reinforced the strategy of waiting and CEUC organizers also found that some of the larger users of electrical energy were being encouraged by existing service providers that it would be in their best interest not to make a move.

In spite of all this, contacts were made, with over 30 additional cooperatives expressing interest in being kept informed. A number of these were waiting for the CEUC numbers. Once the contract with NWE had been consummated, CEUC had the tools to complete its recruitment effort. Potential members will know exactly how to calculate their savings

C. Organization and Governance Issues

1) Membership of Federated Cooperatives

The California Electric Users Cooperative (CEUC) is a one- member, one-vote organization with membership limited to agricultural cooperatives.

Several of the cooperatives that are members of CEUC are classified as federated associations. Each cooperative that is a member of a federated association is incorporated separately, has its own board of directors, and is its own legal entity.

The question that arises in CEUC is how to treat federated associations.

Shall the interests of individual members of a federated cooperative be represented in all cases by the central organizations' membership in CEUC or will they be allowed direct membership?

Some federated cooperatives would prefer to hold a single membership. Others are going to take the position that individual members have the right to join directly. This is an issue that has yet to be resolved.

It is clear, however, that contracts for service in a federated cooperative shall be written with each individual member of the federated association that elects to participate.

2) The Grower Cooperative

Since the bylaws of CEUC provide that only agricultural cooperatives can be direct members, and the intent of CEUC is to provide an organizational structure that would provide electric service to its farmer/growers members at the least cost possible, it is necessary to form an affiliate growers' cooperative.

This cooperative will become a direct member of CEUC and will be open only to those farmers/producers that are members of a cooperative that is participating in CEUC. Each grower will sign his/her own contract for electric service with NWE.

They will, however, receive their proportionate share of the patronage dividend obtained by CEUC.

3) Capitalization and Start-Up Expenses

In the beginning it was assumed that capital to operate CEUC would come from gross savings to cooperative members.

A provision was placed in the bylaws of CEUC which allows the cooperative to withhold or retain from monies, otherwise payable to members, and place them in a Capital Revolving Fund. These monies are each members net savings in energy costs and are used to operate the association. Everything over the cost of operation will be returned to members on an annual basis.

In order to have start-up capital a selected number of cooperatives invested in interest bearing bonds carried by CFC in an amount equal to 20 percent of the initial operating loan.

Most of the administrative support to run the association during the first year will come from in-kind activities of member organizations. As membership grows, more of this work will be handled by paid staff.

III. FORMATION OF CEUC, INC

A. Incorporation

Under California law cooperatives may be formed either under the provisions of the California Agricultural Code or under the provisions of the Corporations Code. Under the Corporations Code, there are two options, incorporation under the General Corporations law or under the Consumer Cooperative law. In forming the CEUC, the CEUC organizers rejected incorporation under the Consumer Cooperative law because of the relatively rigid provisions of that law with respect to governance and purposes. Cooperative status depends on the structure of the organization in fact and not on the decision as to which authorizing statute is utilized.

The CEUC organizers decided to incorporate under the provisions of the Agricultural Code because their intention was to limit potential members to agricultural producers, and the use of the Agricultural Code would compel discipline in retaining that focus. The provisions of the Agricultural Code permits agricultural producers to organize into cooperatives. For purposes of state taxation, incorporation under the Agricultural Code confers automatic application of Revenue & Tax Code Section 24404. This section provides a deduction from the cooperative's gross income for patronage refunds made to members.

For federal tax income purposes, the CEUC applied for status as an electric cooperative under Internal Revenue Code Section 501(C)12.

1) Governance Issues

The CEUC organizers included a group of cooperatives of very diverse memberships and sizes. One of the key elements in maintaining cooperative status is operating on the basis of "one member/one vote." The CEUC organizers improved on this principle by providing for one member/one director in the Articles of Incorporation. However, the CEUC limited membership status in its by-laws to agricultural cooperatives. One of the basic objectives of the CEUC was to bring the benefits of aggregation to the individual farmers who are most at risk in the new markets. The principle of one member/one director meant that in practice farmers could not directly be members of the CEUC. However, farmers could obtain the benefits of CEUC membership by organizing themselves into a "Growers/Producer Cooperative" which in turn will become the CEUC member. Under the structure of the CEUC, there will be member cooperatives and a grower/producer cooperative whose members are themselves members of the constituent cooperatives. The initial ten members of the CEUC would be augmented by an eleventh member, the grower/producer cooperative which itself may have literally thousands of individual farmer members.

2) Membership Issues

The key to successful organizing of the CEUC was the willingness of large consumers to cooperate with small consumers to lend the small consumers the benefit of their attractive load. The membership agreement therefore had to commit the large members to coop membership over a long enough period of time that a potential power supplier could rely on retaining the efficient load while developing the ability to serve the small farmer loads. By providing for a governance structure that preserves the decision-making power of the large coops vis-à-vis the individual farmer members, the CEUC attempted to address a potentially explosive internal political issue.

Related to the big/little issue is the issue of federated cooperatives.

B. Power Supply Arrangements

The decision to delay pursuing the original goal of the CEUC to become an independent ESP was made when cooperative organizers realized that the evolving regulatory process and procedures for direct access were becoming hopelessly complex. Rather than risk the whole effort collapsing in the face of continuing uncertainty, the organizers made a decision to contract with a third party for all services. This approach was successful. The group stayed intact and negotiated a three year contract with NWE that guaranteed savings off the member's bill and provided some working capital for the CEUC to continue. This took care of the immediate problem, but organizers were aware that this choice had a downside. Beyond the short term goal of providing both members with large year round loads and growers with small seasonal loads with moderate savings during the transition period, the CEUC has a long term goal of using the next few years to develop market expertise and strategies so, post transition, the CEUC could take over the responsibility to provide all its members with low-cost energy and related services. If this does not happen, CEUC growers may face higher energy prices due to their low consumption when the NWE contract expires.

Contents of Appendix

The Appendix included the following documents:

- **California Electric Users Cooperative, “A Utility Without Wires,” by Leland H. Ruth**
- **Articles of Incorporation of California Electric Users Cooperative**
- **Bylaws of CEUC Grower Cooperative**

These documents are not available on the Internet / electronic version of this document. Printed copies can be obtained from the California Energy Commission

The **California Electric Users Cooperative Business Plan** also is not included in the Appendix. It can be reviewed but not copied at the California Energy Commission in Sacramento.

Please call Linda Kelly at 916-654-4815 for more information