Memorandum from the Office of the Inspector General

May 13, 2009

Kimberly S. Greene, WT 7B-K

FINAL REPORT – INSPECTION 2008-12040 – DISTRIBUTOR REVIEW OF LEWISBURG ELECTRIC SYSTEM

Attached is the subject final report for your review and action. Your written comments, which addressed your management decision and actions planned or taken, have been included in the report. Please notify us when final action is complete.

Information contained in this report may be subject to public disclosure. Please advise use of any sensitive information in this report that you recommend be withheld.

If you have any questions, please contact Michael A. Driver, Project Manager, at (423) 785-4813 or Gregory C. Jaynes, Deputy Assistant Inspector General, Inspections, at (423) 785-4810. We appreciate the courtesy and cooperation received from your staff during the audit.

Gregory C. Jaynes

(for) Robert E. Martin
Assistant Inspector General
(Audits and Inspections)
ET 3C-K

KSL:JP
Attachment
cc (Attachment):
Peyton T. Hairston Jr., WT 7B-K
Tom D. Kilgore, WT 7B-K
John E. Long Jr., WT 7B-K
Richard W. Moore, ET 4C-K
Emily J. Reynolds, OCP 1L-NST
John M. Thomas III, WT 4B-K
John G. Trawick, WT 3D-K
OIG File No. 2008-12040

Tennessee Valley Authority
Office of the Inspector General

Inspection Report

DISTRIBUTOR REVIEW OF LEWISBURG ELECTRIC SYSTEM

Inspection Team
Michael A. Driver
Michael L. Lane

Inspection 2008-12040
May 13, 2009

TABLE OF CONTENTS

APPENDICES

TVA Office of the Inspector General

May 2009

Inspection 2008-12040 Lewisburg Electric System

Why the OIG Did This Review

As part of the annual inspection plan, the OIG performed a review of Lewisburg Electric System (LES) which is a distributor for TVA power based in Lewisburg, Tennessee. Annual revenues were approximately $22.9 million in fiscal year 2008. TVA relies on distributors to report customer usage and subsequently the amount owed to TVA (Schedule 1). Customers are generally classified as residential, commercial, and manufacturing. Within these classifications are various rate classes based on the customer type and usage.

The objective of the review was to determine compliance with key provisions of the power contract between TVA and LES including (1) proper reporting of electricity sales by customer class to facilitate proper revenue recognition and billing by TVA; (2) nondiscrimination in providing electricity to members of the same rate class; and (3) use of revenues, including any surplus, for approved purposes such as operating expenses, debt service, tax equivalent payments, and reasonable reserves for renewals, replacements, and contingencies.

What the OIG Recommends

We recommend the Chief Financial Officer (CFO) take action to ensure LES complies with the contract provision regarding formal customer contracts. In addition, the CFO, in collaboration with the Board of Directors as needed, should provide additional guidance on proper use of funds and develop criteria to be used in determining whether a distributor's cash reserves are excessive.

TVA and Lewisburg management generally agreed with and are taking actions to address the recommendations. See Appendices for complete responses.

For more information, contact Michael Driver, Project Manager, at (423) 785-4813 or Gregory Jaynes, Deputy Assistant Inspector General, Inspections, at (423) 785-4810.

What the OIG Found

Our review of LES found no material issues related to (1) the proper reporting of electric sales and (2) nondiscrimination in providing electricity to members of the same rate class. However, we found a contract compliance issue regarding LES's implementation of customer contracts. The contract with TVA requires LES to have contracts with all customers whose demand is greater than 50 kW. We found required contracts for LES customers with demand greater than 50 kW were not in place for all customers.

In addition, we found that LES had more than enough cash on hand to fund planned capital expenditures and provide a cash reserve. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive.

- As of June 30, 2008, LES reported cash of $7.5 million and planned capital expenditures of about $4.8 million which left a cash reserve of about $2.7 million.

Finally, we identified opportunities to enhance TVA oversight of the distributors. Specifically, we noted TVA has not (1) provided definitive guidance for distributors on what constitutes prudent expenditures and (2) defined criteria for determining when a distributor's cash reserves are excessive.

BACKGROUND

The Lewisburg Electric System (LES) is a distributor for Tennessee Valley Authority (TVA) power based in Lewisburg, Tennessee, with revenues from electric sales of approximately $22.3 million and $22.9 million in fiscal years (FY) 2007 and 2008, respectively. TVA relies on distributors to report customer usage and subsequently the amount owed to TVA (Schedule 1). Customers are generally classified as residential, commercial, and manufacturing. Within these classifications are various rate classes based on the customer type and usage. Table 1 shows the customer mix for LES as of June 2008.

LES's Customer Mix as of June 2008

Customer Classification	Number of Customers	Revenue	Kilowatt Hours Sold
Residential	4,360	$ 5,198,930	64,274,414
General Power – 50 kW & under (Commercial)	1,200	1,884,062	19,653,436
General Power – Over 50 kW (Commercial or Manufacturing)	206	15,327,425	240,419,226
Street and Athletic	48	362,293	4,224,572
Outdoor Lighting	10	99,634	1,091,792
Total	**5,824**	**$ 22,872,344**	**329,663,440**

Table 1

The distributors are required to establish control processes over customer setup rate application, and measurement of usage to ensure accurate and complete reporting to TVA. LES, like many other distributors, outsources their billing and invoice processing to a third-party processor, Southeastern Data Cooperative (SEDC). LES uses SEDC systems to establish and set up new customers, input customer meter information, perform the monthly billing process, and maintain customer account information. Additionally, SEDC provides LES with the management reporting (e.g., exception reports) designed to ensure the accuracy and completeness of the customer invoice and the purchased power invoice (Schedule 1) to TVA. All other accounting and finance responsibilities are done by LES which has a Board of Directors providing oversight and a general manager and accountant managing the daily activities. LES does not have any nonelectric business interests.

OBJECTIVE, SCOPE, AND METHODOLOGY

This inspection was initiated as a part of our annual workplan. The objective was to determine compliance with key provisions of the power contract between TVA and LES including:

- Proper reporting of electricity sales by customer class to facilitate proper revenue recognition and billing by TVA.

- Nondiscrimination in providing electricity to members of the same rate class.
- Use of revenues, including any surplus, for approved purposes such as:
  - Operating expenses;
  - Debt service;
  - Tax equivalent payments; and
  - Reasonable reserves for renewals, replacements, and contingencies.

To achieve our objective, we:

- Documented and assessed the controls over new customer account setup and master file maintenance.
- Documented and tested the procedures and controls in place to ensure proper sales cutoff and the reconciliation of sales to the general ledger.
- Documented and tested the procedures and controls in place to ensure complete and accurate invoicing of payments to TVA.
- Determined through inquiry and review of documentation whether LES had any nonelectric, system-related business interests supported by electric system funds.
- Reviewed disbursements to determine if electric system funds were used for any items not allowed under the TVA power contract.
- Reviewed cash and cash equivalents in relation to planned capital expenditures and other business uses of cash.

The scope of the review period was July 2006 through June 2008. Fieldwork was conducted in October 2008. This review was conducted in accordance with the "PCIE Quality Standards for Inspections."

FINDINGS

Our review of LES found no material issues related to (1) the proper reporting of electric sales and (2) nondiscrimination in providing electricity to members of the same rate class. However, we found improvement was needed to comply with the contract terms between TVA and LES in the area of implementation of customer contracts.

In addition, LES had more than enough cash on hand to fund planned capital expenditures and provide a cash reserve. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive. Finally, as we explain herein, there are significant opportunities to enhance TVA oversight of the distributors.

CONTRACT COMPLIANCE ISSUE

Our review found contracts were not in place for all customers whose power demand exceeds 50 kW per month. Under LES's contract with TVA, all customers that exceed demand of 50 kW monthly are required to sign a formal contract. LES was unable to provide signed contracts for 71 of their 166 class 50 and above customers. For new customers, we did note LES appears to have controls in place to comply with this requirement.

USE OF ELECTRIC SYSTEM REVENUES

Under the TVA power contract, approved uses of revenues from electric system operations, including any surplus, are (1) operating expenses; (2) debt service; (3) tax equivalent payments; and (4) reasonable reserves for renewals, replacements, and contingencies. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio[1] of 5 to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive.

Our review of LES's financial status and planned capital projects found LES had more than enough cash on hand to fund planned capital expenditures and provide a cash reserve. As of June 30, 2008, LES had about $7.5 million in its actual cash accounts. Table 2 shows plans for major capital expenditures obtained from LES's general manager and our review of LES's Board of Director's meeting minutes.

LES's Planned Capital Expenditures

Capital Expenditure Plans	Project Cost	Planned Completion
Business Park Project	$495,000	Unknown
Business Park Substation	$3,500,000	Unknown
South Ellington Parkway Poles	$400,000	Unknown
Ellington Parkway Extension	$350,000	Unknown
Mayes Substation	$15,000	Unknown
Engineering Department	$65,000	Unknown
Total Cost	**$4,825,000**	

Table 2

When compared to LES's capital expenditure plans for the foreseeable future, the balance in LES's cash accounts was enough to pay for these items and leave about $2.7 million as a reserve, as shown in Table 3. Table 3 also shows LES's cash ratio percentage was about 36 percent before accounting for planned capital expenditures and 13 percent after accounting for them.

[1] TVA reviews the cash ratios of distributors as part of its regulatory rate review function. Cash ratio is calculated as follows: $\frac{\text{Cash + Cash equivalents}}{\text{Total Variable Expenses (Operations and Maintenance + Purchased Power)}}$

LES's Cash Accounts Compared to Planned Capital Expenditures

	Cash and Cash Equivalents	Planned Capital Expenditures	Reserve After Planned Capital Expenditures
	$7,500,000	$4,825,000	$2,675,000
FY 2008 Cash Ratio Percentage	36%		13%

Table 3

Discussions with LES's management indicated the operating philosophy of the LES Board and management was to use a conservative, debt-averse approach. According to TVA records, over the past five years, LES has been approved for rate increases of approximately 3.4 percent in 2003 and 2.5 percent in 2005. Table 4 shows the rate increases received by LES and the cash position and cash ratio at June 30 prior to the effective date of the rate increase.

LES's Rate Increases, Cash Position, and Cash Ratio

Cash on Hand Equivalent to an 8% Cash Ratio	Cash and Cash Equivalents[2] and Cash Ratio	Rate Increase		
		Effect on Revenue	Percent	Effective Date
$1,323,723	$2,074,775 (CR = 12.5%)	$582,455	3.4%	10/1/2003
$1,323,669	$3,546,161 (CR = 21.4%)	$440,000	2.5%	10/1/2005

Table 4

Coupled with this debt-averse philosophy, distributors consider cash reserves as a hedge against the risks of unforeseen costs from an aging infrastructure (e.g., equipment failure), potential loss of revenue from the economic impact on commercial and industrial customers, and unpredictable weather. Examples of weather events[3] TVA distributors have incurred include damage from (1) the recent January 27, 2009, ice storm in Kentucky and Tennessee where about 130,000 of TVA distributor consumers lost their electricity and (2) tornados and the impact of tropical storms, such as the 2005 damage to Mississippi systems resulting from hurricane Katrina.

TVA OVERSIGHT OPPORTUNITIES

We found opportunities to enhance TVA's oversight of the distributors. Specifically, we noted TVA has not (1) provided definitive guidance for distributors on what constitutes prudent expenditures and (2) defined criteria for determining when a distributor's cash reserves are excessive.

[2] The cash and cash equivalents and cash ratio were computed based on information from Lewisburg's annual report as of June 30 prior to the effective date of the rate increase.

[3] After a severe weather event, utilities launch massive and costly round-the-clock restoration efforts. In addition to costs for miles of new wire, new poles, new transformers, and their own crews, utilities often have to pick up the bill for other utility crews providing assistance in the restoration effort.

No Policies Defining Appropriate Expenditures

We noted TVA could improve the controls over the use of electric system funds by providing more definitive guidance to the distributors. While reviewing the proper use of electric system revenue, we noted there were no definitive policies on permitted expenditures (charity, scholarships, etc.) or investments/account establishment. TVA has allowed distributor management and the distributor Board's discretion in the decision-making process for determining what qualifies as operational expenditures. Additional guidance in this area by TVA would decrease the likelihood of misinterpretation of what constitutes a reasonable use of electric funds. In discussions with the TVA Vice President, Strategy, Pricing, and Contracts, actions to address recommendations in a previous review of TVA's role as a regulator (Inspection 2005-522I) include the development of distributor guidance pertaining to the use of electric system funds.

Distributor Cash Position

While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive. TVA uses the cash ratio as one of the factors in determining if a rate increase is warranted for a distributor. However, the lack of defined criteria identifying when a distributor may have more than adequate cash on hand could negatively impact TVA's analysis regarding whether (1) a distributor's rates should be lower or (2) an additional rate review may be warranted.

RECOMMENDATIONS

We recommend the Chief Financial Officer (CFO) work with LES to improve compliance with the contract. Specifically, LES should:

1. Review management reports listing customers that are above 50 kW hours without a contract and work with these customers to obtain signed contracts.

   Lewisburg's Response – Lewisburg stated they are aware of the contract shortage with their customers and have been working on it part time but will make a concerted effort to totally correct the problem. See Appendix A for Lewisburg's complete response.

   TVA Management's Response – The CFO agreed the Schedule of Rates and Charges requires distributors to obtain contracts with all customers whose actual or contract demand exceeds 50 kW. However, the CFO did not agree with our recommendation that Lewisburg should review management reports listing customers that are above 50 kW hours without a contract and work with these customers to obtain signed contracts. Rather, TVA management finds that the contract size threshold of 50 kW was established in 1963, and the relative customer size in 2009 versus 1963 is very different. Likewise, requiring contracts with small commercial customers is a time-consuming and difficult task which may provide little benefit for distributors or the TVA system. TVA management will recommend to the Board that a new and higher threshold be established as part of the rate change process with the distributors. When the rate change is put into effect, all retail customers above the new threshold will be expected to have executed contracts. Target completion date will coincide with the rate change efforts that are currently underway with the distributors and is expected to be in place by October 2010. See Appendix B for TVA's complete response.

Auditor's Response – The Office of the Inspector General (OIG) concurs with the planned action.

The CFO, in collaboration with the TVA Board of Directors where necessary, should:

2. Develop a comprehensive guide on permitted expenditures under the use of electric system revenues provision and expense accrual for distributor management to use going forward.

   TVA Management's Response – The CFO agreed it is appropriate to look at permitted expenditures in the context of the use of revenues provision in Section 6 of the wholesale power contract with the distributors. TVA management is exploring with the TVA Board the extent to which a comprehensive guideline is feasible and whether the TVA Board desires to adopt a policy that would employ such a guideline. Target completion date is December 2010. See Appendix B for TVA's complete response.

   Auditor's Response – The OIG concurs with the planned action.

3. Develop criteria to be used in determining whether a distributor's cash reserves are excessive and incorporate the criteria into the rate setting process.

   TVA Management's Response – Management will make recommendations to the TVA Board that additional financial metrics should be employed for purposes of administering the resale rate provisions in Section 5 of the wholesale power contracts. The need to consider cash reserves will be included in TVA management's recommendations to the Board. A change in the current guidelines to include these additional financial metrics requires Board action. Target completion date is December 2010. See Appendix B for TVA's complete response.

   Auditor's Response – The OIG concurs with the planned action.

Recommendations 2 and 3 also apply to another separately issued distributor report.

Additional Comments From Lewisburg – Lewisburg provided additional comments regarding the Use of Electric Revenues section of the report. Lewisburg stated several years ago prior to the ice storm of 1994, the Board of Lewisburg and the General Manager knew they needed another substation so Lewisburg started a very strict spending policy, which included having enough revenues to pay at least one month's power bill from TVA. Lewisburg constructed Williams Mayes substation which was paid for when finished and continued the strict spending policy then the demand for more power appeared. In 2002, Lewisburg built another substation and was able to pay for it when it was finished. Each time, Lewisburg had enough left for the power bill. Lewisburg management will find a way to control this extra money better in the near future, but without having to borrow and pay interest. See Appendix A for Lewisburg's complete response.

Lewisburg Electric System
P.O. BOX 2727 • 599 W. ELLINGTON PKWY. • LEWISBURG, TN 37091 • (931) 359-2544 • FAX NO. (931) 359-6759

April 7, 2009

Robert E. Martin
Assistant Inspector General, Audits & Inspections
400 West Summit Hill Drive (ET 3C)
Knoxville, TN 37902-1401

Dear Mr. Martin:

Lewisburg Electric System has received the draft report of the OIG Audit and are very pleased. We are aware of the power contract shortage with our customers and have been working on this part time. As for the excess cash, several years ago prior to the ice storm of 1994, the Board of LES and myself knew we had to have another substation so we started a very strict spending policy, which included having enough reserves to pay at least one months power bill from TVA. We constructed the William Mayes Substation, which was paid for when finished and we continued that strict spending policy. Then the demand for more power appeared. In 2002 we built another substation and were able to pay for it when it was finished. Each time we have enough left for the power bill. We will find a way to control this extra money better in the near future, but without having to borrow and pay interest.

We appreciate your comments and will take them all very serious.

Sincerely,

Richard Turner

Richard Turner
General Manager
LEWISBURG ELECTRIC SYSEM

April 30, 2009

Robert E. Martin, ET-3C-K

RESPONSE TO DRAFT INSPECTION REPORT 2008-12007 – DISTRIBUTOR REVIEW OF MONROE COUNTY ELECTRIC POWER ASSOCIATION AND DRAFT INSPECTION REPORT 2008-12040 – DISTRIBUTOR REVIEW OF LEWISBURG ELECTRIC SYSTEM

This is in response to your memorandum dated March 31, 2009.

Agreement or disagreement with all facts, conclusions and recommendations are stated first, followed by the actions planned or taken and completion dates for each of the six recommendations

1. Revenue recognition accounting practice to be in accordance with FERC and accurate recording prepayment of power as a prepaid expense
   - Under section 1 of the Schedule of Terms and Conditions (T&C) to the wholesale power contracts, TVA requires distributors to "keep the general books of account of the electric system according to the [FERC] Uniform System of Accounts" and revenue recognition accounting practice is consistent with the requirements of the Uniform System of Accounts.
   - Section 1 of the T&C also requires distributor financial statements to be examined annually by independent CPAs in accordance with generally accepted accounting procedures (GAAP), which also allow revenue recognition accounting practices.
   - Recording prepayment of power as a prepaid expense is appropriate.
   - **Actions taken or planned, and completion dates:** TVA will rely on each distributor's annual independent auditor to verify material compliance with GAAP and the FERC Uniform System of Accounts. TVA will work with each distributor to ensure energy prepayments are classified as a prepaid expense in the distributor's FY 2009 annual financial statements. Target completion date is December 2009.

2. Work to obtain signed contracts with all customers that are above 50 kW
   - TVA management agrees that the resale schedules of the standard Schedule of Rates and Charges to wholesale contract with distributors require that retail contracts be executed with all customers whose contract demand exceeds 50 kW. TVA management finds that the contract size threshold of 50 kW was

established in 1963, and the relative customer size in 2009 versus 1963 is very different. Likewise, requiring contracts with small commercial customers is a time-consuming and difficult task which may provide little benefit for distributors or the TVA system. TVA management will recommend to the Board that a new and higher threshold be established as part of the rate change process with distributors. When the rate change is put into effect all retail customers above the new threshold will be expected to have executed contracts.

- **Actions taken or planned, and completion dates**: TVA management will recommend to the TVA Board that a higher contract demand threshold for the contract requirement be established through the rate change process. Distributors will be required to have executed retail contracts for customers with contract demands above the new threshold. Target completion date will coincide with the rate change efforts that are currently underway with the distributors and is expected to be in place by October 2010.

3. Develop a comprehensive guide on permitted expenditures and expense accrual for distributor management to use going forward

    - TVA management agrees that it is appropriate to look at permitted expenditures in the context of use of revenues provision in Section 6 of the wholesale power contract with the distributors. TVA adheres to Section 6 of the wholesale contract regarding a distributor's use of revenues, but no guidelines exist that provide an exhaustive list of permitted expenditures within electric systems. TVA management is exploring with the TVA Board the extent to which a comprehensive guideline is feasible and whether the TVA Board desires to adopt a policy that would employ such a guideline.
    - **Actions taken or planned, and completion dates**: Implementation of the recommendation in this report would require the TVA Board to develop a comprehensive guideline on permitted expenditures. TVA management will consult with the Board on the plausibility of developing and implementing policy that would employ a comprehensive guide on permitted expenditures under Section 6 of the wholesale contract. Target completion date is December 2010.

4. Review the definition of cash ratio and determine if the ratio calculation should include some or all amounts in the TVA Power Invoice Prepayment account

    - TVA agrees that it is appropriate for TVA management to review the definition of the cash ratio and determine if any adjustments are appropriate.
    - **Actions taken or planned, and completion dates**: TVA management will review the definition of the Cash Ratio and

determine if any adjustments are appropriate. Target completion date is December 2009.

5. Develop criteria to be used in determining whether a distributor's cash reserves are excessive and incorporate the criteria into the rate setting process.

   - TVA management agrees that it is appropriate for the Board to consider distributor cash reserves as part of the process under which TVA and distributors are to agree upon increases or decreases in the distributor's resale rates as provided for under Section 5 in the wholesale power contract. Under guidelines approved by the Board in 1992, TVA calculates a guideline revenue amount that governs resale rate increases to which TVA will automatically agree without further review. TVA management is making recommendations to the TVA Board that additional financial metrics, including those based on cash reserves, should be considered in determining when agreement upon a resale rate increase or decrease is appropriate.
   - **Actions taken or planned, and completion dates**. TVA management is making recommendations to the TVA Board that additional financial metrics should be employed for purposes of administering the resale rate provisions in Section 5 of the wholesale power contracts. The need to consider cash reserves will be included in TVA management's recommendations to the Board. A change in the current guidelines to include these additional financial metrics requires Board action. Target completion date is December 2010.

6. Review the requirements of the power contract and develop more definitive guidelines on how often meters should be tested.

   - TVA is moving away from end-use-wholesale rates to billing based on the wholesale meters. The accuracy of the distributor meters would then have less of a financial impact on TVA. However, meter testing protects distributors and TVA should continue to encourage it as a matter of good business practice.
   - **Actions taken or planned, and completion dates**: TVA management has been informally discussing a wholesale demand and energy rate structure with distributor representatives. TVA management expects to soon begin formal implementation of a rate change that will replace end-use wholesale rates with a structure that will be primarily based on wholesale meter data. Target completion date will coincide with the rate change efforts that are currently underway with the distributors and is expected to be in place in October 2010.

All of the above recommendations apply to the audit of the Monroe County Electric Power Association. Because of common findings in the two OIG reports, recommendations 2, 3, and 5 also apply to the Lewisburg Electric System review.

Kimberly S. Greene

Kimberly S. Greene
Chief Financial Officer and
Executive Vice President, Financial Services
WT 7B-K

VB:JD
cc: Peyton T. Hairston, Jr., WT7B-K
John P. Kernodle, WT 6A-K
John E. Long, WT 7B-K
Jill M. Matthews, ET 3C-K
Richard W. Moore, ET 4C-K
John M. Thomas III, WT 4B-K
John G. Trawick, WT 3D-K
Benny R. Wagner, ET 4C-K

May 12, 2009

Robert E. Martin, ET-3C-K

AMENDMENT TO RESPONSE TO ITEM NUMBER 6 -- DRAFT INSPECTION REPORT 2008-12007 – DISTRIBUTOR REVIEW OF MONROE COUNTY ELECTRIC POWER ASSOCIATION AND DRAFT INSPECION REPORT 2008-12040– DISTRIBUTOR REVIEW OF LEWISBURG ELECTRIC SYSTEM

This serves as an amendment to our response dated April 30, 2009, to item number 6 in your memorandum dated March 31, 2009.

6. Review the requirements of the power contract and develop more definitive guidelines on how often meters should be tested.

    - TVA is moving away from end-use-wholesale rates to billing based on the wholesale meters. The accuracy of the distributor meters would then have less of a financial impact on TVA. However, meter testing protects distributors and TVA should continue to encourage it as a matter of good business practice.
    - **Actions taken or planned, and completion dates**: TVA management has been informally discussing a wholesale demand and energy rate structure with distributor representatives. TVA management expects to soon begin formal implementation of a rate change that will replace end-use wholesale rates with a structure that will be primarily based on wholesale meter data. Target completion date will coincide with the rate change efforts that are currently underway with the distributors and is expected to be in place in October 2010. The power contracts do not address the frequency of meter testing. TVA views this as a utility standards issue for the distributor. However, TVA will work with the distributor group TVPPA to develop recommendations on common meter testing criteria. Target completion date for common meter testing criteria is October 2010.

John G. Trainor

for
Kimberly S. Greene
Chief Financial Officer and
Executive Vice President, Financial Services
WT 7B-K

VB:JSE
cc: See list on page 2

cc: Peyton T. Hairston, Jr. WT7B-K
John P. Kernodle WT 6A-K
John E. Long WT 7B-K
Jill M. Matthews, ET 3C-K
Richard W. Moore ET 4C-K
John M. Thomas III, WT 4B-K
John G. Trawick WT 3D-K
Benny R. Wagner ET 4C-K