CASE STUDY: POWER COMPANY OPERATES ALABAMA MILL'S "ENERGY ISLAND"

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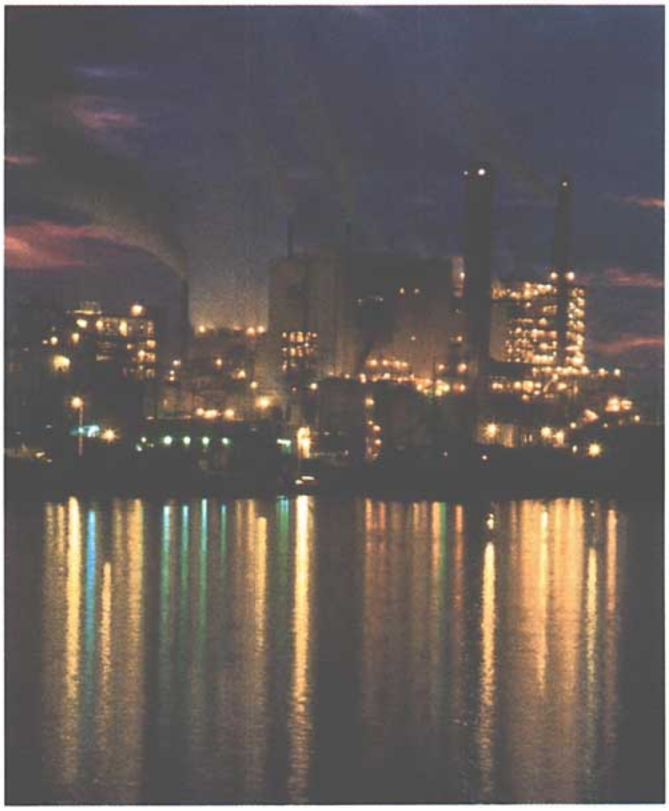
SCOTT PAPER'S DECISION IN 1994 TO SELL THE ENERGY assets of its Mobile, AL, pulp and paper mill to Southern Company illustrates the financial and operational benefits energy companies can offer papermakers.

The "energy island" sale provided Scott an immediate cash infusion of US$ 270 million and the assumption of US$ 80 million in debt. Kimberly-Clark, which later purchased Scott Paper, now operates the integrated facility's pulp and tissue mills, while S.D. Warren operates the fine paper mill. The energy facility is operated by Mobile Energy Services Co. LLC, a Southern Company subsidiary.

In addition to the capital infusion, the energy island sale promised operating benefits because utilities experts would be running the energy island and papermakers would be devoting their attention to papermaking.



The pulp and paper mills at Mobile, AL

"Southern brings a utility perspective to the operation of the energy island, which pulp and paper manufacturers have traditionally treated as a cost," said Dick Koch, general manager of Mobile Energy Services.

Barry Schieb, Kimberly-Clark's pulp mill manager at Mobile agrees, while pointing out that power boiler expertise is not the same as recovery boiler expertise.

"It's true that we've had to pay less attention to the steam boilers and turbine generators," Schieb said. "But recovery boilers are tricky animals. If you aren't careful, they'll blow up. The black liquor system is something we still have to pay close attention to."

Both Schieb and Koch said the joint-operation has, for the most part, gone according to the original plan, which is spelled out in a complex contract.

"We have the luxury here of being one company (prior to the sale). Everyone knows one another. We're able to get past 'who owns what' or 'what does the contract say' to doing what we have to do to get the job done," said Schieb.

Under the agreement, Mobile Energy Services' three power boilers, two recovery boilers, and three steam turbine generators must provide a minimum level and quality of steam and electricity to the mills at a cost calculated from the energy island's operations in 1994. If electricity or steam production falls below the contracted amounts or quality, Mobile Energy Services pays for the difference. Other savings, for example with fuels, are split between the parties. Gains from efficiency improvements are kept by Mobile Energy Services.

Mobile Energy Services made significant investments at the outset of the project. It spent approximately US$ 13 million segregating the energy island's wires, steam fittings and sewer connections, and installing sophisticated metering equipment to keep track of its production and billing. Another US$1.5 million was spent on training for the energy island's 120 employees, all of whom were transferred to Mobile Energy Services from Scott Paper.

The capital improvements and training efforts have improved the energy island's reliability, Koch said. In addition, Mobile Energy Services has reduced its annual coal costs for the plant by more than US$1 million. And there have been intangible benefits too, such as improved communications.

"Every day we provide reports that show our fuel consumption, steam production, steam pressures, temperatures and liquor usage," added Rob Schillinger, operations manager for Mobile Energy Services. "I've worked in several mills before and I've never seen the degree of reporting that we do."

Communication between Mobile Energy Services and the other mills takes place on several levels. In addition to the daily production meetings, a committee that includes representatives from Mobile Energy Services, Kimberly-Clark and S.D. Warren meets weekly to discuss contract-related issues that typically involved capital expenditures or other costs, such as maintenance.

And in the event of a mill expansion, Kimberly-Clark and S.D. Warren are not required to purchase additional steam or electricity load from Mobile Energy Services if they can find a better deal elsewhere. But until electricity deregulation comes to Alabama, their only alternative for electricity is Alabama Power, which is also owned by Southern Company, or an independent power producer willing to invest in additional on-site equipment. The mills cannot buy electricity from another utility and have it delivered to them over Alabama Power's wires.

"They are not obligated to buy additional power from us," Koch said. "If they add additional equipment that would require us to put in more production equipment, we would have to compete with others to get that new business."

In fact, the issue of expansion has exposed one of a few shortcoming Koch said he sees from the Mobile agreement.

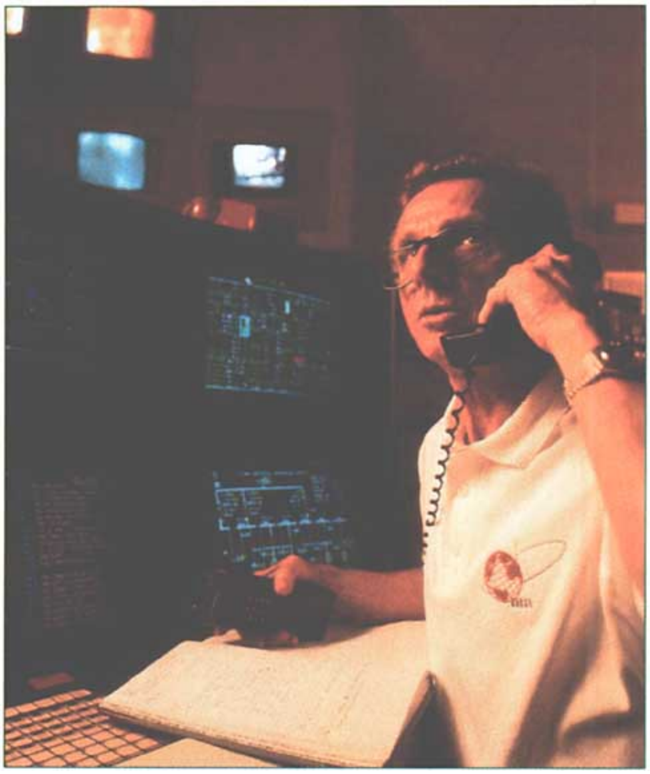
"From an energy consumption point, it's not difficult to measure improvements," Koch said. "But demonstrating efficiency gains according to the agreement has been difficult."

Koch said the agreement between Mobile Energy Services and the other parties measures efficiency gains according to a "process model."

"The initial contract had in it a process model that is extremely sophisticated," Koch said. "It looked good on paper, but it hasn't worked out like we thought. We're trying to use a more simplified model."

As a result, Koch said, Mobile Energy Services has been reluctant to make new investments. "Without a process model in place, we've got no way to recoup our costs. Therefore, we haven't invested any more money. But we'll eventually come up with a new model."

Schieb agreed that the actual measurement of efficiency gain has been difficult.



Monitoring energy use

"You can measure overall operations: uptime, how dry the steam is, and other factors. But tracking the actual conversion of Btus to kilowatt hours is difficult," Schieb said.

Another lurking issue involves labor. Mobile Energy faces its first set of contract negotiations with the two unions representing its workforce, both of whose contracts expire the end of May.

Koch said equitable pay appears to be the biggest concern for the unions and work rule issues have not been a major factor.

"We're trying to keep everyone informed as best we can," Koch said.

Meanwhile, Schieb said the number of inquiries from other pulp and paper companies about the Mobile mills' operations are increasing. "It's getting to be a real popular subject," he said. "I've gotten calls from all kinds of companies from all over the country, and the world." **TJ**

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