

Austin Electric Utility Commission Report and Recommendations Regarding Future Governance of Austin Energy– DRAFT of Working Group – 10 October 2012

Historical Background

Austin is the largest city in the United States whose municipal utility is governed directly by its city council. The City Council has proposed studies of alternative governance in 1994 and 1999, and the Electric Utility Commission has recommended changing to an independent board of directors in 1996, 2002, and 2012, and has conducted extensive public hearings on this topic over the years.

In 2012 Austin Energy adjusted its base rates for the first time in 18 years. Austin Energy had announced several years earlier that it would need a rate increase and that it would begin operating in a deficit and depleting reserves in 2010. The process to adopt new rates took approximately two years and consumed significant staff and community resources as it passed from a preliminary citizen's advisory board (the "PIC"), the Electric Utility Commission and finally the City Council.

During the civic debate about the new rates, some customers of Austin Energy living outside the city limits raised concerns that they have no effective representation on the body making final rate decisions as they cannot vote for Austin City Council representatives.¹

On June 7, 2012 the Austin City Council asked the Electric Utility Commission to evaluate the models provided by the City Manager in a detailed report by Bob Kahn entitled, "Governance Study of Public Power Utilities for the City of Austin," dated August 27, 2012. On June 18, 2012 the EUC created a working group of three members to write this report, consisting of Linda Shaw, Steve Smaha, and Phillip Schmandt.

On September 30, 2012 the City Manager presented Mr. Kahn's report to the City Council and the Electric Utility Commission. The City Manager may submit a separate recommendation to the City Council, which has not been reviewed prior to the issuance of this recommendation by the Electric Utility Commission.

Motivation

The Electric Utility Commission believes that the reasons to adopt an independent board were well summarized by the City Manager of Greenville, Texas when it adopted an independent Board²:

¹ On the date the Electric Utility Commission made its rate recommendations, three out of seven members of the Electric Utility Commission lived outside the Austin city limits.

² Kahn Report, page 7

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“... (1) political interference, (2) lack of consistent policy direction, (3) lack of consistent management at the top, (4) failure to operate the system on a business like basis, has resulted in inefficiently operated and controversial electric utility system...”.

We do not believe Austin’s situation differs greatly, but we believe this situation can be improved greatly.

The Electric Utility Commission also believes that an independent board can increase both the transparency and accountability of the management of Austin Energy. Currently, there is considerable confusion within the City of Austin and Austin Energy as to whether the General Manager of Austin Energy reports to the City Manager or to the City Council. That confusion introduces unnecessary inefficiencies in Austin Energy’s ability to make decisions as a business. Furthermore, to the extent that Austin Energy is managed by oversight from the City Manager, that management occurs outside the public eye and with little or no opportunity for input from customers. And to the extent that Austin Energy is managed by oversight by the City Council, it is not realistic for the City Council to remain fully briefed on the operations of a \$1 Billion per year utility business for it to exercise effective oversight.

An independent board will also allow a mechanism for all Austin Energy customers, not just Austin citizens, to be represented on the governing board of Austin Energy.

Proposed Independent Board for Austin Energy

The Electric Utility Commission recommends that the Austin City Council exercise the powers vested in it by Texas Local Government Code Section 552.122 to transfer management and control of Austin Energy to a Board of Trustees. Section 552.122 also authorizes the City Council to specify by ordinance the number of members of the Board of Trustees and the qualifications for appointment to the Board. The EUC’s recommendations for those details are set forth below.

After experiencing two years of uncertainty regarding the rate case, which remains on appeal, Austin Energy cannot be subjected again to another period of uncertainty and instability regarding the question of governance. The enterprise of Austin Energy needs to return to an environment of clarity and predictability lest it suffer organizational damage as a result of such prolonged uncertainty. The EUC recommends that the transfer of management and control to an independent Board of Trustees be concluded prior to the end of 2013, subject to an interim transition plan described below. The EUC recommends that the transfer of management and control be effected through an ordinance adopted by the City Council, rather than waiting the two or three years that would be required for a Charter amendment election.

To the extent there is uncertainty regarding the requirements of the City’s charter for a transfer of control to an independent Board of Trustees under Section 552.122, the EUC recommends that

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this uncertainty be resolved either by analysis and a clear and timely recommendation of the City Attorney or by seeking an amendment to state law during the 2012 session.

Board characteristics:

The EUC recommends that the ordinance adopted by the City Council include the following specifications regarding the Board of Trustees:

- **7 Members**, with currently serving Mayor as a voting board member ex-officio

Comments: We believe providing a seat to the Mayor would facilitate significant coordination between utility operations and city operations.

- **Qualifications:** A Board member must be a resident of the City of Austin service area. Board candidates should have relevant backgrounds, such as financial, legal, power engineering, and consumer advocacy experience.

Comments: We do not believe a single seat should be reserved for any particular geographical area as we believe that professional skills and experience will be a more critical factor in establishing an effective board, rather than area of residence. Similarly, there would be no limit on the number of Board members who may reside outside the city limits of Austin but otherwise within the Austin Energy service area.

- **Compensation:** \$43,500/year, which is half of what is paid to ERCOT's outside ("unaffiliated") directors in 2012

Comments: Every person we interviewed recommended adequate and not de minimus compensation for board members to allow recruiting the best possible candidates. The members of the EUC, as an advisory board, devote approximately ten to twenty hours per month on EUC activities. We would expect the Board members to spend approximately ten to fifteen hours per week, and thus should be compensated for this significant time commitment.

- **Term:** 4 or 5 years, no more than two full terms, possibly with staggered terms to ease effects of turnover.
- **Meetings:** Full board should meet monthly, with committees of the Board to meet in between full board meetings.

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- **Public participation:** All public meetings shall allow comments by customers of Austin Energy under reasonable guidelines that encourage citizen involvement.
- **Powers of board**
 - Establish rates and related terms
 - Issue bonds to the full extent authorized by Local Government Code Section 552.123
 - Complete and full oversight over all parts of Austin Energy’s businesses
 - Hire/fire the General Manager
 - Vote for Board Chair

Comments: Note that this does **not** include eminent domain, per interviewee recommendations. Requirements for eminent domain have been infrequent in the past, and future needs could be implemented in coordination with city government.

- **Removal of board members** should require a “super-majority” of votes of City Council, where we define “super-majority” as “at least 75% of the members of the City Council” to prevent excessive politicization of AE oversight process.

Comments: If the number of members of the City Council changes, the number of votes required for a 75% “super-majority” will also change.

- **Board selection:** Initially, all six seats should be appointed by the City Council. To fill subsequent vacancies, the existing board will nominate a candidate, and the currently sitting City Council will vote up or down for that candidate within 45 days. Failure to act by the City Council will constitute tacit approval of a candidate recommendation.

Legal and municipal charter issues:

We expect Austin’s City Attorney to provide clear, concise, and timely guidance on whether Texas Local Government Code permits the transfer of management of Austin Energy by ordinance, or what other amendments to City Charter or to Texas state law are required. If state legislative enablement is necessary, we recommend pursuing those modifications during the upcoming Texas Legislative Session.

We further recommend that the enabling ordinance should require that amendment of the governance creation ordinance requires a “supermajority” of Council as defined above to prevent excessive politicization of Austin Energy’s oversight process

Impact on local control and public participation

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We recommend that the City Council promote community-wide debate on how an independent board can most effectively incorporate the values, missions, and outcomes desired from our city-owned utility. This debate should remain a local issue controlled by the customers and owners of the utility. In order to ensure such local control, an open and transparent process should be hosted to foster community wide debate on how the management and control of Austin Energy should be accomplished in a manner that both improves the professional management of the utility and that preserves the community input and process that is so valued in Austin. The ordinance establishing the board may two additional measures to incorporate community values and control.

1. Formalize Austin Energy’s “constitution” that ensures transparency, clean energy, affordability, and other desired metrics. The City Council should request the EUC or the City Manager to develop a draft ordinance detailing all aspects of the independent board. This draft ordinance should then be reviewed by a community-wide “Austin Energy Constitutional Convention” with “founding mothers and fathers” from stakeholders who comment on or revise the “constitution” of the new Austin Energy within a strict time limit. We suggest that a 120 day limit to the process be imposed to increase the odds of reaching a conclusion.
2. The ordinance (or “constitution”) should set forth a clear mission statement for Austin Energy. We suggest starting with Austin Energy’s current charter and mission statement: “To deliver clean, affordable, reliable energy and excellent customer service”. This should be reviewed by the “constitutional convention,” but if it does not reach a successful conclusion, the original mission statement should remain.
3. The ordinance should contain specific procedures to ensure openness and accountability of the independent board. Some aspects that might be included in the ordinance to ensure the board remains accountable to all customers may include all or some of the following:
 - a. Establishing a Residential Customer Ombudsman that reports to the Board and attends board meetings in order to represent residential interests to the Board
 - b. Authorizing the Board to hire independent audit, legal counsel, and subject matter experts, such as experts in renewable energy, in order to properly equip the Board with the tools it needs to oversee and question staff and set strategic direction.
 - c. Requiring the Board to present Five Year Plans to the City Council each five years for public comment on overall strategy and goals, as well as metrics to measure performance.
 - d. Requiring the Board to conduct formal rates proceedings, like a contested rate hearing, with adequate representation to all affected parties, if rates are adopted in excess of the 2% affordability goal that has been set by the City Council.

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- e. Other procedures as may be proposed by stakeholders and agreed upon by the City Council
4. Create a formal Advisory Panel, reporting to the Board, which includes “stakeholder” slots to ensure major customer advocacy groups have input to Board decisions.

Impacts on utility and regional finances:

The EUC has determined that City of Austin budgets are significantly dependent on general fund transfers from Austin Energy and also from other transfers from Austin Energy that are embedded within the City’s and Austin Energy’s budgets. In parallel, Austin Energy currently depends on services provided by the City of Austin, though it is very likely that some of those services could be obtained in a more cost-effective fashion from other sources.

Other municipal utilities with independent boards have greatly reduced or eliminated such budgetary dependencies, but clearly this would take some time to implement in Austin. Therefore we recommend that the enabling ordinance create a transition period of 6 years transition to an operating model in which AE’s Board in its sole discretion decides where to obtain all goods and services required by the utility. The City Council should request the EUC or the City Manager to develop a transition plan to detail how and when certain shared services or transfers are phased out.

This multi-year transition would also affect the status of Austin Energy employees. At the end of this period, utility employees would not be City of Austin employees, and would not participate in the City health and pension plans. Given the size of Austin Energy’s staff and its excellent safety record, we do not anticipate any problem finding an adequate health plan. And we understand that a retirement transition is available to the Texas Municipal Retirement System; this was successfully implemented in Greenville, Texas. The transition process should be undertaken in a manner that does not jeopardize or damage the health insurance and retirement accounts of Austin Energy employees.

Effects on Bond Ratings:

The process of transferring management to an independent board should be carried out in a manner that does not jeopardize Austin Energy’s bond ratings. Mr. Kahn’s report indicates that bond rating agencies prefer that a utility have an independent board and therefore it is the expectation of the EUC that this transfer will not negatively impact, and may positively impact, Austin Energy’s bond ratings.

Conclusion:

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Establishing an independent board of trustees to oversee Austin Energy is a financially prudent decision, consistent with the City Council's responsibility to serve as a responsible steward of this valuable, community-owned asset. The energy utility business is rapidly changing. Old business models will no longer survive indefinitely. Instead, a nimble and knowledgeable leadership is critical to operating a utility that will not just survive in tomorrow's changing markets, but remain the world leader that Austin Energy has become. A more professionally managed Austin Energy will be more capable of keeping rates low for the benefit of all customers, while meeting Austin Energy's announced renewable energy and carbon reduction goals.

Establishing an independent board of trustees is also the most effective way to ensure that the management and operation of Austin Energy remains transparent and accountable to all customers while remaining locally owned and controlled. By drafting a creation ordinance for a new Austin Energy that enshrines the missions and values of the Austin community, this City Council can ensure that Austin Energy will remain not only financially healthy in the years to come, but will also continue to be governed in an open and transparent fashion for the benefit of, and accountable to, all of its owners and customers.

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Appendix I: City Council Resolution NO. 20120607-038, adopted June 7, 2012

WHEREAS, the Austin City Council is the governing body of Austin Energy, establishing rates, policies, and regulations; setting budgets; and authorizing the issuance of bond obligations on behalf of the utility; and

WHEREAS, approximately 50,000 of Austin Energy's more than 400,000 customers are located outside of the jurisdiction of the City of Austin and therefore do not participate in directly electing members of Austin Energy's governing body; and

WHEREAS, according to the American Public Power Association's (APPA) 2010 Governance Survey, 32% of utilities with more than 50,000 customers surveyed use city councils as their governing bodies; and

WHEREAS, other governance models, including independently elected or appointed governing boards, are used throughout the country's public power utilities; and

WHEREAS, according to APPA's 2010 Governance Survey, of the utilities with more than 50,000 customers that serve customers outside of municipal boundaries approximately 12% have a governing board that includes representative(s) from outside the municipality; and

WHEREAS, Austin residents benefit from keeping Austin Energy a municipally-owned electric utility because public power entities provide for local control of energy policy issues, maintain public participation in rate regulation, and offer financial and other advantages to the inhabitants of the region; and

WHEREAS, the benefits of any governance change must be in the best interest of the customer and citizen-owner to continue to meet expectations of having competitive prices; providing safe and reliable service; encouraging local input; and supporting the local community and region;
NOW,

THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF AUSTIN:

The City Manager is directed to study and compile a list of the various governance models of public power utilities that serve customers located outside of the regulating municipality. The study should include municipally-owned utilities from across the country with a focus on Texas-based utilities.

The City Manager should present the models to the Electric Utility Commission no later than August 31, 2012.

BE IT FURTHER RESOLVED:

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The Electric Utility Commission (EUC) is directed to evaluate the models presented by the City Manager, including at a minimum the impacts on local control and public participation, effects on bond ratings, legal and municipal charter issues, and impacts on utility and regional finances. The City Manager and the EUC should consult with former General Managers of Austin Energy, the Texas Public Power Association, the American Public Power Association, and other sources they consider appropriate to inform their understanding of the issues and enhance the analysis. The EUC may form a working group to conduct the analysis, as needed.

The EUC should report its findings and input to the City Council no later than October 31, 2012. The City Manager may also provide his findings and analysis to the City Council during this same timeframe.

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Appendix II: Possible Legal Enablement in Texas

Greenville-type model

SUBCHAPTER G. MANAGEMENT OF CERTAIN ENCUMBERED MUNICIPAL ELECTRIC UTILITY SYSTEMS

Sec. 552.121. APPLICABILITY OF SUBCHAPTER. This subchapter applies only to a home-rule municipality that owns an electric utility system, which by ordinance or charter elects to have the management and control of the utility system governed by a board of trustees, and that: (1) has outstanding obligations payable in whole or in part from and secured by a lien on and pledge of the net revenue of the system; or

(2) issues obligations that:

(A) are payable in whole or in part from and secured by a lien on and pledge of the net revenue of the system; and

(B) are approved by the attorney general.

Added by Acts 1999, 76th Leg., ch. 227, Sec. 13, eff. Sept. 1, 1999. Amended by Acts 2001, 77th Leg., ch. 1420, Sec. 8.106(a), eff. Sept. 1, 2001.

Renumbered from Local Government Code, Section 402.121 by Acts 2007, 80th Leg., R.S., Ch. 885, Sec. 3.76(a) (2), eff. April 1, 2009.

Sec. 552.122. TRANSFER OF MANAGEMENT AND CONTROL OF ELECTRIC UTILITY SYSTEM. (a) A municipality by ordinance may transfer management and control of the municipality's electric utility system to a board of trustees appointed by the municipality's governing body.

(b) The municipality by ordinance shall prescribe:

(1) the number of members; and

(2) the qualifications for appointment to the board.

Added by Acts 1999, 76th Leg., ch. 227, Sec. 13, eff. Sept. 1, 1999. Amended by Acts 2001, 77th Leg., ch. 1420, Sec. 8.106(a), eff. Sept. 1, 2001.

Renumbered from Local Government Code, Section 402.122 by Acts 2007, 80th Leg., R.S., Ch. 885, Sec. 3.76(a) (2), eff. April 1, 2009.

Sec. 552.123. AUTHORITY OF BOARD OF TRUSTEES. (a) The municipality by ordinance may vest in the board the power to establish rates and related terms for its municipally owned electric utility system.

(b) The municipality may delegate to the board of trustees all or part of the municipality's authority to:

(1) exercise the power of eminent domain with respect to property that will be used by, useful to, or required by the utility system; and

(2) issue obligations in the name of the municipality to acquire or construct an improvement to or extension of the utility system or to repair the system.

(c) The municipality may authorize the board of trustees to issue obligations under Subsection (b) (2) without the prior approval of the municipality. The obligations must be payable solely from the net revenue of the utility system.

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(d) The municipality may not delegate to the board of trustees the authority to:

(1) levy or collect ad valorem taxes; or

(2) issue obligations that are payable in whole or in part from ad valorem taxes.

(e) The municipality and the board of trustees may jointly provide for the issuance of obligations payable from ad valorem taxes and the utility system's net revenue by adopting identical provisions in an ordinance or resolution, as appropriate.

Added by Acts 1999, 76th Leg., ch. 227, Sec. 13, eff. Sept. 1, 1999. Amended by Acts 2001, 77th Leg., ch. 1420, Sec. 8.106(a), eff. Sept. 1, 2001.

Renumbered from Local Government Code, Section 402.123 by Acts 2007, 80th Leg., R.S., Ch. 885, Sec. 3.76(a) (2), eff. April 1, 2009.

San Antonio-type Model:

Texas Government Code - Section 1502.070. Management And Control Of Utility System

Legal Research Home> Texas Laws> Government Code> Texas Government Code -

Section 1502.070. Management And Control Of Utility System

§ 1502.070. MANAGEMENT AND CONTROL OF UTILITY SYSTEM.

(a) Management and control of a utility system may be vested in:

(1) the municipality's governing body; or

(2) a board of trustees named in the proceedings adopted by the municipality and consisting of not more than five members, one of whom must be the mayor of the municipality.

(b) The compensation of the trustees shall be specified by the proceedings. The compensation may not exceed five percent of the gross receipts of the utility system in any year.

(c) The proceedings of the municipality may specify the terms of office of the board of trustees, their powers and duties, the manner of exercising those powers and duties, the election of successor trustees, and any matter relating to the organization and duties of the board. On any matter not covered by the proceedings, the board of trustees is governed by the laws and rules governing the municipality's governing body, to the extent applicable.

Added by Acts 1999, 76th Leg., ch. 227, § 1, eff. Sept. 1, 1999.

Renumbered from V.T.C.A., Government Code § 1502.071 and amended by Acts 1999, 76th Leg., ch. 1064, § 22, eff. Sept. 1, 1999.

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Appendix III: Documents Reviewed

Governance Study of Public Power Utilities For the City of Austin, August 27, 2012, Bob Kahn

Staff-Provided Binder Contents:

1. Governance Models:

Governance Alternatives White Paper, Colorado Springs Utilities, 2011

Managing Public Utilities: The American Way, Public Utility Research Center, University of Florida, 2011

Chapter 4: Other Governance Models for Municipal Utilities, Governance in a Changing Market: Alternative Governance Structures - The Los Angeles Department of Water and Power, RAND, 2001

Electric Utility Department Competitive Performance Review, Price Waterhouse, 1996

2. Surveys

Texas and Large Municipally Owned Utilities, Austin Energy, 2012

Testimony of the Texas Public Power Association, Senate Business & Commerce Committee, 2012

2010 Governance Survey, American Public Power Association, 2010

Preliminary Information Regarding Governance and Late Fees from Large Public Power Council (LPPC) Member Utilities, 2008

General Utility Information (of Municipally Owned Electric Utilities), Navigant, 2011

Governance Structures of Municipally Owned Electric Utilities, Texas Public Power Association, 2011

3. Other Utilities: CPS Energy, San Antonio, Texas; Colorado Springs Utilities; Jacksonville Energy Authority

CPS Energy Presentation to the Senate Committee on Business and Commerce, 2012

CPS Energy Governance Structure presentation to the Electric Utility Commission, Austin Energy, 2008

Governance Structure of CPS Energy

CPS Energy Board of Trustees Role & Accountabilities Statement and Invitation to Apply for CPS Trustee, 2012

Governance Structure Review Assignment, presentation to Colorado Springs Utilities Board by the Utilities Policy Advisory Committee, 2012

Jacksonville Energy Authority (JEA) Board Policy Manual, Bylaws and Charter, 2010

4. State Government Code and Austin City Council Resolutions

Texas Government Code Section 1502.070. Management and Control of Utility System

Local Government Code Subchapter G. Management of Certain Encumbered Municipal Electric Utility Systems

Austin City Council Resolution establishing guidelines and financial targets for enhancing the competitive position of Austin Energy, 1999

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Austin City Council Resolution directing a Study of Governance Models, 2012

5. Historical and other materials from EUC Member Shudde Fath

Memos and Letters from the EUC and Commissioner Fath, including EUC recommendations on governance in 1996 and 2002

Board Governance of Austin's Electric Utility, Additional Information requested by the EUC Finance Committee, 1996

Transcripts and Notes from EUC Public Forums on Utility Governance, 1996; including historical City of San Antonio documentation regarding purchase of CPS

News articles and excerpts

Governance materials provided by Ralph Hasson:

CPS 2011 Report of Management

CPS Energy 2012 Annual Report

CPS: A Vision for Sustainability

CPS Budget Book 2013-2014, plus supplements

CPS Energy's Board of Trustees

CPS Energy's Citizens Advisory Committee

Denver Water Board and Organization

Denver Water Citizens Advisory Committee (CAC) Bylaws, Meetings, Purpose, Topics

Denver Water Operating Rules of the Board of Water Commissioners

EPCOR (Edmonton, Canada) Annual Report, 2009

EPCOR (Edmonton, Canada) Corporate Governance

Governance Alternatives White Paper, 2011, Colorado Springs Utilities

Governance in a Changing Market: Los Angeles Department of Water and Power (RAND Corporation, 2001)

Electricity Regulation in the US: A Guide, Regulatory Assistance Project, March 2011

Good Governance in Restructuring Water Supply: A Handbook, Federation of Canadian Municipalities, no date

Guidelines for Governance of the Electricity Sector in Canada, University of Western Ontario, 2011

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Regime Change and Corruption: A History of Public Utility Regulation, National Bureau of Economic Research, 2006

Payments and Contributions by Public Power Distribution Systems to State and Local Governments, 2008 Data, American Public Power Association 2010-2011 Annual Directory and Statistical Report

How Public Power is Governed: The Structures and Authorities of Utility Boards, American Public Power Association, 2011

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Appendix IV: Interviews by EUC Governance Working Group

July 26, 2012:

Juan Garza: Former General Manager of Austin Energy, former General Manager of Pedernales Electric Cooperative, and former City Manager for the City of Corpus Christi

Roger Duncan: Former General Manager of Austin Energy, former Austin City Council Member

Ralph Hasson: Chapter board, National Association of Corporate Directors, and former Director of the Policy Office for the University of Texas System

Bob Kahn: Former Deputy General Manager of Austin Energy, former CEO of ERCOT, retained by Austin City Manager to perform independent study of governance

August 16, 2012:

Milton Lee: Former General Manager of CPS Energy (San Antonio), Former General Manager of Austin Energy, former ERCOT Board, LCRA and PUC staff

September 10, 2012:

Kirk Watson: State senator and former mayor of Austin

Additional interviews to be undertaken before final report submission:

Will Wynn: Former Mayor of Austin; scheduled for week of October 20, 2012

Jesus Garza: Former City Manager of Austin, former Deputy General Manager of LCRA, currently Chief Executive Officer Seton Healthcare Family; scheduled for October 26, 2012