

# Late Backup

## Chapter 4

### Other Governance Models for Municipal Utilities

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While DWP and many municipal utilities operate as city departments, others have different organizational and governance structures. This chapter describes and contrasts five such models:

- Municipal utility reporting to city council (e.g., Austin, Texas; Colorado Springs, Colorado).
- Independent city agency (e.g., Jacksonville, Florida; Knoxville, Tennessee).
- City-owned corporation (e.g., Toronto, Ontario; Safford, Arizona).
- Municipal Utility District (e.g., Sacramento Municipal Utility District).
- Joint Powers Agency (e.g., Southern California Public Power Authority).

#### MUNICIPAL UTILITY REPORTING TO CITY COUNCIL

A number of cities simplify governance by having the municipal utility report directly to the city council. The Colorado Springs City Charter, for example, designates the city council as the board of directors for the utility. The utility executive director then reports directly to the council. Austin, Texas, as well as a number of California cities—including Burbank, Glendale, and Pasadena—have similar governance structures but include council-appointed citizen advisory commissions.

In 1998 Colorado Springs also adopted a new governance framework “suited to today’s business reality in which flexibility, quick responsiveness, and clear long-term direction are essential to success.” The framework, largely developed by consultant John Carver,<sup>26</sup> seeks to separate the policy functions of the board from the operational re-

sponsibilities of the executive director. The board sets policies and communicates them in writing solely to the executive director; it "will never give instructions to persons who report directly or indirectly to the Executive Director." (Colorado Springs, 1998.)

Board policies set out the utility's purpose and ends to be achieved. They also designate what actions of the executive director are unacceptable to the board, in both general ("any practice . . . which is either unlawful [or] imprudent . . . ") and specific ("he or she may not change his or her own compensation or benefits") terms (Colorado Springs, 1998, Policy Numbers EL-1 and EL-4). The executive director may then make all decisions and carry out any activities not expressly prohibited by the board, without seeking further approval.

Direct reporting to the council seems to work well in smaller cities with utilities of relatively modest size. The model does not seem appropriate for a utility as large and complex as the DWP or for a city as diverse and fractious as Los Angeles. However, many of the governance principles adopted by Colorado Springs—particularly the limits set on council involvement in utility operations—are worth consideration here as well.

#### INDEPENDENT CITY AGENCY

Jacksonville, Florida, and Knoxville, Tennessee, have municipal utilities that operate as city agencies with strong, independent governing boards (Table 4.1). Board members are appointed by the mayor and confirmed by the council for fixed, staggered terms. Unlike in Los Angeles, board members are expected to serve their full terms—in Jacksonville, removal requires a two-thirds council vote; in Knoxville, members can be removed for cause only by a four-fifths vote of the board. These arrangements promote board continuity and independence.

The JEA (formerly Jacksonville Energy Authority) and Knoxville Utility Board (KUB) exercise strong authority under their city charters to govern municipal utilities. The boards can hire and fire the CEO without approval from the mayor or council. The boards set rates after holding public hearings. They delegate to the CEO virtually all cus-

tomers contract, procurement, real property management, and personnel matters.<sup>27</sup> Senior management in Knoxville and essentially all managers in Jacksonville are exempt from civil service.<sup>28</sup>

These city councils retain only limited authorities over their utilities. In Jacksonville, the council approves the JEA annual budget and must authorize increases in total utility debt, leaving the approval and details of individual debt issues to the JEA Board. Utility payments to the city, currently set at 5.5 mills per kwh sold, are renegotiated every five years. By contrast, the Knoxville City Council approves individual KUB debt issues, but the board approves the budget. Payments "in lieu of taxes" to the city follow Tennessee state law and are based on net plant value and gross operating revenue. In neither city does the council or mayor exercise control over board agendas, board decisions, utility personnel, or operations.<sup>29</sup>

The Knoxville Charter gives the KUB authority to hire its own legal advisor and staff. In Jacksonville, as in Los Angeles, city attorney staff represents the utility. To hire outside counsel, JEA must obtain approval of the city attorney but not the city council.

The governance systems in Jacksonville and Knoxville were designed to distance utility daily operations from city politics, and they appear to work quite well. JEA and KUB are highly regarded both in their cities and by the U.S. public power community. Although JEA and KUB operate with considerable independence, in each case the board, CEO, and other top managers regularly stay in close touch with the mayor and city council. As one executive told us, "We routinely tell the mayor and council what we're planning and how we're doing, even though we're not legally obliged to do so. . . . That's just good politics and good business."

#### CITY-OWNED CORPORATION

A third governance model involves "corporatization," that is, changing the utility's organizational structure from a city department to a city-owned corporation. The motivation is to improve utility operations and simplify governance, usually in response to or in anticipation of competition. While most electric utility corporatization has

**Table 4.1**  
**Governance Comparisons: DWP and Independent City Agencies**

| Governance Structure  | DWP Under New Charter  | Jacksonville Energy Authority  | Knoxville Utilities Board  |
|---|--|--|--|
| Utility structure and size (1998 electricity revenue in millions) | City department (\$2,163)  | Independent city agency (\$777)  | Independent city agency (\$296)  |
| Governing board   | Five-member commission; five-year, staggered terms<br>Members appointed by mayor, confirmed by council<br>Mayor may remove without council approval  | Seven-member board; four-year, staggered terms; two-term limit<br>Members appointed by mayor, confirmed by council<br>Mayor may remove with two-thirds council approval                  | Seven-member board; seven-year, staggered terms; two-term limit<br>Members appointed by mayor from list of five names submitted by board, confirmed by council<br>Removal only for cause by four-fifths board vote |
| Board authority   | Hires and fires CEO with mayor and council approval  | Hires and fires CEO<br>Rate setting<br>Individual debt issues<br>Entering new businesses   | Hires and fires CEO<br>Rate setting<br>KUB budget approval<br>Entering new businesses  |
| Authority delegated to CEO  | Hiring up to 16 exempt positions with mayor's approval, unless council vetoes by two-thirds vote<br>Customer contracts within council guidelines;<br>Procurement <\$150K   | Hiring 150 exempt positions and other personnel matters<br>Customer contracts<br>Real property sales/leases<br>Procurement   | Hiring 30 exempt positions and other personnel matters<br>Customer contracts<br>Real property sales/leases<br>Procurement  |
| Authority retained by council                                     | Approval of rates<br>Job classification and compensation<br>Procurement >\$150K<br>Real property sales/leases<br>New debt authorization<br>Capital project approval<br>Entering new businesses<br>Customer contract guidelines<br>Veto of any commission decision by two-thirds vote<br>Outside legal counsel approval | JEA budget approval<br>Overall debt limits<br>JEA payments to city (negotiated every five years)<br>JEA Charter amendments by two-thirds vote with mayor's approval, four-fifths without | Individual debt issue approval   |
| Legal staffing  | Provided by city attorney<br>Outside legal counsel must be approved by council and city attorney   | Provided by city attorney<br>Outside legal counsel must be approved by city attorney   | Board hires legal advisor  |
| Payments to city  | 5% of operating revenue<br>Ratepayers pay utility tax  | 5.5 mils per kwh with minimum base of \$58 million in 1998<br>Ratepayers pay utility tax   | Payments "in lieu of taxes," based on net plant value and gross operating earnings   |

occurred outside the United States—in Canada, the United Kingdom, Germany, Australia, and New Zealand, among other countries—it is of growing interest to U.S. municipal utilities as they prepare for competitive electricity markets.<sup>30</sup> Corporatization of the small municipal utility in Safford, Arizona, was highlighted at the 1999 annual meeting of the American Public Power Association (Mecham, 1999).

The recent corporatization of Toronto Hydro, the second-largest municipally owned utility in North America (after DWP), seems particularly relevant to this discussion.<sup>31</sup> Toronto Hydro was restructured under the 1996 Ontario Energy Competition Act, which requires all municipal electric utilities in the province to incorporate by November 2000. At that time, customers will be able to purchase electricity from competitive suppliers and have their bills unbundled to show separate charges for generation, transmission, and distribution.<sup>32</sup> The Toronto Hydro restructuring also amalgamates the City of Toronto's utility operations with those of six adjacent municipalities.<sup>33</sup>

Under the Shareholder Agreement adopted by the Toronto City Council in June 1999, the city transferred all "employees, assets, liabilities, rights, and obligations" of its municipal utility to the Toronto Hydro Corporation, a corporation established under the Ontario Business Corporations Act with the city as the sole shareholder (Toronto, 1999b). The corporation's 11-member board of directors is appointed by the city council for fixed, staggered terms (Table 4.2). Currently, three city council members and eight other citizens serve as directors. The council may remove or replace directors at any time.

As sole shareholder, the council has rights to amend the corporation's bylaws, change the board structure or share structure, and control any change of ownership, dissolution of the corporation, or sale of "all or substantially all" of its assets. The council also retains authority under the Shareholder Agreement to approve new debt issues, annual capital outlays above \$170 million, and any service expansion beyond Toronto Hydro's current territory. Except for these reserved powers, the board has full authority to "supervise the management of the business and affairs of the Corporation."

The board delegates to the CEO "the management of the business and affairs of the Corporation," including personnel, customer contracts, procurement, property management, and the hiring of legal staff and advisors.

When incorporation took place in June 1999, the city received \$100 million in cash and \$34 million in surplus assets from the corporation (Toronto Hydro, 2000). The city also stipulated that of the assets it transferred to the corporation, about 60 percent constituted debt on which the city will receive interest payments of more than \$60 million per year. The city also expects the corporation to pay regular dividends corresponding to two-thirds of gross operating earnings from electricity distribution.<sup>34</sup>

While the Toronto Hydro restructuring is too recent to evaluate in terms of operating results, it appears to be moving ahead after surmounting a number of initial obstacles. Many Toronto citizens objected to the amalgamation bill as having been forced on them by a politically conservative provincial legislature. Labor leaders objected to a companion bill as limiting their right to strike and other worker rights during the transition (Ontario, 1997). The amalgamation required harmonization of some 55 collective bargaining agreements from seven separate municipalities covering nearly 5,000 job classifications. Much in the way of implementation remains to be done. And some saw corporatization as merely a stalking horse for privatization of Toronto Hydro.

The Toronto City Council, however, has affirmed its commitment to operating Toronto Hydro as a city-owned utility. The council's Strategic Policies and Priorities Committee emphasizes the benefits of continued public ownership: "As a major player in the competitive industry, Toronto Hydro could be influential in ensuring that energy conservation and environmental responsibility are retained as important issues for consumers." The committee further recommends "that Council leave open the option for Toronto Hydro to develop and invest in the nonregulated, competitive businesses permitted by legislation whenever there is a good business case, risks are reasonable, and returns are satisfactory. . . . However, care must be taken by Council to permit the new board to operate on a commercially prudent basis if it

Table 4.2

## Governance Comparisons: DWP, City-Owned Corporation, and Municipal Utility District

| Governance Structure  | DWP Under New Charter  | Toronto Hydro Corp.   | Sacramento Municipal Utility District  |
|---|--|---|--|
| Utility structure and size (1998 electricity revenue in millions) | City department (\$2,163)  | City-owned corporation \$1,246 (U.S.\$)   | Municipal Utility District (\$766)   |
| Governing board   | Five-member commission<br>Five-year, staggered terms<br>Members appointed by mayor, confirmed by council<br>Mayor may remove without council approval  | 11-member board of directors<br>18-month terms for city councilors, three-year staggered terms for others<br>Members may be replaced at any time by council majority vote   | Seven-member board, elected by voters for four-year, staggered terms   |
| Board authority   | Hires and fires CEO with mayor and council approval  | All powers except those reserved to city council as shareholder   | All powers as authorized under the California Municipal District Act of 1921                                 |
| Authority delegated to CEO  | Hiring up to 16 exempt positions with mayor's approval, unless council votes by two-thirds vote<br>Customer contracts within council guidelines<br>Procurement <\$150K   | All personnel matters<br>Customer contracts<br>Procurement<br>Real property sales/leases<br>Hiring legal staff<br>"Management of the business"  | Most personnel matters<br>Procurement <\$100K<br>Day-to-day management as delegated by board                 |
| Authority retained by council                                     | Approval of rates<br>Job classification and compensation<br>Procurement >\$150K<br>Real property sales/leases<br>New debt authorization<br>Capital project approval<br>Entering new businesses<br>Customer contract guidelines<br>Veto of any commission decision by two-thirds vote<br>Outside legal counsel approval | Bylaw amendments<br>Board structure<br>Share structure or sales<br>Dissolution or sale of "substantially all" assets<br>New debt issues<br>Approval of annual capital outlays >\$170 million<br>Service expansion beyond Toronto<br>Ontario Energy Board must approve rates | Board is legislative body of the district  |
| Legal staffing  | Provided by city attorney<br>Outside legal counsel must be approved by council and city attorney   | Hired by CEO  | Hired by board   |
| Payments to city  | 5% of operating revenue<br>Ratepayers pay utility tax  | Two-thirds of operating cash flow of distribution company<br>Interest on city debt<br>Initial transfer of \$134 million on incorporation  | The Sacramento Municipal Utility District makes no direct payments, but ratepayers pay utility tax to cities |

is to enter the competitive market. The pursuit of a nonprofit agenda could result in a nonviable business." (Toronto, 1999a.)

### MUNICIPAL UTILITY DISTRICT

Under California's Municipal Utility District (MUD) Act, county voters can establish a separate public agency to provide electricity, water, transportation, or other utility services countywide or within a specified district of the county. If approved by the voters, such a MUD has the same powers as other public agencies, including powers "to sue and be sued, contract, eminent domain, purchase, issue bonds under several authorizing acts, own property and provide utility works and services." (Beck, 1996c.) A MUD is governed by an elected board of directors, with each director representing a specific ward as set out by the county board of supervisors.

As an illustration of MUD governance in California (see Table 4.2), the Sacramento Municipal Utility District (SMUD) Board of Directors has seven members elected for staggered, four-year terms. Directors must be residents of the wards from which they are nominated. However, every voter in the district may vote for all the directors to be elected. SMUD is subject to the Brown Act, so that board meetings are open to the public and must be held at least once a month.

The board appoints a general manager who serves at its pleasure, and it can create or abolish other positions and set salaries as it sees fit. The SMUD Board delegates most personnel decisions to the general manager, so long as they are in accordance with the district's own civil service provisions. No more than 2 percent of appointments can be exempt from civil service. The MUD Act explicitly states that the board may appoint an attorney who serves as the legal advisor to the district.

The SMUD Board generally has broad authority over the district, including setting public tariffs (after a public hearing) and approving customer and supplier contracts. In 1997, the board approved an economic development discount for Intel Corp. in Folsom, California, whereby Intel's base electricity rate would drop by 25 percent if the company added another 600 jobs in the next two years. SMUD offers



similar discounts to other companies. For procurement, awards over \$50,000 must be offered to the lowest responsible bidder. The general manager may determine the lowest responsible bidder for contracts of less than \$100,000.

SMUD has full authority to incur indebtedness and issue general obligation (GO) or revenue bonds. However, voter approval by a two-thirds margin is generally required for new GO bonds, so that municipal utilities rely on bonds backed by their own revenues. The MUD Act requires a municipal utility district to have eight years of operating experience before it can issue revenue bonds.

In 1997, SMUD became California's first municipal electric utility to offer direct access to some of its commercial and industrial customers. It plans to give all its customers direct access to competitive suppliers by 2002. SMUD's strategy to prepare for competition has been to freeze prices for five years through 2002, keep rates 5 percent lower than competitors', and implement a debt-reduction program (SMUD, 1999).

Although SMUD has much more autonomy than a city department and can respond more quickly to competitive changes, converting DWP into a new MUD in Los Angeles would require political approval at several levels. First, the city council would have to pass a resolution calling for the Los Angeles County Board of Supervisors to hold an election to establish the MUD. The supervisors would then submit the proposal to the Local Agency Formation Commission (LAFCO) for analysis and approval. If approved by LAFCO, the proposal would be placed on the ballot at a county election, while the requisite city charter amendments would be submitted to city voters. If both county and city voters passed these measures, the new MUD could be established. For the new entity to be fully functional, however, the California legislature would then have to pass special legislation to permit the MUD to sell revenue bonds prior to its establishing an eight-year operating history. Converting DWP into a MUD thus would require closely coordinated legislation at the city, county, and state levels, as well as approval from city and county voters. Once established with its separately elected board, a MUD would be well insulated from change or control by other local officials.

### JOINT POWERS AGENCY

Under the California Joint Powers Act, two or more cities, counties, or other public agencies can create a Joint Powers Agency (JPA) to manage electricity generation and transmission facilities or other utility operations. Each participating agency executes a Joint Powers Agreement specifying the JPA's structure, scope, and powers.<sup>35</sup> The JPA is governed by a board of directors whose members represent the participating agencies and are usually appointed by each participant's governing body.

The Joint Powers Act grants broad authorities to a JPA to own property, incur debt and issue revenue bonds, purchase, contract, sue and be sued, provide utility services and set rates for them, and engage in selected other municipal enterprises. It may participate in a member agency's civil service system, although it is not required to do so. One significant restriction is that a JPA cannot issue revenue bonds to acquire or construct electric or water distribution facilities.

One JPA, the Southern California Public Power Authority (SCPPA), comprises DWP, nine other municipal utilities, and the Imperial Irrigation District. It was formed in 1980 to finance the acquisition of generation and transmission facilities for its members. The 11 SCPPA directors are the general managers of its member utilities;<sup>36</sup> each utility gets one vote. However, on issues concerning specific projects, each utility's vote is weighted according to its financial contribution to the project. This means that a majority stakeholder in a project can effectively dictate SCPPA policies and actions for that project.

SCPPA operates on an annual budget of less than \$1 million with a staff of three full-time and 10 contract employees. It is a financing rather than an operating organization, unlike its counterpart, the Northern California Power Authority (NCPA), which has 170 employees, operates power plants, and runs power pools.

A JPA has potential advantages of flexibility and, through its appointed board, some independence from local politics. However, the loss of direct control can make local elected officials less than enthusiastic about transferring assets and authorities to a JPA. The restriction against using revenue bonds to acquire distribution facilities also poses a major problem for a utility that intends to offer retail as well as

wholesale services. Although some approaches have been suggested to finesse the distribution facilities issue,<sup>37</sup> restructuring DWP into a JPA might well require new California legislation to amend the Joint Powers Act.