

Testimony of Juan Garza, General Manager  
Pedernales Electric Cooperative, Inc.  
Johnson City, Texas  
Before the  
House Oversight and Government Reform Committee  
June 26, 2008

**The History of Pedernales Electric Cooperative, Inc.**

On September 27, 1938, with about 3,000 Hill Country families signed up for electric service, Pedernales Electric Cooperative was awarded a \$1,332,000 loan from the Rural Electric Administration to build nearly 1,800 miles of electric lines. Owned by the consumers we serve, PEC is now providing electricity to more than 223,000 members throughout 8,100 square miles, with more than 16,000 miles of distribution line. We are the largest electric cooperative in the United States. Our territory includes some of the fastest-growing counties in the State of Texas.

PEC has a rich and proud heritage of providing reliable electric service to its members. It historically focused efforts on setting policies to provide outstanding customer service, strong system reliability, financial stability, and fair rates. These policies have resulted in PEC being rated number one in the country in customer service, and number five of all utilities in the country in overall customer satisfaction by J.D. Powers. The power interruption duration for PEC is 35 percent less than the national cooperative average.

During the 1980s, PEC was one of the first electric cooperatives to purchase its debt back at a discounted rate from the federally subsidized Rural Electrification Administration as part of the Reagan Administration plan to reduce federal subsidies. By going to the bond market, PEC has maintained a strong financial standing with a AA- bond rating which allows it to move more expeditiously on system improvements to meet the challenges of rapid growth.

**Turbulent Times bring about changes at PEC**

As General Manager of Pedernales Electric Cooperative, I have been selected to lead the nation's largest electric cooperative, serving over 223,000 members, including ranches, farms, businesses, retirement communities, and residential subdivisions. Approximately 90 percent of our members are residential consumers.

Over the past 18 months, Pedernales Electric Cooperative, Inc. has been faced with the challenge of responding to the concerns of its members regarding openness, transparency, and governance issues. A lawsuit was filed by members that called for the resignation of the current Board members, the repayment of capital credits or patronage capital, and increased accountability to members of the cooperative. Certain business practices were identified that created serious concerns for members and elected officials.

These turbulent times have brought about significant changes at PEC.

- Our election system was revised to be more democratic and open — eliminating proxies and instituting a nomination by petition of at least 25 members. At our Annual Membership Meeting on June 21, 2008, we had 58 candidates vying for five Board positions.
- The position of Coordinator, a paid position occupied by Mr. Price's predecessor as President and dating to earlier times in the Cooperative, was judged by the Board to be an anachronism and was eliminated.
- We abolished positions for Director Emeritus and Honorary Director, which had been criticized by several members.
- We distributed \$7.3 million in capital credits in December 2007 to more than 74,000 current and former members.
- Our website now includes an array of business and governance information, including our *Bylaws*, Board biographies, Board meeting agendas, our consolidated annual report, our IRS 990 filing, information on subsidiaries, and our capital credits policy.
- We approved and instated a travel policy designed to have expenses contained and reviewed.
- We created an Expense Audit Committee to monitor all Board expenditures and contracts.
- Rather than holding our meetings in the traditional Board Room, the monthly Board meetings are now held in PEC's auditorium to allow for greater member participation, with time reserved on each agenda for member comments. We have also begun to move our monthly Board meetings to other locales in our service area, rather than the headquarters building, on a rotating basis. For members who cannot attend Board meetings, we videotape the meetings and post them online.
- A Board Compensation Committee has been appointed and received an independent survey by Navigant Consulting comparing Board of Director compensation at various electric utilities in Texas and across the U.S. This survey was presented to the Board and members in May and posted to our website. Members were invited to provide their comments directly to Navigant Consulting. The Compensation Committee will report within the month to the full Board on recommended compensation for Board members. The salary adjustment will be retroactive to March 10, 2008, and will be made public on our website.

- We are working to restructure our software subsidiary, Envision Utility Software Corporation, to best serve PEC members. This software product has been highly successful in meeting our own versatile billing and customer information needs but has not been marketed successfully to other utilities. As such, we are ceasing marketing operations and evaluating options, including folding Envision into PEC.
- We have agreed to terms to settle a lawsuit brought by concerned members on March 10, 2008. While we are finalizing details and must resolve two member appeals, our members will benefit when we can return focus to customer care and electric reliability.

To summarize, with the above changes, I can tell you that Pedernales Electric Cooperative is not the same organization as a year ago. We are deeply committed to returning to its roots. We are proud of our rich heritage, but focused on a bright new future. We have made the necessary changes to ensure that we can stay focused on providing affordable rates, reliable electricity, and exceptional member services.

### **Comprehensive Independent Investigation**

PEC has retained Navigant Consulting, Inc. and Cox, Smith, Matthews, Inc. to provide an independent and comprehensive investigation into the cooperative's operations over the last 10 years, with an emphasis on the last five years. The investigation will include, but not be limited to, various PEC transactions, compensation and/or employment arrangements, expense items, and other expressed concerns. Navigant Consulting will also provide business process improvement consulting services in connection with matters evaluated during the investigation, including the review of business policies and processes surrounding certain functional areas, such as the retirement or payment of capital credits and our ownership of Envision Utility Software Corporation. This investigation is being conducted in cooperation with the Public Utility Commission of Texas, and the results will be reported to the cooperative's members through PEC's web site.

### **Capital Credits**

It is appropriate to elaborate further on the issue of capital credits — money from members that goes into the Cooperative's equity base because healthy margins are a reflection of the Cooperative's financial health and enable us to borrow money at the best rates available.

The Cooperative's prior policy, filed with the Texas Public Utility Commission in 1994, was that capital credits not be returned to members in the form of payments until members' equity reached at least 40 percent of total utility plant in service (Appendix A).

This patronage capital has not been held in a fund but has been invested in the costs of meeting the needs of a growing Cooperative, thus reducing the need for borrowing costs and interest payments (Appendix B).

We distributed \$7 million in capital credits to members in December 2007, and the Board has voted to proceed with the retirement of capital credits as defined in our legal settlement agreement, even though the settlement is currently being appealed.

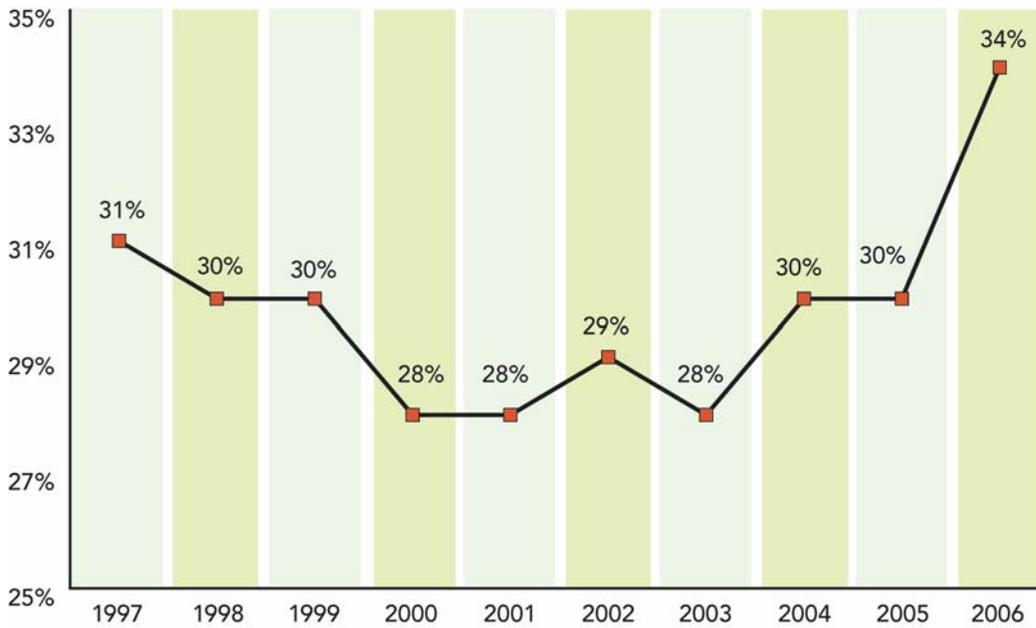
That stated, we believe that the disbursement or reinvestment of capital credits is a business decision that should be made annually, given the financial and operational status of the cooperative with input of members and full disclosure of the decision.

With energy costs continuing to rise, the possibility exists that members could determine that the long-term benefits of a conservative capital credits policy — an investment in their economic future — could well be more beneficial than the short-term benefit of a check in the mail, especially when a complete payout of more than \$226 million could result in interest and principal payments totaling more than \$436 million (Appendix C). PEC must be aware of this possibility and prepared to respond to members' concerns about the big picture of rising energy costs.

## **Summary**

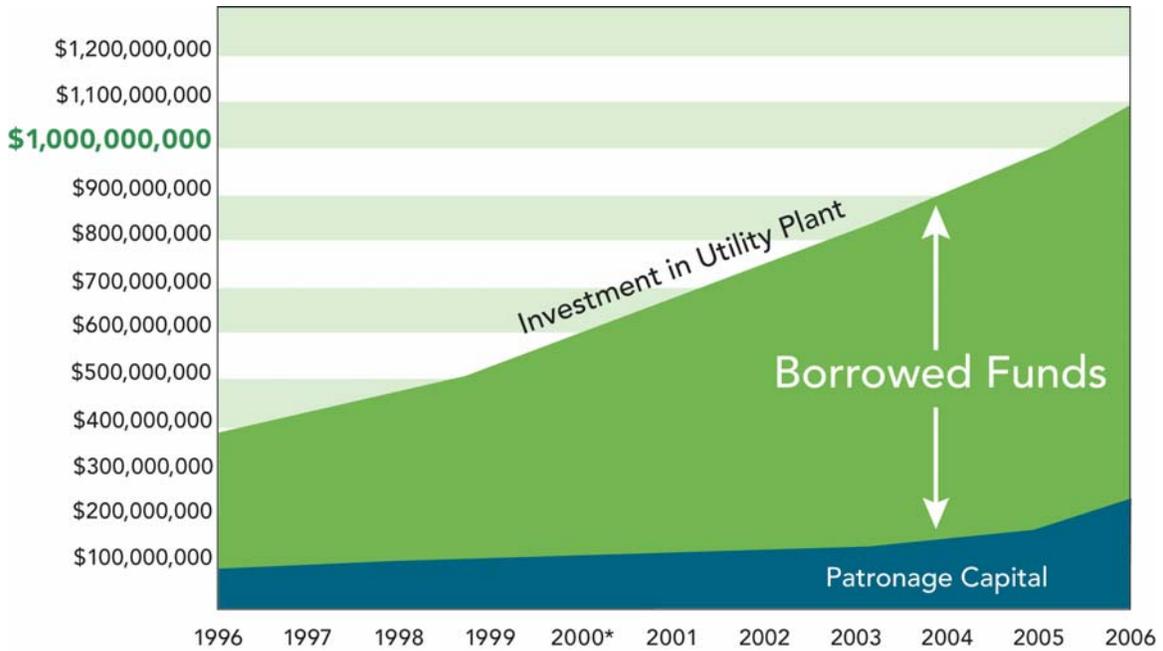
Although PEC has been through the turbulent times, we have made dramatic and long lasting changes. Even as we strive to adhere to these new policies of openness and transparency, we will also strive to be a national model for the principles which the cooperative was originally formed. We will continue to strengthen our relationships with our members, elected officials, and other interested parties. We will hold ourselves accountable to the new standards our members have set because they are the reason PEC exists. As member-owners, they have the right to a voice in the process and we have a sacred obligation to ensure that their voice is being heard and acted upon.

Appendix A  
Percentage of Member Equity to Utility Plant



This chart was created from PEC's Audited Financials. It shows the percentage of member equity changing each year from 1997 through 2006.

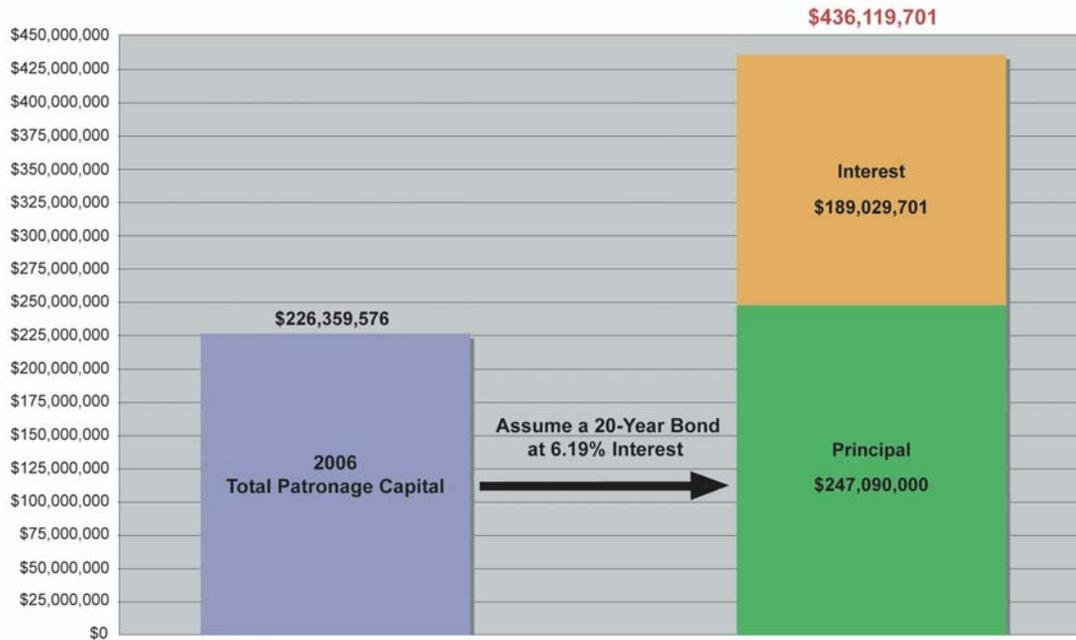
Appendix B  
Total Plant Additions Greatly Surpass Patronage Capital



This chart, created using PEC's Audited Financials from 1996 through 2006, illustrates PEC's investment in utility plant. Because PEC's territory covers some of the fastest-growing areas in the state, we must borrow large amounts to meet the demands of new construction, while maintaining the lines and equipment of our existing system.

Reinvesting patronage capital makes it possible for us to borrow less, which enables us to keep our rates lower and keeps interest payments down.

Appendix C  
Financing of Capital Credits Payout



This chart is based on 2006 PEC Audited Financials and internal documents. It illustrates the funds that may need to be borrowed and the interest that would be paid if all patronage capital were distributed paid to members at one time.