

Reform at the Pedernales Electric Co-op (PEC).
Statement By Carlos Higgins PEC Member Since 1974
June 26, 2008

Chairman Waxman and Committee Members:

I am Carlos Higgins and my message is threefold:

1. The member-owners of the PEC now know that trusting their former General Manager and Board of Directors to do the right thing was a big mistake. The extent of the abuse of that trust by the Manager and Board is not yet known.
2. It took an expensive class-action lawsuit to let us know we had serious problems in our co-op, and to get us on the road to making the needed corrections.
3. Corrective and preventive measures for our co-ops and for other co-ops can be instituted fairly easily, by simply ensuring that co-op owners have the tools they need to rein in wayward managers and non-responsive Boards. A change in co-op bylaws will provide the needed tools. We need to elect responsible, responsive Board members, but the right tools are little more than the inclusion of a few basic provisions in the co-op bylaws.

1. **Abuse of Trust.** The majority of the known excesses may be attributed to a general manager who grew so powerful that he was able to handpick complacent and compliant Board members, who

- Ignored their fiduciary obligations to the co-op owners, or
- Failed to grasp that they, as Board members, were not the general manager's employees or Amen Chorus, and
- Were quick to accept or grant to themselves lucrative compensation and perks, but offered little to no oversight of the co-op's management and financial affairs.

The PEC member/owners typically lead busy lives and trusted in their co-op general manager and Board members to act in the best interests of the membership in conducting the affairs of the PEC. My wife and I have been PEC members for 34 years. We've been completely satisfied with the service. The Company itself has continued to deliver reliable electric service at reasonable rates, so we were like the majority of the owners – we had no compelling reason to probe into other aspects of the co-op's operations. By reading their bios, Board members seemed to be among the pillars of their communities, so trusting them to act fairly and responsibly seemed to be the reasonable thing to do. We were wrong.

A small group of owners had occasion to interact with the co-op leadership. When they were pretty much dismissed as intruders, their determination and persistence before long exposed serious problems at the co-op. Our co-op leaders were taking advantage of our trust in them. They were looking after their own interests instead of ours. They were feathering their own nests at our expense.

We do have a relative handful of members who take the attitude that we shouldn't make a big deal of this, because we are getting good service at good rates. It may be true that whatever the general manager and Board extracted for themselves in excessive compensation and perks may have impacted each PEC member very little on an individual basis, but that kind of almost criminal conduct cannot be condoned or excused. We naturally expect better when we put our trust in these seemingly model citizens. We may muster up some forgiveness, but this contemptible conduct should not be allowed to continue. Further, we do not yet really know the extent and cost of the excesses and self-dealing, so forgiveness is premature.

The previous general manager and the Board members are guilty of self-dealing excesses. That has been well documented. Whether they had any offsetting or redeeming value to the PEC membership is not apparent. To use one small example, a copy of the bonded indebtedness of the PEC is attached. How prudent is it to offer bonds at 8.5% for so many years, without refinancing them when much lower interest rates are available. (See the bond information set out below.) Does this look like anyone has been minding

the store? Also, take a look at the explanation for one part of the PEC's IRS form 990. More than \$13 million was allocated to Admin. Overhead expenses. The table below purports to explain how they arrived at the total of \$13, in miscellaneous expenses. To me, it raises more questions than it provides answers.

2. The Lawsuit and Settlement. The co-op has been operated as pretty much a closed-door enterprise, under the apparent philosophy that the co-op information and business was none of the business of its member/owners. A determined group of members repeatedly sought answers to several operational concerns during Board meetings, but their requests were consistently rejected. The former General Manager and the Board "stonewalled" members who asked for information. With no other meaningful or practical recourse available to them, this group of members successfully brought suit against the PEC and its leadership. These are the fruits of that lawsuit:

- Discovery in the lawsuit revealed ongoing excesses and misdeeds of the former manager and the Board.
- The spotlight of the media aroused us, the PEC membership, to the serious financial and leadership deficiencies within our co-op, and
- Significant reforms have been made and we are now moving toward responsible and responsive leadership for our electric co-op.

The direction we're going is well and good, but here's what's wrong with how we got to this point. Aside from being a huge distraction, the lawsuit is far too expensive. It's costing about \$4 million. And the proposed Settlement of that lawsuit can be most accurately described as awful (or worse) for PEC's member/owners. Only 3 of our members, who acted as plaintiffs in the lawsuit, had any input into the Settlement and only they were allowed by the Court to speak for all the rest of us. (223,000 members.) Well over 200 members took the time to strenuously object to it, but their objections have been brushed aside.

In the Settlement, we are generally required to forgive anyone and everyone and their attorneys for anything they may have done to us at the PEC, whether their deeds are known or unknown, and this forgiveness is specifically extended to any oral agreements that may have been made and any trusts which may have been set up to benefit friends or other chosen individuals. Our PEC may be obligated to pay far more in future years than the excesses we know about, but if the Settlement is finally approved, all will be forgiven. The Settlement is now being appealed. A copy of the Settlement is available to Committee members.

A few people attempt to defend the Settlement on the basis that it gives us some reforms at the PEC. It does not. The reforms stem from the lawsuit discovery and the glare of the media spotlight on the wrongdoing at the PEC. The media and those who brought the lawsuit deserve the credit and the praise for whatever reforms we have so far. These reforms are not necessarily permanent though, and I will address that shortcoming next.

3. Corrective and Preventive Measures. As I've pointed out, we are highly pleased with our co-op service and costs. We just hate for people to take advantage of our trust and take our hard-earned money for themselves without earning it. We have no reason to believe this is a widespread problem among co-ops across the U.S. Ours is probably an aberration. We don't particularly want our isolated problems to cause a lot of expense and heartburn to the memberships of other co-ops where the co-op model serves their needs very well. After all, the co-op model should serve the needs of its consumers very well, since the consumers are also the owners. That is a feature that is worth preserving and protecting.

So what is the solution? To zero in on the problem, you need to first identify the specific problem. I believe ours is this: We did not have the right tools or mechanism we needed to rein in a wayward general manager and a self-dealing Board that was otherwise asleep at the wheel. Our only workable solution was an expensive and awkward class-action lawsuit. What did we need? Bylaws that give the membership final authority over a few critical elements in the governance of the co-op owned by that membership. We had ZIP in terms of any authority. NONE. We could not use our Bylaws as an

enforcement tool, or a tool to change the rules to alter the conduct of the manager and Board, because ALL the power resided in the Board. And that's the way it is to this day. If the Board chose to do so, they could legally and quickly rescind all the recent reforms, including changing the election rules to revert to the old way of hand-picking candidates to preserve their self-perpetuating and exclusive control of the PEC. I maintain the Bylaws must be changed, and soon, to give ultimate control to the membership over certain matters.

Bylaws provisions giving control to the membership must be carefully drawn so that the members have a practical way to exercise appropriate control when they need to, without giving too much of an opportunity to small groups of members to stage a surprise coup and take the co-op in a direction not acceptable to a majority of the members. This kind of final authority and control by the membership should include the nature, number, removal and election of Board members, the necessity for transparency in the co-ops meetings and records, and opportunity for the members to amend their own bylaws. PEC bylaws currently offer none of this to the membership. I believe all co-ops should have these basic provisions in their bylaws and under the ultimate control of the co-op member/owners.

My recommendation is that this committee find a way to require all electric co-ops to incorporate these basic provisions in their bylaws, and then the co-op memberships can continue to control their own operations with no necessity for any added government regulations or oversight. That is the only preventive or corrective measure that is really needed.

I thank the Oversight Committee for inviting me and for allowing me to offer my comments and opinions. I'd just like to end with this thought. We are greatly impressed with our new General Manager, Juan Garza. We believe he will help bring to the PEC the kind of reform we need. He is very open and straightforward in his responses, but whatever problems we have at the PEC we do not in any way attribute to him. Importantly, for at least another year, he will continue to answer to a Board in which the majority of the members are those who were "in charge" and allowed our co-op to wander so far off course. He is therefore probably not the best person to ask questions that accuse or compromise those he will be working for for another year. Those questions should be reserved for the culprits who are to blame for us being here.

Respectfully,

Carlos Higgins

PEDERNALES ELECTRIC COOPERATIVE, INC.

Miscellaneous Admin Expense

STMT 4 - 2007 Form 990

Administrative & General:

Salaries & Wages	8,661,134
Office Supplies	1,787,173
Contract Services	5,776,368
Property Insurance	278,601
Property Insurance Capitalized	(78,259)
Injuries & Damage	1,535,186
Liability Insurance Capitalized	(392,464)
Employee Pension & Benefits	3,999,162
Health & Medical	4,370,552
Pension Plan Benefit	6,831,599
Other Retirement	611,386

Capitalized Employee Benefits	(4,249,609)
PUC Gross Receipts Assessment	748,047
Miscellaneous General Advertising	1,068,583
Miscellaneous General	765,181
Director Fees & Expenses	822,834
Central Files	55,274
Data Processing	2,970,518
Annual Meeting	500,582
Rent & Lease Expense	130,434
Maintenance-General	2,036,626
Postretirement Medical	4,293,417
Credit Card Clearing	8,207
Utility Voucher Clearing	10,294
Telephone Voucher Clearing	23,432
	42,564,258
Less recorded elsewhere on the 990:	
Legal	(2,780,084)
Accounting	(162,980)
Insurance, injuries, damage	(1,343,064)
Salaries and wages	(5,805,662)
Pension plan contributions	(1,219,798)
Employee benefits	(12,563,482)
Directors' fees and benefits	(2,789,875)
Supplies	(1,786,955)
PUC Gross Receipts assessment	(748,047)
Miscellaneous Admin Expense:	13,364,311

PEDERNALES ELECTRIC COOPERATIVE, INC. 74-0828412
FORM 990, PART IV - MORTGAGES AND OTHER NOTES PAYABLE

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LENDER: MULTIPLE BOND HOLDERS
ORIGINAL AMOUNT: 65,000,000.
INTEREST RATE: 0.085500
DATE OF NOTE: 01/18/1993
MATURITY DATE: 11/15/2020
REPAYMENT TERMS: 5/15 & 11/15 YRLY INT PYTS. PRIN PYTS BEG 11/15/17
SECURITY PROVIDED: LIEN ON ELECTRICAL SYSTEM EXCL. EXCEPTED PROPERTY
PURPOSE OF LOAN: REDEM REFUNDED BONDS, PAY LOC ADVANCE, CAP IMPROVE
BEGINNING BALANCE DUE 65,000,000.
ENDING BALANCE DUE 65,000,000.

LENDER: MULTIPLE BOND HOLDERS
ORIGINAL AMOUNT: 15,000,000.
INTEREST RATE: 0.085500
DATE OF NOTE: 01/18/1993
MATURITY DATE: 11/15/2016
REPAYMENT TERMS: 5/15 & 11/15 YRLY INT PYTS, PRIN PYTS BEG 11/15/15
SECURITY PROVIDED: LIEN ON ELECTRICAL SYSTEM EXCL. EXCEPTED PROPERTY
PURPOSE OF LOAN: REDEM REFUNDED BONDS, PAY LOC ADVANCE, CAP IMPROVE
BEGINNING BALANCE DUE 15,000,000.
ENDING BALANCE DUE 15,000,000.

LENDER: MULTIPLE BOND HOLDERS
ORIGINAL AMOUNT: 135,000,000.
INTEREST RATE: 0.075500
DATE OF NOTE: 08/31/1995
MATURITY DATE: 11/15/2015
REPAYMENT TERMS: 5/15 & 11/15 YRLY INT PYTS, PRIN PYTS BEG 11/15/96
SECURITY PROVIDED: LIEN ON ELECTRICAL SYSTEM EXCL. EXCEPTED PROPERTY
PURPOSE OF LOAN: REDEM. REFUNDED BONDS, PAY LOC ADVANCE, CAP IMPROV
BEGINNING BALANCE DUE 85,026,000.
ENDING BALANCE DUE 77,926,000.

PEDERNALES ELECTRIC COOPERATIVE, INC. 74-0828412
LENDER: MULTIPLE BOND HOLDERS
ORIGINAL AMOUNT: 81,600,000.
INTEREST RATE: 0.040930
DATE OF NOTE: 10/24/2002
MATURITY DATE: 11/15/2012
REPAYMENT TERMS: 5/15 & 11/15 YLY INT PYMTS PRI PYMTS BEG.11/15/03
SECURITY PROVIDED: LIEN ON ELECTRICAL SYS EXCL, EXCEPTED PROPERTY
PURPOSE OF LOAN: RETIRE L-T DEBT, PAY LOC ADVANCE, CAPITAL IMPROV
BEGINNING BALANCE DUE 53,845,000.
ENDING BALANCE DUE 45,755,000.

LENDER: MULTIPLE BOND HOLDERS
ORIGINAL AMOUNT: 128,900,000.
INTEREST RATE: 0.059520
DATE OF NOTE: 10/24/2002
MATURITY DATE: 11/15/2022
REPAYMENT TERMS: 5/15/ & 11/15 YRLY INT PYMTS, PRIN. PYMTS 11/15/13
SECURITY PROVIDED: LIEN ON ELECTRICAL SYS EXCL, EXCEPTED PROPERTY
PURPOSE OF LOAN: RETIRE L-T DEBT, PAY LOC ADVANCE, CAPITAL IMPROV.
BEGINNING BALANCE DUE 128,900,000.
ENDING BALANCE DUE 128,900,000.

LENDER: MULTIPLE BOND HOLDERS
ORIGINAL AMOUNT: 239,500,000.
INTEREST RATE: 0.062020
DATE OF NOTE: 10/24/2002
MATURITY DATE: 11/15/2032
REPAYMENT TERMS: 5/15 & 11/15 YRLY INT. PYMTS, PRIN. PYMTS 11/15/23
SECURITY PROVIDED: LIEN ON ELECTRICAL SYS EXCEL, EXCEPTED PROPERTY
PURPOSE OF LOAN: RETIRE L-T DEBT, PAY LOC ADVANCE, CAPITAL IMPROV.
BEGINNING BALANCE DUE 239,500,000.
ENDING BALANCE DUE 239,500,000.