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GOVERNANCE AND FINANCIAL ACCOUNTABILITY OF RURAL ELECTRIC COOPERATIVES: THE PEDERNALES EXPERIENCE

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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CONTENTS

	Page
Hearing held on June 26, 2008	1
Statement of:	
English, Glenn, CEO, National Rural Electric Cooperative Association	122
Fraser, Troy, Chair, Business and Commerce Committee, Texas Senate; Patrick Rose, Texas House of Representatives; John Watson, member of Pedernales Electric Cooperative; Carlos Higgins, member of Pedernales Electric Cooperative; and Juan Garza, current general manager of Pedernales Electric Cooperative	69
Fraser, Troy	69
Garza, Juan	95
Higgins, Carlos	88
Rose, Patrick	78
Watson, John	84
Letters, statements, etc., submitted for the record by:	
Braley, Hon. Bruce, a Representative in Congress from the State of Iowa, prepared statement of	172
Cooper, Hon. Jim, a Representative in Congress from the State of Tennessee, prepared statement of	57
Davis, Hon. Tom, a Representative in Congress from the State of Virginia, prepared statement of	62
English, Glenn, CEO, National Rural Electric Cooperative Association, prepared statement of	125
Fraser, Troy, Chair, Business and Commerce Committee, Texas Senate, prepared statement of	72
Garza, Juan, current general manager of Pedernales Electric Cooperative, prepared statement of	97
Higgins, Carlos, member of Pedernales Electric Cooperative, prepared statement of	90
Rose, Patrick, Texas House of Representatives, prepared statement of	80
Sali, Hon. Bill, a Representative in Congress from the State of Idaho, prepared statement of	51
Souder, Hon. Mark E., a Representative in Congress from the State of Indiana, prepared statement of	174
Watson, John, member of Pedernales Electric Cooperative, prepared statement of	86
Waxman, Chairman Henry A., a Representative in Congress from the State of California:	
Information concerning a policy essay	3
Prepared statement of	45

GOVERNANCE AND FINANCIAL ACCOUNTABILITY OF RURAL ELECTRIC COOPERATIVES: THE PEDERNALES EXPERIENCE

THURSDAY, JUNE 26, 2008

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10:12 a.m. in room 2154, Rayburn House Office Building, Hon. Henry A. Waxman (chairman of the committee) presiding.

Present: Representatives Waxman, Towns, Cummings, Kucinich, Clay, Watson, Braley, Cooper, Sarbanes, Welch, Davis of Virginia, Burton, Souder, Duncan, Issa, Marchant, Westmoreland, Foxx, Sali, and Jordan.

Staff present: Phil Schiliro, chief of staff; Phil Barnett, staff director and chief counsel; Karen Lightfoot, communications director and senior policy advisor; Greg Dotson, chief environmental counsel; David Rapallo, chief investigative counsel; John Wiliams, deputy chief investigative counsel; Brian Cohen, senior investigator and policy advisor; Jeff Baran, counsel; Gilad Wilkenfeld, investigator; Caren Auchman and Ella Hoffman, press assistants; Leneal Scott, information systems manager; Rob Cobbs and Miriam Edelman, staff assistants; Lawrence Halloran, minority staff director; Jennifer Safavian, minority chief counsel for oversight and investigations; Keith Ausbrook, minority general counsel; Ali Ahmad, minority deputy press secretary; Larry Brady, minority senior investigator and policy advisor; Alex Cooper and Adam Fromm, minority professional staff members; Mary Pauline Jones, minority staff assistant; Patrick Lyden, minority parliamentarian and member services coordinator; and Brian McNicoll, minority communications director.

Chairman WAXMAN. The committee will come to order.

Today's hearing focuses on an important issue that has received little attention: electric cooperatives and the billions of dollars they control.

Electric cooperatives are unique structures that provide electricity to millions of customers in rural and suburban areas. They are nonprofit utilities that are owned by their customers, and at least in theory are supposed to be democratically controlled. Nationwide there are 930 co-ops serving over 17 million customers.

What isn't widely known is that these co-ops control over $30 billion in customers' equity. In many cases, even the consumers don't

realize it is their equity and don't know how the co-ops are spending their money.

I want to thank my colleague and friend, Jim Cooper, for bringing this issue to the committee's attention. It is exactly the kind of issue the oversight committee should be looking at, and from what we have already found this is an area in strong need of accountability. In fact, two of the witnesses we wanted for this hearing have refused to attend. They declined to appear voluntarily, and they have evaded Federal Marshals who tried to serve them with subpoenas. The Federal Marshals believe one of the witnesses is now hiding in a remote New Mexico ranch.

These two witnesses essentially ran the Pedernales Electric Cooperative in the Texas Hill country. This co-op has a proud history, having been created in 1938 by a young Congressman by the name of Lyndon Johnson. It is now the largest co-op in the United States.

But Benny Fuelberg, the former Pedernales general manager, and Bud Burnett, the former Pedernales president, aren't reflecting the co-op's proud history by refusing to explain their apparent self-dealings.

There is compelling evidence that the Pedernales Co-op used its customers' private equity as a private piggy bank. Mr. Fuelberg, Mr. Burnett, and the Pedernales board paid themselves well. In 2007 Mr. Fuelberg received over $1 million in salary, benefits, and bonuses. In just 5 years Mr. Fuelberg and the board spent $700,000 to stay in five-star hotels like the Ritz Carlton and Four Seasons, dine at expensive restaurants, and buy themselves fancy chocolates and Celine Dion concert tickets. They also spent millions of dollars in an unsuccessful legal battle against their own customers.

We will learn more about all of this from our witnesses, which include Pedernales Co-op members, two members of the Texas Legislature, and the newly hired general manager of Pedernales. But the questions about the potential abuses of co-ops aren't limited to the Pedernales Co-op, and that brings us back to the $30 billion in customer equity I mentioned a few moments ago.

The Pedernales experience tells us we need to examine whether co-ops are being run in a truly democratic fashion, and we need to take a close look at whether there are adequate financial protections for the investments customers have in these entities.

The 17 million co-op customers' equity investments are worth an average of $2,000 apiece, but there appears to be little transparency and accountability for how co-ops use these funds.

I know co-ops have done a tremendous amount of good for millions of Americans, and I know it is unfair to suggest the potential wrongdoing at the Pedernales Co-op is typical for all co-ops. Congressman Cooper has done a real service by setting the right balance for these issues in a recent article in the Harvard Journal on Legislation, and I ask unanimous consent to include it in the hearing record. Without objection, that will be the order.

[The information referred to follows:]

POLICY ESSAY

ELECTRIC CO-OPERATIVES: FROM NEW DEAL TO BAD DEAL?

REPRESENTATIVE JIM COOPER*

Most people who live or work in rural America must buy their electricity from their local co-operative, a unique and largely unregulated type of utility. Electric co-ops are owned by their customers who are called "members." This Policy Essay by Congressman Jim Cooper focuses on the primary obligation electric co-ops owe their members: "at-cost" service, i.e., the lowest feasible electric bills. To meet this obligation co-ops must provide low electric rates and timely return of equity. They must also reduce the quantity of unneeded electricity purchased. This Essay demonstrates that most distribution co-ops have a financial incentive to sell more electricity, not less. It also shows that co-ops have sought to conceal information from their members—information to which owners are entitled in other business contexts.

America's 930 electric co-operatives[1] are the sole source of electricity for homes, farms, and businesses for parts of 47 states.[2] Although 66 co-ops also generate and transmit wholesale electricity ("G&Ts"), the 864 distribution co-ops ("co-ops") simply resell and deliver electricity to retail customers across the crucial "last mile"[3] between the national electric power grid and the co-op members that ultimately use that electricity. Nationwide electrification is considered by engineers to be the greatest accomplishment of the twentieth century.[4] It is hard to imagine life without it.[5]

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* Member, House of Representatives (D-Tenn.). B.A., University of North Carolina at Chapel Hill, 1975; B.A., Oxford University, 1977; J.D., Harvard Law School, 1980. Representative Cooper is in his third term as U.S. Representative from the 5th Congressional District of Tennessee and represents customers of two electric co-operatives. The author would like to thank James Leuschen, Tyler Allard, and Cicely Simpson for their research assistance, and Lauren Azar, Luke Froeb, and Ted Stroll for their useful comments.

[1] *See* National Rural Electric Co-operative Association (NRECA), Co-ops by the Numbers, [hereinafter Co-ops by the Numbers] http://www.nreca.org/AboutUs/Co-op101/CooperativeFacts.htm (last visited Mar. 21, 2008).

[2] Massachusetts, Connecticut, and Rhode Island are the only three states without co-ops. *Id.*

[3] This term from the telecommunications industry refers to the connection between the cable, trunk, or optic fiber lines, and homes and businesses. This connection may be a few feet or a few miles. *Cf.* TOM STANDAGE, THE VICTORIAN INTERNET 206 (1999).

[4] *See* PHILLIP F. SCHEWE, THE GRID: A JOURNEY THROUGH THE HEART OF OUR ELECTRIFIED WORLD 1 (2007) ("Taken in its entirety, the grid is a machine, the most complex machine ever made. The National Academy of Engineering called it the greatest engineering accomplishment of the 20th century. It represents the largest industrial investment in history.").

[5] Memphis Light, Gas, & Water Div. v. Craft, 436 U.S. 1, 18 (1978) ("[U]tility service is a necessity of modern life; indeed, the discontinuance of water or heating for even short periods of time may threaten health or safety.").

FIGURE 1: MAP OF ELECTRIC CO-OP SERVICE AREAS[6]

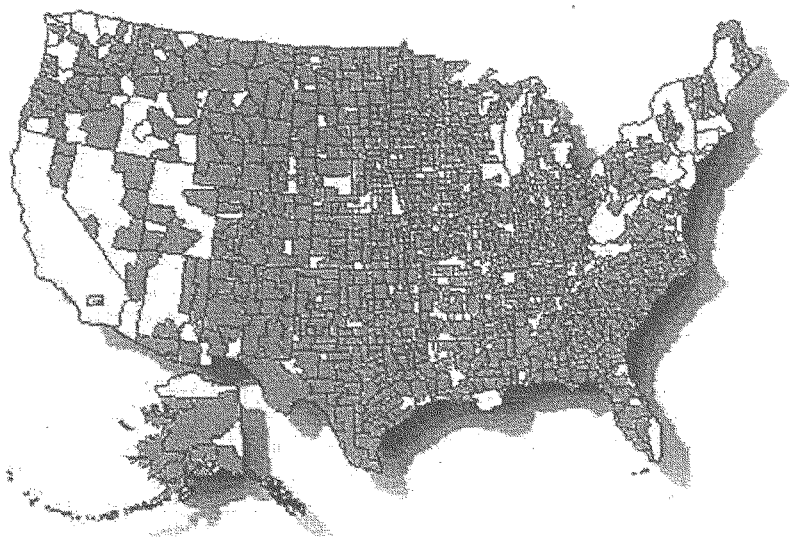

Figure 1 Note: The shaded areas of the map are served exclusively by electric co-ops.

Despite reaching 75% of the nation's land area, co-ops serve only 5% of the population, or 17 million customers.[7] Most co-ops operate in a few rural counties where customers live far apart,[8] although an increasing number of co-ops serve populous suburbs. The median co-op has 12,000 customers.[9] Regardless of size, co-ops strive to deliver reliable, standardized electricity[10] and to quickly restore service after storms, fires, and floods. Maintaining a network of 2.4 million miles of power lines and utility poles is hard work.[11] Virtually every pole also carries the telephone lines and television cables of unaffiliated telephone co-operatives[12] or for-profit telecommunications companies.

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[6] Co-ops by the Numbers, *supra* note 1.

[7] It is surprising that even as recently as thirty years ago, only half the nation's farmers were served by electric co-ops. This is partly due to the gradual expansion of private and municipal power companies into rural areas, and partly due to the decline in numbers of farms. RICHARD B. HEFLEBOWER, CO-OPERATIVES AND MUTUALS IN THE MARKET SYSTEM 131–32 (1980).

[8] Average co-op customer density is seven per mile, versus densities of thirty-five to forty-seven for other types of distributors. *See* Co-ops by the Numbers, *supra* note 1.

[9] *Id.*

[10] The U.S. standard for retail electricity is 120 volts, 60 Hertz, with near 100% reliability. World Electric Guide, http://www.kropla.com/electric2.htm (last visited Apr. 13, 2008).

[11] This number represents roughly half of the miles of electric lines in the U.S. *See* Co-ops by the Numbers, *supra* note 1.

[12] There were at least 227 rural telephone co-ops in 1998. *See* RURAL UTILITIES SERVICE, USDA, PUB. NO. 300-4 STATISTICAL REPORT: RURAL TELECOMMUNICATIONS BORROWERS 3 (1998).

Electric co-ops are owned by their customers, who are called "members" of the co-op due to their dual role as customer/owner.[13] The mission of co-ops is to provide access to electricity at affordable prices for every potential member in their service area, no matter how remote.[14] Co-op prices for electricity are set at the average cost of serving all residential or business customers regardless of the individual or marginal cost of service.[15] Providing service to non-members and selling commodities other than electricity to members are limited by law,[16] although co-ops find ways around the restrictions.[17]

People who live in U.S. cities or towns usually buy their electricity from either a municipally-owned power company ("muni") or a for-profit company ("investor-owned utility" or "IOU"). IOUs are much larger than co-ops; munis vary from large to extremely small based on the size of their

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[13] *See* PUBLIC UTILITIES REPORTS, INC., ELECTRIC COOPERATIVES: ON THE THRESHOLD OF A NEW ERA 6 (1996) [hereinafter PUBLIC UTILITIES REPORTS].

[14] *See* PATRICIA LLOYD WILLIAMS, THE CFC STORY: HOW AMERICA'S RURAL ELECTRIC CO-OPERATIVES INTRODUCED WALL STREET TO MAIN STREET 16 (1995) ("[A]rea coverage [is the] the concept that any customer in an area served by a rural electric system should be able to receive service at the same cost and under the same terms and conditions as all other consumers.").

[15] This is sometimes called the "postage stamp rate" because it does not vary with distance. The rate is expressed in pennies per kilowatt-hour. *See* PUBLIC UTILITIES REPORTS, *supra* note 13, at 27. Co-ops may set different rates for different classes of service, however, so co-ops usually distinguish between residential, commercial, and industrial loads. Some co-ops add classes of service in an effort to recover their marginal cost of service, contrary to co-op principles.

[16] Co-ops risk losing their tax-exempt status if they venture too far beyond their legal purpose. The primary test for co-op tax exempt status is the "like organization" test of section 501(c)(12) of the Internal Revenue Code: "Benevolent life insurance associations of a purely local character, mutual ditch and irrigation companies, mutual or cooperative telephone companies, or *like organizations*" are exempt from federal income taxation. I.R.C. § 501(c)(12) (2006) (emphasis added). An electric co-op is a "like organization" if it receives eighty-five percent or more of its revenues by selling electricity to members on a co-operative basis. Income that does not meet the "like organization" test is called "unrelated business income" and is limited to less than 15% of co-op revenues. Rev. Rul. 67-265, 1967-2 C.B. 205. *See also* Buckeye Power, Inc. v. U.S., 38 Fed. Cl. 154, 158 (1997); BURTON A. WEISBROD; TO PROFIT OR NOT TO PROFIT: THE COMMERCIAL TRANSFORMATION OF THE NON-PROFIT SECTOR 83–104 (1998).

[17] "In 2003, 93.5% of distribution cooperatives responding [to a survey] offer, or own businesses that offer, one or more services in addition to basic electric energy." NATIONAL RURAL ELECTRIC CO-OPERATIVE ASSOCIATION [NRECA] & NATIONAL RURAL UTILITIES CO-OPERATIVE FINANCE CORPORATION (CFC), CAPITAL CREDITS TASK FORCE REPORT 30 (2005) [hereinafter NRECA & CFC, TASK FORCE REPORT] (copy on file with author).

An example of co-op attempts to weaken the "like organization" test includes gaining approval to sell propane through a subsidiary although direct sales of truck-delivered propane by the co-op violate the "like organization" test. Rev. Rul. 2002-54, 2002-2 C.B. 527 (overturning prior letter rulings and banning direct propane sales by truck) and Rev. Rul. 2002-55, 2002-2 C.B. 529 (allowing co-ops to count only dividends and interest income on loans paid by subsidiaries in any line of business to count as non-member income). According to NRECA, "Rev. Rul. 2002-55 thus provides a clear means for 501(c)(12) electric co-ops to diversify into propane sales – via establishment of a subsidiary, without jeopardizing their tax-exempt status." RUSS WASSON, THE ISSUES REPORT OF THE NRECA ENERGY POLICY DEPARTMENT AND ENVIRONMENTAL UNIT, TAX, 5 (Undated).

city or town.[18] Both IOUs and munis have more flexible financial structures than co-ops[19] but usually do not compete with co-ops for customers[20] because each type of distributor has, except in rare circumstances,[21] a monopoly in its service area.

Electric co-ops have a much smaller industry share than munis or IOUs, but they still control $100 billion in assets and $31 billion in member equity.[22] Because so few members are aware of their ownership, this $31 billion may be among the largest "lost" pools of capital in America. Unlike direct shareholders of IOUs who have chosen to purchase shares in a power company, or taxpayers who automatically subsidize their city's muni, co-op members have unknowingly obtained legal title to co-op equity.[23] Unfortunately, however, most co-op members have none of the normal perquisites of ownership.

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[18] The nation's 220 IOUs have combined assets of $700 billion, and the 2000 munis have assets of $200 billion. IOUs serve an average of thirty-five customers per mile, munis serve forty-seven per mile, and co-ops average only seven customers per mile. *See* Co-ops by the Numbers, *supra* note 1.

[19] IOUs are owned by investors or shareholders of the for-profit power company, and munis are owned by the taxpayers of the municipality. IOUs and munis have more equity capital sources than co-ops, which can only receive equity from their own members. *See* PUBLIC UTILITIES REPORTS, *supra* note 13, at 8.

[20] In the early days of electrification, when they did compete with co-ops, munis and IOUs usually only wanted to serve the largest co-op customers, not the entire co-op service area. *See* WILLIAMS, *supra* note 14, at 16 ("Territorial protection was an equally important objective, because efforts by private power companies and municipalities to take over populated areas and the more attractive rural loads threatened the ability of many co-operatives to meet area coverage goals at reasonable rates.").

[21] Municipal annexation of co-op territory is the primary source of conflict between types of distributors because many cities have grown into once-rural areas that were already served by co-ops. Extending muni electric service along with other city services such as water and sewer is a natural desire of city officials, but is fiercely resisted by co-ops that welcome greater customer density.

[22] Co-ops by the Numbers, *supra* note 1.

[23] Although members' rights to receive co-op equity do not vest until actual retirement and receipt of the capital credit's value in cash, the right to eventually receive the credit matures upon allocation of the credit on the books of the co-op. Even prior to allocation, the co-op is obligated to assign credits to members according to usage. Therefore, although credits are technically not in the member's name until retirement, there is no other legal claimant for the credits. See NATIONAL RURAL ELECTRIC CO-OPERATIVE ASSOCIATION AND NATIONAL RURAL UTILITIES CO-OPERATIVE FINANCE CORPORATION (CFC), CAPITAL CREDITS TASK FORCE REPORT 12 (legal supp. 2005) [hereinafter NRECA & CFC, LEGAL SUPPLEMENT] (on file with author).

This article focuses on the primary obligation[24] that electric co-ops owe their members: "at-cost" service, i.e., the lowest feasible electric bills.[25] For distribution co-ops, this means both low electric rates and timely return of equity.[26] Today it also means reducing electricity waste—the quantity of unneeded electricity purchased—an unimaginable problem in the early days of co-ops. There is not enough data to tell whether most of today's co-ops offer these benefits. However, this essay will demonstrate that most distribution co-ops have a financial incentive to sell more electricity, not less. It will also show that co-ops have tried to hide information from their members—information to which owners are entitled in other business contexts. Free of member scrutiny, co-op managers have often failed to serve their members' interests.

The trade association and lobbying arm of co-ops, the National Rural Electric Co-operative Association ("NRECA"), seems to be aware of many of these problems but has difficulties persuading its own membership of their importance. For example, NRECA has long admitted that many small co-ops maintain electricity rates at artificially high levels by not merging with other co-ops.[27] The NRECA has acknowledged that average co-op electric rates are 9% higher than neighboring IOUs,[28] but this average disparity does not reveal the larger disparities that exist in some areas. An estimated 350 co-ops charge at least 15% more than the closest IOU while another 175 co-ops have rates 30% higher.[29] These higher rates harm ratepayers so that small co-op managers can remain employed while members are paying more

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[24] *See, e.g.*, Glenn English, CEO, NRECA, Remarks at the NRECA Annual Meeting 2 (Mar. 20, 2007)(on file with author) ("Basically, it's to keep the lights on and the rates down. Our success or failure will be judged on how we do this job."); *See* National Rural Electric Co-operative Association (NRECA), Electric Consumer Bill of Rights [hereinafter Electric Bill of Rights], http://nreca.org/AboutUs/Co-op101/ElectricConsumerBillofRights.htm (last visited Apr. 11, 2008) ("Consumers have a right to expect reliable, affordable, and safe electric power. Consumers have a right to expect uniform standards of electric power across the country as they travel or move.").

[25] *See* NRECA & CFC, LEGAL SUPPLEMENT, *supra* note 23, at 4 (Operating at cost is "a fundamental requirement to become and remain a "co-operative" under federal tax law and a basic requirement under most electric co-operative acts."). At-cost power has not always been the top priority of co-op managers. A 1968 survey "ranked providing reliable service as the most important of five service issues and providing dependable power supply on reasonable terms second. Low retail rates were ranked as the least important." WILLIAMS, *supra* note 14, at 31. Just as electric rates that are above cost can jeopardize co-op status, so can rates below cost because such rates are subsidized with other sources of income. WASSON, *supra* note 17, at 5-6.

[26] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 7 ("Every electric co-operative should have a policy for annually allocating capital credits, and, subject to the board of directors' discretion and the co-operative's financial condition, annually retiring capital credits.").

[27] The NRECA's chief economist has urged co-ops to merge for many years with little success. The number of co-ops has remained relatively constant. Jim Roberts, *Things are different now*, *in* A FRAMEWORK FOR CHANGE 34 (Glenn English ed., 1996) [hereinafter FRAMEWORK].

[28] Id. at 26.

[29] *Id.*

than is necessary.[30] When co-op members receive a buyout offer from a neighboring IOU this conflict between the interests of members and managers becomes stark. As NRECA admits, "When faced with the tempting offer of a $1,000 check and a 20% reduction in electric rates, consumers naturally weigh that against the value of belonging to a co-operative."[31] Instead of merging and lowering rates, however, most co-ops have used member equity to fund anti-takeover efforts.[32]

Co-ops in some regions of the country have been doing a particularly poor job of protecting member interests. Contrary to national co-op policy,[33] Tennessee Valley Authority ("TVA")[34] co-ops have refused to refund any member equity.[35] A series of TVA Inspector General Reports concluded that dozens of distributors—both co-ops and munis—were guilty of mistreating their customers twice: first by maintaining excess reserves and then by raising electricity rates unnecessarily.[36] TVA distributors had the political clout to get the first report suppressed and the names of any offending distributors removed from both.[37] In addition, although TVA itself has sporadically pro-

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[30] A co-op manager is not only the top official and highest paid co-op employee, but also the most likely to lose his or her job after a merger, because a larger co-op still only needs one top manager.

[31] FRAMEWORK, *supra* note 27, at 28. This example mirrors a buyout offer by Mississippi Power Company of Coast Electric Power Association. The offer included a 10% reduction in rates and $1,700 for each member. *See*, WILLIAMS, *supra* note 14, at 213.

[32] From 1985 to 1995, co-ops thwarted 105 takeover attempts and territorial disputes using a fund coordinated by NRECA and CFC. *See* WILLIAMS, *supra* note 14, at 214–15 ("Of the 510 member systems responding to a CFC survey, 326 indicated a willingness to contribute 5 percent of their patronage capital to the fund. Most of the respondents agreed that establishing the fund was an appropriate rural electric objective.").

[33] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 13 n.1.

[34] The TVA was established by Congress in 1933 to improve navigation, prevent flooding, promote development, and provide electricity in rural areas. *See* Tennessee Valley Authority Act, 16 U.S.C. § 831 (2006).

[35] TVA co-ops cite an obscure paragraph in an early power purchasing contract that requires distributors to reduce electric rates instead of refunding capital credits. *See* Wesley M. Jackson, Assistant Chief – Distributor Marketing Branch, TVA, Testimony to Capital Credits Study Committee, Oct. 1, 1974, at 1 (on file with author); McCarthy v. Middle Tenn. Elec. Membership Corp., 466 F.3d 399 (6th Cir. 2006); Naomi Snyder, *Should Electric Co-ops Give Customers a Refund?*, THE (NASHVILLE) TENNESSEAN, Apr. 11, 2004, at 1A [hereinafter Snyder] (quoting Mike Bash, the CFO of the Minnesota electric co-op Connexus Energy, calling TVA co-op practice "obscene and inappropriate").

[36] *See* OFFICE OF THE INSPECTOR GEN., TENN. VALLEY AUTH., REVIEW OF TVA'S ROLE AS A RATE REGULATOR (2006) (Inspection No. 2005-5221). *See also* OFFICE OF THE INSPECTOR GEN., TENN. VALLEY AUTH., DISTRIBUTORS' SURPLUS CASH AND INVESTMENTS (1994) (Audit No. 92-0540).

[37] *See* Memorandum by William L. Hinshaw, II, Inspector General, Tenn. Valley Auth. 1 (Dec. 1, 1992) (Office of the Inspector Gen. File No. 92-0540) ("We recognized that our . . . 'final report,' would cause problems . . . ; therefore, we elected to not identify the distributors by name, but rather by number . . . . [W]e also recognized the fact that this information could not be withheld under FOIA [Freedom of Information Act], or for that matter from an inquiring Congress . . . . After discussing the audit with the Chairman [of TVA] . . . I decided it would be in TVA's best interest to reclassify the report as a draft. By doing so, it would preclude shrill media attention focused on one issue—cash position—and this would obscure more comprehensive efforts which are currently underway to deal with this complex issue."). *See also, e.g.*, OFFICE OF THE INSPECTOR GEN., TENN. VALLEY AUTH., REVIEW OF TVA'S ROLE

moted energy conservation,[38] most TVA co-ops have been unenthusiastic about educating ratepayers about ways to reduce their electric bills.[39] After seventy years of public power at both the wholesale and retail level, Tennessee leads the nation in per capita residential electricity consumption.[40]

There is anecdotal evidence of co-op abuse in other parts of the United States. An Alabama co-op failed to hold elections for board members for 38 years.[41] A suburban Atlanta co-op turned over its entire operation to a for-profit subsidiary that diversified into "pest control, mortgages, consulting, a customer call center, staffing, security systems, natural gas and another co-op in South Carolina."[42] A suburban Fort Worth co-op borrowed a billion dollars to buy a golf course, Westin hotel, and shopping mall—then declared bankruptcy.[43] Another Texas co-op has paid its board chairman almost $200,000 a year despite his ignorance of basic co-op information.[44]

As embarrassing as these examples are, co-ops have even greater potential for mismanagement and self-dealing. Unclaimed millions of dollars of co-op equity can flood local banks, brokerages, and car dealerships[45], particularly when controlled by overlapping boards of directors. Employees can be

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AS A RATE REGULATOR, *supra* note 36, at 7 ("[T]he normal range for cash ratios is five to eight percent . . . . We . . . identified 50 distributors with cash ratios ranging from 12.5 percent to in excess of 50 percent . . . . Thirty-two of the 50 distributors had rate increases in FY 2006."). The offending distributors are never identified in the report.

[38] In 2002, the GAO reported that other public and private utilities had "gone further than TVA in implementing demand-side management programs" to reduce peak load demands and emissions. U.S. GEN. ACCOUNTING OFFICE, PUB. NO. 02-301, AIR QUALITY: TVA PLANS TO REDUCE AIR EMISSIONS FURTHER, BUT COULD DO MORE TO REDUCE POWER DEMAND 17 (2002).

[39] According to David Lilienthal, the chairman of the TVA in the 1940s, "[I]t was necessary for the TVA Board, at the very outset, to break sharply with the ways of fixing electricity rates that . . . had been followed by the electrical industry . . . . [The] [r]ates [provided] to the ultimate user were based on the principle that people wanted to use electricity not in a niggardly way, but generously and for many new uses . . . . This, we were convinced, would be financially sound, for people would then *use so much more electricity* that the income of distributors would rise proportionately." DAVID E. LILIENTHAL, TVA – DEMOCRACY ON THE MARCH 22–23 (1944) (emphasis added).

[40] *See* Energy Information Administration, State Energy Profiles, http://tonto.eia.doe.gov/state/index.cfm (last visited Apr. 4, 2008).

[41] *See* Margaret Newkirk, *Power to the People? Members Rebelled; Co-op Changed*, ATLANTA J.-CONST., Aug. 20, 2007, at A5.

[42] Margaret Newkirk, *From Co-op to Conglomerate*, ATLANTA J.-CONST., Aug. 19, 2007, at 1A, 3.

[43] *See* Steven Mufson, *Defaults Plague Little-Known Lender*, WASH. POST, Apr. 30, 2007, at D1.

[44] *See* Claudia Grisales, *Testimony Shows How Co-op Operates at Top*, AUSTIN AM.-STATESMAN, Dec. 9, 2007, at A1; Claudia Grisales, *General Manager is Firmly in Control, Co-op Workers* Say, AUSTIN AM.-STATESMAN, Dec. 9, 2007, at A8.

[45] *See* Roberta Aronson et al., *Governance and Accountability in Today's Business Climate: How Do Electric Co-operatives Measure Up?* MGMT. Q. at 2, 31 (2003) ("A conflict of interest can arise under a variety of scenarios . . . . [One] example is a situation in which the board is asked to approve a substantial purchase for fleet vehicles and one director is a close relative of the automotive dealer from which the co-op is considering purchasing its vehicles.").

paid while doing no work.[46] Managers can easily become more concerned with providing benefits to insiders than to ratepayers, especially if ratepayers are not looking.[47] Furthermore, co-op insiders have funded a major political action committee to promote their interests.[48]

While greater regulation could make this sort of misbehavior rare, co-ops are lightly regulated at both the federal[49] and state[50] level. Co-ops often deny that they are "utilities" in order to avoid regulation[51] and to lay claim to a broader mission.[52] State utility commissions usually do not set co-op rates but can settle disagreements about co-op service areas and other technical matters.[53]

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[46] *See* Claudia Grisales, *Pedernales Keeps Paying When Some Are Away from Job*, AUSTIN AM.-STATESMAN, Jan. 6, 2008, at A10.

[47] For example, the retiring General Manager of Pedernales Electric Co-operative, Bennie Fuelberg, obtained a $2 million deferred compensation package from the co-op without disclosing it to members of the co-op. Claudia Grisales, *Testimony Shows How Co-op Operates at Top*, AUSTIN AM.-STATESMAN, Dec. 9, 2007, at A1.

[48] NRECA's political action committee has contributed $1.4 million to federal and state politicians in recent election cycles. Steven Mufson, *Defaults Plague Little-Known Lender*, WASH. POST, Apr. 30, 2007, at D1. The Center for Responsive Politics ranks NRECA as the sixty-fifth largest donor in American politics from 1989 to 2006, with contributions of $9.9 million. *See* Alicia Malone, *Numbers Show Unions Favor Dems with Political Contributions*, TARGETED NEWS SERVICE., Oct. 4, 2007, at 3.

[49] The Federal Energy Regulatory Commission regulates transmission of electric power, not retail distribution by co-ops. "Under the Federal Power Act, for example, electric cooperatives with outstanding financing from Rural Utilities Service (RUS) are not subject to the full authority of the Federal Energy Regulatory Commission (FERC)." Jay Morrison et al., NRECA Legal Reporting Service, The Role of the Co-op Board as Regulator 2 (Mar. 2004) (unpublished editorial, on file with author). *See, e.g.*, City of Paris v. Federal Power Commission, 399 F.2d 983, 985 (D.C. Cir. 1968) ("REA-financed cooperatives as presently administered and financed are not government instrumentalities under Section 201(f) [of the Federal Power Act].").

The Securities and Exchange Commission does not regulate most co-ops despite the resemblance of capital credits to securities. *See* 15 U.S.C. §77b(1) (2006). For a determination of whether co-op membership interests are "investment contracts" or "certificate[s] of interest or participation in a profit-sharing agreement[,]" see United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851–52 (1975).

[50] NRECA claims that "[c]o-operatives in 43 states are subject to some form of state regulation, including 24 states that exercise some degree of statutory authority over rates." NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 61. A look at NRECA's own table summarizing state enabling acts, however, shows that this claim is exaggerated. *See* NRECA, State Regulation of Electric Co-ops Survey Compilations, (2007) (on file with author). An analysis of that table indicates that only 13 states allow regulation of co-op rates, and that only 7 of those states regulate co-op rates similarly to IOUs. For a history of how co-ops stopped or streamlined regulation in several states, see WILLIAMS, *supra* note 14, at 186–89.

[51] *See* ROGER D. COLTON, THE REGULATION OF RURAL ELECTRIC CO-OPERATIVES 19–25 (1993) (discussing the history of co-ops' exemption from state utility commission regulation, including the argument that co-ops are not utilities).

[52] WILLIAMS, *supra* note 14, at 201 ("Co-operatives were recognizing the fact that they weren't electric utilities. They were social organizations providing electric service . . . . Our job was to make sure we were giving them the tools that they would need to fulfill their social purpose."). In fact, the new bank that would finance much of the growth of the co-ops, the CFC, only received tax exempt status from the IRS due to its "social welfare purpose." *See id.* at 65.

[53] Only seven states (Arizona, Hawaii, Louisiana, Maine, Maryland, New York, and Vermont) allow full regulation of co-op rates. Six (Arkansas, Kentucky, Michigan, New Mexico,

The U.S. Department of Agriculture's Rural Utilities Service ("RUS")[54] has general oversight powers over co-ops that still borrow from it,[55] but it is more cheerleader than critic. RUS actively promotes co-ops by offering engineering, accounting, and marketing advice.[56] The RUS received $3.89 billion in annual appropriations in 2006, or an average of $4.3 million per co-op.[57] According to NRECA, this support is much less generous to co-ops than the federal tax code is to munis and IOUs,[58] but co-ops are no more willing to part with it. Additionally, the RUS even delegates governmental authority to co-ops to select worthy local projects for federal grants and interest-free loans.[59] Co-ops have often failed to use this grant-making authority to benefit their local populations. One study, for example, found that co-ops "used discretionary funds to invest in businesses located in urban areas and a variety of securities and commercial paper" instead of creating jobs in rural areas.[60]

As a lender to co-ops, the RUS offers direct and government-guaranteed 35-year loans at favorable interest rates,[61] although it no longer offers the 2% loans that were available for decades. Cumulatively, the RUS and its predecessor agencies have loaned $39 billion to distribution co-ops and $52

Virginia, and West Virginia) allow streamlined or less stringent regulation than faced by IOUs, and the rest of the states either make rate regulation optional to the co-op or disallow it entirely. *See* NRECA, State Regulation of Electric Co-ops Survey Compilations, (2007) (on file with author).

[54] Rural Electrification Act of 1936, 74 Pub. L. No. 605, 49 Stat. 1363 (1936) (codified as amended at 7 U.S.C. §§ 901–18 (2006)).

[55] The RUS conditions loans and loan renewals on adherence to loan agreements requiring minimum performance ratios for co-operatives. *See* 7 C.F.R. § 1718 app. A (2003).

[56] *See* USDA, Rural Development's Electric Programs, http://www.usda.gov/rus/electric/index.htm (last visited Apr. 8, 2007).

[57] Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, Pub L. No. 109-97, 119 Stat. 2142 (2006).

[58] The NRECA claims that munis received $909 million in federal subsidies in 2005, or $55 per customer, that IOUs received $3.3 billion, or $35 per customer, and that co-ops received $2 per customer. *See* National Rural Electric Co-operative Association, Issue Spotlight: Electric Industry Taxation, http://www.nreca.org/PublicPolicy/ElectricIndustry/Taxation.htm (last visited Oct. 25, 2007). If this argument is true, then it would make sense for co-ops to use their political clout to eliminate all distributor subsidies.

[59] The name of the program is USDA's Rural Economic Development Loan and Grant Program ("REDLG"). It has funneled $330 million for such projects through co-ops. *Examining the United States Department of Agriculture's Rural Development Programs: Hearing Before the Sen. Comm. on Agriculture, Nutrition and Forestry*, 109th Cong. 3–4 (2006) [hereinafter *Examining the USDA's Rural Development Programs*] (statement of Glenn English, CEO, NRECA) (citing co-ops' ability "to work in partnership with business and community leaders for all types of economic development projects—business incubators, medical and educational facilities, water systems, emergency vehicles, value-added agricultural processing, manufacturing sites, etc.").

[60] *See* INSPECTOR GEN., USDA, RURAL UTILITIES SERVICE ELECTRICAL GENERATION AND DISTRIBUTION BORROWER INVESTMENTS, at ii (2000) (Audit Report No. 09601-1-Te).

[61] *See* TADLOCK COWAN, CONG. RESEARCH SERV., AN OVERVIEW OF USDA RURAL DEVELOPMENT PROGRAMS 18–19 (2007) (discussing the three basic loan types: hardship, municipal, and Treasury). *See also* U.S. GEN. ACCOUNTING OFFICE, RURAL UTILITIES SERVICE: OPPORTUNITIES TO BETTER TARGET ASSISTANCE TO RURAL AREAS AND AVOID UNNECESSARY FINANCIAL RISK 6–9 (2004).

billion to G&Ts.[62] Defaults on these loans have been rare,[63] partly due to easy credit from RUS, but have still cost several billion dollars. Though NRECA estimates that RUS programs cost only $25 million annually, the federal government's contingent liability is large.[64]

The few teeth in RUS regulations are found in RUS loan covenants and its annual surveys of co-op financials, which restrain co-op spending and standardize co-op reporting.[65] Almost half of co-op financing today, however, comes from a private, not-for-profit, co-op-owned lender, the National Rural Utilities Co-operative Finance Corporation ("CFC").[66] Thus, CFC borrowers do not have to publicly disclose their financials, thereby reducing oversight of the industry.[67]

CFC has been more than a lender to co-ops. It offers management and technical assistance and has been a financial innovator by offering "the forerunner for . . . mortgage-backed securities."[68] CFC also enabled co-ops to target different messages to different audiences without seeming to be inconsistent or hypocritical.[69]

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[62] *See* RURAL UTILITIES SERVICE, USDA, INFORMATIONAL PUB. NO. 201-01, 2005 STATISTICAL REPORT: RURAL ELECTRIC BORROWERS 7 (2006) [hereinafter CO-OP STATISTICAL REPORT].

[63] *Id.* at 1 (noting that 9 borrowers have had loans foreclosed or settled by other means). The trend in foreclosures is very negative, however. From 1935 until 1980, only two co-ops required foreclosure, costing REA $37, 237. But in 1985, REA lost $486 million on the bankruptcy of a single G&T, Wabash Valley Power Association (Indiana). Other famous co-op problems of the period included Sunflower Electric Cooperative (Kansas), Deseret Cooperative (Utah), Soyland Power Cooperative (Illinois), Colorado-Ute Cooperative (Colorado), Illinois Valley Electric Cooperative (Illinois). See WILLIAMS, *supra* note 14, at 189, 215–40. From 1999 to 2003, RUS lost $3.2 billion on loans to just three borrowers. *See* GEN. ACCOUNTING OFFICE, *supra* note 61, at 8.

[64] *See Examining the USDA's Rural Development Programs*, *supra* note 59, at 3 (statement of Glenn English, CEO, NRECA) ("It is important to note that the RUS electric loan programs will cost federal taxpayers less than $25 million to help capitalize a rural electrical infrastructure that is the envy of the world.") *But see* U.S GEN. ACCOUNTING OFFICE, *supra* note 61, at 18–19 (noting that taxpayers faced a theoretical risk of loss of $3 billion in 2003, but that "in the event of default, likely maximum losses could be as much as $1.5 billion.").

[65] *See supra* note 55.

[66] *See Examining the USDA's Rural Development Programs*, *supra* note 59, at 3 (statement of Glenn English, CEO, NRECA). CFC could not have survived without a credential that is rare for a financial institution, a tax exemption from the IRS as a 501(c)(4) social welfare organization. *See* WILLIAMS, *supra* note 14, at 65. Also by 1984, the REA required all borrowers to have supplemental financings, such as from CFC. *Id.* at 159

[67] Co-ops' "financial and statistical operating reports are not generally matters of public record. If more details are needed, requests should be submitted directly to individual [RUS] borrowers." *See* CO-OP STATISTICAL REPORT, *supra* note 62, at 1. Of the 930 electric co-ops that belong to NRECA, only 607 were RUS borrowers in 2005, down from 612 in 2004. *Id.* at 9.

[68] WILLIAMS, *supra* note 14, at viii, 97.

[69] Id. at 269 ("NRECA might highlight the weaknesses in the program to gain support for continuing subsidized interest rates on REA loans, whereas CFC would highlight the strengths in marketing rural electric credit on Wall Street . . . We did not have a conflict in principle in supporting cooperatives, but sometimes we did have a conflict in approach.").

Co-ops continue to be largely free from regulation[70] due to political reluctance to interfere with what appear from the outside to be smoothly-running operations. Co-op members do not complain much, and politicians are afraid of angering co-op managers, directors and employees.[71] Co-ops are so influential inside their communities and keep such a low-profile outside that they are rarely in the news, except for occasional scandals.[72] Customer ownership is another reason for lack of scrutiny. In theory, electric co-ops are continually self-regulating,[73] just as agricultural co-operatives are.[74]

II. History of Electric Co-ops

Electric co-ops were created as one of President Franklin Roosevelt's New Deal programs in order to promote rural development.[75] When Roosevelt was elected in 1932, people living in cities had been enjoying the benefits of electricity for many years. Urban power companies were slow to reach out into the countryside, however, because of the high cost of wiring farms.[76] Frantic federal officials invented a new type of utility in 1935 to fill

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[70] *See supra* notes 50, 51, 53. *Cf.* Stephen J. Piecara & Janet Marchibroda, *Primer on Rural Electric Cooperatives*, Cooperative Acct., 13–16 (1994) (claiming that co-ops "operate in a highly regulated environment," but admitting that only seventeen states regulate co-op rates).

[71] *See, e.g.*, Williams, *supra* note 14, at 259 ("Our political strength will maintain REA for some of us, I am sure, for the foreseeable future.").

[72] *See supra* notes 41-48. *See also* Editorial, *Utility Didn't Want 'No' for an Answer*, St. Petersburg Times and Hernando Times, Nov. 20, 2007, at Hernando Section 2 ("Florida has endured its share of ridicule because of its voting system. But the election methods being used by the Withlacoochee River Electric Co-operative make the state's system look like it is state-of-the-art."). *See also* Williams, *supra* note 14, at 232 (Illinois Valley Electric Cooperative had "substandard quality of service and irate membership" with rates 80% higher than neighboring utilities).

[73] *See, e.g.*, Colton, *supra* note 51, at 20 ("There is no need for protecting the members of the co-operatives from themselves." (citing Virginia Merrills, *Rural Electrification Cooperatives*, 20 Tenn. L. Rev. 406, 406-407 (1948); Hamilton Treadway, *The Public Utility Status of Rural Electric Co-operatives in Illinois*, 40 Ill. L. Rev. 515, 526 (1946)); Electric Bill of Rights, *supra* note 24, ("As recognized by federal courts, since the consumer owns the co-operative, there is no motive for the co-operative to mislead, cheat, overcharge, or act in any way that is not in the consumer-owners' interests."). *See also* Morrison, *supra* note 49.

[74] *See* Katherine L. Hanson, USDA Co-operative Information Report No. 55, Co-operatives in Agribusiness 2 (2000).

[75] *See* Amity Shlaes, The Forgotten Man: A New History of the Great Depression 175 (2007) ("Roosevelt decided now that . . . the government would . . . begin to control power in new areas. He had four goals. The first was to provide electricity to homes and farms–many farms were still without. The second was to increase the use of electricity in all homes, providing Americans with a better standard of living. The third was to reduce the cost of electricity to the average consumer. And there was a fourth, more ephemeral goal: that through the electricity industry the New Deal might create a new and more prosperous form of society.").

[76] *See* Heflebower, *supra* note 7, at 132 ("[C]ompanies usually required that farmers, individually or along a road, pay as much as $2,000 per mile to cover the cost of additional distribution lines, an unusual practice now. Prior to 1940, few farmers could make such outlays and also pay for wiring homes and for appliances.").

the need.[77] Part government agency,[78] part agricultural co-operative,[79] and part not-for-profit company,[80] this curious hybrid was named for the most innocent-sounding of its three components: co-operative.[81]

The word co-operative has deep resonance for rural residents due to the perceived fairness of its organizational structure and its widespread use in agriculture.[82] The co-operative principles of "user-ownership, user-benefit, user-control, and limited returns to the co-op"[83] seem neighborly and safe. It is often assumed that electric co-ops follow all of these co-operative principles since they share the name.[84] The failure of the federal government to precisely define "co-operative" has added to the confusion.

Unfortunately, electric co-ops are not genuine co-operatives[85] because they are not voluntary associations of people with specific expertise in the co-operative venture.[86] Although co-op membership may have been voluntary during the Depression when electricity was an exciting novelty, today it is a daily necessity. Customers do not freely choose to join an electric co-op;

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[77] After private power companies failed to offer an adequate plan to electrify rural America, REA was flooded with loan applications from farm organizations. "REA staff was divided over the inexperienced co-ops' applications—most strongly against, but a few strongly for them. Cooke himself [the REA Administrator] was ambivalent . . . . By December, 1935, it was apparent that farm co-ops were going to the front as the primary borrowers under the REA program." THE NEXT GREATEST THING: 50 YEARS OF RURAL ELECTRIFICATION IN AMERICA 65 (Richard A. Pence ed., 1984).

[78] *See* WILLIAMS, *supra* note 14, at 5 ("When President Roosevelt established the REA, it was part of his overall program for unemployment relief."). The federal government allowed co-ops to borrow up to 100 percent of the cost of building distribution lines. When electricity could not be purchased at low enough prices, loans for generation capacity were provided as well. *See* HEFLEBOWER, *supra* note 7, at 132.

[79] Federal law does not define "co-operative," allowing advocates to mix elements from different statutes, and from the common law, to fit different situations. *See* JOHN A.C. HETHERINGTON, MUTUAL AND CO-OPERATIVE ENTERPRISES: AN ANALYSIS OF CUSTOMER-OWNED FIRMS IN THE UNITED STATES 108 (1991).

[80] Co-ops are private, not-for-profit corporations incorporated under state law. *See* THE NATIONAL SOCIETY OF ACCOUNTANTS FOR CO-OPERATIVES, FINANCIAL REPORTING BY CO-OPERATIVES 32-11 (1999).

[81] The more socialist-sounding name of "people's utility district" never gained currency. HEFLEBOWER, *supra* note 7, at 132.

[82] In 2000, there were 3,346 farmer co-operatives in the United States, with 254,658 employees. *See* HANSON, *supra* note 74, at 2; *see also* JERRY VOORHIS, AMERICAN CO-OPERATIVES (1961).

[83] DONALD A. FREDERICK, USDA, CO-OPS 101—AN INTRODUCTION TO COOPERATIVES 5–6 (1997).

[84] *See, e.g.*, NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 17-18. ("Seven Principles Distinguish Co-ops from Other Electric Suppliers. 1. Voluntary and Open Membership; 2. Democratic Member Control; 3. Member Economic Participation; 4. Autonomy and Independence; 5. Education, Training, and Information; 6. Cooperation among Cooperatives; 7. Concern for Community.").

[85] The first co-operative was formed in Rochdale, England in 1844 on the basis of what came to be called the "Rochdale Principles." Using many similar principles, an estimated 48,000 co-operatives of all types in the United States are generating $120 billion in economic activity for 100 million members. HANSON, *supra* note 74, at 2.

[86] *See, e.g.*, THOMAS W. GRAY & CHARLES A. KRAENZLE, RURAL BUSINESS CO-OPERATIVE SERVICE, USDA, RESEARCH REPORT NO. 192, PROBLEMS AND ISSUES FACING FARMER CO-OPERATIVES 50 (2002).

they buy from the monopoly because they have no choice.[87] Their only alternative is to "go dark," or possibly "go off-grid" by generating their own electricity. Co-ops not only effectively coerce membership,[88] but few, if any, co-op customers are knowledgeable about the electricity business. Co-op customers have other jobs and will sign almost anything to get electricity. The unique nature of electric co-ops is reflected in the state statutes under which co-ops are incorporated, statutes that treat electric co-ops differently than agricultural or other co-ops.[89] The federal tax code also distinguishes them.[90] Unfortunately, most courts have failed to note these crucial differences between agricultural and electric co-ops, particularly the need for greater protection of electric co-op members.[91]

Despite their identity problems, electric co-ops were the business prodigies of their time. The first electric co-op was born in 1934 in the back of a furniture store in Corinth, Mississippi.[92] Within a few years, it had a thousand siblings scattered across the nation. As the accompanying chart shows, before they were twenty years old, electric co-ops had accomplished the impossible: wiring ninety percent of their service territories. No private companies had ever stretched copper wire faster, over longer distances, or been a conduit of more federal subsidy dollars.[93] Electric co-ops eventually reached virtually all potential customers. Some co-ops are still struggling to make

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[87] HANSON, *supra* note 74, at 46 ("Because electric and telephone co-operatives have exclusive rights to serve specified rural areas in most states, anyone living in those areas must join the co-operatives. That exclusivity of service is unique to utility co-operatives.").

[88] Although the first of NRECA's seven co-op principles is "voluntary association," it is essentially defined as non-discrimination by co-ops against paying customers: "Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination." http://www.nreca.org/AboutUs/Co-op101.htm (last visited Mar. 22, 2008). NRECA conveniently ignores the fact that co-op customers have no choice of electricity distributor.

[89] For example, most agricultural co-op statutes limit membership to farmers. JAMES R. BAARDA, AGRICULTURAL CO-OPERATIVE SERVICE, USDA, INFORMATIONAL REPORT NO. 30, STATE INCORPORATION STATUTES FOR FARMER CO-OPERATIVES 65 (1987) (surveying states' agricultural co-op statutes). *See also* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 59–60 (surveying states' electric co-op statutes).

[90] *See* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 54–58; TOUCHE & ROSS, CO., ACCOUNTING AND TAXATION FOR CO-OPERATIVES 323 (4th ed. 1978). *See also* LEE F. SCHRADER AND RAY A. GOLDBERG, FARMERS' CO-OPERATIVES AND FEDERAL INCOME TAXES (1975) (discussing non-electric co-operative taxation).

[91] *See, e.g.*, Peninsula Light Co. v. U.S., 552 F.2d 878 (9th Cir. 1977) (holding that an electric co-operative which charged members rates above costs in order to increase operating reserves was not required to distribute any of its surplus in order to preserve its tax-exempt status). *Cf.* French v. Appalachian Elec. Coop., 580 S.W.2d 565, 570 (Tenn. Ct. App. 1978) ("The membership may bring an appropriate action against the defendant if at some time in the future the defendant fails to properly distribute its revenues.").

[92] LILIENTHAL, *supra* note 39, at 20.

[93] *See* WILLIAMS, *supra* note 14, at 41 ("[Co-ops] were usually the largest business located in their service area.") *See supra* note 76 (noting the New Deal practice of private power companies charging large deposits before extending service, only to be circumvented by co-ops receiving large federal loans).

money in rural areas that remain poor, but some are now serving the richest urbanized counties in America.[94]

Co-ops were wildly popular in their youth. Ending the drudgery of washing clothes by hand, cooking with coal or wood, or reading by kerosene lamps was considered miraculous, especially since the private sector had failed at the job. Early co-op members felt reverence for the co-op's achievements. The official history of electric co-ops is entitled "The Next Greatest Thing," the first being God himself.[95] Co-ops were not satisfied with being competitive: unrivalled service was the goal.[96] This missionary zeal is preserved in the co-op statutes that still require co-ops to fund "education in cooperation" ahead of any member benefits.[97] Taken literally, this requirement means that $31 billion is available to educate Americans about this alternative to capitalism.

The Chairman of the TVA, David Lilienthal, offered an eye-witness account of an electric co-op annual meeting in the 1940s:

> I have been at such meetings where throughout a whole day as many as 2000 farmers and their wives and children discussed the financial and operating reports made to them by their superintendent and board of trustees [of the co-op], and later while we ate a barbecue lunch watched new uses of electricity demonstrated . . . . But these membership "town meetings" are not simply business sessions. They have an emotional overtone, a spiritual meaning to people who were so long denied the benefits of modern energy and convenience which had become a commonplace to their city neighbors. The talk turns to the hard days before "we won our fight," to the dark difficulties that had to be gone through before the crews came down the road, the poles were set, the copper lines were strung, and the lights went on.[98]

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[94] 29.2% of co-ops now serve metropolitan areas (including the 9.4% of co-ops serving counties with over one million residents), 46.4% serve counties with more than 2,500 urban residents, and 24.4% serve counties with fewer than 2,500 urban residents. U.S. GEN. ACCOUNTING OFFICE, *supra* note 61.

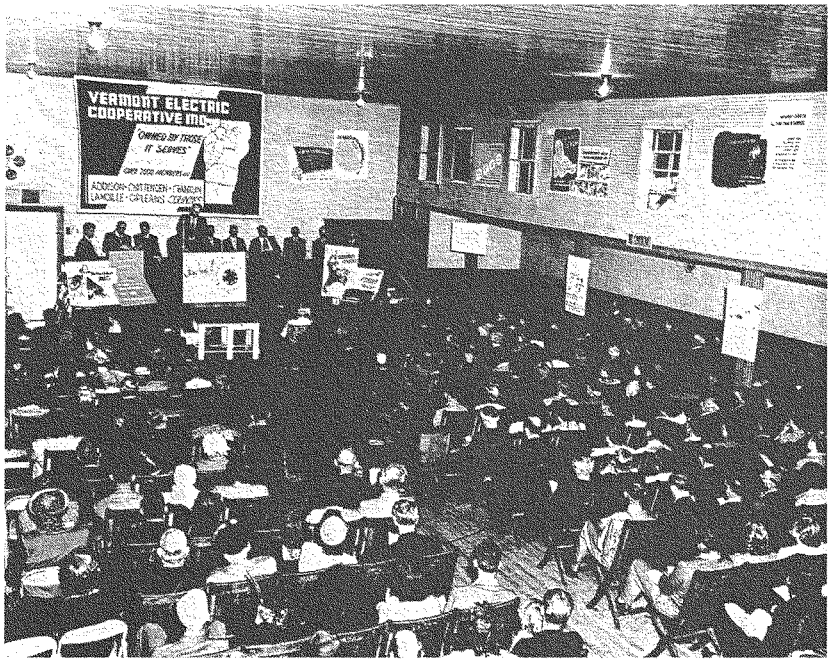
[95] THE NEXT GREATEST THING, *supra* note 77, at 2. Another miraculous feature of co-ops was their frequent use of the honor system for billing. "[I]n order to keep expenses down, the members of the cooperatives read their own meters. The [commercial] bankers could not believe that." WILLIAMS, *supra* note 14, at 101.

[96] Today, the NRECA's "Electric Consumer Bill of Rights" concludes by saying "co-operatives should be able to work together to provide a 'yardstick' by which all consumers can measure the performance of the market and market participants." Electric Bill of Rights, *supra* note 24.

[97] *See* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 59. ("Revenues of a co-operative for any fiscal year in excess of the amount thereof necessary . . . . To provide a fund for education in co-operation and for the dissemination of information concerning the effective use of electrical energy and other services made available by the co-operative, shall . . . be distributed by the co-operative to its members as patronage refunds . . . .").

[98] LILIENTHAL, *supra* note 39, at 19–20.

FIGURE 2: ANNUAL MEETING OF VERMONT CO-OP IN 1949[99]



As the decades passed, attendance at annual meetings fell because members started taking electricity for granted, even wasting power that had once been considered precious.[100] No one wanted to discuss co-op financial statements anymore. Co-op managers were busy maintaining existing power lines instead of building new ones.[101] They boosted sales by increasing customer density and by promoting appliances. They focused on higher co-op revenues, not lower member bills. Even the legal mandate for co-operative education dwindled into an automatic subscription to a co-op magazine with massive circulation, but barely a mention of co-op mechanics.[102] Today, co-

[99] Annual Meeting of Vermont Co-op in 1949 (National Archives Oct. 4, 1949) (on file with author).

[100] *See* James M. Andrew, Administrator, RUS, Remarks at NRECA Regional Meeting 25–26 (Sept. 26, 2007) ("The estimate is that between five and ten percent of our annual power bills is consumed by this so called phantom or vampire power. Another estimate is that seventy-five percent of the electricity used to power home electronics is still consumed even when we think the devices are turned off.") (transcript on file with the author).

[101] These impressions were gained by the author's attendance at local, state, and national co-op meetings over many years, beginning with an NRECA Manager's Conference, Aug. 10–14, 1996, at Hilton Head, South Carolina.

[102] *See, e.g.*, TENNESSEE ELECTRIC COOPERATIVE ASSOCIATION, TENN. MAG., Nov. 2003, at 4 ("Published monthly to communicate electrical use and safety, economic development, educational and community interests of more than 770,000 Tennessee families and businesses who

op insiders gather regularly at state and national conventions but do little to educate anyone, even themselves, about co-ops.[103] The most informative NRECA website, www.cooperative.com, is password-protected so that no outsider can access it.[104] Even co-op insiders seem to be unfamiliar with the site.[105]

Today, fast-growing metropolitan areas like Atlanta, Orlando, Washington, D.C., Cincinnati, Fort Worth, Austin, Denver, and Nashville have expanded into co-op service territory, blurring the lines between urban and rural, although many co-ops keep the adjective rural in their name.[106] Regardless of how urbanized their territory has become,[107] all co-ops can still receive federal loans under a policy entitled, "once rural, always rural." If you were eligible for government assistance in 1936, you are still eligible today.[108]

Today every electric co-op is about seventy years-old.[109] As co-ops have aged, their equity has grown from zero in 1936 to $31 billion today.[110] Despite this success, co-op managers have been surprisingly reluctant to share the news, or the money, with their members. NRECA began noticing this

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own, operate and control the tax-paying, business-managed, locally owned electrical distribution and service systems of the Tennessee Electric Co-operative Association . . . . Cost of subscription to members of participating electric co-operatives is $2.40 per year (20 cents per month) . . . ."). The "total paid circulation" of this magazine in Tennessee was 523,847 in 2003. *Id.* at 24. Likewise, even the CFC reduced its mandatory educational efforts from 1% of net margins to 0.25%, which CFC maintained was sufficient for "meaningful education program" of $1.5 million from 1980 through 1994. See Williams, *supra* note 14, at 161.

[103] *See* Claudia Grisales, *Pedernales Co-op Executives–and their Spouses–Go First Class: Credit Card Bills Document Spending Habits of Utility's Top Officials*, AUSTIN AM.-STATESMAN, Jan. 6, 2008. *See also* Andrew, *supra* note 101, at 8–9 ("We all went to board meetings and did an hour or so deciding on a Ford or Chevrolet. Then the manager would present the REA report and it involved borrowing a million dollars for the future work plan. We would spend about five minutes on the report . . . . Long debate on trucks, short discussion on borrowing millions to operate the co-op.").

[104] Co-operative.com, http://www.cooperative.com (last visited Mar. 10, 2008). The author's congressional office was denied permission by NRECA to access the website for research on this article, but access had already been obtained by other means.

[105] Author's conversations with a wide variety of co-op managers and insiders.

[106] For a list of co-ops by state, see National Rural Electric Cooperative Association, Our Members, http://www.nreca.org/AboutUs/OurMembers.htm (last visited Mar. 18, 2008). The word "rural" is more than a naming preference; the tax-exempt status of co-ops can depend on service to rural areas. See *infra* note 178.

[107] Average co-op customer density has more than doubled from 3.3 customers per mile in 1961 to 7 per mile today. *See* WILLIAMS, *supra* note 14, at 10. Today, 29.2% of co-ops serve metropolitan areas (including the 9.4% of co-ops serving counties with over one million residents). U.S. GEN. ACCOUNTING OFFICE, *supra* note 61, at 11.

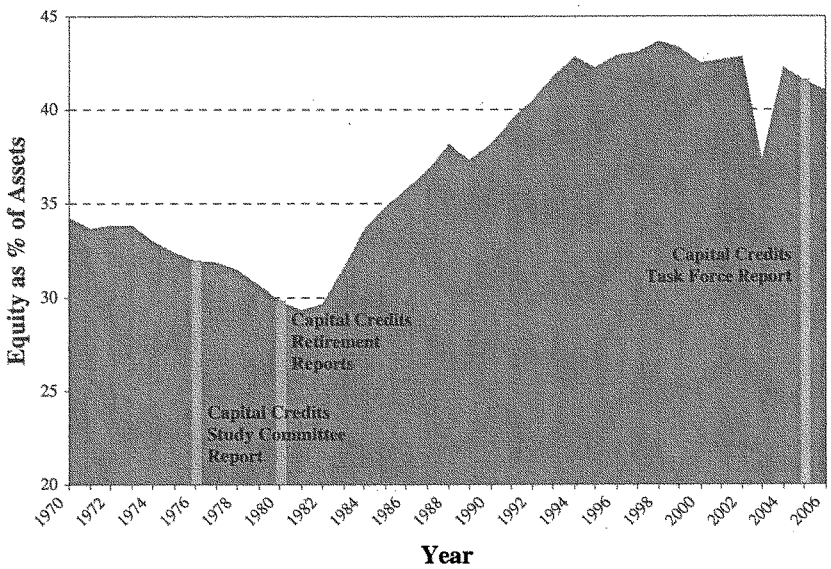
[108] *See* Tyrus H. Thompson, Editorial, *Once Rural, Always Rural*, NRECA LEGAL REPORTING SERVICE, Sept. 2004, at 3 (although the issue "has been brought to the attention of Congress many times . . . [Congress has] not enacted provisions or provided guidance for addressing or altering the Once Rural, Always Rural principle"). Federal policy is showing signs of change, however, with the Bush Administration's proposal for co-ops to recertify their rural status. *See infra* note 256.

[109] No tax-exempt rural electric co-ops existed before the New Deal, and the vast majority of co-ops were started soon after passage of the Rural Electrification Act of 1936 in order to take advantage of federal assistance in electrifying rural America.

[110] Co-ops by the Numbers, *supra* note 1.

unexpected but fundamental problem in the mid-1970s, urging co-ops to return equity to their customers more quickly.[111] Unfortunately, co-ops did the opposite, boosting equity levels to new highs as shown in the accompanying NRECA graph. After further warnings published in 1996, the NRECA commissioned another, more urgent report on capital credits in 2005, urging prompter and larger returns of equity.[112]

FIGURE 3: DISTRIBUTION SYSTEM EQUITY (PERCENT OF ASSETS)[113]



The reason for NRECA insistence on greater return of "capital credits" is that the tax and legal status of co-ops depends on such a policy. Under current law, failure to enforce an adequate capital credit policy is one way to lose tax-exempt status, and possibly even co-operative status.[114] NRECA still

[111] Calling this a "critical issue", CFC noted at the time that co-ops "didn't have a significant pattern of actually revolving capital credits . . . . Many systems were not even doing an effective job of keeping records, so that if they wanted to revolve capital credits they would have difficulty in doing so." WILLIAMS, *supra* note 14, at 105, 130. "[I]n 1975, only 127 co-ops out of 1,050" refunded capital credits despite high levels of equity, causing NRECA and the CFC to form the first Capital Credits Study Committee, which issued its "Final Report and Recommendations" in February, 1976. NRECA AND CFC, CAPITAL CREDITS STUDY COMMITTEE (1976); *see also* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 13. Apparently, many co-ops did not get the hint, so the NRECA created a more focused Capital Credits Retirement Procedures Task Force, which issued its specific recommendations in 1980. *Id.*

[112] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 30. *See also* NRECA & CFC LEGAL SUPPLEMENT, *supra* note 23, at 30.

[113] This graph was created by author's Legislative Director, James Leuschen. It is based on data provided by USDA's Rural Utilities Service (RUS).

[114] *See Id.* at 54–58.

considers co-op resistance to be a problem despite the fact that eighty-four percent of eligible[115] co-ops are returning some capital credits annually.[116] The reason for NRECA concern is the fact that co-ops are accumulating equity faster than they are refunding it.[117] Equity increased by $2 billion in 2006 alone, but only $499 million was refunded.[118]

It is noteworthy that NRECA could have a multi-decade disagreement with its members on such a fundamental issue. Clearly it is touchy; the major NRECA reports on capital credits are worded diplomatically and found only on their password-protected website, not in the public domain. NRECA knows that co-op managers simply do not want to relinquish control of their members' funds. Some managers fear that members might not understand that co-op equity is illiquid and that refunds are very limited.[119] However, co-op managers effectively control member opinion. There is little to prompt an inquiry or a complaint into these matters. Usually, members are grateful for any refund they receive,[120] having no way to compare it to the size of their investment in the co-op or to what other co-ops are paying. In areas with co-ops that refuse to refund, there are no membership certificates to remind members of their ownership because most co-ops were formed so quickly and with little expectation of profit.[121] Today, if certificates are offered at all, they are sold as souvenirs,[122] not as tangible proof of an account that is growing in value.

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[115] *Id.* at 13 n.1.

[116] *Id.; see also, e.g.*, Nancy Kimball, *Flathead Electric to Rebate Three Million Dollars to Customers*, MONT. DAILY INTER LAKE, Oct. 30, 2007, http://www.dailyinterlake.com/articles/2007/10/30/news/news02.txt; *SCI REMC Members to Get $750,000 in Capital Credits This Holiday*, HOOSIER TIMES, Dec. 15, 2007, http://reporter-times.com/?module=displaysotry&story_id=9240&format=print; The Bus. J., *Energy United Awarding Members Capital Credits*, AMER. CITY BUS. JOURNALS, Dec. 17, 2007.

[117] Average member co-op equity has increased by $1 billion, or approximately $200 per member, just during the process of editing this essay. NRECA advocates using "Boatman's Theorem" to help co-op managers calculate and pay larger refunds. The Boatman Theorem indicates that the "percentage amount of equity that should be returned each year is equal to the difference between the co-op's rate of return on equity . . . and the co-op's growth in capital." NRECA & CRC, TASK FORCE REPORT, *supra* note 17, at 37.

[118] NRECA, PowerPoint Presentation: Vital Signs–How Rural Electric Systems Performed in 2006, at 43, 49 (Oct. 2007) ("Net Margins and Patronage Capital" increased to $112 per co-op customer in 2006)(on file with author).

[119] Author's conversations with a wide variety of co-op managers.

[120] According to a survey commissioned by NRECA, 70% to 80% of co-op members think it is "very important" for "[c]o-operatives [to] give money back to their customers when revenues exceed costs." A majority of members over 55 think that such refunds are, in fact, made. However, younger members are more skeptical, with only one-third of 19 to 43 year-olds agreeing that co-ops ever actually refund capital credits. NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 66.

[121] The excitement and urgency of electrifying rural America, as well as the large federal subsidies required, caused people to underestimate the long-term development potential of the heartland. Some areas took longer to grow than others. As recently as the early 1950s, about twenty percent of electric co-ops were operating at a loss. *See* HEFLEBOWER, *supra* note 7, at 133.

[122] For example, a question in the "About Us" page of the Middle Tennessee Electric Membership Co-operative website asked, "Do the members actually own the co-operative?"

Even accountants,[123] lawyers,[124] and business people[125] are often unfamiliar with the unusual rules that apply to co-ops. Take, for example, the co-op practice of "special retirements." This common bylaw[126] allowed spouses of deceased co-op customers to obtain a refund of all or part of their capital credits, often to pay for burial expenses. Sadly, co-op practices like this are not always honored despite substantial national payouts.[127] Member-friendly co-op managers should never fail to mention the "special retirement" opportunity to the widow or widower.[128]

The genius of co-ops is their hybrid nature, which has allowed them to adapt to gradually changing conditions. As the following chart shows, most co-ops have experienced three phases, each one featuring a different hybrid element.[129] Co-ops acted much like "government agencies" from 1936 to 1973 because they received so many federal tax dollars. Co-ops resembled true "co-operatives" from 1974 to 1984 because they were able to generate sufficient member equity. Finally, co-ops grew more ambitious and began acting like not-for-profit or even for-profit businesses from 1985 to the present.[130] Of course, each co-op has matured at its own rate, depending on its

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The co-op's answer was: "Yes. Members pay $5 for a membership certificate, which grants the rights and privileges of ownership." Middle Tennessee Electric Membership Corporation, What's a co-op?, http://www.mtemc.com/faq.cfm/name/1#faq6 (visited Mar. 2, 2004). The co-op's answer has subsequently been changed to "Yes. The members are the co-operative." *Id.* (last visited Mar. 10, 2008).

[123] Co-op accountants have their own association, the National Society of Accountants for Co-operatives, and journal, The Co-operative Accountant. The autobiography of a certified public accountant who claimed to have audited more electric co-operatives than anyone else reveals many of the quirks of the business. *See* WALTER G. SCHMIDT, RURAL AND SUPPLY CO-OPERATIVES WERE MY CONCERN 176 (1987).

[124] Co-op lawyers are encouraged to belong to the Electric Co-operative Bar Association in order to keep up with co-op law. NRECA, SAMPLE ELECTRIC CO-OPERATIVE ATTORNEY POLICY, 8 (2003) (on file with author). Co-op legal documents are relatively obscure and are often only found on NRECA's password-protected website.

[125] Although classes on non-profits are increasingly available, very few business schools offer courses on co-operatives, a term that is often used to mean either a type of apartment in cities like New York, or a student internship at the business of a prospective employer.

[126] *See, e.g.*, Middle Tennessee Electric Membership Corporation, Bylaws art. I, § 9(a) (2006), *available at* http://www.memtc.com/acrobat/BylawsElectranet_20061207.pdf ("when in the judgment of the Board of Directors, the financial condition of the Co-operative justifies it, the Board may authorize the repurchase of the membership of any deceased member, such membership to be held by the Co-operative as a treasury membership which may be disposed of by the Board of Directors upon non-discriminatory terms.").

[127] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 59 (in 2003, $94 million of special retirements were made, versus $351 million in general credit retirements.)

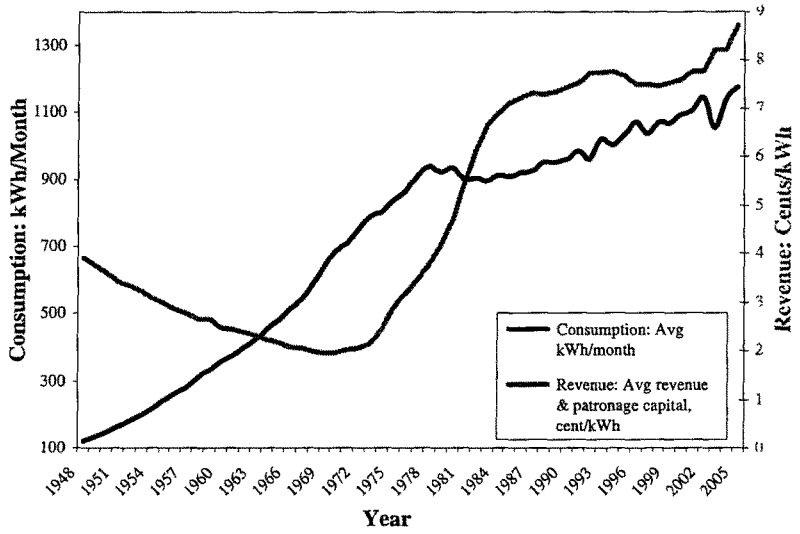
[128] NRECA urges its co-ops to pay attention to the age of its members in order to better anticipate their attitudes and needs. *See id.* at 65, also note 118.

[129] *Cf.* SCOTT RIDLEY, PROFILE OF POWER, AMERICAN PUBLIC POWER ASSOCIATION (1996) (Ridley divides the public power industry into five phases: infancy from 1879–1907, private-sector consolidation from 1907–32, creation of rural co-ops and federal power projects from 1933–61, completion of the grid from 1961–89, and the new era of deregulation and competition 1990–96).

[130] Changes in government loan policy did much to shape behavior. Until 1973, the REA offered direct 2% loans to co-ops, then shifted to 5% loans and loan guarantees in an effort to reduce federal government subsidies to co-ops. WILLIAMS, *supra* note 14, at 113–14. *See also* PUBLIC UTILITIES REPORTS, *supra* note 13, at 18–24. The next big shift in government lending

local service area, so it is difficult to generalize. Some small co-ops are still in their "government agency" stage,[131] and may remain so. Some still act like genuine co-operatives.[132] But others grew so rapidly that they quickly became, like the Atlanta co-op that subcontracted out its entire operation,[133] distressingly similar to for-profit enterprises. Many co-op observers, including many co-op directors, have not understood the gradual transformation of co-ops from emergency relief agencies[134] to, in some cases, wealthy power companies.[135]

FIGURE 4: RESIDENTIAL ENERGY CONSUMPTION & REVENUE/KWH[136]



policy was in 1993, when the Clinton administration moved to market-rate loans, reserving 5% loans for only the neediest borrowers. As the federal government receded from utility lending market, CFC and CoBank (a bank created for rural cooperatives) filled the void. WILLIAMS, *supra* note 14, at 266–67.

[131] *See, e.g.*, CO-OP STATISTICAL REPORT, *supra* note 62, at 76 (Swans Island Electric Co-operative of Swans Island, Maine, serves only 575 customers, and has only 7% equity as a percentage of assets).

[132] *See, e.g.*, *id.* at 42 (discussing La Plata Electric Association in Durango, Colorado, with 36,772 customers and an equity to assets ratio of 38%).

[133] *See* Newkirk, *supra* note 42.

[134] Co-ops, and even co-op banks, have stressed almost from the beginning that they are not utilities but "social welfare agencies." WILLIAMS, *supra* note 14, at 65. Co-op performance was supposed to be superior to anything that for-profits could produce. *See supra* note 96.

[135] *See* WILLIAMS, *supra* note 14, at 48–49 ("[T]he same people were sitting on the boards who were sitting on the boards when the co-op was founded. These were well-meaning, dedicated individuals, but the co-op they were involved with in the early days was no longer the same organization thirty years later. It was a more complicated, more sophisticated operation, and a lot of directors didn't keep up to date. There was a crying need for turnover.").

[136] This graph was created by author's Legislative Director, James Leuschen. It is based on data from PUBLIC UTILITIES REPORTS, *supra* note 13, at 22.

Not only does excessive equity endanger co-op tax and legal status, it also makes electric co-ops attractive takeover targets despite numerous barriers (particularly against IOUs) to acquisition.[137] A more subtle danger to co-ops is their attractiveness as a financing source for the estimated $35 billion in new electricity generating capacity that may be needed in America over the next thirty years.[138] Co-ops are being targeted due to their apparently deep pockets, low cost of capital due to their tax-favored status, and (except for a few G&Ts) relative inexperience in power generation.[139] Co-ops are probably not the most astute investors in new generation facilities.

NRECA is asking co-ops nationwide to conduct "Straight Talk" campaigns in their communities to spread the message that "rates are going up" because of new generation and pollution controls.[140] This message creates an expectation of increased co-op revenues and blames government for new regulations. But such "Straight Talk" efforts are also an opportunity for co-ops to level with their members on all issues, including ways of reducing members' bills with improved efficiency, capital credit retirement, conservation, and avoiding unnecessary plant construction and pollution-control costs.

III. Member Control of Electric Co-ops

A. *Equity Interest*

Electric co-op customers own their co-op. The more electricity a member buys from the co-op, the more equity he or she owns.[141] The average monthly electric bill in 2006 was $102 for a co-op residential customer.[142] These bills are not itemized; customers cannot see the wholesale cost of electricity, cost of retail distribution, overhead and interest expense, or the co-op equivalent of profit—the average seven percent additional "margin".[143] In good years, the co-op accumulates this operating income mar-

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[137] *See* NRECA & CFC, Task Force Report, *supra* note 17, at 11 ("Sellout exposure: Could failure to retire capital credits lead to internal or external pressure to sell the co-operative?"). Most state co-op statutes have a variety of anti-takeover protections, particularly against IOUs, such as a requirement that other co-ops be given a first right-of-refusal before any acquisition could take place. These protections limit the "market for corporate control" described in Henry G. Manne, *Market for Corporate Control*, 73 J. of Pol. Econ. 110 (1965).

[138] *See* NRECA, 2006 NRECA Annual Report 3 (2006), *available at* http://www.nreca.org/Documents/AboutUs/NRECA_AnnReport.pdf [hereinafter NRECA Annual Report]. Note in particular the letter from the CEO promoting 15,000 megawatts of new power generation for co-ops. *Id.* at 1.

[139] *See Distributors Want to Help Fund TVA Plans for New Power Stations: Group Would Have Ownership Stake in Venture*, The (Nashville) Tennessean, Jan. 7, 2008, at B2.

[140] English, *supra* note 24, at 12.

[141] See Public Utilities Reports, *supra* note 13, at 83.

[142] NRECA Strategic Analysis (Apr. 27, 2007), http://www.cooperative.com (password protected).

[143] Framework, *supra* note 27, at 34.

gin[144] much like retained earnings. The accumulated margin is called "capital credits," "patronage capital," "member equity," or "total earnings reinvested in the system," depending on each co-op's preferred terminology.[145] Today almost every co-op has millions of dollars, if not tens or even hundreds of millions of dollars of capital credits,[146] which, when allocated to members according to their usage, determine the members' exact legal ownership of the co-op.[147] When this equity is finally transferred to members, it may be called "capital credits," "refunds,"[148] "return of capital," or "dividends."[149] In short, for about seven dollars a month, co-op members own a growing share of an electric utility, whether they want to or not.

The converse of the customer/owner principle is that non-members may not own any of it.[150] This restricts the co-op's source of capital to insiders. Co-ops' deep suspicion of outside capital[151] extends even to their own wealthy members, who are not allowed to buy more equity in the co-op than their usage would dictate. Co-ops overcame their initial lack of equity with long-term loans from the Rural Electrification Administration, the predecessor to the RUS, for up to 100% of the cost of line construction or power generation.[152] As start-up enterprises in poor rural areas, co-ops could not have survived without receiving and distributing federal funds as quasi-governmental agencies.

The average co-op member owns roughly $1824 of equity in his or her co-op,[153] but accounts can range from hundreds of thousands of dollars for heavy commercial users to almost nothing for new customers. Although

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[144] Non-operating income, such as investment income or money management income, may not accrue to a member's benefit. NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 25.

[145] The Middle Tennessee Electric Membership Co-operative uses the term "total earnings reinvested in the system." *See, e.g.*, *TVA Rate Adjustment Means Higher Bills for MTEMC*, *supra* note 102, at 3, 14.

[146] In 2005, only 15% of co-ops failed to report positive margins, and the average co-op equity level was 42%. See CO-OP STATISTICAL REPORT, *supra* note 62, at 19.

[147] There appears to have been a long-lasting disagreement between NRECA and the IRS about the need to promptly allocate margins to customers. *See* SCHMIDT, *supra* note 123, at 175. ("My advice to our clients was to assign all margins to patrons and to notify the patrons as required by the IRS."). NRECA comes down strongly on the side of annual allocation. *See* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 24. Allocation does not mean rights to capital credits have vested; vesting occurs only when the credits are retired. *Id.* at 33.

[148] *See* R. Jeff Turnage & James H. Pollack, *Utility Co-operative Forum: TAMs Bring Good/Bad New on Patronage Dividends*, CO-OPERATIVE ACCT., Summer 1996, at 1, 60–64 (1996) (describing a variety of terms for these payments).

[149] Members of rural electric co-operatives "share in operational profits, just like members of other co-operatives, through patronage dividends." HANSON, *supra* note 74, at 48.

[150] *See* PUBLIC UTILITIES REPORTS, *supra* note 13, at 7.

[151] Not only do co-ops fund themselves with member equity, even their debt comes from either the government, RUS, or a co-operatively-owned lender, CFC. Even a newer lender like CoBank is a subsidiary of a government-sponsored enterprise. See PUBLIC UTILITIES REPORTS, *supra* note 13, at 94–95.

[152] *See supra* note 78.

[153] This rough calculation divides total co-op equity ($31 billion) by total number of co-op customers (17 million). *See* Co-ops by the Numbers, *supra* note 1.

$1824 may seem *de minimis*, the average American family has only $3,105 in brokerage accounts and $3469 in checking and savings accounts.[154] Like stock, co-op equity conveys to the owner an interest in the residual assets of the co-op in the event of liquidation.[155] Unlike stock, it is often overlooked, not only by its owners but also by bankruptcy courts,[156] divorce courts, welfare administrators, and others with a claim on a member's assets.

The exact nature of this member property interest is unclear. Co-ops treat it in several different, inconsistent ways: as an investment, loan, capital contribution, or even as a charitable donation.

- An investment: Since a member's margin payment becomes equity in the co-op, it resembles an investment. Indeed, that term is commonly used in co-op literature, although it differs from a normal investment because it does not pay explicit dividends or interest.[157] NRECA acknowledges that members rightfully expect significant benefits from their investment, if only due to its opportunity cost, but the investment's intangible benefits are hard to identify.[158] The argument that the margin payment is an investment has very serious consequences because member equity could then become a "security" under federal securities law.[159] The legal argument for terming the payment an "investment" hinges on an investor's initial expectation of return,[160] a test

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[154] *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, Fed. Reserve Bull., 2006, at A1, http://www.federalreserve.gov/pubs/oss/oss2/2004/bull0206.pdf.

[155] *See* Peninsula Light Co. v. U.S., 552 F.2d 878, 879 (9th Cir. 1977) (In the event of "dissolution of the corporation, the articles provide that the net assets would be distributed equally to the members of the corporation.").

[156] *See* NRECA & CFC, LEGAL SUPPLEMENT, *supra* note 23, at 39–49.

[157] The common understanding of the member/co-op financial relationship is as follows: "Patronage capital, capital credits, member equity—by any name, any co-op revenues in excess of expenses, or margins, are investments by members in the organization and ultimately belong to the members and should be returned to them . . . . A co-operative member does not receive a return on this investment in the co-operative, other than the ability to buy power essentially at cost." PUBLIC UTILITIES REPORTS, *supra* note 13, at 83.

[158] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 37 ("While each member is different, the cost of its equity investment in the co-op is probably at least as high as the return the member could expect to earn on a similar investment, such as a ten-year Treasury bond, and may be as high as a credit card rate."); USDA, *Co-operative Financing and Taxation* 11 (Rural Business Co-operative Service 1995) ("The member should still attempt to measure the return provided by the investment in the co-operative. One measure may be the lower price paid on products or services purchased . . . . A member must evaluate the transaction price, plus the value of patronage refunds and the discounted value of retains to be received in the future, to arrive at the total return on investment.").

[159] Most co-op securities cases involve agricultural, not electric, co-operatives. Although United States v. Davis, 40 F. Supp. 246 (N.D. Ill. 1941), found that co-operative membership certificates were profit-sharing agreements under the Securities Act of 1933, and Reves v. Ernst & Young, 494 U.S. 56, 65 (1990), presumes that co-operative financial instruments are securities if they are specifically named in the 1933 Act, courts have resisted finding that co-operatives issue securities. *See* L. Keith Parsons, *Federal Regulation of Co-operative Securities Transactions: An Update*, CO-OPERATIVE ACCOUNTANT, Spring 1990, at 35.

[160] The so-called Howey test was reiterated in United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851–52 (1975) (citing SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946)). The

which makes little sense in the context of forced membership in electric co-ops.

- A loan: Since many co-ops return members' margins after twenty years, usually without interest, the property interest resembles a bad loan because, after inflation, members receive roughly half the value of their original margin payment.[161] Members usually do not complain about this return because they have low expectations. They are largely unaware that the growing prosperity of their co-op allows the return of more margin dollars, and without a twenty-year delay.
- A capital contribution: The argument for treating a member's interest as a capital contribution is that membership conveys intangible benefits,[162] similar to membership in a country club. According to the NRECA Electric Consumer Bill of Rights, "the co-op difference resides in customer ownership and control."[163] Perhaps because this control is so tenuous, the NRECA advocates return of capital credits because that shows "tangible evidence of members' ownership in the co-operative and demonstrates the difference between co-operatives and other organizations."[164]
- A donation: If you believe that margins are hopeless investments or loans, it is a short step to believe that they are charitable gifts contributed for the good of the co-op and the community.[165] Co-ops encourage this view with "Operation Roundup" and trips to Washington for co-op youth.[166] However, this causes confusion between the 501(c)(12) status of co-ops and the 501(c)(3) status of charities. Elec-

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Howey test requires four elements to be present in any security: an investment of money, in a common enterprise, with an expectation of profits, to be derived solely from the efforts of others. *Id.* at 851-52. The most recent case, Great Rivers Co-operative of Southeastern Iowa v. Farmland Indus., Inc., 198 F.3d 685, 699–701 (8th Cir. 1999), noted:

> [T]he capital credits lack the essential characteristics of a security. First, the class members enter into the co-operative relationship not in expectation of the profits that will be generated from such a relationship but instead to reap the benefits of that relationship. The capital credits are non-interest bearing and thus do not provide the valuable return on an investment normally expected from the purchase of a security . . . . [A]ny distribution of 'profits' were patronage refunds, i.e. a price or cost adjustment, resulting from the member's own transactions with [the co-operative].

[161] Forty-three percent of co-ops that refund capital credits use the first-in, first-out (FIFO) method to benefit the oldest members. This method gives priority to returning the earliest margin payments by customers, usually decades earlier. These co-ops often use a twenty-year rotation cycle, although length of the cycle can vary. *See* NRECA & CRC, TASK FORCE REPORT, *supra* note 17, at 41.

[162] PUBLIC UTILITIES REPORTS, *supra* note 13, at 83 ("A co-operative member does not receive a return on this investment in the co-operative, other than the ability to buy power essentially at cost.").

[163] Electric Bill of Rights, *supra* note 24.

[164] PUBLIC UTILITIES REPORTS, *supra* note 13, at 84.

[165] Business customers may make the same current expense deduction whether the electricity purchase is treated as an ordinary and necessary expense or a donation. *See* I.R.C. §§ 162, 170 (2006).

[166] Many co-ops boast of their charitable work funded by members who choose to "round up" their utility bills to the nearest whole dollar. This, of course, slightly increases members'

tric co-ops are not charities; they are not-for-profits that are free to pursue profit as a secondary objective.[167]

Regardless of how the co-op member's margin payment is classified, return on that payment is central to the operation of the co-op.[168] In fact, failure to return capital credits can destroy the tax-exempt status of the co-op by depriving customers of membership status.[169] Despite the critical nature of this requirement, it is hard to find a single co-op that can prove it has returned the right amount of capital credits, or, for that matter, kept member rates low or electric bills at a minimum. Co-ops do not want outsiders to check their results of operations;[170] they argue that co-op procedures automatically produce superior outcomes.[171]

What about co-op procedures? Co-op business software keeps exact accounts of each member's allocated ownership in dollars and cents, but these accounts and amounts are seldom, if ever, revealed to members, or allowed to vest until the actual refund occurs.[172] Since co-ops are in constant contact with members by means of monthly bills and issues of a co-op magazine, this failure to communicate important information is troublesome. Another concern is the simplistic, self-serving financial information that is released annually to co-op members in lieu of financial statements.[173] Members receive less factual information than the owners of any other widely-held company.[174] Comparisons with other co-ops' performance are never made. This paternalistic treatment makes it extremely difficult for anyone but a specialized researcher to understand a single co-op, much less the industry's performance as a whole. The only new window on co-op performance is the

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bills, although it is done voluntarily. Many co-ops also invite selected high school students in the co-op's service area to travel to Washington, D.C., partially or wholly at co-op expense.

[167] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 54–58.

[168] *Id.* at 9 ("allocating and retiring capital credits are two of the practices that distinguish co-operatives from other businesses . . . . Adopting and implementing a capital credits policy are key responsibilities of a co-op's board of directors and management."); Thomas M. Strait, *Patronage Dividends of Electric and Telephone Co-operatives*, CO-OPERATIVE ACCOUNTANT, Summer 1995, at 58 ("a utility co-operative's patronage dividend ('capital credit') policies are crucial to its competitive position and financial integrity.").

[169] Bill Clayton & Russell D. Wasson, INTRODUCTION TO UTILITY CO-OPERATIVE TAXATION (2005), *available at* http://www.cooperative.com (password protected).

[170] TVA began marking its annual "Summary of Financial Statements, Sales Statistics, and Rates: Distributors of TVA Power" as "Business Sensitive" on June 30, 2002, in order to limit disclosure of muni and co-op finances, despite their public power status and the availability of their not-for-profit 990 tax returns.

[171] After the Enron scandal, for example, NRECA officials stressed that such problems could not occur in member-owned co-ops. *See, e.g.*, Morrison, *supra* note 49.

[172] The exact sequence in which capital credits return to members—allocation, vesting, retirement, and distribution—is seldom revealed to members, and seems poorly understood by co-op managers themselves. *See* NRECA & CFC, LEGAL SUPPLEMENT, *supra* note 23, at 12.

[173] Non-members lack access to any co-op financial information because co-ops are viewed as private companies, not publicly-owned utilities. *See* PUBLIC UTILITIES REPORTS *supra* note 13, at 8.

[174] *See, e.g.*, Morrison, *supra* note 49, at 1–10 (never mentions disclosure obligations of co-ops); *see also* John D. Reilly, *Recent Changes to the State Securities Law Exemption for Cooperatives*, CO-OPERATIVE ACCOUNTANT, Summer 1996, at 3.

availability of IRS Form 990, a disclosure required from any tax-exempt entity.[175]

A co-op must meet three different sets of conditions to maintain its tax-exempt status. The co-op must be a genuine co-operative, an electric co-operative, and a tax-exempt electric co-operative. Specifically, a genuine co-operative must subordinate its capital and ensure democratic control, allocation of capital, and operation at cost.[176] An electric co-op must serve "rural areas"[177] and generate at least eighty-five percent of its income from selling electricity to its members.[178] Finally, an exempt electric co-op must not withhold member access to co-op accounts[179] or retain earnings "beyond the reasonable needs of the organization's business."[180] NRECA seems worried that many co-ops may be violating one or more of these conditions.[181] There are three levels of penalties for failing these tests: become a taxable electric co-op, a taxable general co-operative, or, worse, a "membership organization" with less favorable tax treatment than a corporation.[182]

Two of the specific conditions the IRS requires of exempt electric co-ops—the ban on closed records and excessive reserves—are easy to understand, even if they are not easy to define. A third condition—that electric co-ops may not forfeit member assets—requires some additional explanation. A

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[175] Co-op 990 tax returns may be accessed at http://www.guidestar.org or http://foundationcenter.org; *see also* Electric Co-operative Bar Ass'n, PowerPoint Presentation: About Hot Topics in Form 990 Compliance 50–52 (June 12, 2007).

[176] I.R.C. § 501(c)(12)(A) (2006); *see* Exempt Organizations; Proposed Examination Guidelines Regarding Rural Electric Co-operatives, Announcement 96-24 (1996).

[177] Rural area is defined as "any area of the United States not included within the boundaries of any urban area, as defined by the Bureau of the Census. . . ." Rural Electrification Act of 1936 tit. 1, § 13, 7 U.S.C. § 913 (2006). The Census defines an urban area as populations of "at least 2,500 for urban clusters, or at least 50,000 for urbanized areas." *See* http://ask.census.gov/cgi-bin/askcensus.cfg (copy on file with author). According to these definitions, only 24.4% of co-op counties can claim to be rural areas. See U.S. GEN. ACCOUNTING OFFICE, supra note 61, at 12. This could mean that 75.6% of co-op counties are already ineligible for service by tax-exempt co-ops under the statute.

[178] I.R.C. § 501(c)(12)(A) (2006). Anything other than sales of electricity to members may be classified as "unrelated business income" and is limited to less than fifteen percent of co-op business. See WASSON, *supra* note 17, at 2.

[179] Co-op financial records, including a member's capital credits account, are supposed to be "open and accessible to members at any time." Rev. Rul. 72-36, 1972-1 C.B. 151.

[180] *Id.*

[181] The 1976, 1980, and 2005 NRECA Capital Credits Reports repeatedly admonished, in increasingly urgent language, that "[a] co-operative's policy for allocating and retiring capital credits must comply with applicable state and federal laws as well as the co-op's articles of incorporation and bylaws," NRECA & CRC, TASK FORCE REPORT, *supra* note 17, at 12. The NRECA's Director of Tax, Accounting, and Finance Policy, warns "It is very important . . . for an electric cooperative to comply with the cooperative principles and remain a 'cooperative' under federal tax law." WASSON, *supra* note 17, at 5.

[182] Taxable electric co-ops are governed by pre-1962 co-op case law, taxable general co-ops are governed by I.R.C. Section 1381 (Sub T), and co-ops that lose all of their tax-favored status are corporations classified as "membership organizations." This may be roughly described as descending from tax-exempt status for the co-op and its members, to federal taxation at the co-op level, to federal taxation at both the co-op and member level. *See* WASSON, *supra* note 17, at 7.

member's capital account may not be terminated without consent of the member, the member's estate, or—in the event the estate's books are closed—his or her descendants.[183] The enduring nature of this obscure property right has surprising implications. State escheat laws and unclaimed property laws often do not apply to capital accounts, even for those that have been dormant for decades.[184] The good news for members is that children and grandchildren can often get full credit for the original co-op member's account. The bad news for co-ops is that refusal to refund capital credits or settle with estates means that co-ops are increasingly owned by former customers, whether they are deceased or living in another area. No one knows how many co-ops have fifteen per cent or more of their equity owned by non-members, such as dead or absent customers, but this could also force revocation of a co-op's tax-favored status.[185]

B. Voting Rights in Co-ops

In contrast to the complexity of co-op capital accounts, the voting rights of members are simple: one member, one vote.[186] Unlike with IOUs, even large "shareholders" only get one vote. This radically democratic policy not only reduces the influence of a large customer in co-op elections, but also reduces his or her interest in participating at all. Co-ops usually ban proxy voting on the New Deal theory that all members should attend annual meetings because nothing could be as urgent as the co-op's ability to electrify your home or farm.[187] At these annual meetings, quorum requirements are impractically high for fundamental changes in the co-op but comparatively low for director elections.[188] Without proxy voting, requiring a super-majority for mergers or acquisitions makes such transactions nearly impossible.[189]

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[183] Rev. Rul. 72-36, 1972-1 C.B. 151; 26 C.F.R. 1.501(c)(12)-1 (2007).

[184] NRECA & CRC, LEGAL SUPPLEMENT, *supra* note 23, at 50–52.

[185] At least eighty-five percent of co-op income must come from member purchase of electricity. *See* Bill Clayton, Vice President e-Business and Marketing, Co-operative Fin. Corp., & Russell D. Wasson, Director of Tax, Fin., and Accounting, Nat'l Rural Elec. Co-operative Ass'n, Remarks at Accounting, Finance & Tax Conference: Introduction to Utility Co-operative Taxation, PowerPoint (May 16-19, 2005).

[186] *See* PUBLIC UTILITIES REPORTS, INC., *supra* note 13, at 7.

[187] *See* Roger Croteau, *Legislator Says Utility's Reforms Fall Short*, SAN ANTONIO EXPRESS-NEWS, Nov. 15, 2007, at 1B. Pedernales now allows proxy voting and for petitions from 25 or more members to nominate new members for the board, but still counts unmarked proxies as votes for the management slate.

[188] Compare the Tennessee legislature's quorum requirements: the lesser of 100 members or 2% of membership for transacting regular business at the annual meeting (which may fall to 51 people or 1% once a quorum is established) versus a meeting-long requirement of ten percent of membership in person for any substantial asset sale or other major co-op transaction. TENN. CODE ANN. §65-25-211(d) (2000).

[189] For example, the ten percent permanent quorum requirement for Tennessee co-ops would mean that, for the largest co-op, over 15,000 customers would have to gather and remain in attendance in order to consider a major co-op transaction. In the current Pedernales scandal, less than one-fifth of one percent of Pedernales membership participated in any way in one of the nine public forums designed to elicit customer views. *See* Claudia Grisales,

Conversely, the number of co-op employees may be enough to pick all the directors during an annual meeting that is poorly attended by members who are not employees.[190] Such rules serve to entrench co-op directors, management, and employees.

Co-ops are governed by a board of directors composed of members from each of the co-op's service areas, elected by the general membership. Co-op board seats are very attractive positions, but few members apply because they know little about the benefits, which appear to be nominal according to the bylaws. In reality, according to the new Form 990 disclosures, annual compensation for co-op board members can reach $15,000 to $50,000,[191] depending on the size of the co-op, frequency of meetings, value of health insurance, and attendance at expense-paid state and national conventions. No expertise is required. Co-op board members sometimes display astonishing ignorance of co-op business but are insulated from liability for their decisions due to the co-op's not-for-profit status.[192] Sarbanes-Oxley requirements for independent directors or audit committee experience do not apply.[193] The ability of co-op employees to control these board seats—and, through the directors, the co-op—has made employees much more influential than the co-op's apathetic membership.[194] Co-op managers and employees have often become the de facto owners of the co-op.

IV. Co-op Treatment of Members

There is no bright-line test to determine whether a co-op has surplus equity and therefore must lower rates, return member equity, or promote

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Utility Customers Speak Up for a More Open Board, Austin Am.-Statesman, Oct. 21, 2007, at B1. Co-ops realize that supermajority requirements are unrealistic and have modified them in order to allow co-ops to borrow from CFC. See Williams *supra* note 14, at 67.

[190] *See supra* note 188; *see also infra* note 193. Co-ops usually hire employees from their service area, partly because others would have too far to drive and partly because it is very convenient for employee-members to be able to vote with management in co-op elections. From an employee standpoint, co-ops provide stable employment in areas that may provide few other jobs. *See supra* note 93.

[191] The chairman of the Pedernales board was paid almost $200,000 annually. *See* Roddy Stinson, *PEC Board's Pay, Perks Are Filed with IRS–And They're Astounding*, San Antonio Express-News, Nov. 25, 2007, at 1B.

[192] *See supra* note 135. "White-collar rural residents, who provided the greatest economic growth, were underrepresented on the systems' boards." Williams, *supra* note 14, at 214. For many years, almost two-thirds of co-op directors were farmers, although only 12% of co-op members were farmers. *Id.*

[193] *See* Claudia Grisales, *Pedernales Co-op Changes Leaders and Bylaws, but Members are Still Locked Out*, Austin Am.-Statesman, Jan. 6, 2008, at A1, *available at* http://www.statesman.com/business/content/business/stories/other/01/06/0106pecgovern.html.

[194] For example, in the Pedernales scandal, "co-op employees at the forums were attentive and at times outnumbered those in attendance." Claudia Grisales, *Pedernales Customers Give Co-op Their Ideas*, Austin Am.-Statesman, Sept. 29, 2007, at E8.

energy conservation. But there are frequently unexplored ways for the co-op to lower its operational expenses without harming service.[195]

A. Distribution (In)efficiency

The core business of co-ops is distribution ("wheeling") or delivering electricity to local meters for as few cents per kilowatt-hour as possible. Different regions have different wholesale costs of electricity (depending, for example, on the availability of hydro power) but all regions can try to distribute electricity efficiently. In 2005, the average co-op charged 2.56 cents per kilowatt-hour, or roughly one-third of its total rate, for distribution costs.[196] This is more than double the one-cent per kilowatt hour average distribution cost for IOUs, which serve higher density areas but which are also more efficient.

Co-ops prefer to focus customer attention on their all-inclusive rates, without breaking out the cost of distribution. This policy hides their relative inefficiency and gives them credit for others' low-cost generation.[197] Co-ops also resist focusing on the volume of electricity purchased—the kilowatt hours—although such information could help customers decide how to reduce wasteful purchases. Reducing either the price or volume of electricity threatens co-op management, however, since managers are motivated to improve the co-op's top-line revenue, not the member's bottom line.[198] An extremely successful conservation program would make the co-op look like it has stopped growing, and co-op managers lack incentives to promote such a result.

The relatively high cost of co-op distribution is due to dispersed customers, a high number of employees per customer, and excessive investment in capital plants. Scale is the primary factor. The 43 co-ops with fewer than

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[195] A small but telling example of prolonged co-op inefficiency was the fact that from approximately 1930 to 1970, all co-ops mailed their interest payments on REA loans to Washington, D.C. Co-ops lost an average of 60 days of float annually on billions of dollars. Only CFC's "check delivery" service in 1975 began improving their money management. *See* WILLIAMS, *supra* note 14, at 133. As a result of this reform, non-operating margins nearly doubled from $33.2 million in 1976 to $62.6 million in 1979. *See id.* at 127.

[196] NRECA, U.S. ELECTRIC UTILITY OVERVIEW (2007) (indicating that the average distribution cost for all utilities is 2.1 cents per kilowatt-hour. Co-op costs are not released but can be derived from CO-OP STATISTICAL REPORT *supra* note 62, at 20. *See also* FRAMEWORK, *supra* note 27, at 30.

[197] Another way that co-ops get credit for others' generation is when co-ops use gross receipts instead of gross income as the denominator in their calculation of the fraction of unrelated business income. Gross receipts is defined as gross income, plus the cost of wholesale power. "[F]or most cooperatives, gross receipts is an easier test to pass than gross income." WASSON, *supra* note 17, at 2.

[198] *See* LILIENTHAL, *supra* note 39, at 22. (noting that as of 1944 "[o]f the eighty-four municipal distributors of TVA power that have been operating two years or more, all except three exceed the national average in the use of electricity in homes . . . . In the homes of forty-two of these cities and towns the average use is 50 per cent greater than the national average . . . . In thirteen communities the average use is 100 per cent greater . . . .").

2500 customers charge each member $531 for distribution every year, whereas the 144 co-ops with more than 25,000 customers have reduced the cost to $266 each.[199] According to the NRECA, mergers among the co-ops that are uneconomically small could save customers at least $220 each per year, resulting in huge savings for customers:[200] this amount is roughly the equivalent of two free months of electricity. Trimming payrolls and optimizing capital plant investments can also make distribution more efficient. The median customer-employee ratio is 276 to 1, which could be lowered if co-ops grew larger.[201] As for capital plant expenditures, the NRECA has encouraged members to ask if such expenses could be cut in half without loss of service.[202] Today, the average plant investment per customer has climbed to $4121.[203]

B. Timing of Member Benefits

When co-op distribution expenses are excessive, margins are less likely to be available to return to members although, with enough rate increases, even inefficient co-ops can generate positive margins. Since most states do not regulate co-op rates,[204] co-ops are free to raise rates until members revolt at annual meetings, a very difficult task. Whether or not the co-op is running efficiently, there are several ways of estimating whether a co-op has an adequate capital cushion.[205] The appropriate level of equity for co-ops depends on several factors including loan covenants, expected capital needs, and, of course, board discretion.[206]

The simplest financial test of a co-op's ability to benefit members is to determine the co-op's "equity as a percent of assets." According to RUS loan covenants, the minimum equity threshold is thirty percent, but the RUS recently waived this "current ratio test"[207] for all co-ops. The result is that

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[199] CO-OP STATISTICAL REPORT, *supra* note 62, at 18.

[200] FRAMEWORK, *supra* note 27, at 35 ("Many co-ops are now considering mergers as a means to reduce costs and rates, because consumer size of a co-op is the most statistically significant indicator of a distributor's costs. For example, if a 3,000 member co-op merged to become a 15,000 member co-op, it could reduce costs by average of $220 per customer per year. Can we afford not to consider mergers?").

[201] Vital Signs, *supra* note 118, at 47.

[202] FRAMEWORK, *supra* note 27, at 34A.

[203] NRECA, Vital Signs, *supra* note 118, at 46.

[204] *See supra* notes 50, 51, 53, 70.

[205] The CFC boasts about its Key Ratio Trend Analysis (KRTA) statistical test, which includes 145 ratios of performance variables for each co-op for the last five years. *See* Press Release, CFC, 2006 KRTA Reflects Electric Co-ops' Consistent Financial Strength (Aug. 29, 2007) [hereinafter Press Release], *available at* http://www.nrucfc.org/news/pdfs/krta_press_release8-29-07_.pdf.

[206] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 36.

[207] Memorandum from Blaine D. Stockton, Assistant Adm'r, Electric Program, Rural Utils. Serv., U.S. Dep't. of Agric., to All Electric Borrowers on Waiver of Provisions of RUS Loan Documents and Current Ratio Distributions (May 15, 2001), *reprinted in* NRECA & CFC, LEGAL SUPPLEMENT, *supra* note 23, at 14. *See also* Loan Security Documents for Electric Borrowers, 7 C.F.R. §1718.6.8 (2003); Post-Loan Policies and Procedures Common to

co-ops with equity levels far below thirty percent can refund capital credits. Today, distribution co-ops average 42.01% equity, but many are above 50% or 60% and some even reach 92%.[208] These data mean that, although co-ops can safely borrow more than two dollars for every dollar of equity, most co-ops are borrowing significantly less.[209]

Another threshold for co-op financial performance is TIER (times-interest-earned ratio), which measures co-ops' ability to pay interest on debt. The suggested appropriate TIER is 1.25.[210] Most co-ops today easily meet this threshold. The median electric co-op TIER was 2.29 in 2006, or nearly twice the financial strength that is required.[211]

These ratios indicate that co-ops are overcapitalized by roughly ten to thirty percent. Electric co-ops pass the "current ratio" and TIER tests so easily that the tests seem obsolete, which the recent RUS waiver of the current ratio test demonstrates. Individual co-ops vary but, in the aggregate, co-ops could offer one-time benefits to their owners of three billion to nine billion dollars without endangering co-op financial stability. Co-ops could also continue capital credit refunds at a higher level than today. In fact, such an enhanced refund policy would strengthen co-ops' tax and legal position as well as their relationship with customers.[212]

The irony of RUS loan covenants is that they were drafted to prevent co-ops from being too generous to their members.[213] Now the problem is often the reverse: not being generous enough. Equity is accumulating faster than co-ops are returning it to its rightful owners. Not even the blanket waiver of the "current ratio test" has induced co-ops to refund more capital. The "limited benefit to the co-op" principle is being stretched to the limit,[214]

Insured and Guaranteed Electric Loans, 7 C.F.R. §1717.617 (2006). Historically, according to Schmidt, "REA personnel have urged some of our clients [co-ops] to pay cash dividends to patrons when the members' equity was ten percent or less." SCHMIDT, *supra* note 123, at 174.

[208] CO-OP STATISTICAL REPORT, *supra* note 62, at 18. *See also* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 37 (noting that "[s]ome co-operatives have reached the conclusion that it is in the members' best interest to finance the co-op entirely through equity, while others would use 100 percent debt financing if possible. The best approach avoids either extreme.").

[209] *See* Frank W. Bacon et al., *Co-operative Debt Usage: The Case of Rural Electric Co-operatives*, CO-OPERATIVE ACCOUNTANT, Fall 1995, at 36 (finding that co-op debt levels have fallen substantially since 1980, and are lower in the Eastern U.S. than in the West).

[210] Rates to Provide Revenue Sufficient to Meet Coverage Ratios Requirements, 7 C.F.R. § 1718 subpt. C, app. A, § 5.4 (2006).

[211] Press Release, *supra* note 205, at 1.

[212] If co-op managers were able to designate five percent of capital credits for an anti-takeover fund to improve their own job security, co-ops should be able to return a higher percentage of capital credits to co-op members as refunds. *See supra* note 32.

[213] *See* NRECA & CFC, LEGAL SUPPLEMENT, *supra* note 23, at 14.

[214] Because co-ops have accumulated twice the amount of capital required by regulators before the regulators waived the capital requirement entirely, co-ops seem to have built up greater reserves than any regulator, or customer, could have anticipated or intended. *See* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 35.

as is the tax-favored status of co-ops.[215] As the leading author on electric co-ops states:

> Any net margin of revenue over expenses is credited to members in proportion to their usage of electricity in the form of capital credits, or patronage capital. No interest is paid on this form of investment, but co-operatives are required to return this capital to their members. Size of margins and the timing of capital returns are key decisions for the board [of the co-op].[216]

Board refusal to return equity or lower rates reflects their penchant for gilding financial ratios instead of understanding that, regardless of their monopoly status, co-ops are ultimately in a competitive environment. As the chief economist of the NRECA wrote,

> Co-ops can become much more competitive by simply revising their financial policies. *Reduce margins*. Maintain or *reduce equity*. Reduce general funds. Increase capital credit retirements to all members. These can make a big difference.[217]

The ability of electric co-ops to obtain virtually unlimited equity from their members, while retaining broad board discretion[218] as to when, if ever, members benefit from their ownership, has given them a government-like power to tax[219] and created co-op balance sheets unlike any others.[220] Some

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[215] "The IRS has rarely challenged the business judgment of boards that fail to authorize capital credits retirements. At some point, however, capital accumulation may exceed any legitimate business need. If challenged by the IRS, this has the potential for serious consequences, such as the loss of co-operative status under federal tax law and member relations problems, which could lead to lawsuits to claim member capital or even action by members to sell the system in order to recoup their investment in the co-operative." *Id.* at 10, 54–58. *See also* SCHMIDT, *supra* note 123, at 175 ("The area of exemption from income tax and my advice to my clients became a source of irritation . . . . Briefly, a co-operative pays no income tax because legally it is a nonprofit. This means that the bylaws of the corporation must demand that the corporation divest itself of margins by turning the margins back to the customer, like a sales discount. According to the IRS, this means calculating the amount and notifying the members of the amount.").

[216] PUBLIC UTILITIES REPORTS, *supra* note 13, at 7, 83. "Patronage capital, capital credits, member equity—by any name, any co-op revenues in excess of expenses, or margins, are investments by the members in the organization and ultimately belong to the members and should be returned to them. Patronage capital is allocated to individual members based on the member's use of electricity, or contribution to margins. A co-operative member does not receive a return on this investment in the co-operative, other than the ability to buy power essentially at cost." *Id.*

[217] *See* FRAMEWORK, *supra* note 27 (emphasis in original).

[218] Strait notes that "[i]n most cases, the board of directors of electric and telephone co-operatives have considerable discretion in redemption of capital credits. Their bylaws typically provide that redemption of capital credits is within the discretion of the board based on the circumstances and financial condition of the co-operative at that time. Therefore, capital credits allocated to utility patrons normally do not have a readily determinable value and thus do not give rise to income at the time of allocation." Strait, *supra* note 168, at 61.

[219] Munis are particularly prone to add city expenses to electric bills, effectively taxing residents through their electric meter for other city services. Co-ops can cross-subsidize businesses other than electricity unless strict accounts are kept, and, even then, money is fungible.

co-ops operate almost entirely on equity, if only due to their board's distaste for debt. Equity is perceived as either costless[221] or extremely cheap.[222] Therefore, debt—even at subsidized interest rates—is co-ops' most expensive form of capital.

This upside-down world of co-op finance has created several anomalies. Co-op managers argue that returning any capital credits to members, or reducing any New Deal subsidies, would force them to raise electric rates unnecessarily.[223] Co-op managers are essentially saying that any change in the status quo would harm members. This argument, though it sounds persuasive, is flawed. It assumes that all co-ops are efficient and should be able to continue their current practices—practices which amount to confiscating member equity.

The ultimate issue in co-op refund policy is intergenerational fairness. As the NRECA says, "retiring capital credits is a way to ensure that each generation of members pays its own way by providing its own equity."[224] But co-op managers naturally tend to favor new customers over old, knowing that older customers have already paid a lifetime of margins and are powerless to reclaim them. Co-op managers are motivated to boost sales to new members and those with future buying power.[225] If co-ops offer refunds

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[220] *See* Claudia Phillips, *Revisiting Equity Management–The Art of Wise Compromise*, MGMT. Q., Winter 2001, at 24.

[221] WILLIAMS, *supra* note 14, at 130. ("Some people said it was zero cost capital and that you shouldn't give back zero cost capital, only to borrow at 7 to 10 percent . . . [but] we have to return capital to the membership. We just can't keep it indefinitely.") *Cf.* Wesley M. Jackson, Assistant Chief, Distrib. Mktg. Branch, Testimony to Capital Credits Study Comm. 3 (Oct. 1, 1974) (noting that "[t]he refund to members of their capital contributions deprives the co-operative of interest-free equity capital. It increases the cost of doing business . . .").

[222] NRECA appears to be on the defensive on this key issue. *See* NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 36 ("Since a co-operative is not allowed to pay a return on equity contributed by its members, some people say that the cost of equity to a co-operative is zero, but that is incorrect. The Goodwin formula offers a more realistic view. It calculates the return on equity a co-op must earn to maintain equity at a given level while meeting growth needs and retiring capital credits. It shows that there is a cost of equity even for a co-op experiencing very low growth."). NRECA's reasoning is specious, however, because co-ops may use members' margin payments indefinitely, and without cost to the co-op. The Goodwin formula also falsely implies that faster-growing co-ops have a higher cost of capital, simply because they are growing, when such co-ops have access to more such margins.

[223] The manager of Duck River Electric Membership Co-operative, Jim Allison, said that "if DREMC were to reduce its equity to 40 percent . . . it would require the utility to raise its electric rates to compensate–robbing Peter to pay Peter, as it were." John I. Carney, *DREMC official responds to Cooper equity comments*, SHELBYVILLE TIMES-GAZETTE, April 12, 2004, at 1. However, any rate increases that a more generous refund policy could cause would be small, if not negligible. One article found that another Tennessee co-op could refund $366 to each of 150,000 customers while maintaining equity at forty percent. Assuming the co-op borrowed the amount of the refund, it would cost each ratepayer 50 cents per month. Snyder, *supra* note 35.

[224] NRECA & CFC, TASK FORCE REPORT, *supra* note 17, at 10.

[225] "Last-in, first-out" or LIFO refund policies return the margin payments of the newest customers first, retaining older customers' capital credits longer. Under the "percentage" method, both new and old customers receive refunds, according to the fraction chosen. *See* WILLIAMS, *supra* note 14, at 133 ("You might as well burn the money in terms of what it does for your co-operative [by refunding capital credits to old customers]. By retiring capital cred-

at all, co-op managers increasingly favor "last in, first out," or "percentage-based," refund plans that favor newer customers.[226] Decreasing the benefits distributed to long-time customers subsidizes newer customers with the older customers' equity.

C. *Ways of Benefiting Members*

Once a co-op board has determined that there is a surplus in its patronage capital account, and allocated that surplus to its members, it finally has the ability to provide "at-cost" service. The primary tools are reducing rates, volume, or patronage capital. Although economists consider these three member benefits to be similar, they have very different practical effects.

Lowering electric rates benefits members according to their future usage, but rates are very difficult for members to monitor and compare. Most members do not track their bills year-over-year closely enough to appreciate a reduction in millage rates.[227] Lowering electric rates also reduces incentives for conservation.[228] Finally, without knowing the size of a member's capital account, it is also hard to compare the rate reduction to member equity.

Lowering the volume of electricity purchased is ultimately up to the customer, not the co-op, although higher rates for electricity at times of peak demand can influence customer decision-making. Co-ops often underestimate the need for conservation which, according to some utility experts, is seventy-five percent cheaper than new base load generation.[229] The co-op is uniquely able to educate customers on the costs and benefits of better home insulation, more efficient bulbs and appliances, or timing the use of appliances at night.[230] Digital readout meters or even a more visible meter loca-

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its on a percentage basis, we felt that current members would see a rebate now, an ownership interest in the system, and better understand the philosophy of co-operatives. If they had to wait 20 or 30 years to get their patronage capital, they wouldn't get the same feeling.").

[226] *See id.* at 41 (showing that 36% percent of co-ops use one of these refund methods, as opposed to 41% percent for FIFO).

[227] Customer-friendly billing software could help members compare, for example, rates in August 2008 with those from August 2007. This could help customers compare their electricity usage during similar seasons.

[228] Some studies have estimated that the elasticity of demand for electricity is -1.0, meaning that a 25% drop in rates would result in a 25% increase in consumption. Michael T. Maloney & Robert E. McCormick, Issue Analysis: Customer Choice, Customer Value—Setting the Record Straight: The Consumer Wins with Competition 8, Citizens for a Sound Economy, Jan. 30, 1997.

[229] Letter from Tom Kilgore, President and CEO of TVA, to author (March 14, 2008) (on file with the author).

[230] In its 2006 Annual Report, NRECA presented statistics about co-ops' promotion of energy efficiency and conservation, such as "92% [of co-ops] actively educate consumers on energy conservation" and "41% offer weatherization services," but did not indicate how effective these education or weatherization opportunities are. NRECA ANNUAL REPORT, *supra* note 138, at 22.

tion can help customers understand how much excess electricity they are consuming.

The best way to achieve "at cost" electric service is, as the NRECA agrees, increased return of capital credits to co-op members. In 2006, $499 million of electric co-ops' $31 billion in patronage capital was returned,[231] although many co-ops, including some of the most prosperous, never return any credits.[232] Co-ops that make refunds should also disclose the size of a member's remaining patronage account in order to improve co-op accountability.[233] An interesting question is whether members should also be able to benefit more directly from the $3.9 billion investment that co-ops have made in CFC, itself a co-operative that is wholly owned by co-ops.[234]

An indirect benefit to members—as well as the public—is reducing the environmental harm that power generation inevitably produces.[235] Burning coal produces pollutants such as mercury, sulfur dioxide, nitrogen oxide, and particulates, which harm the region surrounding the power plant and beyond. Another form of pollution, carbon dioxide, affects the global environment. Of course, most other energy sources pollute as well,[236] whether CO_2 from natural gas or long-term radioactive waste storage for nuclear plants.

Some co-op managers are glossing over the environmental impacts of their decisions and exerting their political influence to exempt co-ops from laws that apply to other utilities. Montana and Virginia co-ops recently lobbied their U.S. Senators to allow a twenty-year delay in complying with new pollution control standards.[237] They argued that avoiding national pollution

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[231] *See* NRECA, About Us, http://www.nreca.org/AboutUs/Co-op101/Co-operativeFacts.htm (last visited Mar. 9, 2008). Co-ops are not required to file Form 1099 to report payments of capital credits, except for business customers (who presumably have deducted their purchases of electricity, unlike residential customers). *See* James Howard Smith, *IRS Proposes Examination Guidelines for Rural Electric Co-operatives*, CO-OPERATIVE ACCOUNTANT, Fall 1996, at 32.

[232] The largest co-op in America, Pedernales Electric Co-operative, had not paid one until scandal forced them to this year. Claudia Grisales, *Pederanales Execs Plan to Step Down*, AUSTIN AM.-STATESMAN, Nov. 14, 2007, at A1.

[233] The ratio of the member's refund to the remaining balance of the member's capital credits account determines the member's return on his or her investment, loan, or contribution. *See supra* note 153. Ideally, the co-op would help the member understand how much a delayed return of equity has cost the member due to inflation. *See supra* notes 161, 222.

[234] *See* NATIONAL RURAL UTILITIES CO-OPERATIVE FINANCE CORPORATION, 2007 CFC ANNUAL REPORT 8 (2007).

[235] Co-ops have been aware since at least the mid-1990s that "the environmental impact of electric generation [is] a national concern." WILLIAMS, *supra* note 14, at 151.

[236] New hydro power requires dam construction, interrupting free-flowing streams and often depleting oxygen levels in lake water. Wind power generates noise pollution and harms bird migration. Solar power may involve toxic substances in its manufacture. As of the mid-1990s, co-ops owned "over 3,000 megawatts of operating nuclear capacity in 15 plants." *Id.* at 173.

[237] Efforts by Sens. Max Baucus (D-Mont.) and John Warner (R-Va.) enabled co-ops in Montana and Virginia to get 20 additional years to meet emissions standards for greenhouse gases, and obtain emission allowances that could be worth as much as $4.2 billion over that time period. *See* Faith Bremner, *Sweet Deal for Montana Rural Electric Co-ops in Climate Bill*, GANNETT NEWS SERVICE, Nov. 8, 2007.

control requirements is more valuable than cleaner air to their members.[238] It is unknown whether co-op managers considered the damage to customer health that increased and prolonged pollution can cause. It is unlikely that co-op members were aware of the decision by co-op managers to lobby on their behalf, and possibly against their interests.

V. Strategies for Change

There are a number of ways that co-ops could return to their pro-consumer roots, but each will require a radical change in the attitude of co-op directors and managers. These co-op insiders have benefited most from the erosion of co-operative principles and will probably be the chief obstacles to reform.[239] This is a classic "principal-agent" problem because the principals (co-op members) are unable to control their agents (co-op directors and managers), in part due to collective action problems and prohibitive monitoring costs. These agents have entrenched themselves in their control of the co-ops and sometimes run the co-ops to the detriment of the members' best interests. The situation is so severe that even the agents' agents, namely the NRECA and CFC, seem to be quietly siding with the principals.[240] Because it is unlikely that co-op insiders will voluntarily change their behavior, even at the urging of their own advisors, legislation will be necessary.

Restoring the original mission of co-ops—i.e., "at cost" service, including the costs of electricity waste and pollution—will require the following legislative steps:

- Operations: Increasing co-op minimum size in order to promote efficiency and conservation; analyzing future power demand.
- Governance: Mandatory disclosure of membership interests, a grading system so that members can easily evaluate co-op performance, and, at least for larger co-ops, making membership interests securities. Taking co-ops public is one way to achieve all of these objectives by vote of the membership.
- Subsidies: After seventy years of subsidies, only co-ops that need government help should receive it. Threatening to withhold federal assistance will also aid compliance with the preceding co-op reforms.

A. *Operations: Optimizing Co-op Size*

In the short term, increasing the number of each co-op's customers means either expanding service areas or combining with another co-op or

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[238] *Id.*

[239] The author's access to NRECA's and CFC's password-protected website, www.cooperative.com, was terminated by late March, 2008.

[240] NRECA publications and The CFC Story have adopted a critical but polite tone towards co-op business practices. *See, e.g., supra* notes 25–27, 69, 137. NRECA speeches, in contrast, are very diplomatic, often pandering. *See, e.g., supra* notes 24, 58, 59, 64, 100.

power company, either by merger or acquisition. Other co-ops are the most obvious merger candidates,[241] but co-ops should not neglect opportunities to merge with munis or telephone co-ops; both are already community-owned and may provide more synergy. Munis have higher customer density as well as smaller average size, making them ideal takeover targets if local governments can be persuaded to relinquish ownership.[242] Of course, sometimes the merger should go the other way, with munis acquiring co-ops. It will be interesting to see whether members care enough about belonging to a co-op to revive its atrophied features, or whether "municipalization" (i.e., becoming a taxpayer without equity in the local power company), is sufficient. For small patronage-capital holders, the debate is academic; for large accounts, mergers could unlock a lot of value.

The most aggressive bidders for co-ops may also be neighboring IOUs, although co-ops are also capable of acquiring IOUs.[243] IOUs are usually much larger than co-ops and more accustomed to acquisitions. Allowing takeovers from outside the public-power "family" is controversial, but suburban co-ops already have much in common with IOUs. The principle of "member benefit" should guide any such transactions, just as "shareholder benefit" theoretically guides corporations.

The rapid decline in the number of telephone co-operatives in recent decades is an indication of the merger potential of electric co-ops, particularly if their local monopolies erode.[244] There were 878 rural telephone co-ops in 1980, but only 227 today.[245] Over the same time period, the number of electric co-ops has declined only from 1,020 to 930 because electric monopolies remain robust.

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[241] A few co-op mergers are taking place, with significant savings for members. *See, e.g.*, Lauren Donovan, *Consolidated Co-op OK'd*, BISMARCK TRIB., Dec. 8, 2007 *available at* http://www.bismarcktribune.com/articles/2007/12/08/news/local/144061.txt (merger of Oliver Mercer Electric Co-operative with West Plains Co-operative, member savings projected at $5 million over 10 years); Jannette Pippen, *Opinions Mixed on Possible Co-op Merger*, DAILY NEWS (Jacksonville, N.C.), Nov. 26, 2007, *available at* http://www.jdnews.com/news/island_53516___article.html/harkers_merger.html (merger of Carteret-Craven Electric Co-operative with Harkers Island Electric Membership Co-operative, member savings projected at $6 million over 10 years). For an earlier example of a co-op merger, see Shane Adams, *The Merging of Two Electric Membership Co-operatives*, CO-OPERATIVE ACCOUNTANT, Fall 1999, at 76.

[242] *See* RON NICHOLS, NAVIGANT CONSULTING, COST SAVINGS FROM ALTERNATIVE COMBINATION OF MUNICIPAL LIGHT & POWER AND CHUGACH ELECTRIC ASSOCIATION (2007), http://www.muni.org/iceimages/mayor/ACF1471.pdf (last visited Feb. 8, 2008) (demonstrating several ways of combining a co-op and a muni; also projecting savings of as much as $218 million over 10 years).

[243] *See* PUBLIC UTILITIES REPORTS, *supra* note 13, at 167–168.

[244] Deregulation of the telecommunications industry fostered the formation of the competitive local exchange industry ("CLECs") comprised of smaller telephone companies which have consolidated and offered enhanced telecommunications services. Not all have been successful. The New York firm Forstman-Little invested $1.2 billion in McLeodUSA, a rollup of telephone co-operatives and other carriers that resulted in bankruptcy. Adam Lishinsky, *How Teddy Forstmann Lost His Groove*, FORTUNE, June 26, 2004, *available at* http://money.cnn.com/magazines/fortune/fortune_archive/2004/07/26/377149/index.htm.

[245] *See* TELECOMMUNICATIONS STATISTICAL REPORT, *supra* note 12.

More efficient co-ops will result in lower members' bills. Most co-ops have experimented with other lines of business than electricity, with mixed success.[246] Co-ops could have concentrated on their core business instead by finding new ways to benefit electric customers. Conservation directly benefits members and does so in the amount of the members' own choosing. Every co-op should be mandated to promote conservation in ways that have proven to be effective.[247]

Of course, conservation will also slow the growth of co-op sales. Co-op managers have been paid to boost consumption for so long[248] that they have naturally been slow to innovate with variable-price electricity, time-of-day meters, remote monitoring of meters, and prepaid electricity cards. These and other demand management techniques should be promoted by co-ops in order to put members first. Once co-ops have lowered members' bills, they should be allowed to continue venturing into other lines of business that are appropriate for co-ops.

Co-ops should be extremely wary of the effort to take advantage of co-ops' superficially strong balance sheets in order to finance a particular energy industry's new mode of power generation.[249] Most co-ops lack the expertise to make such a commitment to coal or any other fuel, and their capital should be for the benefit of members, not energy companies. Co-ops over-invested in new generation capacity in the 1970s, resulting in wasted capacity and bankrupt co-ops.[250] Co-ops are unusually dependent on coal-fired steam plants, relying on them for eighty percent of their power versus fifty percent for IOUs. As a result, co-op decisions about new generation capacity may be biased toward coal. Some investment in coal-fired steam plants may be necessary, but co-ops are not able to decide such questions without thorough research and the approval of their members, after careful consideration of the environmental impact.

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[246] *See, e.g.*, Wallace F. Tillman, Moderator, *How Can Your Cooperative Meet the Legal Challenges of Restructuring and Diversification,* NRECA 1999 Annual Meeting, Monday, March 8, 1999, PowerPoint Presentation (on file with author).

[247] NRECA survey data of 88% of co-ops offering renewable energy, 77% offering energy-savings audits, etc. do not reveal how effective these offers have been. More persuasive are the 49% of co-ops that offer financial incentives for customer efficiency/conservation, or the 37% that have direct control over some members' appliances, or the 40% that have advanced metering devices. Still, even these numbers do not reveal how much electricity waste is reduced. Getting all utilities to share best practices should enable co-ops to regain their credibility as the most consumer-friendly of the power companies in regard to conservation. *See* Nreca Annual Report, *supra* note 138, at 22–23.

[248] In the same NRECA Annual Report, conservation is relegated to the last two pages of the Report, despite the phrase, "Co-ops aggressively promote energy efficiency and conservation." *Id.*

[249] The NRECA 2006 Annual Report reads like coal industry promotion, particularly the opening letters from the Chairman and CEO. *Id.* at 1, 3. The bankruptcy of Sunflower Electric Co-operative was caused by construction of an unneeded 280 megawatt coal-fired steam plant. *See* WILLIAMS, *supra* note 14, at 229.

[250] *See* PUBLIC UTILITIES REPORTS, *supra* note 12, at 104; *see also supra* note 63.

B. Governance: Empowering Members

Once co-ops are large enough to be efficient and more focused on serving their members' needs, co-op members must be enabled to protect their own interests. Empowerment is better than rate regulation by state utility commissions because it enhances "The Co-op Difference." Empowerment begins with requiring all co-ops to disclose each member's equity stake at least annually and easing member access to their capital credits. Every co-op with a strong balance sheet should return some credits.[251] This would reinforce NRECA's own advice and could be achieved at low cost since co-ops already have the software and monthly contact with customers to return capital credits efficiently.

In addition, a simple grading system should be developed so that all members can easily evaluate their co-op's relative performance against their peers by using benchmarks that are appropriate for co-ops. To further empower members, Congress should pre-empt the portions of state electric co-op laws relating to proxy voting and quorum requirements so that members can better defend their own interests at annual meetings. These changes should be sufficient for all but the largest of co-ops which, due to their similarity to IOUs, must do more to protect member interests.

The risk of the disclosure approach is that many newer co-op members would still not consider their ownership stake large enough to be worth the effort to obtain and analyze co-op information, and that many older members, even with large accounts, might remain passive. For this reason, at least for larger co-ops, capital credits should be made "securities" under the federal securities laws.[252] Alert judges should already realize they are securities, but it will probably be necessary for Congress to clarify the Securities Act of 1933, which fudged the issue. Trial lawyers would jump at the chance to seek damages under the securities law for co-op abuses of member rights.

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[251] This advice is hardly new to co-ops. *See* Strait, *supra* note 168, at 62 ("To engender member loyalty and attenuate possible take-over threats, some utility co-operatives are considering patronage capital redemption approaches already used by other types of co-operatives. Electric and telephone co-operatives with strong equity balances are considering whether or not the redemption cycle for capital credits can be shortened. Others are examining whether the traditional first-in, first-out redemption approach to a base capital plan, percentage-of-all-equities redemption plan, or another plan which results in earlier redemption to current patrons.").

[252] "The larger the co-op, the more it looks like a public company. So the more you would expect it to follow public company norms in terms of its governance." Grisales, *supra* note 193 (quoting Charles Elson, John L. Weinberg Center for Corporate Governance, University of Delaware). *See also* Frank A. Taylor, *Are Financial Instruments Issued by Agricultural Co-operatives Securities?: A Framework for Analysis*, 5 DRAKE J. AGRIC. L. 171 (2000) (discussing agricultural co-operatives and securities); Kathryn J. Sedo, *The Application of Securities Laws to Co-operatives: A Call for Equal Treatment for Nonagricultural Co-operatives*, 46 DRAKE L. REV. 259 (1997) (same); William E. Van Valkenberg & Robert G. Bergquist, *Securities Law Update: Reves v. Ernst & Young*, CO-OPERATIVE ACCOUNTANT, Summer 1990, at 36 (arguing that demand notes issued by a co-operative are securities under federal law).

Litigation would lead to instant co-op reforms, but attorney fees and court costs would be high.

Fortunately, an elegant and voluntary means of empowerment exists that also avoids litigation. Informed co-op members should vote to take their co-op public on the NASDAQ stock exchange.[253] Although initial public offerings sound radical to incumbent co-op managers, this way of unlocking shareholder value is commonplace in the business world. Unfortunately, because so few co-op managers are familiar with the process, it looks more threatening than it is. Essentially, members would be choosing to turn their capital credits into securities that are traded on the stock exchange.

The widespread conversion of mutual insurance companies, savings and loan associations, and credit unions to stock companies shows that member rights can be enhanced by floating shares in public markets.[254] Of course, when poorly handled, such conversions can disproportionately benefit insiders. Nevertheless, this abuse can be avoided if careful attention is paid to the terms of the offering. The key benefit of conversions is that a member's ownership becomes instantly visible, liquid, and priced to the market every day. No member would have to sell their stock after such an offering; in a well-run co-op, no one would want to. Voluntary conversion allows members to decide what is best for themselves and their property, ending the paternalism of co-ops' current method of operation.

C. Subsidies: Means-Testing Co-ops

The final co-op reform is the most obvious and overdue. If federal aid were restricted to the co-ops that truly needed help, and suburban co-ops were left to fend for themselves, federal taxpayers could save money and improved co-op management might result.[255] Means-testing co-ops will almost certainly be bitterly resisted by co-op managers, but co-op members themselves would probably not be so critical. Most Americans claim to be opposed to government waste; they know it does not make sense to subsidize utilities that serve wealthy counties,[256] whether they are IOUs, munis, or co-ops. Removing federal subsidies for co-ops would strengthen the argument for dismantling the larger subsidies for IOUs and munis. Selective removal could also be an effective enforcement tool against co-ops that refuse to become more efficient or member-friendly.

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[253] The author participated as an investment banker in one such effort to take a telephone co-operative public in 2000. *See* DTC Commc'ns Corp., Prospectus (Rule 424(B)(3)) (Jan. 11, 2000), *available at* http://www.sec.gov.

[254] *See* WEISBROD, *supra* note 16, at 129–150.

[255] The Bush administration has proposed that each co-op recertify its rural status before new loans can be made to it by the RUS. *See* OFFICE OF MGMT. & BUDGET, APPENDIX TO THE BUDGET OF THE UNITED STATES, FISCAL YEAR 2008, at 146 (2007).

[256] A key advisor in the formation of CFC said, "Any subsidy [to co-ops] should be justified on the basis of national interest involved, such as the immense task of rural development." WILLIAMS, *supra* note 14, at 38–39.

A tougher question involves the possibility of removing tax-favored status from wealthy co-ops that, for example, no longer serve rural areas, refuse to keep open records, fail to refund capital credits, or have diversified far outside the electricity business. Many co-op managers view tax-favored status as a permanent entitlement instead of a special incentive to provide public goods. Revising co-op tax status for prosperous co-ops would also allow legislators to consider removing the tax subsidies from other power companies.

VI. Conclusion

Too many electric co-ops have turned away from their historic role as exciting, pro-consumer organizations and have instead taken on deeply troubling anti-consumer behaviors. Ideally, co-ops will return to their roots voluntarily, but a legislative push will likely be necessary. Carefully considered, member-friendly reforms are long overdue in order to protect the rights of the co-ops' legal owners, including members' rights to receive refunds of $3 billion to $9 billion of capital credits. In addition, the conservation and environmental impact of co-op decision-making must be considered. It is time for members to take back their property and their co-ops, for the good of themselves and their country.

Chairman WAXMAN. I am looking forward to the testimony of our witnesses and learning more about this important issue.

[The prepared statement of Chairman Henry A. Waxman follows:]

Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
Governance and Financial Accountability of Rural Cooperatives:
The Pedernales Experience
June 26, 2008

Today's hearing focuses on an important issue that has received little attention: electric cooperatives and the billions of dollars they control.

Electric cooperatives are unique structures that provide electricity to millions of customers in rural and suburban areas. They are nonprofit utilities that are owned by their customers and, at least in theory, are supposed to be democratically controlled. Nationwide, there are 930 co-ops serving over 17 million customers.

What isn't widely known is that these co-ops control over $30 billion in customer equity. In many cases, even the customers don't realize it's their equity and don't know how the co-ops are spending their money.

I want to thank my colleague and friend, Jim Cooper, for bringing this issue to the Committee's attention. It's exactly the kind of issue the Oversight Committee should be looking at. And from what we've already found, this is an area in strong need of accountability.

In fact, two of the witnesses we wanted for this hearing have refused to attend. They declined to appear voluntarily, and they have evaded federal marshals who tried to serve them with subpoenas. The federal marshals believe one of the witnesses is now hiding in a remote New Mexico ranch.

The two witnesses essentially ran the Pedernales Electric Cooperative in the Texas Hill country. This co-op has a proud history, having been created in 1935 by a young congressman by the name of Lyndon Johnson. It is now the largest co-op in the United States.

But Bennie Fuelberg, the former Pedernales General Manager, and Bud Burnett, the former Pedernales President, aren't reflecting the co-op's proud history by refusing to explain their apparent self-dealings.

There is compelling evidence that the Pedernales co-op used its customers' equity as a private piggy bank.

Mr. Fuelberg, Mr. Burnett, and the Pedernales board paid themselves well. In 2007, Mr. Fuelberg received over $1 million in salary, benefits, and bonuses. In just five years, Mr. Fuelberg and the board spent $700,000 to stay at five-star hotels like the Ritz Carlton and the Four Seasons, dine at expensive restaurants, and buy themselves fancy chocolates and Celine Dion concert tickets.

They also spent millions of dollars in an unsuccessful legal battle against their own customers.

We'll learn more about all of this from our witnesses, which include Pedernales co-op members, two members of the Texas legislature, and the newly hired general manager of Pedernales.

But the questions about potential abuses by co-ops aren't limited to the Pedernales co-op. And that brings us back to the $30 billion in customer equity I mentioned a few moments ago.

The Pedernales experience tells us we need to examine whether co-ops are being run in a truly democratic fashion. And we need to take a close look at whether there are adequate financial protections for the investments customers have in these entities.

The 17 million co-op customers' equity investments are worth an average of almost $2,000 apiece. But there appears to be little transparency and accountability for how co-ops use these funds.

I know co-ops have done a tremendous amount of good for millions of Americans. And I know it's unfair to suggest that potential wrongdoing at the Pedernales co-op is typical for all co-ops. Congressman Cooper has done a real service by setting the right balance for these issues in a recent article in the Harvard Journal on Legislation, and I ask unanimous consent to include it in the hearing record.

I'm looking forward to the testimony of our witnesses and learning more about this important issue.

Chairman WAXMAN. I now want to recognize for his opening statement any Member who wishes to make an opening statement. Mr. Sali.

Mr. SALI. Thank you, Mr. Chairman. I want to thank you for calling this important hearing about the governance and financial accountability of rural electric cooperatives. We will hear here today that the Pedernales incident in Texas is indicative of the conduct of rural electric cooperatives across the country. I anticipate we will hear remarks that most rural electric cooperatives are poorly managed and may need further regulation.

Certainly in Idaho—I would presume in many areas of the country—rural electric cooperatives serve a critical and positive role in our communities, providing service to rural areas at an affordable rate.

In the northern part of my District in Idaho, if you will look at the map there, there are several electric cooperatives providing electricity to just over 100,000 residential and business consumers. These electric cooperatives serve some of the most isolated, rural consumers in our Nation. On average, the electric cooperatives in Idaho serve 6 customers per mile of wire, in contrast to the 20 customers per mile of wire for the investor-owned utilities.

I have serious concerns if, by holding this hearing today, this committee is suggesting that we must impose more stringent regulations on the rural electric cooperative industry due to the mismanagement of one cooperative. Regulations already exist at the cooperative board level and at the State level, and the cooperatives in northern Idaho already have transparency policies in place where consumers can review all financial data on a Web site.

Most cooperative consumers in Idaho receive a capital credit refund. In the case of Clearwater Power—that is the green area on the map—General Manager Dave Hagen stated, "Our consumers have received capital credit refunds since 1988 amounting to the total of $5 million."

Additional regulations imposed at the Federal level will only increase the cost of electricity to our rural communities and small businesses, which are already struggling to get by as they struggle with high food prices and high gas prices.

My constituents cannot afford higher electric bills with the cost of gasoline and food on the rise, as well. New regulations and higher utility bills are an unnecessary burden, especially for my constituents in north Idaho who receive electricity from a cooperative because their per capita income is just $18,555, and they have an average household income of $6,000 less than the other utility consumers in my State. This would be a tremendous burden for them.

For these reasons, Mr. Chairman, I respectfully will oppose any new regulatory burden that would increase the cost of doing business for the rural electric cooperative industry. I would ask my colleagues to do the same.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Bill Sali follows:]

Statement of Bill Sali
Oversight and Government Reform Committee
Hearing on "Governance and Financial Accountability of Rural Electric Cooperatives: the Pedernales Experience"
June 26, 2008

Mr. Chairman and Ranking Member Davis,

I want to thank you for calling this important hearing about "Governance and Financial Accountability of Rural Electric Cooperatives."

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For these reasons, Mr. Chairman, I respectfully oppose any new regulatory burden that would increase the costs of doing business for the rural electric cooperative industry, and would ask my colleagues do the same.

Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Mr. Sali.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I really regret that we must have this hearing today. I love electric co-ops and I don't want to see any of them harmed. But I also love co-op customers. So far, I have not introduced any legislation because my only goal is to return co-ops to their roots. I don't even want to draw attention to co-ops because I know how publicity shy they are.

My father helped start a rural electric cooperative and I have represented roughly 20 electric co-ops, or at least their customers, and that is perhaps more than any other Member.

I started learning about electric co-ops almost two decades ago when I first attended a co-op annual meeting. For almost 10 years I have been talking privately with various co-op leaders, speaking at co-op conventions, both State and national, to warn them about problems that even I could see as a co-op observer.

I worked hard for many years to solve co-op problems within the co-op family, but I was rebuffed at almost every turn, so here we are today with one, the largest co-op in America, in serious scandal; two, its former leaders hiding from Federal Marshals; and, three, loads of other co-op problems bubbling publicly to the surface.

For much of the last 10 years I didn't really know for sure whether my co-op worries were justified, but then I saw the outstanding reporting of Margaret Newkirk of the Atlanta Journal Constitution and of Claudia Grisales of the Austin American Statesman chronicling the abuses of Georgia and Texas co-ops. I also found that TVA, the Tennessee Valley Authority, Inspectors General had been complaining about Tennessee co-op misbehavior for a long time, but, due to co-op pressure, hiding the report from Congress and, as the IG put it in writing, from shrill media attention.

I also stumbled upon the National Co-op Trade Association's own secret, password-protected Web site and discovered that some of my worst fears about co-ops were substantiated by the Trade Association, itself, and NRECA, the same organization that had been stonewalling me.

That is when I decided to write a law review article that the chairman mentioned. If you have got to wash your dirty laundry in public, you might as well get it cleaned.

I want to make seven quick points: No. 1, if you think Pedernales is the only electric co-op scandal in America, then you believe that there can only be one cockroach. If such abuses can happen in the largest co-op in the country founded by a former U.S. President within sight of the regulators in the State capital in Austin, TX, then I think it can happen anywhere.

Co-ops serve portions of 47 States. They serve 75 percent of the land area of America, and I am thankful for that. Overall, they have done a superb job. But we already know of separate, unrelated, major co-op scandals outside of Atlanta and Birmingham and Fort Worth. Is your State next? How could you even know unless you have seen the audited co-op financials? Or are you willing just

to take the co-op lobbyist's word for it? Our friends in the Texas Legislature did that for too many years.

Point No. 2: co-ops don't have to be mired in scandal to still have serious problems. It doesn't take a spike in temperature to have a sick patient. A chronic, low-grade fever can be just as damaging. The NRECA has been issuing reports for over 30 years warning all co-ops in the country that they need to be refunding more money to customers, because if they don't they risk losing their tax-exempt status. For decades too many co-ops have turned a deaf ear to their own trade association on this and other important issues involving their precious tax-exempt status.

Why would NRECA go to so much trouble and pay for such expensive secret reports as this one that can only be found on their password-protected Web site unless they were really worried about an IRS crackdown under current law? Ironically, much of this hearing will be spent just reinforcing NRECA's own message to its own members.

Point No. 3: are co-op customers being treated fairly today? Remember here that co-ops were founded under Franklin Roosevelt's New Deal to be probably the most pro-consumer organizations in America. Co-ops always brag about the "co-op difference." Yet, NRECA, itself, has written that countless co-op customers, particularly in the most rural areas, pay an extra $220 a year. Why? Just so that their own co-op can remain inefficient.

This is the NRECA book. According to the NRECA, itself, if small co-ops simply merged with other co-ops they could save their customers' 2 months of electricity bills a year. Wouldn't it be nice to give customers a 2-month holiday from their light bills?

Point No. 4: private property rights. Co-op customers really do own their co-op. This isn't any theoretical interest like taxpayers who may have an undivided interest, say, in the Smithsonian Museum. Co-op customers literally have or will have legal title in their own name to a piece of the $30-plus billion in co-op equity. That is about as much stock as Amazon.com has. It averages out to $1,824 per customer, an amount comparable to the economic stimulus checks that Congress voted for just a couple of months ago. Here's the picture. Yet, how many co-op customers have ever been told exactly what is in their co-op account? Have any? I have not found one yet except for one top power company executive who got all of his money out every time he moved from one co-op to another.

Why can't regular co-op customers get this benefit? Or is it reserved for VIPs? After all, internal co-op software calculates individual ownership to the penny, yet co-ops somehow run out of ink on the monthly bills before they disclose your ownership stake.

All this leads me to conclude that this $30 billion plus may be the largest lost pool of capital in America. I estimate that co-ops could safely return between $3 billion and $9 billion of customers' own money to them. This money could help millions of rural ratepayers today who are having a hard time in a soft economy. And it is not a Government handout; this is just a return of the customers' own money.

Chairman WAXMAN. Mr. Cooper, thank you very much for your opening statement. We will allow you to submit additional informa-

tion and material in the opening statement. It is not fair, because you know more about co-ops than anybody else on this committee, so I am reluctant to invoke a time limit on you, but I see other Members are seeking recognition, as well.

Mr. COOPER. Thank you.

[The prepared statement of Hon. Jim Cooper follows:]

Committee on Oversight and Government Reform
Opening Statement of Rep. Jim Cooper
June 26, 2008

Thank you, Mr. Chairman. I regret that we must have this hearing. I love rural electric co-ops and don't want to see any of them harmed… but I also don't want to see any co-op customers harmed. I don't even like to draw attention to co-ops because I know how publicity-shy they are. So far, I have not introduced any legislation to change co-ops because my only goal is to return them to their roots. My father helped start a rural co-op and I have represented the customers of over 20 co-ops during my time in Congress, perhaps more than any other member.

I started learning about co-ops almost two decades ago when I first attended a co-op annual meeting in my district. For almost ten years I have been talking privately with co-op leaders, speaking at co-op conventions – both state and national – to warn them about problems that even I could see as a co-op observer. I've worked hard for many years to solve co-op problems within the co-op family. But I was rebuffed at almost every turn, so here we are today with 1) the largest electric co-op in America in a serious scandal, 2) its former leaders hiding from federal marshals, and 3) loads of other co-op problems bubbling, publicly, to the surface.

For much of the last ten years, I didn't know for sure whether my co-op worries were justified. But then I saw the remarkable reporting of Margaret Newkirk at the *Atlanta Journal-Constitution* and of Claudia Grisales at the *Austin American-Statesman* chronicling the abuses of Georgia and Texas co-ops. I also found that TVA Inspectors General had been complaining about Tennessee co-op misbehavior for a long time but, due to co-op pressure, hiding their report from Congress and, as the IG put it, "shrill media." I also stumbled upon the national co-op trade association's own secret, password-protected website and discovered that some of my worst fears were substantiated by the NRECA itself, the same organization that had been stonewalling me. That's when I decided to write a law review article which is being published this week by the *Harvard Journal on Legislation*. If you've got to wash your dirty laundry in public, you might as well get it clean.

I want to make seven quick points:

1. If you think Pedernales is the only electric co-op scandal, then you believe that there can be only one cockroach. If such abuses can happen in the largest co-op in America, founded by a former U.S. President [SHOW Picture of LBJ], within sight of regulators in the Texas state capitol in Austin, they can happen anywhere. Co-ops serve portions of 47 states. [SHOW MAP and keep it up there] We already know of other, completely unrelated, co-op scandals near Atlanta, Birmingham, and Ft. Worth. Is your state next? How would you even begin to know, unless you've seen your co-op's audited financial statements? Or do you

just take the co-op lobbyist's word for it? That's exactly what legislators in Texas did for too many years.

2. Co-ops don't have to be mired in scandal to have serious problems. It doesn't take a spike in temperature; this chronic, low-grade fever could even be the most damaging to co-op health. The NRECA has been issuing reports for over 30 years warning all co-ops that they need to be refunding more money to customers because, if they don't, they risk losing their tax-exempt status. For decades, too many co-ops have turned a deaf ear to their own trade association on this other issues regarding their precious tax-exemption. Why would NRECA go to so much trouble, and pay for such expensive, secret reports as this one [Cooper: WAVE Report], unless they were really worried about an IRS crackdown? Much of this hearing will be spent spreading NRECA's own message to its members.

3. Are co-op customers being treated fairly? Remember, co-ops were founded under Franklin Roosevelt's New Deal to be the most pro-consumer organizations in America. Co-ops brag about the "Co-op Difference." Yet NRECA itself has written that countless co-op customers pay an extra $220 a year -- why? -- just so their co-op can remain inefficient. [Cooper: SHOW "A Framework for Change."] According to the NRECA itself, if small co-ops simply merged with other co-ops, they could save their customers two months of electricity bills every year. Wouldn't it be nice to give customers a two-month holiday from their light bills?

4. Private property rights. Co-op customers really do own their co-op. And this isn't like taxpayers who, in theory, own an undivided interest in, say, the Smithsonian Museum. Co-op customers literally have, or will have, legal title in their own name to their piece of $31 billion of co-op equity, which is roughly the market value of Amazon.com. This averages out to $1,824 per customer, an amount comparable to the economic stimulus checks that Congress passed this spring. [PICTURE of Stimulus Check and keep it up] Yet how many co-op customers have ever been told exactly what they own? Have any? I have not found one yet, except for one top power company executive who got all his money out every time he moved from one co-op to another. Why can't regular customers get this benefit, or is it reserved for VIPs? After all, internal co-op software calculates individual ownership to the penny; co-ops just run out of ink on their monthly bills before they disclose that ownership stake. All this leads me to conclude that this $31 billion is probably the largest lost pool of capital in America. I estimate that co-ops could safely return $3 billion to $9 billion of customer funds this year. That money could help millions of rural ratepayers today who are having a hard time in a soft economy. And it's not a government handout; it's just returning their own money!

5. When co-ops do not tell their customers the truth about exactly how much of the co-op they own, they break faith with their customers and they effectively confiscate customer property without permission. What if your bank or credit union refused to tell you how much is in your account? And when co-ops fail to

make any refunds, they are unable to settle the accounts of former customers. As a result, many co-ops today are increasingly owned by dead people and people who have moved away, possibly destroying the legal status of the cooperative itself. Co-ops were never intended to be ghost houses.

6. This year, giant energy companies are trying to take advantage of co-ops' strong balance sheets and tax-exempt borrowing authority in order to finance new power generation, particularly new coal-burning units. They want co-ops to generate more power, to increase pollution, and to issue billions of dollars of bonds to be sold on Wall Street. The last time co-ops fell for such a sales pitch was in the 1970s and 1980s, and many co-ops went bankrupt as a result. I think co-ops should make energy conservation their first priority and then, once they have helped reduce their customer's bills, think about other ventures. Let's keep co-op customers healthy and take care of Main Street before we take care of Wall Street.

7. We need more disclosure from co-ops because sunshine is the best disinfectant. Today, even the richest co-ops insist on receiving full federal subsidies, even though some of them don't let the government, or even their own customers, look at their books. Without full disclosure, co-op democracy is a sham and co-op regulation is impossible. The official biography of the lending arm of co-ops, CFC, says that it was formed to tell Wall Street how rich co-ops are, while NRECA is telling Washington how poor they are. When did this double-talk become part of the honorable co-op tradition? Why do co-ops spend almost as much money as Boeing trying to influence Congress? If all co-ops are really as good as motherhood and apple pie, why do they have to spend so much money on politicians? Are these political contributions just a narcotic to keep the regulators and watchdogs asleep?

Thank you again, Mr. Chairman, for holding this hearing. Thanks also to the best staff on Capitol Hill. We have a chance today to help 17 million co-op customers, and probably 40 million rural and suburban residents, get better treatment from their co-op. In my state alone, hundreds of thousands of co-op customers own close to a billion dollars in co-op equity that they have never been told about, and never received a penny of in 70 years. Pedernales also never refunded a penny in 70 years until it was forced to, under pressure. Our job today is to persuade electric co-ops, these wonderful New Deal organizations, to give today's customers a better deal. Co-op customers are getting electricity today, but most of them don't have much power, and virtually all of them are in the dark.

# # #

Chairman WAXMAN. Mr. Davis.

Mr. DAVIS OF VIRGINIA. Thank you.

Let me just thank Mr. Cooper for bringing this up to the committee's attention.

We are here because questions have been raised about the vulnerability and even the relevance of a venerable business model that helped modernize post-Depression rural America and today serves over 41 million consumers in 47 States. Rural electric cooperatives, member-owned power generation and distribution companies, bring the power of economic development and growth to diverse communities who might otherwise languish off the national grid.

But the apparent plundering of one large co-op, the Pedernales in Texas, by entrenched directors and officers has caused some to ask more broadly whether these tax-exempt, federally subsidized organizations are governed democratically, managed efficiently, regulated effectively, or operated transparently enough to prevent self-dealing and abuse.

In the Pedernales case, millions of dollars of capital owned by co-op members was misspent on excessive compensation packages, phantom employees, first-class travel, and luxury hotel expenses. High-living insiders even paid $2,000 for Celine Dion tickets.

So it is fair to ask, as our committee colleague, Representative Cooper, does, if this useful New Deal tool has become a potentially bad deal for taxpayers and customers. In this post-Enron Sarbanes-Oxley era of strengthened corporate governance accountability and transparency, it is worth asking what rural electric co-ops are doing to keep pace with regulatory standards and governance reforms in the increasingly complex and changing electric industry.

At the same time, there is little to suggest the abuses uncovered at Pedernales are symptomatic of widespread fiscal profligacy throughout the national network of 931 electric co-ops. That critical infrastructure transmits power over 75 percent of the Nation's vast geography. At every juncture, co-op member owners have the legal rights and powers under State and corporation and utility regulation laws to police or replace irresponsible directors and managers.

Eventually, Pedernales customers regained control of their company and co-op democracy remains the most potent safeguard against mismanagement and waste. But in the face of global energy pressures and modern mandates to diversify co-op activities for economic and social reasons, the quaint old ways of doing business that worked in the 1950's and 1960's can begin to look a bit threadbare. Even newly expanded IRS disclosure requirements for non-profits may not give co-op members, regulators, or taxpayers enough timely information to prevent the next Pedernales from blooming in the crevices of a patchwork regulatory and oversight system.

So we need to know how safeguards can be strengthened and how rural electric co-ops can continue to fulfill their potential as stable, responsible drivers of economic development and community growth.

We appreciate the testimony of our witnesses this morning as we explore these important issue.

Thank you.

[The prepared statement of Hon. Tom Davis follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

ONE HUNDRED TENTH CONGRESS

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Statement of Rep. Tom Davis
Ranking Republican Member
Committee on Oversight and Government Reform
"Governance and Financial Accountability of Rural Electric Cooperatives: The Pedernales Experience"
June 26, 2008

Thank you, Mr. Chairman. We're here because questions have been raised about the vulnerability, even the relevance, of a venerable business model that helped modernize post-Depression rural America and that today serves over 41 million consumers in 47 states. Rural electric cooperatives, member-owned power generation and distribution companies, bring the power of economic development and growth to diverse communities that might otherwise languish off the national grid.

But the apparent plundering of one large co-op, Pedernales in Texas, by entrenched directors and officers has caused some to ask more broadly whether these tax-exempt, federally subsidized organizations are governed democratically, managed efficiently, regulated effectively or operated transparently enough to prevent self-dealing and abuse. In the Pedernales case, millions of dollars of capital owned by co-op members was misspent on excessive compensation packages, phantom employees, first class travel and luxury hotel expenses. High-living insiders even paid $2000 for Celine Dion tickets.

So it's fair to ask, as our Committee colleague Rep. Jim Cooper does, if this useful New Deal tool has become a potentially bad deal for taxpayers and consumers. In this post-Enron/Sarbanes-Oxley era of strengthened corporate governance, accountability and transparency, it's worth asking what rural electric co-ops are doing to keep pace with regulatory standards and governance reforms in the increasingly complex and changing electric industry.

At the same time, there is little to suggest the abuses uncovered at Pedernales are symptomatic of widespread fiscal profligacy throughout the national network of 931 rural electric co-ops. That critical infrastructure transmits power over seventy-five percent of this nation's vast geography. At every juncture, co-op member-owners have the legal rights and powers, under state incorporation and utility regulation laws, to police or replace irresponsible directors and managers. Eventually, Pedernales customers regained control of their company and co-op democracy remains the most potent safeguard against mismanagement and waste.

But in the face of global energy pressures and modern mandates to diversify co-op activities for economic and social reasons, the quaint old ways of doing business that worked in the 1950s and 60s can begin to look a bit threadbare. Even newly-expanded IRS disclosure requirements for non-profits may not give co-op members, regulators or taxpayers enough timely information to prevent the next Pedernales from blooming in the crevices of a patchwork regulatory and oversight system.

So we need to know how safeguards can be strengthened and how rural electric co-ops can continue to fulfill their potential as stable, responsible drivers of economic development and community growth. We appreciate the testimony of our witnesses this morning as we explore these important issues.

Chairman WAXMAN. Thank you, Mr. Davis.

Let me ask unanimous consent that all Members' opening statements be inserted in the record. I will recognize Members who feel that they still want to say a few words of their opening statement before we actually begin.

I will go to this side. I think Mr. Clay came in first.

Mr. CLAY. Thank you, Mr. Chair. I have a very brief opening statement and I appreciate your holding this hearing.

While I represent an urban area, I am aware that there are 47 rural electric co-ops in Missouri that serve nearly 1.5 million customers. The Quiver River Electric Cooperative serves approximately 65,000 Missouri customers living close to my District. Since 1976 Quiver has distributed $51.5 million in capital credits to its members. In 2008 Quiver's board of directors authorized a distribution of $3.8 million in refunds.

Quiver also conducts elections where the co-op's members select the board of directors. In 2007 the elections were held in August and involved 4 of the 12 board members.

Finally, Quiver prepares an annual report that is available to its members. This report explains the financial conditions of the co-op, as well as the assets that the co-op owns. Based on this report and other information, the members are notified about the co-op's activity.

The problems involving capital credits and board of directors and general manager abuses that existed at the Texas electric co-op have not occurred at Quiver. While there are individual bad actors in every industry, I hope that this is an isolated situation.

Mr. Chairman, I yield back my time.

Chairman WAXMAN. Thank you, Mr. Clay.

Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman. I will be brief.

I would just like to bring greetings to Senator Fraser and Representative Rose. It was my privilege when I was a member of the Texas House to serve with both of them, and I have the utmost confidence in their ability. Senator Fraser has been involved in the co-op part of legislation for many years, and I, myself, am a co-op customer. I do business with three different co-ops. It is still my belief that the governance of co-ops should stay at the local level and at the State level. I believe the actions that the State took to correct the Pedernales problem were appropriate, and I believe that they have a handle on it.

I deeply appreciate you guys coming up today and participating in the hearing, because I think in the long run this will be a good day for the co-ops and a day where the co-ops will be able to explain to the public and answer some of these allegations.

Thank you.

Chairman WAXMAN. Thank you, Mr. Marchant.

Mr. Kucinich.

Mr. KUCINICH. Thank you, Mr. Chairman, for holding this hearing, and thanks, Mr. Cooper, for bringing it to the attention of the committee.

We put this in the context of rural America, where you see the physical infrastructure of rural America fraying, the telecommunication infrastructure where people are paying more for less, water

rights are under attack in rural areas. Now we see co-ops, in this case one that is under inspection, exploiting the resource of the members.

You have to remember, let's go back historically, why we saw rural electrification and why these co-ops were created: to make sure the people in rural areas had reliable access to electricity at a low cost, because the big energy companies didn't want to spend the money and invest in infrastructure, didn't want to do that. So our mission as a committee, I hope, is going to be to find a way to not just call these particular individuals to an accounting, as we should and must, but to find a way to make sure that we protect the philosophical underpinnings of rural electrification and of rural co-ops so that people can have access to electricity at a low cost, so that rural areas can find a way to survive in these very troubled economic times.

Thank you.

Chairman WAXMAN. Thank you.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. Thank you for calling this hearing. It is very appropriate, considering the scandal that has gone in in Texas with this largest co-op in the United States.

First of all I want to say that I have the greatest respect for my colleague, Congressman Cooper, who is a good friend of mine, and I salute him for raising these concerns and asking these questions. He used to represent a very rural District in Tennessee, and he has studied this issue and these co-ops for many years and I have not, so he knows far more about this than I do. He and I now represent the two fastest-growing areas in Tennessee. He represents the Nashville area and I represent primarily an urban/suburban District in and around Knoxville. Only about 12 percent of my constituents are served by co-ops, but overall I understand that about one-third of the people in Tennessee are served by co-ops, so this is very important to Tennessee.

I am told that the average profit per member in Tennessee, the annual profit is around $82 per member for a year. I also have learned that, under agreements with TVA, since the Tennessee co-ops are supplying TVA power, that TVA requires that, rather than rebate money, that these co-ops do one of three things, are limited to three things: keeping rates low, paying down debt, or investing in the infrastructure. They couldn't, I suppose, do all three in any 1 year.

Those seem like good things to me. I haven't read any articles about any co-ops in Tennessee doing anything even remotely close to what has happened in Texas, but there is certainly nothing wrong about looking into this and making sure that the customers or members are treated fairly and honestly, and that co-ops any place are not making investments in things that they should not be investing in. So I thank you for calling this hearing and for allowing me to participate.

Chairman WAXMAN. Thank you, Mr. Duncan.

Other Members who wish to make opening statements? Ms. Watson.

Ms. WATSON. Thank you, Mr. Chairman. And thank you for holding today's hearing where we will be examining the managerial practices of Pedernales Electric Cooperative.

Co-ops were created during the era of President Roosevelt's New Deal, and their purpose was to supply millions of Americans who lived in under-developed, rural communities with electricity.

Presently, the conditions of modern and rural areas are not in the dire situation they experienced during the Great Depression, but 70 years later 930 co-ops are still responsible for providing electricity for the 17 million Americans across the country.

Pedernales has been providing reliable electrical service to rural Texans for over 70 years; however, recently there have been numerous allegations ranging from excessive personal spending of co-op funds by board members, unearned compensation for former board members, improper election methods, non-beneficial investment practices, and numerous IRS reporting infractions.

Even though this hearing is focusing mainly on the questionable practices of Pedernales, it is important to find out if the problems are widespread throughout the cooperative industry.

Mr. Chairman, I hope that we will consider holding a future hearing that will examine the nature of financial practices of other cooperatives. In the end, what this committee desires to uncover is why Pedernales and board members allegedly took advantage of other member customers, how these practices were carried out with the use of company funds, and if the practices of the board members could plausibly be repeated in other electric cooperatives around the country.

So I look forward to hearing from the panel, and especially the testimony of Mr. Glenn English, the CEO of the National Rural Electric Cooperative Association. I hope that he can provide more insight on the co-op industry and give us a general overview on the use of co-op funds in the industry as a whole.

Mr. Chairman, I thank you. I yield back.

Chairman WAXMAN. Thank you very much, Ms. Watson.

Any other Members seek to make an opening statement? Mr. Sarbanes.

Mr. SARBANES. Very quickly, Mr. Chairman, thank you.

You know, we talk about expertise on the part of fellow Members of Congress, but Congressman Cooper's expertise in this area is so deep that he would easily be qualified by a judge in any court case as an expert witness, based on all of the research that he has done in his own personal and professional experience with co-ops.

A hearing like this predictably will produce a response among sort of three categories of actors. There will be those who have engaged in outrageous practices who had better start quickly figuring out how to fix the situation. There will be those who maybe could do better than they have done and ought to look at that. And then there will also be those who have acted in a responsible manner.

I don't have any electric cooperatives in my district. In Maryland we have one in southern Maryland called the Southern Maryland Electric Cooperative, from my understanding, one of the more responsible actors in this drama, but I would assume that the responsible folks would step up within whatever the association is to make the case that others need to clean up their act and improve

their own sort of self-regulation. But I think Mr. Cooper bringing this issue to light as he has points us to examining whether there ought to be more oversight and regulation from third parties, including Government oversight. That will be part of the discussion today, so I want to thank him for making all of us look carefully at this issue.

I yield back my time.

Chairman WAXMAN. Mr. Welch.

Mr. WELCH. We have two excellent co-ops in Vermont of that category that my colleague, Mr. Sarbanes, was just talking about. They take their democratic duties seriously. Service on the board is much a sacrifice; it is not a bonanza. And they are doing tremendous work on alternative energy, providing real leadership in the State. That is the Vermont Electric Co-op and the Washington Electric Co-op.

Mr. Chairman, if there is no objection, I would like to introduce their newsletters into the record.

Chairman WAXMAN. Without objection, they will be made a part of the record.

Mr. WELCH. But those of us who support co-ops have the major responsibility to root out when it is being abused, because if we are going to allow there to be continued support to do the good work, we have to make certain there is no latitude to make this into a rip-off, and I really applaud Congressman Cooper and would like to yield him at least part of the balance of my time, Mr. Chairman. I know we are short, but to finish a couple of points that he has, if that is possible.

Mr. COOPER. I thank my friend for yielding.

Two points that haven't been made so far: this year some giant energy companies in America are trying to take advantage of co-ops' strong balance sheets and tax-exempt borrowing authority to get co-ops to issue billions of dollars worth of bonds for new power generation, particularly coal-fired units. They want co-ops to generate more power, to increase pollution, and to issue these bonds. The last time co-ops fell for such a sales pitch was in the 1970's and 1980's, and many co-ops went bankrupt as a result. I think co-ops should make energy conservation their first priority, and then, once they have helped reduce customer bills, focus on other ventures.

Also, you all know that sunshine is the best disinfectant. Without full disclosure, co-op democracy is a sham. Did you know that in the official biography of the official lending arm to co-ops, the CFC, they state explicitly that it was formed to tell Wall Street how rich co-ops are so that NRECA can at the same time tell us how poor they are.

Did you know that the PAC associated with NRECA gives almost as much money to Congress as Boeing Corp.? Why are they spending all this money to defend motherhood and apple pie organizations? Is it just a narcotic to make sure that we, the watchdogs, stay asleep.

So thank you, Mr. Chairman.

You have the best staff on the Hill. Co-op customers get electricity today, but they don't have power and they are being kept in the dark.

Chairman WAXMAN. Thank you very much, Mr. Cooper and Mr. Welch.

Unless our witnesses want to yield the rest of their time to Mr. Cooper, we are going to hear from you. [Laughter.]

I am pleased to welcome them to our hearing today.

The first panel is going to focus on the Pedernales Electric Cooperative.

The Honorable Troy Fraser is a member of the Texas Senate and a member of the Pedernales Co-op. He chairs the Texas Senate's Business and Commerce Committee and has chaired a hearing on the co-op's business practices.

The Honorable Patrick Rose is a member of the Texas House of Representatives. He also is a member of the Co-op and has been investigating business practices at the Pedernales.

Mr. John Watson is a member of the Pedernales Co-op.

Mr. Carlos Higgins is a member of the Pedernales Co-op and recently ran for a position on its board of directors.

Mr. Juan Garza is the new general manager of Pedernales. Before he started at Pedernales in February 2008 he was the general manager of the publicly owned Austin Energy.

I want to thank all of you for traveling to be with us today.

I would like to note again the absence of two invited witnesses, Mr. Bennie Fuelberg was a long-time general manager of Pedernales. He is not present today because he is evading service of the committee's subpoena. His attorney advised committee staff that he would assert his fifth amendment right against self-incrimination if he did appear.

Mr. Bud Burnett was a long-time president of Pedernales. He is also evading service of the committee's subpoena. His attorney advised committee staff that he would assert his fifth amendment right against self-incrimination if he did appear.

They don't have to assert it. They are not here.

We are pleased to have you with us. It is the practice of this committee that all witnesses who testify do so under oath. I would like to ask, if you would, to please stand and raise your right hands.

[Witnesses sworn.]

Chairman WAXMAN. The record will indicate that each of the witnesses answered in the affirmative.

Your prepared statements will be in the record in their entirety. What I would like to ask each of you to do is to limit your oral presentation to around 5 minutes. We will have a clock that will indicate green, and then the last minute will turn yellow, and then when the time is up it will turn red. If you see red on the clock, we would welcome you to summarize your testimony.

Mr. Fraser, why don't we start with you?

STATEMENTS OF TROY FRASER, CHAIR, BUSINESS AND COMMERCE COMMITTEE, TEXAS SENATE; PATRICK ROSE, TEXAS HOUSE OF REPRESENTATIVES; JOHN WATSON, MEMBER OF PEDERNALES ELECTRIC COOPERATIVE; CARLOS HIGGINS, MEMBER OF PEDERNALES ELECTRIC COOPERATIVE; AND JUAN GARZA, CURRENT GENERAL MANAGER OF PEDERNALES ELECTRIC COOPERATIVE

STATEMENT OF TROY FRASER

Mr. FRASER. Mr. Chairman, I am extremely honored to be here in your committee today. Also other Members, thank you for being here, especially Representative Marchant. He served with distinction in Texas, and we are very proud of Mr. Marchant and the service he has given to the great State of Texas. Thank you for being here.

Members, I currently serve as chairman of the Texas Committee on Business and Commerce. That gives me oversight over the electric industry. I also, along with Representative Rose, am a member of the Pedernales Electric Cooperative.

I would like to emphasize, first of all, that I have been and continue to be a strong supporter of the rural electric cooperatives. These cooperatives brought electricity to many parts of Texas and the Nation that no one else wanted to serve.

I also believe that the beauty of the electric co-op system is that co-ops are designed so that member owners can determine how best to run the system through the election of board of directors. If members don't like the policies that are being set by the board of directors, they can and they should vote them out of office.

In 1995 the Texas Legislature allowed cooperatives to opt out of retail rate regulation by majority vote of the members, and a vast majority of the 66 distribution co-ops did that, but the wires and the transmission lines continue to be regulated by the State of Texas and the Public Utilities Commission.

I want to be clear that I believe that the best way to control a cooperative is through the democratic participation of members; however, the members of Pedernales Electric Cooperative over the last year have raised many concerns that they did not have a voice in their cooperative. Many of these customers are also mine and Representative Rose's constituents.

Late last spring the constituents began contacting the office to complain about the closed nature of the board of directors. Specifically, concerns were raised over the nomination and election process, the lack of transparency by the board of directors and senior management by prohibiting members from even attending board meetings or accessing cooperative information, the failure of the cooperative to return excess profits by paying capital credits, and the extreme levels of compensation and benefits received by board members and senior management.

In May 2006 a group of Pedernales members filed a civil lawsuit against the cooperative and the board of directors, making the same claims I just mentioned. Basically, these members were suing themselves over perceived wrongdoings of the cooperative and the board. A settlement to the lawsuit has been reached, but it is currently under appeal.

This lawsuit, the watchful eye of the media, and the legislative scrutiny by Representative Rose and myself have led also to an ongoing criminal investigation that is being led by the District Attorney but with the assistance of the Texas Attorney General's office.

It became apparent that the inability to elect anyone except the board's hand-picked candidates allowed Pedernales Electric to become a self-governed entity with no way to be controlled. With no one to look over their shoulders, abuses occurred.

First of all, as was mentioned, Mr. Chairman, the president of the board not only received the perks of being a board member; he also paid himself $190,000 a year annually as an employee, making him eligible for retirement benefits, but he also had no real duties or also a severe lack of knowledge of what was going on in the co-op. He currently today, after leaving, is receiving $10,000 per month in retirement benefits, and we just discovered in IRS filings that, as he was leaving, he was paid an additional $600,000 retirement package that they had voted in in 2001, again without our knowledge.

The general manager, Bennie Fuelberg, was being paid $390,000 annual salary. In addition, the board secretly voted to give him an additional $2 million in deferred compensation over a 5-year period, and then they gave him another $375,000 what they called a signing bonus, in order to sign the $2 million bonus contract.

Last year Bennie Fuelberg, his last year at the company, made $1.4 million. None of this additional pay was disclosed to the members. It is also alleged that the board and management falsified the 990 report to the IRS and all reports prior to 2006 by not reporting the general manager's total compensation and bonuses.

We know the PEC board had paid themselves excessive salaries totaling over $1 million per year. All board members, including non-voting members, were given free lifetime health insurance for themselves and dependents. They received free $3,000 physicals for the members and spouses at the Cooper Health Clinic Spa in Dallas. The board also created policies that, when you left the board, you would become eligible for $1,500 per month retirement as an emeritus status and free lifetime insurance for not only the members but all dependents.

The board, senior management, and their spouses and girlfriends traveled first-class to destinations all over the world. They stayed at luxury hotels, as you said, Ritz Carlton, the Four Seasons, and the like, when traveling on Cooperative business, with no approval process.

Mr. Chairman, as you said, we have identified $700,000 in credit card bills that were paid without any approval process of whether those expenses were legitimate cooperative business.

Additionally, almost all cooperative expenditures were not competitively bid, and the value of those expenditures is not known and is currently under audit.

Compounding these abuses, board meetings were not publicized or open to members. Members could not know or attend meetings. I personally attempted to attend a board meeting on January 3, 2008, and I was denied entrance into the board meeting.

I could go on, but the fact that Pedernales Electric, if they had had an open election process, probably these abuses would not have

occurred. Texas removed regulatory oversight over cooperatives in 1999 because we thought it was redundant. We thought the members could determine how to run the cooperative through the election process. If the members were unhappy, they should be able to vote them out of office.

The failures to have true and honest elections at Pedernales is the reason the Senate Committee on Business and Commerce is currently looking at all electric cooperatives to make sure that what happened at Pedernales is not happening in other parts of the State with those 66 co-ops.

There have been reforms this year at Pedernales. Juan Garza is going to outline the things that have happened this year. We just had an election where five new members were elected.

I will conclude with that and I will open up for questions after the rest of the testimony.

Thank you.

[The prepared statement of Mr. Fraser follows:]

The Senate of The State of Texas

TROY FRASER

PREPARED STATEMENT OF
TROY FRASER
TEXAS STATE SENATOR

Pedernales Electric Cooperative

Before the House Committee on Oversight & Government Reform
June 26, 2008

Mr. Chairman, Members of the Committee, I would like to thank you for this opportunity to brief you on Pedernales Electric Cooperative.

I currently serve as Chairman of the Texas Senate Committee on Business and Commerce and have oversight of the electric industry. I am also a member of Pedernales Electric Cooperative.

I want to emphasize that I have been and continue to be a strong supporter of rural electric cooperatives. These cooperatives brought electricity to many parts of Texas and the nation that no other company wanted to serve.

The beauty of the electric cooperative system is that cooperatives are designed so that the member-owners can determine how best to run the system through the

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election of a board of directors. If members do not like the policies set by the board of directors, they can and should vote them out of office.

Prior to 1995, the Public Utility Commission of Texas had general supervisory authority and rate setting authority over electric cooperatives even though these entities were democratically controlled.

In 1995, the Texas Legislature allowed cooperatives to opt out of retail rate regulation by a majority vote of its members and the vast majority of the 66 distribution cooperatives did just that. In 1999, the Legislature deregulated cooperatives as to rates, general PUC supervisory authority and public interest review of a sale or merger.

We believed that state regulation of cooperatives was redundant because the cooperatives were democratically controlled. Also, deregulating these cooperatives allowed them to save thousands of dollars on regulatory hearings and processes - savings that could be passed on to the members.

I want to be clear that I believe that the best way to control a cooperative is through the democratic participation of its members. What we need to do as elected officials is to ensure that members have a voice and have the ability to know how and why a board of directors is making decisions.

However, the members of Pedernales Electric Cooperative have raised many concerns over the past year that they did not have a voice in their cooperative. Many of these customers are also my constituents.

Late last spring, my constituents began contacting my office to complain about the closed nature of the board of directors. Specifically, concerns were raised over the nomination and election process, the lack of transparency by the board of directors and senior management by prohibiting members from accessing cooperative information and board meetings, the failure of the cooperative to return excess profits by paying Capitol Credits, and the level of compensation and benefits received by board members and senior management.

In May 2006, a group of Pedernales members filed a civil lawsuit against the cooperative and the board of directors making the same claims I just mentioned. Basically, the members were suing themselves over perceived wrongdoing by the cooperative and the board. A settlement in the lawsuit has been reached, but has been appealed by two members of the cooperative.

This lawsuit, the watchful eye of the media and legislative scrutiny have led to an ongoing criminal investigation by the District Attorney with the assistance of the Texas Attorney General's Office.

It became apparent that the inability to elect anyone except the board's handpicked candidates allowed the Pedernales Electric Cooperative's Board of Directors to become a self-governed entity with no way to be controlled. And with no one able to look over their shoulders, abuses occurred. Examples of the excess abound.

First, the president of the board not only received the perks of being a board member, he also paid himself $190,000 annually as an employee, making him

eligible for retirement benefits with no real job duties. He currently is receiving over $10,000 a month in retirement benefits - all paid by the cooperative.

The General Manager was paid a $375,000 annual salary. In addition, the board secretly voted to give him an additional $2 million in deferred compensation over five years and a $375,000 signing bonus. None of this additional pay was disclosed to the members. And, it is alleged that the board falsified the 990 report to the IRS in 2004 by not reporting the general manager's total compensation and bonuses.

We know that the PEC board paid themselves excessive salaries and benefits - totaling over $1 million per year. All board members, including non-voting members, were given free lifetime health insurance for themselves and all dependents, and free $3,000 physicals for members and spouses at the Cooper Clinic Health Spa in Dallas. The board also created policies allowing for retiring board members to receive emeritus status with compensation of $1500 per month for life, in addition to the free lifetime health insurance for both member and dependents.

The board, senior management and their spouses or girlfriends traveled first class and stayed in luxury hotels - such as the Ritz Carlton, Four Seasons, Anatole Hilton - when traveling on cooperative business with no oversight or approval process.

$700,000 in credit card bills were paid without any approval process of whether those expenses were legitimate cooperative business - - such as $20,000 for furniture and several $2,300 restaurant tabs that included meals and alcohol.

Additionally, most large cooperative expenditures were not competitively bid and the value for those expenditures is not known.

Compounding these abuses, board meetings were not publicized or open to the members, so members could not know how and why decisions were being made. I personally attempted to enter a board meeting on January 3, 2008, and was denied entrance.

I could go on, but the fact is that if Pedernales Electric Cooperative had a true and open election process, these excesses probably would not have occurred.

Texas removed regulatory oversight over cooperatives in 1999 because it was redundant. We thought the members could determine how to run the cooperative through the election process - - if the members were unhappy with the decisions of the board of directors, they could and should vote them out of office.

This failure to have true and honest elections at Pedernales Electric Cooperative is the primary reason why the Senate Committee on Business and Commerce is taking another look at all electric cooperatives to make sure what happened at PEC is not happening in other parts of our state.

There have been reforms at Pedernales Electric Cooperative over the past year. These reforms have created a more democratic system and gives the members a voice. This voluntary compliance is encouraging because my preference is always to allow for local control. Pedernales Electric Cooperative just had its first open election last weekend with five new directors elected. This is a great first step on the path toward openness.

But if a cooperative board does not or will not remove the barriers for members to be involved, the state could be forced to address these issues through legislative action. I expect that the issues of requiring electric cooperatives to comply with open meetings and open records laws, plus mandating fair and open elections, will be addressed in the next legislative session.

I appreciate that Congress also is studying the issue of electric cooperatives. However, I want to assure each one of you that Texas is not asleep at the wheel and we are actively looking into the issue as our legislative session approaches. Please know that Texas will exercise its authority to regulate these entities at a state-level if necessary.

Thank you again for allowing me to be here today. I would be happy to answer any questions.

Chairman WAXMAN. Thank you very much, Mr. Fraser.

Mr. Rose.

STATEMENT OF PATRICK ROSE

Mr. ROSE. Mr. Chairman, Mr. Marchant, it is a pleasure to be with you. I am sorry that we have to be with you today.

Since 2003 I have represented Johnson City and the Pedernales Electric Cooperative headquarters in the Texas House of Representatives. It is impossible to represent this District and not recognize PEC's rich history and foundational role in central Texas. As an elected official representing thousands of members and employees of this organization, it is my duty to ensure its long-term success, and that is why I am here before you today.

As the co-op navigates these turbulent times, I am committed to reforms that strike the balance between statutory oversight and local control. PEC members need and deserve a co-op that is open and transparent. We can do that with the right reforms at the State level, and Senator Fraser and I, working closely together over this last year and as we approach next session, are committed to do just that.

With the cost of energy continuing to rise at an alarming rate, our constituents rely on us to guarantee that the price we pay for gas at the pump and for the electricity we use to heat and cool our homes is reasonable and fair. We must provide those we represent the security of knowing that they are not paying unwarranted prices for basic necessities, and when we find that those we have entrusted to deliver these essential services have wasted PEC members' resources for their own gain, it is the role of government to step in and fix this problem.

Bloated overhead, lavish expense accounts, full-time employees who never showed up to work all were common practice at the old PEC. The PEC board and senior management have clearly taken advantage of its employees and members. PEC employees are doing their job, and customers have excellent service at a cost that is considerably lower than investor-owned utilities in the State of Texas. We must end the PEC board's and senior management's high salaries and lavish spending in order to protect ratepayers in our co-op. We need to implement laws that regulate co-op boards and at the same time protect customers from high electricity costs.

I believe that statutory changes are the only way to ensure that PEC keeps its electric rates low and shares its profits with its members today and in the future. This starts by overseeing the Navigant audited PEC that was mandated as part of the settlement proceedings of the lawsuit of which the Senator spoke. We must learn what went wrong in order to craft legislation that prevents mismanagement in the future.

The results of the Navigant audit are expected in August, and nothing short of a complete retrospective look at past practices and transactions, as well as an analysis of appropriate benchmarks and standards to apply to PEC's operations prospectively, nothing short of both will be acceptable.

Should Navigant fall short, I will statutorily require an audit to be conducted by the State Auditors Office when the Legislature reconvenes in January 2009.

Mr. Chairman, public power only works when it is transparent, and without transparency there is no meaningful local control. During the next legislative session I am prepared to file legislation that will require all electric cooperatives in Texas to comply with the open meetings and open records laws, to submit annual audits to the PUC for their review, the Public Utilities Commission for their review, and ensure fair and open elections at all co-ops in Texas.

The intent of this legislation is to promote transparency and informed member participation in all co-ops in Texas. I believe this is the only way to fully prevent mismanagement and fraud, guarantee low rates for our members, and ensure the long-term success of one of central Texas' greatest assets.

Thank you for allowing us to be here today.

[The prepared statement of Mr. Rose follows:]

COMMITTEES:
Human Services, Chair
Higher Education

Patrick M. Rose
Texas State Representative
District 45

COUNTIES:
Blanco
Caldwell
Hays

Testimony Submitted by
Texas State Representative Patrick M. Rose

Governance and Financial Accountability of
Rural Electric Cooperatives: the Pedernales Experience
Committee on Oversight and Government Reform
Thursday, June 26, 2008, 10:00 AM
2154 Rayburn House Office Building

Since 2003, I have represented Johnson City and the Pedernales Electric Cooperative (PEC) headquarters in the Texas House of Representatives. It is impossible to represent this district and not recognize the PEC's rich history and foundational role in the Texas Hill Country. As an elected official representing thousands of members and employees of this organization, it is my duty to ensure its long-term success, and that is why I am here before you today.

As the co-op navigates these turbulent times, I am committed to reforms that strike a balance between statutory oversight and local control. PEC members need and deserve a co-op that is open and transparent. We can do that with the right reforms at the state level, and I know that Sen. Fraser and I will continue to work together so that Texas can become an example for states across our nation.

Why are we here? The PEC Board has historically relied on a self-perpetuating nominating committee and a proxy system for its elections. This policy and a lack of transparency in the co-op's business practices are at the core of the PEC's problems today.

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At the PEC annual board meeting last June, members advocated for a democratic process to elect directors and a more open co-op. In the months that followed, Sen. Fraser and I publicly asked the co-op to make these and other changes.

Disappointed by the arrogance shown by the board, the absolute lack of acknowledgment of member concerns, and desire for reforms, on September 4th, 2007, I formalized my request to PEC. I wrote then PEC General Manager Bennie Fuelberg asking for a series of reforms and informing the co-op of my intention to require these statutorily if needed. As a starting point, I requested that the PEC do the following:

- Submit compensation information for PEC senior staff and board members to the IRS as required by federal law from 2004 to the present;

- Implement a standing policy, effective immediately, prohibiting board members from serving as employees of PEC;

- Change bylaws with regard to the process of electing board members;

- Begin paying some level of capital credits in the next year; and

- Disclose immediately to the public audit financials for PEC as well as any and all subsidiaries and publish this information at its annual meetings and on its website.

The good news is that during the last year, the PEC has made all of these changes. And during last Saturday's annual meeting, members participated in democratic elections with 58 candidates vying for 5 board positions.

However, I believe that these reforms only took place because of a bright public spotlight, relentless members, a lawsuit, and media

scrutiny that together have unveiled severe financial and management lapses.

The PEC board and senior management have clearly taken advantage of its employees and its members. PEC employees are doing their job, and customers have excellent electric service at a cost that is considerably lower than the average rate charged by private utilities in areas such as Dallas, Houston, and South Texas.

Texas co-ops bring an important balance to our electric market and have the opportunity to be our best consumer advocates. I believe that the Texas Legislature must keep this in mind as excessive regulation in response to the mismanagement at PEC could lead to higher rates for Texas customers.

We must end the PEC board and senior management's high salaries and lavish spending in order to protect ratepayers. We need to implement laws that regulate co-op boards and, at the same time, protect customers from high electricity costs.

I believe that statutory changes are the only way to ensure that the PEC keeps its electric rates low and shares its profits with ratepayers today and in the future.

This means overseeing the Navigant audit of PEC that was mandated as part of settlement proceedings in district court. We must learn what went wrong in order to craft legislation that prevents mismanagement in the future.

The results of the Navigant audit are expected in August, and nothing short of a complete retrospective look at past practices and transactions, as well as an analysis of appropriate benchmarks and standards to apply to PEC's operations prospectively, will be acceptable. Should Navigant fall short, I will statutorily require an audit to be conducted by the State Auditor's Office when the Legislature reconvenes in January 2009.

Sen. Fraser and I worked together to request that the Texas Public Utility Commission direct and control the management of the audit to secure independence from the PEC board and senior management. Although I am pleased with the PUC's oversight of the Navigant audit, I have always maintained that the severity of the alleged fraud requires a non-biased state audit for the membership to get the answers it needs and deserves.

During the next legislative session, I am prepared to file legislation that will require all electric cooperatives in Texas to:

- Comply with Open Meetings and Public Information statutes;
- Submit annual audits to the PUC for review; and
- Stop the use of nominating committees as a way of selecting candidates for elections.

The intent of this legislation would not be to add unnecessary costs or regulation, but to promote transparency and informed member participation. I believe this is the only way to fully prevent mismanagement and fraud, not only today, but in the future.

Thank you.

Chairman WAXMAN. Thank you very much, Mr. Rose.

Mr. Watson.

STATEMENT OF JOHN WATSON

Mr. WATSON. Chairman Waxman and Ranking Member Davis, I appreciate the opportunity to offer a member's perspective on the questionable and abusive practices at the Pedernales Electric Cooperative. I will describe how those abuses led to a member uprising and reforms. In spite of the problems, I want to leave no doubt as to my strong support for electric distribution co-ops and public power.

As a PEC member, I had attended annual meetings and asked for increased efforts toward greater energy conservation and increased reliance on renewable energy. I had urged greater transparency and openness. Those pleas produced no meaningful results.

In January 2007 the San Antonio Express News ran an article detailing PEC Director compensation as disclosed on the form 990 from the year 2000. This report triggered a series of events that I believe can rightly be called a member uprising. We began to organize. Other newspapers began to investigate and report on the PEC. A class action lawsuit was filed alleging abusive practices. Elected officials were besieged by constituents and began demanding more information and reforms.

Among the abusive practices uncovered at PEC were excessive compensation and benefits for Directors and senior management; a closed nominating and election process leading to a self-perpetuating board with an average tenure of 22 years; closed board meetings; absolute refusal to return capital credits to members; refusal to provide information on the wholly owned subsidiary, Envision, and an utter lack of transparency and openness.

Through the lawsuit discovery, we later learned of still more serious lapses in fiduciary responsibility and ethical conduct.

In January 2007 a small group of members decided to take coordinated and decisive action to establish co-op member control, the core co-op principle. We continued to attempt to work within the existing framework. I called the former general manager, Bennie Fuelberg, and asked to appear before the board's nominating committee. Seven members attended and presented three candidates. All were highly qualified, but the committee renominated the directors whose terms were expiring so they were unopposed on the proxy ballots mailed to members.

Next, a group of members attended the March 2007 board meeting and presented a by-law amendment to change the nominating and election process. Again, we were ignored.

In May 2007 the class action lawsuit was filed. Throughout the summer and fall we continued to voice our demands. By now, those demands included the resignation of all directors.

In November 2007, after plaintiff's deposition of senior co-op management and directors, several rapid developments occurred. The general manager, Mr. Fuelberg, and the president of the board, Mr. Burnett, announced their retirements. New nominating and voting procedures were adopted. The return to members of $7.3 million of capital credits was announced.

In January 2008 Mr. Juan Garza was hired as the new general manager. The local District Attorney launched a criminal investigation. The board meetings were open to members for the first time.

In March 2008 settlement of the class action lawsuit was announced. In May, despite almost 300 objections protesting the terms of that settlement, the judgment was entered. That judgment is now on appeal.

Most members I think believe strongly in electric co-ops and public power. We are convinced that the efforts of activated members such as myself and Mr. Higgins; the press, especially Claudia Grisales of the Austin American Statesman and Jodi Lehman of the Horseshoe Bay Beacon; elected officials such as Senator Fraser and Representative Rose; and the lawsuit have combined to begin the process of establishing control of our co-op by its members. Quite frankly, we were asleep at the switch for far too long.

Mr. Garza has committed to work for many of the reforms we have long sought, including bringing PEC into the provisions of the Texas Open Meetings and Open Records Act; however, I endorse it being embedded in the legislation.

Transparency and openness, combined with fair elections leading to reduced director tenure, could have prevented many of the abuses we suffered at Pedernales. Much remains to be done, and we intend to remain active and vigilant. Working with Mr. Garza and the five newly elected directors, we will push until we have a co-op that is truly responsive to its members and complies fully with the co-op principles.

Thank you for this opportunity to tell part of our story. I will be pleased to answer any questions that the Members might have.

[The prepared statement of Mr. Watson follows:]

Statement of John Watson
To the Committee on Oversight and Government Reform
June 26, 2008

Chairman Waxman and Ranking Member Davis, I appreciate this opportunity to offer an ordinary member's perspective on the questionable and abusive practices at the Pedernales Electric Cooperative ("PEC" or "co–op"). I will describe how those abuses led to a member uprising beginning in January 2007, and the reforms that have resulted. In spite of the difficulties, however, I want to leave no doubt as to my strong support for electric distribution co–ops and public power.

My wife, Erin, and I have been PEC members for 14 years. As individual members we had attended Annual Meetings, and asked the management and Board to increase efforts toward greater energy conservation and an increased reliance on renewable energy. We had urged greater transparency and openness when members sought to participate or obtain information. These pleas produced no meaningful results.

In January 2007, the San Antonio Express–News ran an article detailing PEC director compensation. The information was from the 2005 IRS Form 990. This report triggered a series of events that can rightly be called a member uprising.

We began to organize. Other area newspapers began to investigate and report on PEC. A class action lawsuit was filed in Austin alleging a catalogue of abusive practices. Elected officials were besieged by constituents, and began playing an active role in demanding more information and reforms.

Among the abusive practices uncovered at PEC were excessive compensation and benefits for the 17 directors and several senior management officials, a closed nomination and election procedure leading to a self–perpetuating Board (22 years average tenure), closed Board meetings, absolute refusal to return capital credits (members' equity) to member/owners, refusal to provide any information on the wholly owned subsidiary, Envision (that has been losing several million dollars a year), and utter lack of transparency and openness. Through the lawsuit discovery, we later learned of still more serious lapses in fiduciary responsibility and ethical conduct.

In January 2007, a small group decided to take coordinated and decisive action to establish co–op member control, one of the core co–op principles.

We continued the attempt to work within the existing framework, as unfair as it was. I called the former General Manager, Mr. Bennie Fuelberg, and requested the opportunity for a group to appear before the Board's Nominating Committee. Seven members attended and presented three candidates. All were highly qualified, but the Committee re–nominated the directors whose terms were expiring, so they were unopposed on the proxy ballots sent to all members.

Next, a group of members attended the Board meeting in late March 2007, and presented by–law amendment language to change the nomination and election process. Again, we were ignored.

In May 2007, the class action lawsuit was filed. Throughout the summer and fall we continued to voice our demands. By now those included a demand for the resignation of all directors.

In November 2007, after plaintiffs' deposition of senior PEC management officials and some directors, there were several rapid developments:

- The General Manager and President of the Board announced their retirements.
- A change in nomination and voting procedures was adopted.
- Return of $7.3 million in Capital Credits to members was announced.

In January 2008, Mr. Juan Garza was hired as the new General Manager. The local District Attorney, Mr. Sam Oatman, launched a preliminary criminal investigation. Board meetings were opened to members for the first time. In March 2008, settlement of the class action lawsuit was announced. In May, despite the almost 300 objections filed with the court by members protesting the terms of the settlement, judgment was entered.

Members with whom I worked on the reforms believe strongly in electric co–ops and public power. We think that the efforts of activated members; the press, especially the persistence of Ms. Claudia Grisales of the Austin American Statesman and Ms. Jodi Lehman of the Horseshoe Bay Beacon; elected officials, particularly Sen. Troy Fraser and Rep. Patrick Rose; and the lawsuit have combined to begin the process of establishing control of our co–op by its member/owners. Mr. Garza has committed himself to work for many of the reforms we have long sought, including voluntarily bringing PEC under the provisions of the Texas Open Meetings and Open Records Acts.

Transparency and openness, combined with a fair electoral process leading to much reduced director tenure, could have prevented many of the abuses suffered by PEC members. Much remains to be done, and we intend to remain active and vigilant. Working together with Mr. Garza and the newly elected directors, we will push until we have a co–op that truly is responsive to its members and that complies fully with the co–op principles.

Thank you for this opportunity to tell part of our story. I will be pleased to answer any questions that Committee members might have.

Chairman WAXMAN. Thank you very much, Mr. Watson.

Mr. Higgins.

STATEMENT OF CARLOS HIGGINS

Mr. HIGGINS. Mr. Chairman and Members, I am Carlos Higgins from Austin, TX. When you look at the name of our co-op, you would naturally try to pronounce it Pedernales. Those of you who knew President Johnson probably see him saying Perdinalis. That is the way it is pronounced down there. It is along the Perdinalis River.

This is my message, though: we know it was a big mistake now to trust that general manager and our board. We don't know yet what all they have done to us or how much it is going to cost us. It took that expensive class action lawsuit to get where we are now to find out that we had serious problems, and the pending settlement of that lawsuit is awful.

What can you do for our co-op and other co-ops? I do have a suggestion. First, what went wrong here with our co-op, we had a general manager who became so powerful he was able to hand pick the board, get-along board members who just merely did as they were told, apparently. The board members ignored their fiduciary obligations to the co-op owners and they apparently did not know they were not the general manager's employees or his amen chorus. They were quick to help themselves, though, to lucrative compensation and perks, but gave us little to not oversight of our co-op.

My wife and I have been members of the Pedernales Electric Co-op for 34 years now. Our co-op has grown immensely in those years, but we have been completely satisfied with the service and the rates all that time. We do get reliable service.

We are like the majority of the owners: we lead fairly busy lives, and we thought we had no reason to worry about our co-op's operations. Board members seemed to be among the pillars of their communities, so trusting them seemed to be a reasonable thing to do. We were wrong.

A small group of owners had their suspicions about what was going on, especially when they got totally brushed off by the general manager and the board. They persisted and finally filed this lawsuit, and that shed some light on what was going on at our co-op.

This is clear: the board members are guilty of self-dealing and pretty much being asleep at the wheel when it comes to their oversight responsibilities. The is what the lawsuit did for us: all of the attention and publicity about the misdeeds at the PEC gave us some reforms, mainly letting the membership actually vote for its own board members.

So is everything OK now? Not at all. The lawsuit is far too expensive. It is costing about $4 million. As to the settlement of that lawsuit, it was forced on the membership. I challenge any of you to read through this settlement agreement and then stand up and say, well, not so bad. It is really bad.

More than 200 members took time to strenuously object to provisions in this settlement. The court ruled that three of our members, the plaintiffs in the lawsuit, were competent and able to

speak for all 223,000 members. It is fiction to claim that they even came close to representing the views of the rest of us.

In this settlement we, the members, forgive anyone and everyone and their attorneys for anything they may have done at the PEC, whether their deeds are known or unknown. We specifically forgive even any oral agreements that may have been made and any trusts that may have been set up. That arouses my suspicions right away.

What might all this forgiveness cost us? We don't have a clue. We don't know. Some people tried to defend the settlement on the basis that it gave us good reforms at the PEC. That is not exactly so. What gave us those reforms is the discovery in the lawsuit and the subsequent publicity, the spotlight of the press revealing misdeeds and who the culprits are.

I doubt that this is a widespread problem among other co-ops. It is probably just ours, and we don't really want all the other co-ops and their members to be burdened because our manager and board messed up. Co-op owners are also, of course, co-op customers, and so that is an idea that ought to be protected and preserved. I really believe that. We have been punished enough at our PEC, so we don't want a bunch of other regulations to come down that burden us further and punish us any more.

So what is the solution? We had a general manager grow so powerful he could run our co-op like it was his personal fiefdom. It took that expensive and awkward lawsuit to penetrate his barriers. We need a better tool.

I think if we had had any authority at all under our own by-laws, a way to get through there and make some changes, we could have reigned these people in a whole lot sooner with a whole lot less fuss and cost. In our by-laws, all the power resides in our board. All of it. If the board chose to do so right now, legally and quickly they could do away with all of the reforms that have gone on before. So we really need some tools. That is what I recommend: that as a minimum, that the by-laws of co-ops be required to give members some ultimate control.

You have to be careful about how you structure the by-laws, but members have to have some tools. They can be as vigilant as all get-out, but they have to have the tools that allow them to do something about it, so that is my recommendation.

One more thought, Mr. Chairman. Thank you very much for allowing me to speak. We like our new general manager, Juan Garza. He is getting our co-op back on course, but it is not that easy. The problem is for at least one more year he is working for this board, the majority of them who got us into this mess, so he is not really the guy that you need to ask the tough questions to. Those two and others are out there hiding some place. You really need to bring them in and make them answer some of these questions.

Thank you very much.

[The prepared statement of Mr. Higgins follows:]

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
==========

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.

Chairman WAXMAN. Thank you, Mr. Higgins.

Mr. Garza.

STATEMENT OF JUAN GARZA

Mr. GARZA. Mr. Chairman, as the son of a migrant farm worker, Alejandro and his wife Maria, I am deeply, deeply honored to be here. Thank you so much for inviting us.

President Johnson taught school in Cotulla, my home town, and even though he did teach there, we never were able to teach him that the proper way to pronounce Pedernales is Pedernales. [Laughter.]

As general manager of Pedernales, I have been selected to lead the Nation's largest electric cooperative, serving over 225,000 members, which was 219,000 when I started just in February.

PEC has a rich and proud heritage of providing reliable election service to its members. Historically, PEC has focused on providing outstanding customer service, strong system reliability, financial stability, and fair rates. This focus has resulted in PEC being rated No. 1 in the country in customer service and No. 5 of all utilities in the country in overall customer satisfaction by J.D. Power.

Throughout the service territory, as I have toured it since I have been appointed, I hear about the quality of the employees at PEC. They are the backbone of this company, and they carry out the mission of the corporation in a manner that makes me proud, indeed, to be their general manager.

The people on this panel, especially Senator Fraser and Representative Rose, have been directly involved in helping to bring about dramatic and long-lasting changes to PEC. I know they are here today because they are interested in the future well-being of the cooperative.

For the past 18 months Pedernales Electric has been faced with the challenge of responding to the concerns of its members regarding openness, transparency, and governance issues; however, I am here today to testify that these challenges have resulted in significant changes at PEC.

In short, the cooperative system of local member control I believe has worked. Under the leadership of Mr. E.B. Price, the PEC's board has made these major changes: Our election system was revised to be more democratic and open. This past Saturday we had 58 candidates vying for five board positions. Over 30,000 members voted in that election.

The position of coordinator, which is a paid chairman's position, the director emeritus, and the honorary director positions have all been eliminated and abolished.

Our Web site now includes an array of business and governance information, including board meeting agendas, our IRS 990 filings, and other critical information.

We have implemented a credible policy that includes expenses of the board being reviewed by a newly created expense and audit committee and made public. I want to add that even though I was at the game last night, I paid for that out of my pocket and I also used the Metro system.

The monthly board meetings are now open to the public, videotaped, and posted online to allow for greater member partici-

pation. A board compensation committee has been appointed to make recommendations for adjusting compensation, which will be retroactive to March 10th when the settlement was first announced of the lawsuit.

On March 10th a settlement agreement of the lawsuit brought by our members was reached. Judge Dietz, who presided, approved the agreement in April. PEC will comply with the terms of the settlement agreement, even though it is currently under appeal by a couple of our members.

As part of the settlement agreement and as a condition of my employment, Navigant Consulting and Cox, Smith, Matthews, in cooperation with the Public Utility Commission of Texas, are conducting an investigation into the cooperative's operations over the last 10 years. The results will be reported to our members.

On the issue of capital credits, it is important to note that capital credits are not held in a fund; rather, they have been invested in electric infrastructure of a growing cooperative. This investment of capital credits reduces the need for borrowing, thereby lowering our rates. While the cooperative industry averages a percentage of assets at just over 40 percent, PEC's corresponding ratio is about 35 percent, and for all but the last 2 years it has hovered at or below 30 percent. This fact should dispel the myth that PEC has been hoarding dollars and not paying capital credits.

The disbursement or reinvestment of capital credits is a local business decision that should be made annually, given the financial and operational status of the cooperative, with input—emphasize input—from the members and full disclosure of the decision annually.

The PEC has made dramatic and long-lasting changes. 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 upon which the cooperative was originally formed. We will continue to strengthen our relationships with our members, elected officials, and other interested parties. We 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.

This has been a very difficult year for the PEC, but when you step back and look at the relatively rapid change in policies and the result of our historic election, I want this committee to know that the co-op system of member control works, at least I believe that has been our experience at PEC.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Garza follows:]

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.

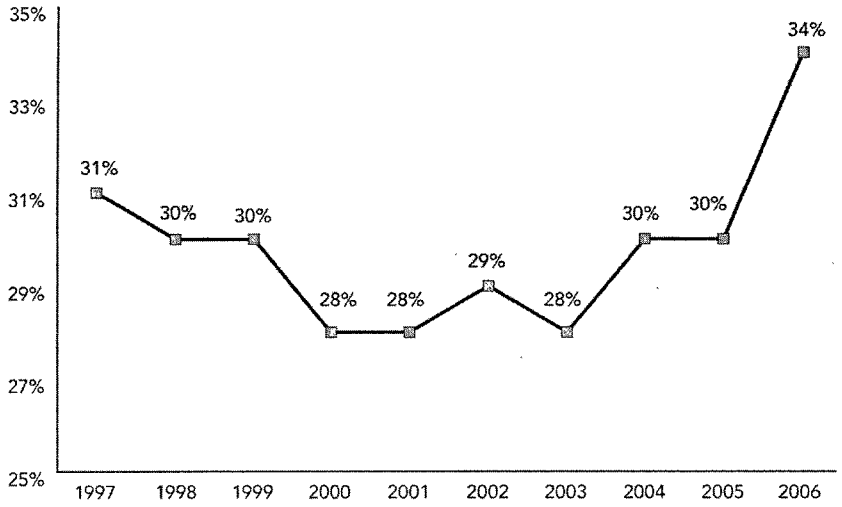
That stated, we believe that the disbursement or reinvestment of capital credits is a business decision that should be made annually, given the financial and operational status of the cooperative with input of members and full disclosure of the decision.

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

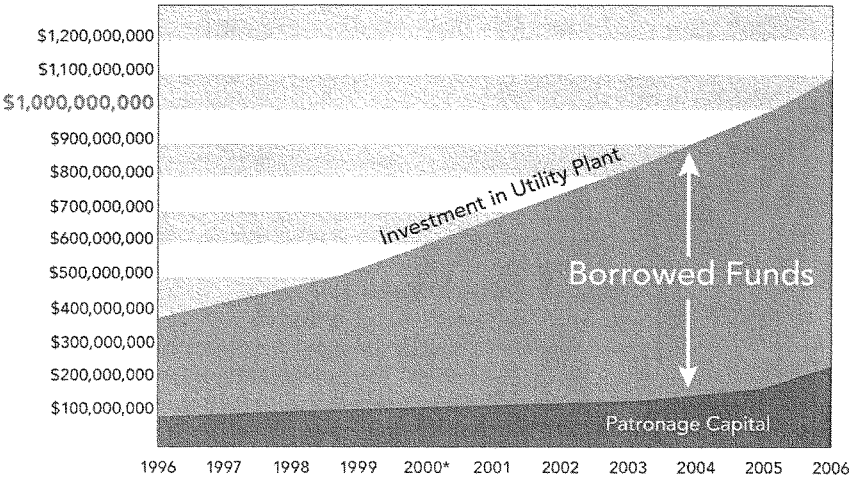
Although PEC has been through the turbulent times, we have made dramatic and long lasting changes. Even as we strive to adhere to these new policies of openness and transparency, we will also strive to be a national model for the principles which the cooperative was originally formed. We will continue 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.

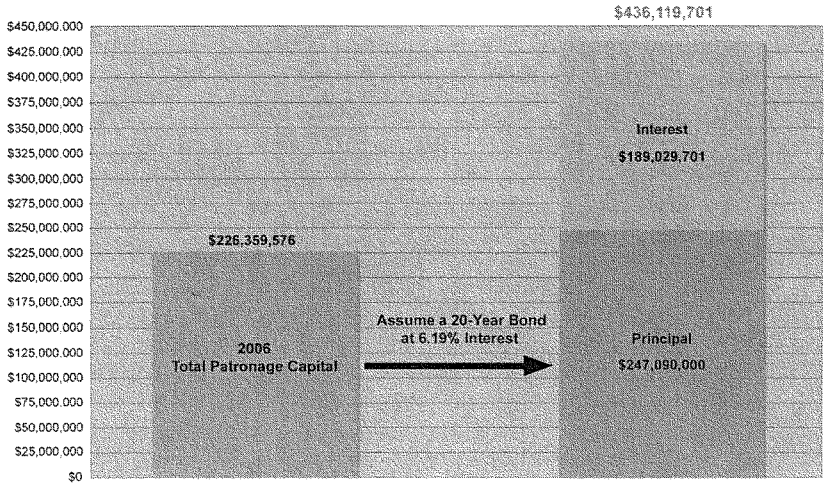
Appendix B
Total Plant Additions Greatly Surpass Patronage Capital



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.

Chairman WAXMAN. Thank you, Mr. Garza.

We are now going to go to the Members' questions at 5 minutes each, and I will start off with myself.

What you have described is really astounding. Here is a co-op—co-op, the name sounds like everybody is part of it and it is going to serve everybody's interests, and they are delivering the power. There doesn't seem to be any question about that. They are doing their job of getting electricity to their customers. But it is a closed system, very much like any undemocratic institution around the world. I think Mr. Mugabe could probably learn some things from Mr. Fuelberg. It is a closed system.

Now, I could go through all these things that you have outlined: the expenses for travel, the self-dealings and pensions, the chocolates, the girlfriends traveling around, their wives getting physicals. It is just plain self-dealing, and I am sure in their minds they rationalized it. They had been working there for so long and they are delivering the electricity, and why not a few little perks, and who is going to ever know because they are never going to let it out publicly.

It took a lawsuit, it took courageous and crusading journalists, it took members of the legislature to try to get information about—forgive my pronunciation—the Pedernales Co-op. And even then, as Mr. Higgins points out, we don't know that it might not revert back until some of the board members who perpetuated all of this are replaced, or at least they are on notice that what they do is going to be made public.

It is what we have heard on this committee over and over again. We have heard from investors who tell us that the board of directors set the salary and compensation of their executives, and they walk away with huge bonuses, even when the corporations go in the tank and people are losing their money who owned the corporation and people are losing their jobs that worked for the corporation and the CEOs walk away with a huge amount of money.

It seems to me that President Bush should be going back to Texas to try to democratize the co-ops. It would be a chance for more success there, I think, than some of the places where we are making a huge military commitment.

Mr. Garza, how do you respond to what Mr. Higgins said about the settlement? Do you think it was the best settlement just to avoid throwing more money into the lawsuit and didn't really resolve all the issues?

Mr. GARZA. Your Honor, it was my considered opinion that it was. The lawsuit was draining the energy of the co-op and the focus away from doing our job, and I felt that we needed to bring this to as quick a halt as we could. The minimum price for those lawyers was something like $500 an hour, and every hour just keeps mounting the cost.

Chairman WAXMAN. Who paid for the lawyers?

Mr. GARZA. The insurance company is paying for a portion, $2.4 million, and the co-op membership is paying the remainder of it, $1.6 million, for a total of $4 million.

Chairman WAXMAN. Were co-op members paying for both sides in the lawsuit, the plaintiff and the defendants?

Mr. GARZA. In effect, that is basically what it amounts to, Your Honor.

Chairman WAXMAN. I am just a chairman, not an Honor, but thank you. [Laughter.]

Well, that sounds like public financing of lawsuits. A lot of people say we shouldn't allow these lawsuits because so much money goes into attorneys' fees. Well, that is absolutely right. They shouldn't be necessary. But if you didn't have that lawsuit, Mr. Higgins, I suppose a lot of these facts never would have gotten out. Is that your assessment?

Mr. HIGGINS. Absolutely. That is the only way that we were going to learn what was going on there was this lawsuit.

Chairman WAXMAN. You had to force the information out. Do you think if we had a requirement in all of these co-ops around the country—we don't know if any other co-op is acting the way Pedernales has, but if we had at least a requirement of more openness with the by-laws allowing members to get information, try and eliminate the iron curtain that blocks out what the investors and the owners of the co-op should know, do you think that would be helpful?

Mr. HIGGINS. Absolutely, but you need two things. You need at least some of the members that are vigilant, paying attention, and trying to find out what is going on, but they need the tools to work with in order to do anything about it, and we did not have the tools here, and that is what I am a strong advocate for. Give us the tools to work with. We don't have them yet really. We have some reforms, but they can be reversed.

Chairman WAXMAN. I would like to get from you in more detail some of your recommendations for what you think the Federal Government might do by way of legislation.

Mr. HIGGINS. Yes, sir. I would be happy to.

Chairman WAXMAN. I say that, I want to make it very clear. We don't want to regulate these. We don't want to put extra burdens on them financially. We are not talking about that. I would just like to make sure that there is an openness in co-ops so that when the pillars of the community tell our members that they are certainly running honest co-ops, not like those Pedernales people, we don't know if that is true or not.

Mr. HIGGINS. And one other thing there. When you look at how much they have siphoned off, whatever amount that is, we don't know, but whatever it is, when you spread it among 223,000 or more people or households, then it is not going to make or break any individual, and it may not be enough to get our attention to know that there is something going wrong there, but whatever amount it is spread among it ought to be stopped. It is the principle of the thing.

It is repugnant to have people like this get in and abuse our trust in these positions, siphon off an awful lot of money to feather their own nest at our expense.

Chairman WAXMAN. Thank you very much.

I think Mr. Marchant is the one I would call next to pursue questions.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. Rose, you have outlined a prospective legislative package if the Navigant audit does not come back the way you think it ought to. Do you have the same kind of agreement with the Senate as far as their willingness? Senator Fraser, are you willing to enter into the same kind of legislative package?

Mr. ROSE. I will begin by saying the three legislative proposals that I outlined in the opening remarks I want to have occur however that Navigant audit turns out. We need open meetings and open records to apply to all co-ops across the State. We need all of our co-ops to submit third-party, independent audits to the Public Utility Commission annually, in my opinion. We also need minimum standards of governance so that good people can run for the board and have a fair shot at being elected.

Unless those three things occur, I don't think we have real local control. If we have real local control, we have over 200,000 highly qualified, very intelligent, very able members of the co-op who are going to be able to make sure that goes well.

So the Navigant audit, Congressman, it is important for us to monitor, it is important for us to see just what happened so that we can figure out what is needed in the way of reform. If that Navigant audit stops short of disclosing everything it needs to do from past practices and policies and abuses, then I believe the State ought to step in, and I believe we ought to mandate the same State audit that the Senator and I spoke about earlier this year requiring of the co-op.

Mr. MARCHANT. Senator, what course would you plan on taking in your committee?

Mr. FRASER. I think Representative Rose has outlined it exactly right, the things that we have to do is to put a little sunshine on this, that open records, open meetings are a must, and I think it will have broad support, bipartisan support in both the Senate and the House. But we have also got to ensure fair elections and also have the ability to audit.

One of the things that we are going to be looking at is a sunset review. They are the equivalent of a quasi-State agency, and the State has to know what they are doing, of which obviously in the past we haven't had the ability to do that. So it is going to depend a lot on what happens between now and November, but we have, as you know, the authority in Texas the any regulatory authority that we need, even to the point of dismissing the current board if needed.

Mr. MARCHANT. Thank you. It is a little bit like being in high school again, being in Congress. They ring the bells. We have votes.

Thank you, Mr. Chairman.

Mr. ISSA. Would the gentleman yield?

Mr. MARCHANT. Yes. Absolutely.

Mr. ISSA. Thank you. If the gentleman would yield, I just want to followup on the gentleman's statement. He knows more about Texas than I do, but I just want to understand. You have the ability essentially to regulate this and any corporation, and if you choose to you can create all the transparency that you want to within State law; is that correct?

Mr. FRASER. I am going to clarify. You used the word corporation, and regulating the corporation is not——

Mr. ISSA. Let me rephrase. I will take the corporation out. What Federal assistance, if any, would you need because you lack the authority within the State of Texas to create the transparency you need?

Mr. FRASER. We appreciate the input of this committee looking at it, but Texas has all the authority we need and actually are moving forward in making sure that we exercise that authority, so there is nothing in the regulatory spectrum that Texas does not have.

This is a quasi-State agency. It was created by the State, and we believe we have sufficient authority to do anything we need, even to the point of full regulation.

Mr. ISSA. So today the things we should realize are: don't mess with Texas, and let's get on to providing low-cost electricity in a time of incredible spiraling energy costs, natural gas, coal, and all other forms.

Mr. FRASER. And we believe this is the State's issue and we have sufficient authority. We are not asleep at the wheel. We are aggressively going after this and we will address this. I am making sure. This happened once; I want to make sure it is not happening other places. In Texas we have 66 co-ops. We are looking at all of them.

Mr. ISSA. Excellent. Thank you.

Mr. Chairman, I would also ask unanimous consent that my opening statement be made a part of the record.

Chairman WAXMAN. That is already agreed to.

Have you already adopted your legislation, or are these just proposals?

Mr. FRASER. We have not been in session since this is going on. We go into session January 8th of next year, and Patrick is going to carry the legislation on the House side, I will be carrying it on the Senate side. And so the answer is no, it has not been adopted, but I have an interim study going that we are in the process of meeting on right now, so it is being formulated.

Chairman WAXMAN. Well, I wish you all the best.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I think Mr. Clay wanted to go ahead. I yield to him.

Chairman WAXMAN. Mr. Clay, I will recognize you.

Mr. CLAY. Thank you, Mr. Cooper, and thank you, Mr. Chairman.

The leadership of Pedernales didn't just spend co-op money on hotels and flights for themselves and their spouses; they also charged Pedernales for thousands of dollars worth of meals and drinks. One group dinner at a San Antonio steak house cost $3,500. Another steak house meal cost $2,900. We have the co-op credit card statements and receipts for a lobster dinner for two and a trip to an oyster bar in New Orleans.

Here is a bill from Morton's Steak House, 7 rib-eyes, 20 mini crab cakes, 20 salmon pinwheels, even 3 callosal shrimp Alexanders. Those were $59 each.

We also know the co-op was paying for bar tabs when Bennie Fuelberg and the board of directors drank while traveling for conferences and meetings. The members were paying for alcohol at a jazzy hotel lounge in New Orleans and hotel bars at the Four Sea-

sons and the Ritz Carlton in St. Louis, Big Sky Resort in Montana, and I could go on.

Mr. Garza, was this kind of spending or fancy meals and drinks excessive to you?

Mr. GARZA. Yes, it was.

Mr. CLAY. Will the new expense policy allow the directors to charge the co-op for their fine dining?

Mr. GARZA. No, it will not.

Mr. CLAY. You have changed that policy in a way that what will happen? Will they pay their own meals?

Mr. GARZA. Theoretically it could happen. Yes.

Mr. CLAY. And they will pay for their own bar tabs?

Mr. GARZA. Yes. The policy does not allow paying for alcohol.

Mr. CLAY. Let me ask Mr. Watson, Mr. Watson, were you surprised when you learned that you and the other co-op members were footing the bill for these steakhouse dinners?

Mr. WATSON. Yes, sir, I was.

Mr. CLAY. And the former general manager also charged thousands of dollars to his co-op credit card for Godiva chocolates. Apparently he had Godiva chocolates in his office for select staff and visitors. Is that accurate, Mr. Garza?

Mr. GARZA. That is correct.

Mr. CLAY. And I assume the co-op is no longer spending thousands of dollars on chocolates?

Mr. GARZA. That is correct.

Mr. CLAY. All right. I am glad to hear that these abusive practices have been stopped. What concerns me is that the excessive spending on meals, alcohol, and chocolates went on for years and years without being detected, and they could be going on at other co-ops. It is the absence of oversight and true member control that allows this kind of behavior to go undetected for decades.

I will yield to the gentleman from Indiana.

Mr. BURTON. I just have one question. Well, two really. Who won the ball game last night?

Mr. GARZA. The Nationals.

Mr. BURTON. I was just kidding.

Mr. GARZA. The Nationals, bottom of the ninth.

Mr. BURTON. OK. All right. Do you have a Public Service Commission in Texas? I presume you do.

Mr. GARZA. Yes, we do.

Mr. CLAY. I am going to reclaim my time and yield back. Thank you so much, Mr. Chairman.

Mr. BURTON. I just have one or two questions real quick.

Mr. CLAY. The gentleman has time. Why doesn't he yield?

Mr. BURTON. We have votes on and I am not going to take all the time.

You have a Public Service Commission. I am just curious. The co-ops are regulated or overseen by the Public Service Commission, aren't they, in Texas?

Mr. FRASER. No, they are not.

Mr. BURTON. They are not?

Mr. FRASER. The wires and transmission is regulated by rate. We have a postage stamp rate.

Mr. BURTON. OK.

Mr. FRASER. But the rate authority is not overseen. They are unregulated.

Mr. BURTON. So I presume your legislation is going to give the Public Service Commission some oversight authority there?

Mr. FRASER. We are going to determine what is needed. We believe that if you put sunshine on the process where we allow open meetings, open records where the members can see what is going on and you have fair elections, we solve a lot of that.

Mr. BURTON. Well, Senator, the only reason I ask that is in any State it seems to me that if there is a question of abuse there ought to be a regulatory agency they can go to immediately and start raising the issue so that there can be an investigation. I don't know if it is that way in Indiana. I am going to check after having heard your testimony.

Mr. FRASER. The place of appeal on this, we didn't have a place for them to go for appeal. I agree with you.

Mr. BURTON. Thank you.

Thank you, Mr. Chairman.

Chairman WAXMAN. We do have some votes on the House floor. We will recess. I think we can get back here in 15 or 20 minutes, so let's recess until 11:50.

[Recess.]

Chairman WAXMAN. The hour of 11:50 having come and gone, I would like to reconvene the meeting. I am sorry it took a little longer than I had hoped it would.

To pursue further questions, I want to recognize Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

Mr. Garza, does Pedernales belong to the National Rural Electric Co-op Association?

Mr. GARZA. Yes, it does.

Mr. COOPER. Are you aware that Mr. English, the head of the Association, who will be testifying on the next panel, has at least stoutly claimed to me—and I think this is an official position of the Association—that co-ops are not public power?

Mr. GARZA. I have heard the argument. If you look at Pedernales, we buy 99 percent of our power from the LCRA. We are accountable to our members, which essentially is the public. To me that pretty much defines public power. But I understand there is another argument here.

Mr. COOPER. But Representative Rose, Mr. Watson, and perhaps some others stoutly stress in their testimony that they believe in their co-op, they believe in public power, and yet you belong to a trade association that says you are not public power?

Mr. GARZA. That is correct.

Mr. COOPER. Why do you pay dues for an organization that doesn't uphold your beliefs?

Mr. GARZA. Because we come from the same roots as the rest of the co-ops in the country.

Mr. COOPER. This is the opposite. You say you are public power; they say you are not. Who is right?

Mr. GARZA. I believe that I am right.

Mr. COOPER. But you are paying your ratepayers' money to an organization that says you are wrong.

Mr. GARZA. If you go beyond that fundamental difference of opinion—and I understand that it is a difference—and you look at the technical problems that we face as distribution co-ops, how to deal with the——

Mr. COOPER. I agree on engineering and things like that.

Mr. GARZA. We can share good information.

Mr. COOPER. But on the fundamental, philosophical point of what your organization is, as you say, there is a fundamental disagreement, so why do you belong to it?

Mr. GARZA. For the purpose of sharing information on how to best serve our members, and especially sharing technical information on how to best design and implement the most modern innovations that we can use to serve our members.

Mr. COOPER. Would you belong to a communist organization that had good engineering capabilities?

Mr. GARZA. Absolutely not.

Mr. COOPER. But one that denies the existence of public power for co-ops is OK?

Mr. GARZA. Even though it is a fundamental difference, I consider it something that is outweighed by the value that they bring in terms of the exchange of technological knowledge.

Mr. COOPER. Senator Fraser.

Mr. FRASER. Yes. I think the clarification you are trying to make, I actually agree with the concept that they are not public power because they are a distribution. Really they are a resale and a billing operation as a co-op. If they were generation, as we have nine generation co-ops, they are part of the power generators. And so I would say that Pedernales, I don't think they are public power. I think they are a distribution and a billing entity as a co-op.

Mr. COOPER. So you are contradicting your colleague, Representative Rose, and Mr. Watson——

Mr. FRASER. Well, I won't speak for Representative Rose.

Mr. COOPER [continuing]. In their sworn testimony before this committee?

Mr. FRASER. I am giving my opinion that I believe that it is a distribution company.

Mr. COOPER. So this is a fundamental difference of opinion. Another fundamental issue—and I don't want to unsettle your settlement down there, but I am a little worried that you all may have been hoodwinked and perhaps sucker punched by this, because everyone wants full disclosure, right?

Mr. FRASER. And, Representative Cooper, I appreciate that. I have oversight over the industry, and the industry—this is a co-op distribution company, and I personally see that——

Mr. COOPER. But, Senator, in response to Congressman Burton's question it was revealed that there was no one to complain to in Texas State government about co-op problems because you all had abjured your jurisdiction, apparently.

But this other fundamental disagreement we need to get into is this: everyone is for disclosure. Why hasn't anyone told you it has been a Federal tax law since 1972, a long time, that every electric co-op shall keep open books and records accessible to members at any time? That was a ruling from 1972. All we need to do is enforce existing Federal law.

Mr. WATSON. May I comment on that?

Mr. COOPER. Yes, sir.

Mr. WATSON. I am aware of that law. I will say about the NRECA, last year when I began looking into capital credits I became aware that there was something called the Task Force Report on Capital Credits that had been prepared under the auspices of the NRECA. I called the NRECA and talked to, I would say, about six or seven people attempting to get a copy of that report, and they would not give it to me. They asked me, are you a board member? I said, no, I am merely the person that pays your salary. I am a member of a co-op that is a member of the NRECA. Yet they stonewalled me on attempting to get that.

Now, on public power I finally did get it through the Blue Bonnet Electric Co-op in Texas, of which I am also a member. But I disagree with Senator Fraser. I believe it is public power, although we are in a shady area here.

I think when Texas deregulated utilities they let the co-ops slide into a netherland; yet, on the other hand, with all due respect to our elected representatives here, I have observed Texas government for many, many years. I am 71 years old. I worked in the government when I was in law school. Regulatory agencies in Texas are all too often the captive of the regulated industries. It would not lend comfort to me to think that the PUC was all we could rely on. Please do not accept assurances that the State of Texas can take care of its own problems. We have often demonstrated that, in fact, we cannot do that in Texas.

Mr. COOPER. Representative Rose.

Mr. ROSE. Congressman, I appreciate all the work that you have done on this issue. I read your article on the plane write-up here last night. I will say this: the Senator and I both agree that it is important for us to have meaningful local control at the co-op level, and ultimately that is the best check and balance on decisions at the board and senior management level in co-ops.

I do believe in statute we can require open meetings and open records. I do believe we can require an annual report to the PUC. And I do believe we can set minimum standards for governance. If we do that, I believe we have taken a long step forward toward correcting these problems moving forward. And on those three points we absolutely agree.

Mr. COOPER. I heard that you favor a State audit. It is my impression that Pedernales rejected a State audit because that would have been——

Mr. ROSE. Yes, sir. The Senator and I formally requested that earlier this calendar year. I believe the more light we can shine on these past practices the better for our co-op and our membership so that we can figure out exactly what is needed in the way of reform and statute as we move forward. This Navigant audit, we are working very closely, the Senator and I both are, with Navigant and with the PUC as they oversee and review. I said it in my opening remarks and I will say it again: if that Navigant audit stops in any manner, shape, or form short of where they need to get totally to get the answers to the co-op membership, the questions that we have, I will move forward next session and require a State audit.

Mr. COOPER. Last question, because I see my time has expired. Is Pedernales today telling every customer what is in his or her capital accounts?

Mr. WATSON. No.

Mr. COOPER. Why not?

Mr. WATSON. I don't know. It is required by law, and yet they are not.

Mr. COOPER. So this is private property that citizens are not allowed to know about?

Mr. WATSON. Well, at least it is not being reported to us on an annual basis, which is my understanding of what the Internal Revenue Code requires.

Mr. COOPER. After all the turmoil and upset you all have gone through, all the $4 million in legal fees, members still don't know exactly what they own?

Mr. WATSON. That is correct. And I will also say that 2 weeks ago I requested the opportunity to come to the headquarters of the PUC in Johnson City and read the minutes from January 2007 through the current date. Those minutes were not made available to me, couldn't be made available to me because they are being redacted. There was even a scrivener's error or correction in connection with this lawsuit, if you can believe that old term. Mr. Garza is working hard to open up. Mr. Garza I hope has become a friend of mine, but he understands that I am still extremely critical.

We have four hold-over board members from the old regime who have the nerve to think that they can constitute a Compensation Committee to correct the mistakes they made themselves, who are undermining, in my view, Mr. Garza's efforts to open up this. I am doubtful now whether there is a majority on the board as it currently exists to voluntarily come under the Open Records Act, which is what we had all been hoping for pending legislation, perhaps in the session which will begin in January. We want it to begin now.

Mr. COOPER. When did Texas stop believing in private property?

I thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Mr. Cooper.

I want to pursue some further questions.

Mr. Watson, you have expressed your view that you don't think the State law in Texas, as good as it may be, that is being offered by Mr. Fraser and Mr. Rose is going to be enough. Is that a correct statement?

Mr. WATSON. Well, I am not certain it is going to be enough. It is easier to kill a legislative proposal in the State of Texas than it is to pass one.

Chairman WAXMAN. That is true here, too.

Mr. WATSON. And it is possible that these are highly skilled legislators and influential legislators, and so it is quite possible that the good legislation that I am sure they will draft and introduce will, in fact, wend its way through committees and stalling and go to other committees, the calendars committee and so forth and so on. It is a very convoluted process. I am trying not to be too pessimistic about it; however, I am not sure that will fully take care of it.

It worries me. The practices of the PEC—and I have said this for almost 3 years now—I believe jeopardized the tax-exempt status of the PEC, hoarding and building up permanent equity, which is not permitted; not complying with the disclosure about property ownership, as Congressman Cooper pointed out. So some of these may be more national issues or issues related to matters that are more under the purview of the committee.

Chairman WAXMAN. Mr. Higgins, what are your thoughts on that?

Mr. HIGGINS. Well, I tend to agree with Mr. Watson here, but I would just add to that there is one PEC here in one area of the State, and the members of the legislature in that area are very concerned and determined to do something. At the same time, legislators in other areas of States with their own co-ops will probably have a different view about added regulation. So it is a huge barrier to overcome to get to the point that legislation is, in fact, enacted to become law to regulate all of the co-ops.

Chairman WAXMAN. Does anybody on the panel know how many States that have co-ops also have laws like that being proposed? Mr. Fraser. Mr. Rose.

[No response.]

Chairman WAXMAN. We don't know that.

Well, I must share my concern also that even when you have regulatory agencies that are supposed to be watching over the industries to be regulated, they often become captive of the industries, themselves, although at least you have some place to go when you have a complaint with the regulatory agency.

A root cause of the problems at Pedernales appears to be the undemocratic process it had for selecting its board members. In theory, the board of directors is directed by the members and members are able to hold the board accountable through the electoral process, but that is not what happened at Pedernales. Until recently, incumbent directors selected a nominating committee, which in turn endorsed the preferred slate of incumbent directors, in some cases family members of the incumbent directors were placed on the nominating committee, so the son or brother of a director would be on the nominating committee and, surprise, that director would be nominated for another term. Only the slate of candidates approved by the nominating committee appeared on the ballot, so there was a ballot with just one name for each open position. It was all but impossible for anyone but hand-picked members to be elected to the board.

Mr. Watson, when you and other members tried to get some new candidates on the ballot what happened?

Mr. WATSON. When we appeared before the Nominating Committee in March 2007 we presented three candidates that we asked be placed on the ballot. We didn't say, don't place your own other people on the ballot. By the way, it is my understanding that those seven appointees, one from each of the seven voting directors, that constituted that committee were paid a stipend for serving on that committee.

I looked at all 17 directors, 7 voting directors and 10 advisory directors. Every single one of those 17 people were originally appointed to the board by the board. In other words, a vacancy oc-

curred during a term—I think that is the way they arranged it—and a new member was appointed by the board, who then became the incumbent when the election rolled around. Not that it would have mattered, because there was never any competition.

But they absolutely refused. In fact, when we were leaving the committee hearing that day at the headquarters at the PEC, Mr. Fuelberg walked us down to the lobby, and we asked him specifically, is there anything in your view in the by-laws that would prevent the nominating committee from nominating more than one person for a position? In other words, setting up, oh my goodness, an election that actually had two people or three. He said no, but it had never been done in his memory, and his memory went back about 40 years. And we said, well, do it this time, please. Of course, they didn't do it.

Chairman WAXMAN. Well, as I understand it, you say 40 years. My information was no one successfully challenged the slate picked by the board's nominating committee for 30 straight years, maybe longer, and when write-in candidates challenged the official slate the sitting directors exercised thousands of proxy votes to defeat them. There were even prize give-aways for members who signed their votes over to the board's proxy committee. The prizes, which were donated by vendors, ranged from TVs to gift certificates.

Is that correct?

Mr. WATSON. That is correct.

Chairman WAXMAN. And, Mr. Garza, you wouldn't say this was a fair or democratic system for electing directors, would you?

Mr. GARZA. No, I would not.

Chairman WAXMAN. Under your State law would that be prohibited or change, Mr. Rose?

Mr. ROSE. Congressman, when this began to come to light a year ago, the Senator and I both became engaged because we had members and our constituents and ourselves were all alarmed by what was going on. This is a statement of the obvious, but, just to be clear, unless your name is on the proxy ballot that is mailed to the membership, you don't have a chance to win that vote. There aren't enough people who show up at the meeting, itself, to vote. You are overwhelmed by the votes that come in by mail.

The old PEC process was such that, as Mr. Watson says, nobody other than the hand-picked Nominating Committee designated candidates were in the proxy ballot in the mailbox. So on September 4th of last year I wrote to the PEC and requested five changes or reforms. One of them was to reform the election process so that folks could access that proxy ballot, members could access the proxy ballot by petition. Some co-ops do that today in Texas.

I want to praise the co-op board for having made that change and what resulted in 58 candidates running this time. When I received the ballot in the mail as a member, I had those names on my ballot and I could cast, as a mail-in ballot—I attended the meeting, but as a mail-in voter I could choose any of them.

I think as we look toward governance changes next session—the Senator and I have been talking about it—we are going to work on it as we approach the January session. We have to have a signature-based or petition-based avenue to the proxy ballot guarantee.

Short of that, you don't have real democratic governance for the co-op.

Chairman WAXMAN. Thank you.

Mr. Cooper, I want to recognize you.

Mr. COOPER. Thank you, Mr. Chairman.

We have focused just on Pedernales, but let's talk about another Texas co-op. It is outside of Fort Worth, got tired of being in the co-op business, so it decided to go in the hotel and golf course business, borrowed a billion dollars—billion with a B—and went bankrupt. This is in the jurisdiction of the great State of Texas. Any opinion on that? Is that proper co-op behavior? You want to sanction Pedernales going into the hotel/golf course business like the Fort Worth co-op did?

Mr. FRASER. If you will allow me to answer that, Mr. Cooper, Federal law very clearly says that 85 percent of the business has to be in the resale of power. We did have a renegade that took off.

I actually would take it one step further and say I don't believe a distribution company should even be in the generation business. I don't believe they should be getting in outside businesses. I think they should concentrate only in the sale of the resale of electricity. So no, that is not acceptable behavior.

Mr. COOPER. My memory is not perfect, but I think the committee memo for this hearing said that under investigation 50 percent of the co-ops that have gone into other businesses have exceeded the 15 percent threshold. That is a 50 percent error rate. That is a very high percentage. For anyone to borrow a billion and put at risk the good faith of their customers who signed up for electricity business, not a hotel business/golf course business, that is amazing.

Let's look at some others outside of your State. There is a co-op outside of Atlanta, Cobb, that subcontracted out its entire operation—every truck, every light pole—to a for-profit subsidiary secretly owned by co-op managers. So if you think you have a scandal at Pedernales, Godiva Chocolates and Celine Dion seems a little bit tame in comparison to this master plan. And it has been under way and is still underway for the last 10 years.

Mr. FRASER. One of the things that I plan to pursue is a prohibition against the co-ops getting into other sideline businesses. One of those would be generation of power. We have a concern about using capital credits to invest in power generation. At least it is my opinion that co-ops in Texas should not be doing that, and that is not a good use of capital credit money.

Mr. COOPER. What about our friends in Alabama who did not have a board of directors election for their co-op for 38 years? So as great as the Texas Legislature is, you all don't have jurisdiction outside of the State boundaries. These problems seem to be mounting in a number of different areas, but it all depends on an enterprising reporter like Margaret Newkirk, like Claudia Grisales, and there was another one you mentioned, Mr. Watson, that I don't remember.

Mr. WATSON. Jodi Lehman from Horseshoe Bay.

Mr. COOPER. Those have become the watchdogs of democracy. The legislature was asleep, we were asleep, and those few intrepid reporters, sometimes relying on inside tips, were able to blow the whistle and help shine the light where it needed to be shined.

I thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Mr. Cooper.

Mrs. Foxx.

Mrs. FOXX. Thank you very much, Mr. Chairman.

Let me say that I am a long-time member of a rural cooperative. Both my electricity and my telephone services come from co-ops. I am very dependent on those for my energy and my phone. In fact, I think my phone service is superior to phone service I could get anywhere else.

But I am not a fan of the Federal Government getting involved in things that it doesn't need to get involved in. I have made many speeches in this committee, on the floor, and in other committees about that.

I was the only member of North Carolina State Senate that voted against allowing co-ops to compete with private enterprise in North Carolina, because I have great concerns about that, too. I told the head of my co-op, with whom I have spoken recently, that I would be happy to come to this hearing and talk about my concern about the Federal Government not getting involved, but would also express my concerns that I have expressed in the past about the role of co-ops.

I guess one of the questions I would like to ask Mr. Fraser or others on a panel is: how do you think that the problems that have been exposed by this panel and by Mr. Cooper should be dealt with if not dealt with by the Federal Government? What do you think should be done? And if you could make fairly short answers, then I would like to make a couple of other comments.

Mr. FRASER. Madam Representative, we believe the State of Texas has sufficient authority to solve this problem. We have full regulatory control that we can exercise if needed, and we are in the process to determine that. I appreciate, as I said in my opening comments, that the Federal Government is looking at this. We appreciate their interest, but the State of Texas has sufficient authority and we need no other additional authority from the Federal Government to address this issue.

Mr. COOPER. Would the gentlelady yield for just a second?

How about on disclosure of private property in Texas? Do you need any help on that issue?

Mr. FRASER. Disclosure of private property? Give me a——

Mr. COOPER. That is what we were discussing earlier. Pedernales is still not telling each member what he or she owns in the cooperative. That is private property.

Mr. FRASER. You missed the conversation I had with Juan Garza, general manager. Starting within the next billing cycle, he is going to be putting on all the bills everyone's capital credit issue. I have been advised by the Association of Co-ops in Texas that the bulk of those are doing it, but it is something that I am going to pursue that every month on their bill it will say that in Pedernales I have $2,342 in equity in that company.

The thing you are asking is something we have the ability to do, and it is just a matter of we didn't have it done, but it is going to get done.

Mr. COOPER. Thank you.

Mrs. FOXX. Mr. Rose.

Mr. ROSE. Congresswoman, thank you for your interest and your service in North Carolina. I have read up a little bit about you. I don't know how the North Carolina Senate and House operate, but Senator Fraser and I have been commenting back and forth today. It is strange to sit here and look at one party on one side of this dias and the other party on the other side of this dais, the majority and minority reports, and all those things. I wish it wasn't that way. It is not that way in Texas.

One thing that I might suggest that we all would agree on, on both sides of this room, would be that the Federal Government needs to enforce the laws that exist on the books. To the extent that we have co-ops spending more of their capital and resources outside of their core mission, if that violates Federal statute you all ought to do something about it.

To the extent that you need to make sure that open meetings and open records are being followed and that comports with their nonprofit, tax-exempt status, you have to do something about it.

What we can do in the State of Texas—and we talked about this a good bit, but I will just mention—we have to make sure that every co-op in the State of Texas follows open meetings, open records. We have to make sure that every co-op in Texas submits at least an annual audit report to the Public Utility Commission every year. Part of that might be a very clear statement about the capital credit accumulation in that co-op, and that is something that I would like to consider as we move forward next session. But also, and finally, the third point, we have to make sure that there are minimum standards of democratic governance where members can seek, through fair elections, a membership on their board.

Mrs. FOXX. Mr. Watson, go ahead.

Mr. WATSON. Yes, Congresswoman Foxx. Thank you.

One of the things that inhibited us members from learning about the workings of the PEC was that they filed inadequate and really incomplete form 990's, which are the forms required by all nonprofits. The IRS, from what I read in the press, has been starved of enforcement money, so I would urge you to, as a Congressman, vote to beef up that enforcement, for one thing.

The other problem that we faced was the advisors, the professional advisors to the co-op. They worked for Mr. Fuelberg. They did not work for me as a member. They didn't work for any of us 220,000 members. I am going to name them. KPMG, the accounting firm, signed off on audits and on form 990's that were incomplete on their face.

The law firm of Clark Thomas, which has represented the PEC for 70 years probably, one of their lawyers Mr. Fuelberg reported in public or in the press had said there was a loophole in the Internal Revenue code that allowed him not to put in a key employee compensation, which is clearly called for on the form and in the instructions. So I asked the lawyer, I said, are you glad now that you advised him that way? And he sort of gave me a sheepish look. But I understood at the time that about 40 percent of all Texas co-ops were failing to accurately and correctly report on the form 990.

That is the only instrument which is publicly available to members such as myself to learn about the compensation and perks that are being paid to co-op employees, key employees, and the

board. So I implore you, talk to the Internal Revenue Service. I understand that within the last year they have let it be known that they intend to begin finally looking at non-profits and enforcing the requirements for 990's, but it just simply takes away the only tool that we had.

Mrs. FOXX. Mr. Chairman, I know——

Chairman WAXMAN. I think Mr. Higgins had a comment.

Mrs. FOXX. OK. Go ahead.

Mr. HIGGINS. When you talk about the co-op that went bankrupt getting into the golf course business, that is a surprise to me. I don't think that co-ops ought to be in any business except the business that they are supposed to be in. When you say there is 15 percent latitude, I wonder about that.

The first red flag that caught my attention was that apparently nobody was minding the store there enforcing it. The second big red flag that catches my attention is if you merely say to the IRS, Enforce these provisions, I am afraid that you may punish the people who have already been punished if they put our nonprofit status in jeopardy. So they need to be enforced, but don't come down on us and take away the advantages, whatever they are, of having a co-op to begin with.

Mr. COOPER. Will the gentlelady yield just for one quick point?

Of co-ops, 93 percent are in other businesses, 93 percent, according to the NRECA, itself, so we have a lot more work to do in this regard.

Mrs. FOXX. Thank you, Mr. Chairman, for your latitude. I appreciate it.

I do want to say again that we have excellent service from our co-op. We had over 900 people at our annual meeting about a month ago. I have attended every annual meeting for 15 years. I realize that it is the members who have the control over what happens in the co-ops. If they want to have things done, they can have things done. But I have to say the capital credits are being paid out by our co-op in I think a reasonable manner. I have not investigated the books, but I have no doubt that things are being done. We have excellent people on our board.

I want to say that I know there are co-ops that are operating very effectively and very well, but I think it worries all of us in Congress when there are problems with some co-ops. As with other things, it taints everyone involved. I think that it is in the interest of the co-ops to make things better so that people aren't tainted.

It is just like us in Congress. If we have a Member of Congress who performs badly, all of us get tainted with that, all of get accused of being bad. So I would hope that the message from this hearing would be that if there are problems, the co-ops, themselves, and the States, themselves, would start looking at where the problems are. I don't want to see an Enron kind of situation develop here because the kinds of comments you have made—and I have only heard a few of them, and I apologize, because I had voting in another committee and testifying in an other committee, so I apologize for being here only part of the time, but I do want to caution you on that.

I again thank the chairman for his latitude.

Chairman WAXMAN. I thank the gentlelady for her comments and questions.

Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

I think it is good that we have this hearing, and I appreciate the chairman having it, and Mr. Cooper's asking for it, but I am a little bit perplexed, having listened to some of the testimony and having read some of the different things. I can't fully grasp why the membership of these EMCs—and I belong to an EMC. I buy my electricity from an EMC and I go to the annual meetings where new board members are elected, and there is probably anywhere from 1,500, 2,500 people there.

Why they don't govern themselves? I know from experience we have had some problems, or at least some complaints, about an EMC in Georgia. I believe it is the Cobb EMC. Yet, over the past 8 or 10 years, their electricity bills have come down, actually dropped about 7 percent, versus where the national average has gone up about 20 percent. So in Georgia I guess we oversee ours, I think, and I am not sure what the Senator from Texas could say about it, but it looks to me like this is a State issue, and not really a Federal issue.

But I would like to ask the Senator a question, if I could. From one of the press releases after you attended a cooperative meeting at the United Cooperative Services you lauded the group and said the cooperative spirit of rural Texans created this system which electrified rural Texas is the same spirit that allows the majority of cooperatives to continue to operate efficiently and effectively for their members.

Senator, would you say that you have acknowledged that Pedernales situation is an isolated incident?

Mr. FRASER. We do believe that Pedernales was an isolated incident. We have not found any indication at the other 65 distribution co-ops in Texas that there is a problem. That doesn't mean we are not looking, and we have an ongoing investigation, but I sent a letter to every member of the legislature asking them to research the co-ops in their area. We have not found anything else, so we believe yes, it was isolated.

We are addressing the Pedernales problem, but I am not in favor of throwing the baby out with the bath water and totally abandoning the system, because co-ops in Texas are needed. I am still a strong proponent, and yes, I agree, this is a State's issue and we have the ability to address.

Mr. WESTMORELAND. Senator, wouldn't you want to keep that ability to address it without having the Federal Government come in and try to do it that might preclude you from addressing and legislating those things that are inside your State?

Mr. FRASER. Absolutely. The problem I always see with State and Federal Government is you are trying to do a one size fits all. It doesn't work. Texas has a unique system in the way we do our independent system operator. We are the only State that is totally defined in one network, the ERCOT, and because of the way we govern, we take care of our own business. I think it would be a mistake for the Federal Government to try to intervene or to dictate a one size fits all policy.

I agree with Representative Rose: if we will enforce Federal law that is on the books today, that should be done; but other than that, the regulatory authority should lie with the State.

Mr. WESTMORELAND. Thank you. And just keep in mind that we have two speeds up here, knee-jerk and stop. This is one of those knee-jerk speed things.

Thank you, Mr. Chairman. I yield back.

Chairman WAXMAN. Thank you, Mr. Westmoreland.

Mr. Jordan, do you have some questions?

Mr. JORDAN. Thank you, Mr. Chairman. This is the first time I have ever walked in and got to go right away. I appreciate that. The timing works out nice.

Let me just go to the two members of the General Assembly, if I could, Senator Fraser and Representative Rose. I apologize, this may have been asked, but I just read some information from one of our largest co-ops in our District and how dissimilar they do things compared to how Pedernales's board and their CEO handled things. People I think are, as has been said earlier, very pleased with the treatment they get from their co-op and how it functions, and we certainly are in Ohio.

When you did your investigation of Pedernales, did you look at others, as well, in your State? Was this just totally an isolated incident, or did you see in your investigation other co-ops around Texas, or, for that matter, around the country who were engaged in similar practices?

Mr. FRASER. The last hearing we had with the Senate Committee of Business and Commerce, we addressed Pedernales, but we did exactly the same as the chairman is doing here. The second portion was the co-ops, as a whole. We had the co-op association, of which we had one of the people from the Texas Association here today, Eric Craven, which is their political arm and their lawyer, and we instructed them to go out and look at the other 65, determine if there is a problem, and bring us back the data. I also requested the same thing of the other members of the legislature.

To this point, we have not uncovered anything other than there have been several small changes in the way that they elect members of the co-op, some of the reimbursement, travel policies, some of the capital credits going out. They realize that they are being watched and are correcting some of the small problems.

Mr. JORDAN. In your professional judgment as the chairman of the committee that oversees this industry, you felt this was just one co-op in your State that had a problem?

Mr. FRASER. We believe that. Unfortunately, it was the co-op where Patrick and I live, and the largest in the Nation, so yes, we believe that they were a renegade, one co-op, and we believe that most problems were just in that co-op.

Mr. COOPER. Would the gentleman yield for a moment?

Mr. JORDAN. I would be happy to.

Mr. COOPER. We discussed the Fort Worth co-op borrowed a billion dollars to go into the hotel and golf course business and then went bankrupt, so there must be at least one other Texas co-op that has had significant problems, unless you view in Texas a billion dollars as not being a lot of money.

Mr. FRASER. And, Representative, we are referencing what is happening during current periods, which is the last few years. The incident you are talking about was not in the current period, I don't believe, and we are looking at what has happened in the last current period. Of the current, ongoing co-ops that are doing business in Texas, we believe Pedernales right now is the only one we have identified that are still doing business in Texas.

Mr. JORDAN. Mr. Representative.

Mr. ROSE. Congressman, thank you for your question. I think it would ill suit us to just focus on the question is there one co-op who has acted poorly. I think for us as we move forward we have to make sure that each Texan who lives in a co-op and is a member of a co-op has certain basic assurances.

I have said it before today, but I will say it again: I would challenge anybody to disagree with the notion that open meetings and open records aren't appropriate in a co-op setting. I challenge anybody to disagree with the notion that we ought to have a democratic election that is fair for the board. I would also challenge anybody to say that we ought not have our co-ops report to the Public Utility Commission a basic accounting of their books, and perhaps also, Representative Cooper, a snapshot of capital credits and where that co-op is from that standpoint.

No disrespect, Congressman Westmoreland, but knee-jerk and stop, neither one of those speeds is appropriate in this situation as we approach it from the Texas legislature. We have to be mindful to keep this balance of statutory oversight and local control. I think those three reforms next session can do that.

Mr. JORDAN. I thank the chairman.

Chairman WAXMAN. Thank you for your questions.

I want to thank this panel. You have been very patient, sitting here for quite a long time, but very responsive to the questions that we have been asking, and also sharing with us your insights about this whole problem that you have experienced, and I think it has been very, very helpful. Thank you so much for being here.

We have another panel, but I want to take a short break of 5 minutes, and then we will hear from Mr. English.

[Recess.]

Chairman WAXMAN. I am pleased to welcome to our committee hearing today a former member of this committee and a classmate of mine when I was first elected to Congress. Mr. Glenn English is the CEO of the National Rural Electric Cooperative Association, which is the electric co-op trade association. For years he represented the sixth Congressional District in Oklahoma.

I am pleased to have you here. Before you sit down, you might as well continue to stand and take the oath.

Mr. ENGLISH. That is the reason I was standing, Mr. Chairman.

[Witness sworn.]

Chairman WAXMAN. The record will indicate that was an affirmative answer.

Mr. ENGLISH. Yes, it was. It was, indeed. But I have been mistaken a couple of times in my life, Mr. Chairman. Just a couple of times.

Chairman WAXMAN. The full statement that you have submitted to us will be in the record. We will have a clock to let you know

when 5 minutes is up, and would like you to be mindful of that, and then we can pursue questions from members of the panel.

Let's hear from you.

STATEMENT OF GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. ENGLISH. Again, first of all, let me just say I am delighted to be back to this committee. I have many fond memories here of this committee, and am certainly happy to come back and talk about electric cooperatives.

The first thing, I guess, that I am struck by as I looked over the witness list, Mr. Chairman, is I wondered where the Administrator of the Rural Utilities Service was. I know each time that I ever had a hearing here in this committee dealing with electric cooperatives, I always invited the Administrator of the Rural Utilities Service. I got to thinking about that a little bit, and it made sense to me. Golly, gee, I guess I am here in place of the Administrator of the Rural Utilities Service, and that I think says something.

I would like to point out, Mr. Chairman, I think you and I made a big, big mistake 25 years ago, a big mistake. If you look at the Rural Utilities Service today, we ended up through those years of cutting out two-thirds of the staff at RUS, and if you look at many of the issues that we are talking about here today, the Rural Utilities Service still has rules and regulations on the books to be able to deal with those issues, but they don't have the staff and don't have the funding. They have pretty much been neutered, to be honest about it, when we talk about regulation. Probably that is the reason we are raising questions, and we have some folks here that obviously are not operating in the way that their membership thinks that they should have operated. I think that has become very, very obvious.

I think that is something that we have to weigh and take into consideration. Maybe that is something the Congress would want to do, maybe go back and rectify that mistake and bring the Rural Utilities Service up to full funding and put them in a position to where, in fact, they are able to carry out all their duties.

I wasn't aware at the time—maybe you are—the Rural Utilities Service still has the authority to remove a CEO. They are supposed to be going in each year and auditing the books of every co-op. We have an apparatus here that has fallen into disuse simply because of the fact that the folks don't have the resources. This was all a part of the changes that took place, Democratic and Republican administrations and Democratic and Republican Congresses. We pretty much, as I said, neutered this agency.

Second point I would like to make, Mr. Chairman, is the fact that—and I have been struck by this for some time—that the directors of electric cooperatives are elected officials, and as we look at them as elected officials, I would suspect that the members of this committee and certainly in the Congress should feel a great deal of empathy with some of the challenges and difficulties that they face. They are not dissimilar.

I think that you and I have both seen, as we have moved through the last 30 years or so, that people really make up the institution. It is not the institution, itself. This democratic process of ours is

good. It is good as far as the Congress and our Government, it is good as far a electric cooperatives are concerned. It is the people that we get involved. And so we run into some of those issues with regard to people, and people, well, they damage everybody. Everybody gets painted with the same brush.

I think that is important for us to keep in mind. You made mention of that, that it would be unfair to just say everybody is the same. I think that is true.

As we have seen, whenever individuals stub their tow or perhaps don't move in the direction that the public thinks they should, then the public brings about changes. Sometimes it takes time. I have seen an awful lot of elected officials in this body from time to time who probably were not operating in a way that their constituents thought they should, but sooner or later their constituents took action and they dealt with that. I think we have the same thing here.

In these days, everyone should be sensitive of the fact of the smell test. I know each and every elected official, they are always mindful of that, particularly these days. I know the Congress is particularly sensitive about it. I was when I was on the Congress. And you are always looking at this thing. Golly, how would this read on the front page of the newspaper? What kind of a headline would this make? Maybe you are not doing anything wrong, but the appearance of impropriety is bad enough and that damages you if you are an elected official, and I think that is what we are talking about.

So whether you are an electric cooperative director or a Member of Congress, we face the same constituency. These are the same people that elect us. Whether we agree or disagree with the wisdom of their decision as to who they pick, we have to work together, and that is true within the electric cooperative program, as well. We all try to work together, and you do it in the Congress, and this is a struggle as to how do we deal with it.

I think it really comes down to this question, bottom line: how do we come to grips with this with our peers? How do other electric cooperative directors deal with it, other electric cooperative CEOs, how do Members of Congress deal with it with their peers? It is not easy. It is not an easy thing to do.

So I appreciate your having the hearing, and certainly appreciate the fact that we have had this little airing here with regard to one property that got off track and obviously did some things wrong. As I understand it, there may even be the consideration of criminal penalties against some that committed some wrongs.

I will be very straightforward with you: if there are any violations of the law, we ought to prosecute. That ought to be true for Members of Congress. It ought to be true with CEOs or directors of cooperatives. That is one line.

Second line I think we come into is this question of it may not be illegal, but it may not be something that is very commendable.

Those are issues that I think are going to have to be taken care of by the local people that they represent, just as they take care of any disagreements they might have with their elected officials.

And I think we also come down to the bottom line, Mr. Chairman, that we all want a fair and open process. We want everyone engaged in competition. We want everyone doing the right thing,

and we want all of the voters, whether they are voting for Members of Congress or voting for directors of electric cooperatives, to be involved in that process.

Thank you very much.

[The prepared statement of Mr. English follows:]

Statement of NRECA

To The House of Representatives

Committee on Oversight and Government Reform

Full Committee Hearing on
"Governance and Financial Accountability of Rural Electric Cooperatives:
The Pedernales Experience"

June 26, 2008

Testimony of

The Honorable Glenn English, C.E.O.

National Rural Electric Cooperative Association

4301 Wilson Boulevard
Arlington,VA 22203

Chairman Waxman, Ranking Member Davis, and Members of the Committee:

My name is Glenn English, and I am the Chief Executive Officer of the National Rural Electric Cooperative Association (NRECA). I had the distinct honor of serving on this Committee as a Member of Congress and I appreciate the invitation to appear before you today to discuss the transparency, governance, oversight, and capital credit practices of electric cooperatives.

NRECA is the national service organization dedicated to representing the national interests of cooperative electric utilities and the members they serve. Founded in 1942, NRECA was organized specifically to overcome World War II shortages of electric construction materials, to obtain insurance coverage for newly constructed rural electric cooperatives, and to mitigate wholesale power problems. Since those early days, NRECA has been an advocate for member-owned cooperatives on energy and operational issues as well as rural community and economic development. Over 900 electric cooperatives are members of NRECA. As a trade association with voluntary membership, NRECA is not a regulator, nor do we have enforcement powers over electric cooperatives.

Overview of Cooperatives

A cooperative is a private business. Cooperatives (also referred to as "co-ops") empower people to improve their quality of life and enhance their economic opportunities through self-help. Throughout the world, cooperatives are providing co-op members with financial services, utilities, consumer goods, affordable housing, and other services. In many ways, they are like any other form of business; but in several important ways they are unique and different.

Cooperatives are owned and democratically controlled by their members - the people who use the cooperatives services or buy its goods. They are not controlled by outside investors. In addition, consumer cooperatives are not motivated by profit, but rather by meeting their members' needs for affordable and high quality goods or services. Cooperatives distinguish themselves through the seven cooperative principles. The principles, listed below, serve as the guiding business philosophies for cooperatives across the country.

- Voluntary and Open Membership
- Democratic Member Control
- Member Economic Participation
- Autonomy and Independence
- Education, Training and Information
- Cooperation Among Cooperatives
- Concern for Community

Electric Cooperatives: An Integral Part of the U.S. Electric Utility Industry

As member-owned, not-for-profit organizations, electric cooperatives have an obligation to provide a reliable supply of electricity to all consumers in our service areas at the lowest possible price. Electric cooperatives take their obligation to serve very seriously - the personal and economic health of their members and communities depends on it. Cooperatives play a critical role in our nation's economy and in local communities. Many are unfamiliar with the business structure of electric cooperatives. Some have characterized electric cooperatives as subdivisions of government or quasi-governmental. For that reason, I believe it is important to outline the basics of the electric cooperative business model.

Electric cooperatives are:

- Private independent electric utility businesses,
- Owned by the consumers they serve,
- Incorporated under the laws of the states in which they operate,
- Established to provide at-cost electric service, and
- Governed by a board of directors elected from the membership, which sets policies and procedures implemented by the cooperative's professional staff.

I would like to re-iterate the first bullet point. An electric cooperative is not a state or federal government body, public entity, or administrative agency. It is a private corporation. Federal courts have defined a "cooperative" under federal tax law as an organization operating with subordination of capital, democratic member control, and operation at-cost. Electric cooperatives are "true" cooperatives under federal tax law.

Today, electric cooperatives serve over 41 million consumers in 47 states. Electric co-ops bring electricity to 12 percent of the population but maintain 42 percent of the nation's electricity distribution lines. There are 850 distribution cooperatives in America; the most populous serves over 200,000 member-owners. The least populous serves 112 member-owners. The median distribution cooperative serves 12,467 member-owners.

Covering 75 percent of the nation's land mass means co-ops serve widely diverse communities with sharp economic and geographical differences. Electric cooperatives serve communities ranging from frontier Alaskan villages, to fast-growing suburban areas in Florida, to Native American reservations in Arizona and island communities in Maine and Hawaii. This diversity is a great testament to the cooperative business model and the success of the electric cooperative network. If Members of the Committee have not done so, I urge you to attend an electric cooperative annual meeting where members-owners, often in the thousands, interact about the business of the local co-op. For many communities, it is the largest annual gathering in the entire area. It is hard to describe the enthusiasm and pride member-owners have for their local distribution cooperative.

Democratic Process is Working at Electric Cooperatives

Local ownership makes rural electric systems responsive to the needs of communities they serve. Electric cooperative directors are elected by cooperative members. Most cooperatives permit directors to be nominated by a nominating committee, or by one or more petitions signed by a specific number of member-owners. Many cooperatives divide their service areas into districts and nominate directors by district to ensure equitable, geographic representation on their boards. A growing number of electric cooperatives are enabling their member-owners to vote by mail ballot. This democratic process among electric cooperatives is alive and well. In recent years, more than 3,000 new directors have been elected to electric cooperative boards. There are approximately 7,400 cooperative directors nationwide.

This dramatic level of turnover confirms what we are seeing across the entire electric cooperative network: an active and engaged membership that wants to participate in the local process. Co-op board members bring a wide range of expertise and experience to their local cooperatives. They are farmers, ranchers, small business owners, teachers, bankers and just about every other profession you can name.

These board members serve because they want to contribute to their communities in a meaningful way. Electric cooperative boards typically meet monthly. Board members also devote time outside of meetings, preparing and staying up-to-date with developments in an increasingly complex and changing electric industry. Thousands of board members participate in regional and national meetings of electric cooperatives, linking them to a broader network of electric cooperatives and allowing them to draw upon the knowledge and support of their peers.

Survey information collected by NRECA indicates that the median compensation for distribution cooperative directors is $9,304 annually. Cooperative director compensation continues to be considerably below the norm when compared to director compensation in the for-profit arena, despite having the same corporate fiduciary responsibilities. According to the 2007-2008 National Association of Corporate Directors (NACD) *Director Compensation Report* the median total direct compensation for a director in the for-profit "Utility & Energy Industry" (with revenues of $50 mil. to $500 mil.) is $67,129. The average director compensation for all for-profit industries surveyed in this revenue category is $95,868.

Electric Cooperative Practices are Transparent

Most electric cooperatives are exempt from federal income taxation. As exempt organizations, they annually file IRS Form 990, "Return of Organization Exempt From Income Tax." (Attached). As revised for the 2008 tax year, Form 990 requires even greater disclosures of compensation for current and former directors, key employees and highest compensated employees. These disclosures address, among other things, compensation reported to the IRS, deferred compensation, health benefit plans, retirement plans, travel expenses, and other compensation and benefits.

The revised Form 990 also requires increased governance, management, and transparency disclosures. These disclosures address, among other things, information regarding: (1) loans and grants to directors and key employees, if any; (2) transactions with related organizations; (3) business relationships between a cooperative and its directors and key employees, their family members, and entities with which they are affiliated; (4) family and business relationships among directors and key employees; (5) written conflicts of interest, whistleblower, and document retention and destruction policies; and (6) processes for determining director and key employee compensation. The filed IRS Form 990 is publicly available from the IRS or from the filing organization. NRECA has put considerable resources into educating our membership about the requirements of the IRS Form 990, including its recent changes. For example, NRECA has highlighted the revised Form 990 in its monthly newsletter, *Legal Reporting Service* and discussed it during many conferences, seminars, meetings, conference calls, and webinars.

RUS has Regulatory Authority Over Its Electric Cooperative Borrowers

Established in 1935, the Rural Electrification Administration (REA) - now the Rural Utilities Service (RUS) - is a federal agency that administers electric and telecommunications loan and loan guarantee programs, as well as water and waste-water loan and grant programs.

RUS has a broad range of regulatory authority over its electric cooperative borrowers. RUS regulations applicable to electric program borrowers are found at 7 C.F.R. Parts 1710, 1714, 1715, 1718, 1720, 1721, 1724, 1726, 1728, 1730, 1767, 1773, 1786, 1788, 1789, 1792 and 1794. In addition to regulations specifically related to its insured and guaranteed loan programs, RUS regulations, loan contract and mortgage provisions reach many areas of electric cooperative operations - from accounting requirements to electric engineering, system design, construction, operations and maintenance, as well as environmental reviews.

RUS has the right to audit and inspect borrowers' utility systems, encumbered property and all books and records "of every kind." In addition to its regulations, RUS publishes hundreds of pages of guidance in the form of "bulletins" with a broad range of subject matter, including capital credits, financial planning, internal controls, and sales of capital assets.

Additionally, cooperatives in 44 states are subject to some form of state public utility commission regulation, including regulation of terms and conditions of service, safety, facility siting, territorial issues and financing.

Cooperatives are Responsible Stewards of Member Equity and Capital Credits

I believe it is important for the Committee to understand the basics of capital credits. Hopefully, this will clear up some of the vast misrepresentations that have been made about electric cooperatives' capital credits.

Like other businesses - at least well-run businesses - an electric cooperative annually collects more money than it spends. Unlike other businesses, an electric cooperative annually "allocates" its excess revenue, or its "margins," to its member-owners. This allocation is based upon a member's business with the cooperative during the year. The more business a member does with the cooperative during the year, the more the member contributes to the co-op's margin for the year, and thus, the greater the member's allocation. These allocated margins are called "capital credits."

After the cooperative allocates its capital credits, it uses them as "capital" to expand its electric system and meet other capital needs. Using the capital credits in this manner decreases the funds a cooperative must borrow. By decreasing borrowing, a cooperative decreases interest payments and keeps its electric rates lower than they would be otherwise. At a later date determined by the cooperative's board of directors, the cooperative "retires" - or pays - capital credits. Until the cooperative retires these capital credits, the cooperative owns them and the members have a conditional, or contingent, right to the retirement and payment of them. As recognized by federal courts, capital credits are not securities under federal securities law.

Let me be clear: There is no unused or unneeded "pool of capital" or "pool of cash" available to immediately retire and pay capital credits.

A board's decision when to retire capital credits, and how much to retire, is based, among other things, on the cooperative's financial condition; regulatory and other contractual limitations on retirements; contemplated capital needs for electric system maintenance, repair, and expansion; rate competitiveness; financial market considerations; and member considerations. Generally, in its loan documents and regulations, RUS requires its prior approval of a capital credit retirement if such retirement would lower the co-op's equity below 30 percent of its total assets.

Now, let me establish that electric cooperatives have a proud track record with respect to capital credits. In 2004, NRECA surveyed its members regarding capital credit practices. Of 885 surveys sent, 502, or 57 percent, were completed and returned. Based upon these responses: (1) 95 percent of NRECA electric cooperative members have retired or plan to retire general capital credits; (2) 78 percent retire general capital credits annually; and (3) 77 percent annually notify members of capital credit allocations. It's important to note: some electric cooperatives purchase power from the Tennessee Valley Authority (TVA). As explained in an October 1, 1974 memorandum, TVA interprets its standard power contract with electric cooperatives as prohibiting the retirement of capital credits.

As evident from survey responses, the majority of electric cooperatives which may retire capital credits do, in fact, retire them. Prudent equity management by responsible boards of directors - which are accountable to their members - has yielded an amazing record of financial responsibility, low risk, and high stability for over 70 years. During the last five years, annual capital credit retirements have increased an average of 4.3 percent per year.

In 2007, electric distribution cooperatives retired more than $500 million in capital credits to their members. Cumulatively, electric distribution cooperatives have retired a total of $8 billion of capital credits. (See Attachment).

As of December 31, 2006, electric distribution cooperatives had an average equity as a percent of assets equaling 40.6. The composite equity of distribution cooperatives and generation and transmission cooperatives (G&Ts), entities formed by voluntary associations of distribution cooperatives to generate, transmit and purchase power, is 31 percent. According to Fitch Ratings, one of the leading rating agencies in the country, an electric distribution cooperative with reasonable quality and average credit features needs 30 to 50 percent equity for an investment grade rating.

Capital credits are an important part of electric cooperative operations. In NRECA Member Resolution (05-E-7), entitled "Capital Credits," NRECA's members encourage NRECA to "assist cooperatives in this vitally important matter via equity management and capital management planning and the use of financial forecasting models, training, and other related support activities." As requested by its members, NRECA educates them regarding legal, tax, and financial developments affecting capital credits.

Electric Cooperatives: Leaders in Renewable Energy, Energy Efficiency and Customer Satisfaction

Electric cooperatives lead the industry in the areas of renewable energy and efficiency. Well over 300 cooperatives offer members a separate green power product and over 750 cooperatives own or buy renewable resources for their members. In 2007, co-ops received 11 percent of their power from renewable sources, as compared to 9 percent for the nation's entire utility sector.

The National Renewables Cooperative Organization (NRCO) is a new entity formed by electric cooperatives to develop and deploy renewable energy resources for all cooperatives throughout the United States. NRCO reflects the commitment of cooperatives around the country to the responsible development of cost effective renewable resources in a manner that benefits their members, their communities, and the nation as a whole.

Electric cooperatives are using their energy and business expertise to develop innovative member programs that reduce their electricity usage - providing incentives and technical support for highly efficient appliances and comprehensive weatherization. Over 90 percent of electric cooperatives provide their members with energy efficiency education and 77 percent offer energy audits that help consumers reduce energy costs and waste. Electric cooperatives also employ demand response programs to ensure the efficient use of resources. Electric cooperatives are at the vanguard of technology. For example, the Federal Energy Regulatory Commission (FERC) has recognized electric cooperatives for leading the industry in the deployment of smart meters.

NRECA and the Natural Resources Defense Council (NRDC) recently announced they have signed a memorandum of understanding outlining an array of joint programs that aim to improve energy efficiency in America, including:

- Expanding the involvement of NRECA and its members in regional and national energy efficiency alliances;
- Creating an energy efficiency center within NRECA to help members pool resources and learn about best practices within the electric cooperative community; and
- Supporting the establishment and expansion of academic centers on energy efficiency at colleges and universities nationwide, to help accelerate technology innovation, improve program design and train efficiency experts.

The North American Electric Reliability Corporation - the electric utility watchdog charged in the Energy Policy Act of 2005 with monitoring the bulk power system - has honored several cooperatives with *Examples of Excellence.* This included a cooperative honored for its "restoration efforts after Hurricane Katrina hit the Gulf coast in August 2005."

For all these programs and active involvement in our communities, it is not surprising that electric co-ops enjoy the highest average customer satisfaction rating in the industry, according to the University of Michigan's American Customer Satisfaction Index. (April 2008). This is yet another example of how local control sets cooperatives apart from other utilities.

The financial strength electric cooperatives have carefully built over time has been well documented by the rating agencies on Wall Street. In June 2007, Fitch Ratings noted that *"over the past quarter century, the financial performance of the electric cooperative industry has generally been good. This reflects the cooperative industry's primary role as provider of electric service to retail customers, the risk adverse nature of most cooperative boards, and the overall stability of its largely residential and agrarian loads. As nonprofit organizations, cooperatives are designed by policy to keep rates as low as possible."*

Moody's, another nationally recognized rating agency, said in 2006 that generation and transmission cooperatives *"have conservatively and efficiently managed their business in recent years by tightly controlling operating costs, planning power needs and avoiding investor-owned utility diversification mistakes."*

Electric Cooperatives are Engines for Economic Development

Because electric co-ops are member-owned and controlled, by nature they are integral parts of the communities they serve. Co-ops employ more than 65,000 people and in many cases are the largest employer and economic engine in an area, and provide a ready-made delivery system to get things done. For instance, a recent study among

Iowa's electric cooperatives showed that electric cooperatives and their support network added about $900 million in output to their local economies.

Many electric co-ops respond to community needs beyond just providing safe, reliable, affordable electric power. These additional services are an extension of the rural electrification program's original goal: to improve the quality of life for residents in the areas they serve. Many electric co-ops are involved in community development and revitalization projects, such as small business development and jobs creation, improvement of water and sewer systems, and assistance in delivery of health care and educational services.

Through a 1987 amendment to the Rural Electrification Act of 1936, Congress encouraged RUS electric cooperative borrowers to invest in "rural community infrastructure projects" and "job creation activities."

An electric cooperative's ability to engage in businesses unrelated to providing electric energy, or to own businesses unrelated to providing electric energy, is governed by state law. Under the Internal Revenue Code, however, an exempt electric cooperative must pay tax on all income that is not substantially related to its exempt purposes. This unrelated business income tax is equal to the corporate tax. An exempt electric cooperative may collect up to 15 percent of its income from non-members or from activities unrelated to its exempt purpose. Further, like other exempt organizations, it may own a separate, taxable business unrelated to its exempt purpose.

As noted by the United States Energy Information Administration and industry participants, the electric energy and gas industries were converging in the late 1990's and early 2000's. This trend was widely expected to continue. Further, because many states were restructuring their electric industries, electric energy companies began diversifying into other businesses. Because of this convergence, to better compete in a restructured electric industry, and to meet community needs, some electric cooperatives began providing goods and services unrelated to electric energy.

In March 2000, the U.S. Department of Agriculture Inspector General issued a report citing the changing and complex utility industry and strongly advised that electric cooperatives enter diversified business enterprises. The Inspector General recommended that "RUS coordinate with Congress to develop a strategy to encourage electric borrowers to make discretionary investments in rural areas *as intended by Congress* (emphasis added)."

NRECA Member Resolution (01-D-4), entitled "Meeting Consumer Needs," recognizes that an electric cooperative may be the most capable entity in a community to meet an un-served or underserved need. This resolution encourages electric cooperatives to consider providing additional goods and services, where appropriate, needed and desired by their communities. NRECA Member Resolution (94-E-2), entitled "Legal Basis for Diversification," discusses the potential for revitalizing rural America and maintaining a strong cooperative through diversified activities and directs NRECA to provide analysis

of the proper legal basis for any diversified activities by electric cooperatives. NRECA Member Resolution (08-E-4), entitled "Cooperative Business Strategy," advises cooperatives to engage in strategic planning when considering all the possible functions of a cooperative, including subsidiary businesses, and to demonstrate the highest degree of due diligence and transparency by the cooperative's board and management. NRECA Member Resolution (99-G-4), entitled "Separation of Functions," states that a cooperative's electric energy activities should not subsidize its non-electric energy activities, and that costs should be allocated between the activities on the basis of fully allocated costs, and not on the basis of incremental costs.

Electric Cooperatives Receive Less Federal Assistance than Other Utility Sectors

All electric utilities in the United States receive federal assistance, or subsidies. This was the conclusion of University of Pennsylvania economics professor and Nobel Laureate Lawrence R. Klein and has been further substantiated in numerous studies by federal agencies and others.

Calculations based on federal government financial reports show that rural electric cooperatives receive the *least* amount of subsidy per customer: $3 compared to $36 for IOUs and $55 for city-owned utilities. Municipalities are able to issue tax-exempt bonds to finance generation and transmission facilities. Investor-owned utilities (IOUs) benefit from investment tax credits and accelerated depreciation. The difference in federal subsidies for each type of utility becomes even sharper after considering that because most electric cooperatives serve sparsely populated areas across the vast countryside, they have on average only seven customers per mile compared to 35 for IOUs and 47 for city-owned utilities. In addition, the appropriation to finance RUS electric loans has declined over the last ten years from $55 million in fiscal year 1995 to $5 million in fiscal year 2005. Although the RUS subsidy has declined substantially, the federal assistance to the investor-owned and city-owned utilities continues at high levels.

Compared with other electric utilities:

- Co-ops serve an average of 7 consumers per mile of line and collect annual revenue of approximately $10,565 per mile of line,
- Investor-owned utilities average 35 customers per mile of line and collect $62,665 per mile of line,
- City-owned utilities, or municipals, average 46.6 consumers and collect $86,302 per mile of line.

In 2006, electric co-ops paid $1.3 billion in taxes. Federal government and state governments recognize the way that cooperatives operate and tax them accordingly. While cooperatives generally do not pay income tax, they are subject to taxes paid by other utilities. Co-ops pay property tax, sales tax, gross receipts tax, ad valorem tax, unemployment tax, and payroll tax. These taxes support local schools, police and fire departments and roads.

NRECA Supports Informed Co-op Governance Through Education and Training

NRECA offers numerous education, training and certificate programs for co-op CEOs, employees and directors. (See attached lists). NRECA's primary objective is to give our electric cooperative membership the tools to make informed decisions on a wide range of issues. I will highlight some of the specific governance-related programs NRECA offers.

For over 50 years, NRECA has offered education programs to electric cooperative directors, emphasizing fiduciary responsibility and director accountability. In 1998, NRECA introduced a Credentialed Cooperative Director certificate program (CCD) - a multi-part education program for electric cooperative directors. CCD is a classroom-based, instructor-led curriculum of five courses that focus on core knowledge of governance principles, key utility operational and financial issues, and the skills required of cooperative directors. The CCD curriculum provides the important foundation directors require to effectively oversee the business of their cooperative.

Of 7,400 active electric cooperative directors serving on boards today, 58 percent have completed five courses on director fundamentals to earn NRECA's Credentialed Cooperative Director (CCD) certificate. Successful completion of a learning assessment is required before credit for this course is awarded to the director. In 2007, NRECA directors attended 312 classroom-based education programs on the subject of board governance and related topics, up from 260 programs in 2006. These courses are offered at individual cooperatives, statewide offices, and in advance of NRECA's annual Directors' Conference as well as NRECA's annual and regional meetings.

The Board Leadership Certificate (BLC) program is the second component of the director education program. BLC consists of a series of classroom-based courses focusing in greater depth on specific industry and governance issues. BLC courses provide advanced study in areas such as risk management, rate making, and policy development. Additionally, the topics covered in the more intense credentialing courses are covered more generally in annual "Summer" and "Winter" schools for directors.

The third part of NRECA's director education program is the annual NRECA Directors' Conference, which focuses on key industry trends and how they play out in the electric cooperative board room. This annual event provides directors with an opportunity to hear industry experts, work in small-group learning labs, and collaborate with peers.

NRECA also offers training opportunities in advance of the NRECA annual meeting for co-op directors to enhance their knowledge in the areas of fiduciary responsibilities and governance issues. Courses provide an overview of what directors should know about rules and procedures for effective board meetings, appraising and compensating the CEO, strategic planning and more.

NRECA regional meetings include the following events: New Director Orientation, four general sessions on key issues in the energy industry, a business meeting and a CEO breakfast. At the 2007 regional meetings a 90-minute session was presented on electric

cooperative transparency expectations. This session, entitled *Achieving Transparency and Preserving Confidentiality,* addressed, among other things, issues of transparency and reporting to members as well as the public on annual filings of IRS Form 990 "Return of Organization Exempt from Income Tax."

For the past 30 years NRECA has offered a university-based Management Internship Program (MIP) that provides management training for CEOs and senior executives throughout the electric cooperative network. This rigorous program consists of six weeks of on-site training annually and coursework in a university setting. The objective of this intense learning environment is to enhance the skills needed to manage various aspects of a modern electric cooperative. Among the key topics addressed in this program are strategic planning, cooperative business planning, process analysis and design, legal compliance issues, project management, capital and financial management, and the role and duties of the board and of management and their mutual relationships. The MIP has graduated more than 1,100 co-op CEOs and staff.

At other forums, including the hundreds of smaller cooperative meetings held throughout the United States each year, NRECA presents or facilitates a wide variety of courses covering topics relevant to transparent and democratic cooperative governance. Following is a list of these courses, taken from the NRECA Education and Training Course Catalog:

- Basic Credentialed Cooperative Director Courses 2600 and 2620. Attendees at these courses receive information on board duties as well as relationships and other transparency issues. Course 2600, *Director Duties and Liabilities*, addresses their fiduciary obligations under the law and bylaws to the co-op and the members. Course 2620, *Board Roles and Relationships,* addresses the board's responsibility for knowing and responding to the membership.
- Course 930, *Ethics and Governance: Implementing the New Accountability*, addresses a board's role to ensure ethics in all that the board and management do, as well as the need of a policy on record keeping and retention. In this course, all attendees are supplied with information that addresses the board's role in risk management, record keeping and whistle-blowing.
- Course 929, *Current Issues in Policy Development*, also disseminates the policy on record keeping and retention. Also included in the appendix to this course are policies on director standards of conduct and delegations to the general manager.

NRECA Member Resolutions have addressed the issue of transparent and democratic governance. Member Resolution (04-I-1), entitled "Member Involvement and Education," sets out the seven cooperative principles and advises that "member involvement is vital to ensure the future direction and success of individual cooperatives and the entire electric cooperative network. This can best be achieved by offering programs and policies that encourage open communication and participation in co-op programs and the governing process."

Local Control Works for Electric Cooperatives

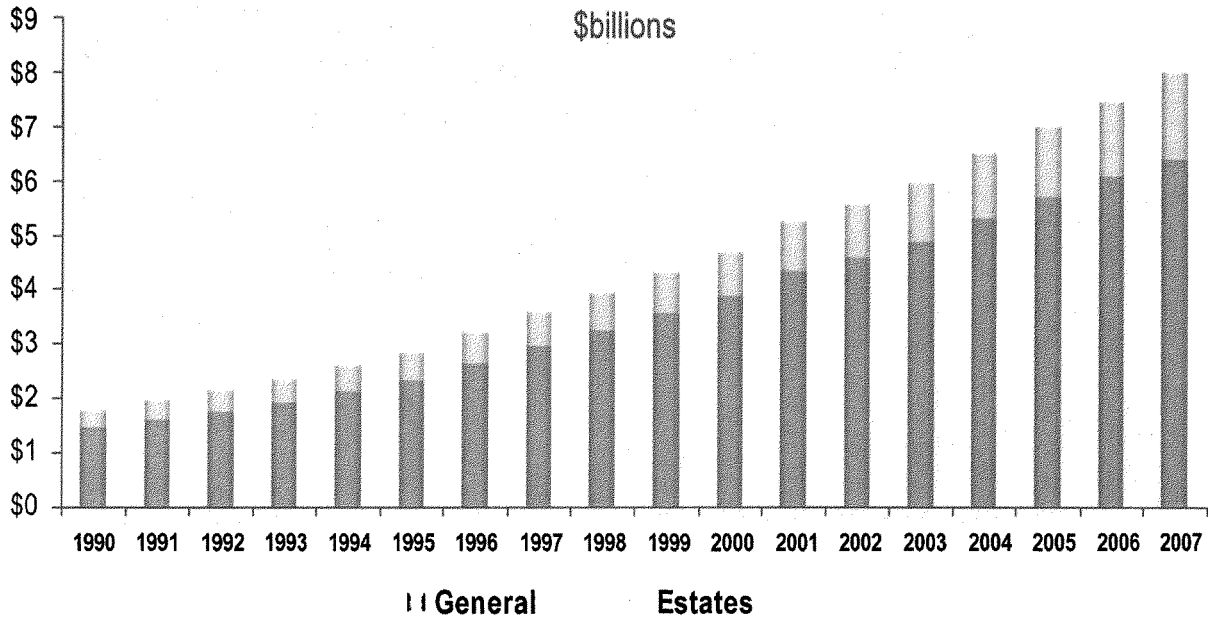
In conclusion, during my 14 years at NRECA, I have had the opportunity to meet scores of cooperative leaders, from directors, to managers and employees. I have found remarkable similarities with these people and the people I was privileged to serve with in Congress. An overwhelming number are dedicated professionals, committed to doing the right thing for their communities and the people they serve.

Mr. Chairman, we have heard many of today's allegations before. They are nothing new. Many of the slings and arrows of 2008 resemble what we heard in the 1930's. Listen to *Business Week*, from July 2, 1936. "Many of REA's projects will struggle along for a time under the burden of weak local management and inefficient maintenance... [and] eventually seek the protection of the nearest strong company." This, of course, has been proven wrong many times over.

If I have learned one thing from my life in public service and representing this nation's electric cooperatives, it is that voters - or member-owners - tend to correct the situation if they do not believe they are being well represented. The checks and balances are in place. We have seen the evidence of this today. The cooperative business model - and local control - worked, just as it has since the inception of the rural electric cooperative program. There are approximately 900 electric cooperatives in the United States. But only one electric cooperative was invited here today.

I would be happy to answer any questions.

Cumulative Retirements of Capital Credits



One of the benefits of being a cooperative member is receiving capital credits. Rural electric co-ops have returned $8 billion of equity to their members over the years.

Source: Form 7 data for distribution systems

Form **990**

Department of the Treasury
Internal Revenue Service (77)

Return of Organization Exempt From Income Tax

Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)

▶ The organization may have to use a copy of this return to satisfy state reporting requirements.

OMB No. 1545-0047

2008

Open to Public Inspection

A For the 2008 calendar year, or tax year beginning , 2008, and ending , 20

B Check if applicable:
- ☐ Address change
- ☐ Name change
- ☐ Initial return
- ☐ Termination
- ☐ Amended return
- ☐ Application pending

Please use IRS label or print or type. See Specific Instructions.

C Name of organization

Doing Business As

Number and street (or P.O. box if mail is not delivered to street address) | Room/suite

City or town, state or country, and ZIP + 4

D Employer identification number

E Telephone number

( )

G Enter gross receipts $

F Name and address of Principal Officer:

H(a) Is this a group return for affiliates? ☐ Yes ☐ No

H(b) Are all affiliates included? ☐ Yes ☐ No
If "No," attach a list (See instructions)

I Tax-exempt status: ☐ 501(c) ( )◀ (insert no.) ☐ 4947(a)(1) or ☐ 527

J Website: ▶

H(c) Group Exemption Number ▶

K Type of organization: ☐ Corporation ☐ trust ☐ association ☐ Other ▶

L Year of Formation:

M State of legal domicile:

Part I Summary

Activities & Governance

1 Briefly describe the organization's mission or most significant activities:

2 Check this box ☐ if the organization discontinued its operations or disposed of more than 25% of its assets.

3 Enter the number of voting members of the governing body (Part VI, line 1a) 3

4 Enter the number of independent voting members of the governing body (Part VI, line 1b) . . 4

5 Enter the total number of employees (Part V, line 2a) 5

6 Enter the total number of volunteers (estimate if necessary) 6

7a Enter total gross unrelated business revenue from Part VIII, line 12, column (C) 7a

b Enter net unrelated business taxable income from Form 990-T, line 34 . . . . . 7b

		Prior Year	Current Year
Revenue	8 Contributions and grants (Part VIII, line 1h)		
	9 Program service revenue (Part VIII, line 2g)		
	10 Investment income (Part VIII, lines 3, 4, and 7d)		
	11 Other revenue (Part VIII, lines 5, 6d, 8c, 9c, and 10c of column (A), and 11e)		
	12 Total revenue—add lines 8 through 11 (must equal Part VIII, line 12, column (A))		
Expenses	13 Grants and similar amounts paid (Part IX, lines 1–3, column (A))		
	14 Benefits paid to or for members (Part IX, line 4, column (A))		
	15 Salaries, other compensation, employee benefits (Part IX, lines 5–10, column (A))		
	16a Professional fundraising expenses (Part IX, line 11e, column (A))		
	b (Enter amount from Part IX, line 25, column (D) _____).		
	17 Other expenses (Part IX, lines 11d, 11f–24f)		
	18 Total expenses—add lines 13–17 (must equal Part IX, line 25, column (A))		
	19 Revenue less expenses—line 12 minus line 18		

		Beginning of Year	End of Year
Net Assets or Fund Balances	20 Total assets (Part X, line 16)		
	21 Total liabilities (Part X, line 26)		
	22 Net assets or fund balances, line 20 minus line 21		

Part II Signature Block

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

▶ Signature of officer | Date

▶ Type or print name and title

Paid Preparer's Use Only

Preparer's signature ▶ | Date | Check if self-employed ▶ ☐ | Preparer's PTIN (See Gen. Inst.)

Firm's name (or yours if self-employed), address, and ZIP + 4 ▶ | EIN ▶ | Phone no. ▶ ( )

May the IRS discuss this return with the preparer shown above? (See instructions) . . . . . ☐ Yes ☐ No

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11282Y Form **990** (2008)

Dissolution of Corporation 2007 DO NOT FILE

Part III **Statement of Program Service Accomplishments** (See the instructions.)

1 Briefly describe the organization's mission:

2 Did the organization undertake any significant program services during the year which were not listed on the prior Form 990 or 990-EZ? . . . . . ☐ Yes ☐ No
If "Yes," describe these new services on Schedule O.

3 Did the organization cease conducting or make significant changes in how it conducts any program services? . . . . . ☐ Yes ☐ No
If "Yes," describe these changes on Schedule O.

4 Describe the exempt purpose achievements for each of the organization's three largest program services by expenses. Section 501(c)(3) and (4) organizations and 4947(a)(1) trusts are required to report the amount of grants and allocations to others, the total expenses, and revenue, if any, for each program service reported.

4a (Code:) (Expenses $ including grants of $) (Revenue $)

4b (Code:) (Expenses $ including grants of $) (Revenue $)

4c (Code:) (Expenses $ including grants of $) (Revenue $)

4d Other program services. (Describe in Schedule O.)
(Expenses $ including grants of $) (Revenue $)

4e **Total program service expenses $** *Must equal Part IX, Line 25, column (B).*

Draft as of December 19, 2007 DO NOT FILE

Part IV Checklist of Required Schedules

			Yes	No
1	Is the organization described in section 501(c)(3) or 4947(a)(1) (other than a private foundation)? *If "Yes," complete Schedule A*	1		
2	Is the organization required to complete Schedule B, Schedule of Contributors?	2		
3	Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office? *If "Yes," complete Schedule C, Part I*	3		
4	*501(c)(3) organizations.* Did the organization engage in lobbying activities? *If "Yes," complete Schedule C, Part II*	4		
5	*501(c)(4), 501(c)(5), and 501(c)(6) organizations.* Is the organization subject to the section 6033(e) notice and reporting requirement and proxy tax? *If "Yes," complete Schedule C, Part III*	5		
6	Did the organization maintain any donor advised funds or any accounts where donors have the right to provide advice on the distribution or investment of amounts in such funds or accounts? *If "Yes," complete Schedule D, Part I*	6		
7	Did the organization receive or hold a conservation easement, including easements to preserve open space, the environment, historic land areas or historic structures? *If "Yes," complete Schedule D, Part II*	7		
8	Did the organization maintain collections of works of art, historical treasures, or other similar assets? *If "Yes," complete Schedule D, Part III*	8		
9	Did the organization provide credit counseling, debt management, credit repair, or debt negotiation services, report an amount in Part X, line 21, or serve as a custodian for amounts not listed in Part X? *If "Yes," complete Schedule D, Part IV*	9		
10	Did the organization hold assets in term, permanent, or quasi-endowments? *If "Yes," complete Schedule D, Part V*	10		
11	Did the organization report an amount in Part X, lines 10, 12, 13, 15, or 25? *If "Yes," complete Schedule D, Parts VI, VII, VIII, IX, or X as applicable*	11		
12	Did the organization receive an audited financial statement for the year for which it is completing this return that was prepared in accordance with GAAP? *If "Yes," complete Schedule D, Parts XI, XII, and XIII*	12		
13	Is the organization operating a school as described in section 170(b)(1)(A)(ii)? *If "Yes," complete Schedule E*	13		
14a	Did the organization maintain an office, employees, or agents outside of the U.S.?	14a		
b	Did the organization have aggregate revenues or expenses of more than $10,000 from grantmaking, fundraising, business, and program service activities outside the U.S.? *If "Yes," complete Schedule F, Part I*	14b		
15	Did the organization report on Part IX, line 3, more than $5,000 of grants or assistance to any organization or entity located outside the United States? *If "Yes," complete Schedule F, Part II*	15		
16	Did the organization report on Form 990, Part IX, line 3, more than $5,000 of aggregate grants or assistance to individuals located outside the United States? *If "Yes," complete Schedule F, Part III*	16		
17	Did the organization report more than $15,000 on Part IX, line 11e? *If "Yes," complete Schedule G, Part I*	17		
18	Did the organization report more than $15,000 total on Part VIII, lines 1c and 8a? *If "Yes," complete Schedule G, Part II*	18		
19	Did the organization report more than $15,000 on Part VIII, line 9a? *If "Yes," complete Schedule G, Part III*	19		
20	Did the organization operate one or more hospitals? *If "Yes," complete Schedule H*	20		
21	Did the organization report more than $5,000 on Part IX, line 1? *If "Yes," complete Schedule I, Parts I and II*	21		
22	Did the organization report more than $5,000 on Part IX, line 2? *If "Yes," complete Schedule I, Parts I and III*	22		
23	Did the organization answer "Yes" to questions 3, 4, or 5 of Form 990, Part VII, Section A? *If "Yes," complete Schedule J*	23		
24a	Did the organization have a tax-exempt bond issue with an outstanding principal amount of more than $100,000 as of the last day of the year, and that was issued after December 31, 2002? *If "Yes," answer 24b–24d and complete Schedule K. If "No," go to question 25.*	24a		
b	Did the organization invest any proceeds of tax-exempt bonds beyond a temporary period exception?	24b		
c	Did the organization maintain an escrow account other than a refunding escrow at any time during the year to defease any tax-exempt bonds?	24c		
d	Did the organization act as an "on behalf of" issuer for bonds outstanding at any time during the year?	24d		
25a	*501(c)(3) and 501(c)(4) organizations.* Did the organization engage in an excess benefit transaction with a disqualified person during the year? *If "Yes," complete Schedule L, Part I*	25a		
b	Did the organization become aware that it had engaged in an excess benefit transaction with a disqualified person from a prior year? *If "Yes," complete Schedule L, Part I*	25b		
26	Was a loan to or by a current or former officer, director, trustee, key employee, highly compensated employee, or disqualified person outstanding as of the end of the organization's tax year? *If "Yes," complete Schedule L, Part II*	26		
27	Did the organization provide a grant or other assistance to an officer, director, trustee, key employee, or substantial contributor, or to a person related to such an individual? *If "Yes," complete Schedule L, Part III*	27		

Business as of
May 19, 2007
Not a TRUE

Part IV **Checklist of Required Schedules** *(Continued)*

			Yes	No
28	During the tax year, did any person who is a current or former officer, director, trustee, or key employee:			
a	Have a direct business relationship with the organization (other than as an officer, director, trustee, or employee), or an indirect business relationship through ownership of more than 35% in another entity (individually or collectively with other person(s) listed in Part VII, Section A)? *If "Yes," complete Schedule L, Part IV*	28a		
b	Have a family member who had a direct or indirect business relationship with the organization? *If "Yes," complete Schedule L, Part IV*	28b		
c	Serve as an officer, director, trustee, key employee, partner, or member of an entity (or a shareholder of a professional corporation) doing business with the organization? *If "Yes," complete Schedule L, Part IV*	28c		
29	Did the organization receive more than $25,000 in non-cash contributions? *If "Yes," complete Schedule M*	29		
30	Did the organization receive contributions of art, historical treasures, or other similar assets, or qualified conservation contributions? *If "Yes," complete Schedule M*	30		
31	Did the organization liquidate, terminate, or dissolve and cease operations? *If "Yes," complete Schedule N, Part I*	31		
32	Did the organization sell, exchange, dispose of, or transfer more than 25% of its net assets or undergo a substantial contraction? *If "Yes," complete Schedule N, Part II*	32		
33	Did the organization own 100% of an entity disregarded as separate from the organization under Regulations section 301.7701-2 and 301.7701-3? *If "Yes," complete Schedule R, Part I*	33		
34	Was the organization related to any tax-exempt or taxable entity? *If "Yes," complete Schedule R, Parts II, III, IV, and V, line 1*	34		
35	Is any related organization a controlled entity within the meaning of section 512(b)(13)? *If "Yes," complete Schedule R, Part V, line 2*	35		
36	*501(c)(3) organizations.* Did the organization make any transfers to an exempt non-charitable related organization? *If "Yes," complete Schedule R, Part V, line 2*	36		
37	Did the organization conduct more than 5 percent of its exempt activities through an entity that is not a related organization and that is taxed as a partnership? *If "Yes," complete Schedule R, Part VI*	37		

Date of 2007 October 15, DO NOT FILE

Part V Statements Regarding Other IRS Filings and Tax Compliance

			Yes	No
1a	Enter the number reported in Box 3 of Form 1096, *Annual Summary and Transmittal of U.S. Information Returns. Enter -0- if not applicable*	1a		
b	Enter the number of Forms W-2G included in line 1a. Enter -0- if not applicable	1b		
c	Did the organization comply with backup withholding rules for reportable payments to vendors and reportable gaming (gambling) winnings to prize winners?	1c		
2a	Enter the number of employees reported on Form W-3, *Transmittal of Wage and Tax Statements* filed for the calendar year ending with or within the year covered by this return	2a		
b	If at least one is reported in 2a, did the organization file all required federal employment tax returns? **Note:** *If the sum of lines 1a and 2a is greater than 250, you may be required to e-file this return.*	2b		
3a	Did the organization have unrelated business gross income of $1,000 or more during the year covered by this return?	3a		
b	If "Yes," has it filed a Form 990-T for this year? *If "No," provide an explanation in Schedule O*	3b		
4a	At any time during the calendar year, did the organization have an interest in, or a signature or other authority over, a financial account in a foreign country (such as a bank account, securities account, or other financial account)?	4a		
b	If "Yes," enter the name of the foreign country: _____ See the instructions for exceptions and filing requirements for **Form TD F 90-22.1**, *Report of Foreign Bank and Financial Accounts.*	5a		
5a	Was the organization a party to a prohibited tax shelter transaction at any time during the tax year?	5b		
b	Did any taxable party notify the organization that it was or is a party to a prohibited tax shelter transaction?	5c		
c	If "Yes," to 5a or 5b, did the organization file Form 8886-T, *Disclosure by Tax-Exempt Entity Regarding Prohibited Tax Shelter Transaction*?	6a		
6a	Did the organization solicit any contributions that were not tax deductible?	6b		
b	If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible?			
7	*Organizations that may receive deductible contributions under section 170(c).*			
a	Did the organization provide goods or services in exchange for any contribution of $75 or more?	7a		
b	If "Yes," did the organization notify the donor of the value of the goods or services provided?	7b		
c	Did the organization sell, exchange, or otherwise dispose of tangible personal property for which it filed Form 8282?	7c		
d	If "Yes," indicate the number of Forms 8282 filed during the year	7d		
e	Did the organization, during the year, receive any funds, directly or indirectly, to pay premiums on a personal benefit contract?	7e		
f	Did the organization, during the year, pay premiums, directly or indirectly, on a personal benefit contract?	7f		
g	For all contributions of qualified intellectual property, did the organization file Form 8899 as required?	7g		
h	For contributions of cars, boats, airplanes, and other vehicles, did the organization file a Form 1098-C as required?	7h		
8	*501(c)(3) and other sponsoring organizations maintaining donor advised funds and 509(a)(3) supporting organizations.* Did the supporting organization, or a fund maintained by a sponsoring organization, have excess business holdings at any time during the year?	8		
9	*501(c)(3) and other sponsoring organizations maintaining donor advised funds.*			
a	Did the organization make any taxable distributions under section 4966?	9a		
b	Did the organization make a distribution to a donor, donor advisor, or related person?	9b		
10	*501(c)(7) organizations.* Enter:			
a	Initiation fees and capital contributions included on Part VIII, line 12	10a		
b	Gross receipts, included on Form 990, Part VIII, line 12, for public use of club facilities	10b		
11	*501(c)(12) organizations.* Enter:			
a	Gross income from members or shareholders	11a		
b	Gross income from other sources (Do not net amounts due or paid to other sources against amounts due or received from them.)	11b		
12a	*4947(a)(1) non-exempt charitable trusts.* Is the organization filing Form 990 in lieu of Form 1041?	12a		
b	Enter the amount of tax-exempt interest received or accrued during the year	12b		

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Part VI Governance, Management, and Disclosure *(Sections A, B, and C request information about policies not required by the Internal Revenue Code.)*

Section A. Governing Body and Management

			Yes	No
	For each "Yes" response to lines 2-7 below, and for a "No" response to lines 8 or 9b below, describe the circumstances, process, or changes in Schedule O. See instructions.			
1a	Enter the number of voting members of the governing body	1a		
b	Enter the number of voting members that are independent	1b		
2	Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee?	2		
3	Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors or trustees, or key employees to a management company or other person?	3		
4	Did the organization make any significant changes to its organizational documents since the prior Form 990 was filed?	4		
5	Did the organization become aware during the year of a material diversion of the organization's assets?	5		
6	Does the organization have members or stockholders?	6		
7a	Does the organization have members, stockholders, or other persons who may elect one or more members of the governing body?	7a		
b	Are any decisions of the governing body subject to approval by members, stockholders, or other persons?	7b		
8	Did the organization contemporaneously document the meetings held or written actions undertaken during the year by the following:			
a	the governing body?	8a		
b	each committee with authority to act on behalf of the governing body?	8b		
9a	Does the organization have local chapters, branches, or affiliates?	9a		
b	If "Yes," does the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with those of the organization?	9b		
10	Was a copy of the Form 990 provided to the organization's governing body before it was filed? All organizations must describe in Schedule O the process, if any, the organization uses to review the Form 990	10		
11	Is there any officer, director or trustee, or key employee listed in Part VII, Section A, who cannot be reached at the organization's mailing address? If "Yes," provide the names and addresses in Schedule O	11		

Section B. Policies

			Yes	No
12a	Does the organization have a written conflict of interest policy? *If "Yes":*	12a		
b	Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?	12b		
c	Does the organization regularly and consistently monitor and enforce compliance with the policy? If "Yes," describe in Schedule O how this is done	12c		
13	Does the organization have a written whistleblower policy?	13		
14	Does the organization have a written document retention and destruction policy?	14		
15	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision:			
a	The organization's CEO, Executive Director, or top management official?	15a		
b	Other officers or key employees of the organization?	15b		
	Describe the process in Schedule O.			
16a	Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year?	16a		
b	If "Yes," has the organization adopted a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable Federal tax law, and taken steps to safeguard the organization's exempt status with respect to such arrangements?	16b		

Section C. Disclosure

17 List the States with which a copy of this Form 990 is required to be filed. .....

18 IRC Section 6104 requires an organization to make its Form 1023 (or 1024 if applicable), 990, and 990-T (501(c)(3)s only) available for public inspection. Indicate how you make these available. Check all that apply.

☐ own website ☐ another's website ☐ upon request

19 Describe in Schedule O whether (and if so, how), the organization makes its governing documents, conflict of interest policy, and financial statements available to the public.

20 State the name, physical address, and telephone number of the person who possesses the books and records of the organization: .....

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Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors

Section A Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1a Complete this table for all persons required to be listed. Use Schedule J-2 if additional space is needed.

* List all of the organization's **current** officers, directors, trustees (whether individuals or organizations) and key employees regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.

* List the organization's five **current** highest compensated employees (other than an officer, director, trustee or key employee) who received reportable compensation (Box 5 of Form W-2 and/or Box 7 of Form 1099-MISC) of more than $100,000 from the organization and any related organizations.

* List all of the organization's **former** officers, key employees, or highest compensated employees who received more than $100,000 of reportable compensation from the organization and any related organizations.

* List all of the organization's **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than $10,000 of reportable compensation from the organization and any related organizations.

List persons in the following order: individual trustees or directors; institutional trustees; officers; key employees; highest compensated employees; and former such persons.

☐ Check this box if the organization did not compensate any officer, director, trustee, or key employee.

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(A) Name and Title	(B) Average hours per week	(C) Position (check all that apply): Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former	(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations

Part VII Continued

Part VIII Statement of Revenue

		(A) Total Revenue	(B) Related or Exempt Function Revenue	(C) Unrelated Business Revenue	(D) Revenue Excluded from Tax under IRC 512, 513, or 514
Contributions, gifts, grants and other similar amounts	1a Federated campaigns . . . 1a				
	b Membership dues 1b				
	c Fundraising events 1c				
	d Related organizations . . . 1d				
	e Government grants (contributions) 1e				
	f All other contributions, gifts, grants, and similar amounts not included above . 1f				
	g Noncash $				
	h **Total (lines 1a–1f).** . . . . . ▶				
Program Service Revenue	Business Code				
	2a				
	b				
	c				
	d				
	e				
	f				
	g **Total** . . . . . ▶ $				
Other Revenue	3 Investment income (including dividends, interest, and other similar amounts) . . . . . ▶				
	4 Income from investment of tax-exempt bond proceeds ▶				
	5 Royalties . . . . . ▶				
	(i) Real / (ii) Personal				
	6a Gross Rents . .				
	b Less: rental expenses				
	c Rental income or (loss)				
	d Net rental income or (loss) . . . . . ▶				
	(i) Securities / (ii) Other				
	7a Gross amount from sales of assets other than inventory				
	b Less: cost or other basis and sales expenses .				
	c Gain or (loss) . .				
	d Net gain or (loss) . . . . . ▶				
	8a Gross income from fundraising events (not including $ of contributions reported on line 1c). *Attach Schedule G if total exceeds $15,000* . . . . . a				
	b Less: direct expenses . . . . . b				
	c Net income or (loss) from fundraising events . . ▶				
	9a Gross income from gaming activities. *Complete Schedule G if total exceeds $15,000* a				
	b Less: direct expenses . . . . . b				
	c Net income or (loss) from gaming activities . . ▶				
	10a Gross sales of inventory, less returns and allowances . . . . a				
	b Less: cost of goods sold . . . b				
	c Net income or (loss) from sales of inventory . . . ▶				
	Miscellaneous Revenue / Business Code				
	11a				
	b				
	c				
	d All other revenue				
	e **Total** . . . . . $				
	12 **Total Revenue.** Add lines 1h, 2g, 3, 4, 5, 6d, 7d, 8c, 9c, 10c, and 11e . . . . . ▶				

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Part IX Statement of Functional Expenses

501(c)(3) and (4) organizations must complete all columns.
All other organizations must complete column (A) but are not required to complete columns (B), (C), and (D).

Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
1 Grants and other assistance to governments and organizations in the U.S. *See Part IV, line 21*				
2 Grants and other assistance to individuals in the U.S. *See Part IV, line 22*				
3 Grants and other assistance to governments, organizations and individuals outside the U.S. *See Part IV, lines 15 and 16*				
4 Benefits paid to or for members				
5 Compensation of current officers, directors, trustees, and key employees				
6 Compensation not included above, to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)				
7 Other salaries and wages				
8 Pension plan contributions (include section 401(k) and section 403(b) employer contributions)				
9 Other employee benefits				
10 Payroll taxes				
11 Fees for services (non-employees):				
a Management				
b Legal				
c Accounting				
d Lobbying				
e Professional fundraising. *See Part IV, line 17*				
f Investment management fees				
g Other				
12 Advertising and promotion				
13 Office expenses				
14 Information technology				
15 Royalties				
16 Occupancy				
17 Travel				
18 Payments of travel or entertainment expenses for any Federal, state, or local public officials				
19 Conferences, conventions, and meetings				
20 Interest				
21 Payments to affiliates				
22 Depreciation, depletion, and amortization				
23 Insurance				
24 Other expenses—Itemize expenses not covered above (Expenses grouped together and labeled miscellaneous may not exceed 5% of total expenses shown on line 25 below.)				
a				
b				
c				
d				
e				
f All other expenses				
25 **Total functional expenses.** Add lines 1 through 24f				
26 **Joint Costs.** Check ☐ if following SOP 98-2. Complete this line only if the organization reported in column (B) joint costs from a combined educational campaign and fundraising solicitation				

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Part X Balance Sheet

			(A) Beginning of year		(B) End of year
Assets	1	Cash—non-interest-bearing		1	
	2	Savings and temporary cash investments		2	
	3	Pledges and grants receivable, net		3	
	4	Accounts receivable, net		4	
	5	Receivables from current and former officers, directors, trustees, key employees or other related parties. *Complete Part II of Schedule L*		5	
	6	Receivables from other disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B). *Complete Part II of Schedule L*		6	
	7	Notes and loans receivable, net		7	
	8	Inventories for sale or use		8	
	9	Prepaid expenses and deferred charges		9	
	10a	Land, buildings, and equipment: cost basis 10a			
	b	Less: accumulated depreciation. *Complete Part VI of Schedule D* 10b		10c	
	11	Investments—publicly traded securities		11	
	12	Investments—other securities. *Complete Part VII of Schedule D*		12	
	13	Investments—program-related. *Complete Part VIII of Schedule D*		13	
	14	Intangible assets		14	
	15	Other assets. *Complete Part IX of Schedule D*		15	
	16	**Total assets.** *Add Columns A and B, lines 1 through 15 (must equal line 34)*		16	
Liabilities	17	Accounts payable and accrued expenses		17	
	18	Grants payable		18	
	19	Deferred revenue		19	
	20	Tax-exempt bond liabilities		20	
	21	Escrow account liability. *Complete Part IV of Schedule D*		21	
	22	Payable to current and former officers, directors, trustees, key employees, highest compensated employees, and disqualified persons. *Complete Part II of Schedule L*		22	
	23	Secured mortgages and notes payable to unrelated third parties		23	
	24	Unsecured notes and loans payable		24	
	25	Other liabilities. *Complete Part X of Schedule D*		25	
	26	**Total liabilities.** *Add lines 17 through 25*		26	
Net Assets or Fund Balances		**Organizations that follow SFAS 117, check here ▶ ☐ and complete lines 27 through 29, and lines 33 and 34.**			
	27	Unrestricted net assets		27	
	28	Temporarily restricted net assets		28	
	29	Permanently restricted net assets		29	
		Organizations that do not follow SFAS 117, check here ▶ ☐ and complete lines 30 through 34.			
	30	Capital stock or trust principal, or current funds		30	
	31	Paid-in or capital surplus, or land, building, or equipment fund		31	
	32	Retained earnings, endowment, accumulated income, or other funds		32	
	33	Total net assets or fund balances		33	
	34	Total liabilities and net assets/fund balances		34	

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Part XI Financial Statements and Reporting

			Yes	No
1	Accounting method used to prepare the Form 990: ☐ cash ☐ accrual ☐ other			
2a	Were the organization's financial statements compiled or reviewed by an independent accountant?	2a		
b	Were the organization's financial statements audited by an independent accountant?	2b		
c	If "Yes" to 2a or 2b, does the organization have a committee that assumes responsibility for oversight of the audit, review, or compilation of its financial statements and selection of an independent accountant?	2c		
3a	As a result of a federal award, was the organization required to undergo an audit or audits as set forth in the Single Audit Act and OMB Circular A-133?	3a		
b	If "Yes," did the organization undergo the required audit or audits?	3b		

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Education & Training

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Arlington, VA 22201-1860
www.nreca.coop

Professional Certificate Requirements

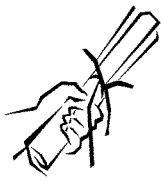
The Supervisory Certificate (SC)

NRECA's curriculum is based on a set of supervisory competencies identified by new cooperative supervisors, experienced supervisors, and CEOs. These courses deliver instruction on core competencies in the areas of leadership, communication, and basic administrative skills.

The Supervisory Certificate is earned by completing nine (9) ½ day required courses.

Required courses

380.05 Getting Started as a Supervisor
381.05 Personal Time Management
382.05 A Supervisor's Role in Managing Change
383.05 Maximizing Effectiveness Through Communications
384.05 Resolving Conflict Through Negotiation
385.05 Motivating Employees
386.05 The Supervisor and Human Resources
387.05 Tools for Effective Performance Management
388.05 Occupational Health and Safety for Supervisors



The credit value is indicated after the decimal point for each course. For example, course 380.05 provides one half day (1/2) credit and course 640.1 provides one (1) credit.

Management Essentials Certificate (MEC)

The Management Essentials Certificate (MEC) program is designed for experienced supervisors and mid-level managers who seek professional development beyond the scope of NRECA's Supervisory Certificate (SC) program. The MEC curriculum builds on the competencies from the SC and introduces additional topics to bolster participants' skills in those areas.

The Management Essentials Certificate is earned by completing four (4) required courses and three (3) credits from a list of elective courses.

Required courses

640.1 Essentials of Workplace Communication
641.1 Essentials of Organizational Teamwork
642.1 Essentials of Performance Management
643.1 Essentials of Managing Change

Elective courses are currently under development and will include instructor-led and online courses in such critical areas as cooperative finance and accounting, delegating effectively, project management, contracts and contracting, human resources management, and written communication.

The Robert I. Kabat Management Internship Program (MIP)

MIP is your next step in executive development beyond NRECA's Management Essentials Certificate (MEC). This intensive, six-week program is broken into three two-week units that focus on contemporary management issues. The program provides comprehensive analysis of the functions and processes of management. More importantly, it emphasizes practical applications, strategic understanding and advanced proficiency in critical areas of cooperative management.

The MIP certificate is earned by completing the following requirements:

- 701 Unit A
- 702 Unit B
- 703 Unit C

- Complete and present the results of a personal project that applies MIP skills to issues at your cooperative.

The MIP focuses on cultivating the best talent in the electric cooperative industry.

For more information about events and training programs click on "Conferences & Training" at www.cooperative.com.

4/25/2008

The Certified Key Account Executive (CKAE®) Program

The Certified Key Account Executive (CKAE) Program helps key account executives and their electric co-ops construct and implement a winning key accounts management program, or further strengthen a program already in place.

The CKAE certificate is earned by completing the following requirements:

- Three (3) required courses:
  477.2 Key Accounts Management
  478.2 Advanced Key Accounts
  481.2 The Key Accounts Resource Workshop
  OR
  677.5 CKAE Fast Track (all 3 courses combined)
- Submit a Business Plan and a Marketing Plan.
- Pass the CKAE Exam and a sales presentation.

* You have 24 months from the date you pass the CKAE Exam to complete all requirements.

Continuing Education

After becoming a CKAE, you must earn 1.0 continuing education units (CEUs) each calendar year and pay an annual $50 professional fee to maintain the CKAE designation. CEUs can be earned in a variety of ways—courses,conferences, seminars, etc. CKAEs can earn CEUs through events sponsored by NRECA, NRECA member systems, and other organizations, e.g., other associations,universities, organizations, etc.

Look under "My Profile" on cooperative.com to view your attendance record

Certified Loss Control Professional (CLCP) Program

The NRECA Loss Control Program consists of four one-week seminars that are designed to provide up-to-date information and training for loss control professionals.

The Loss Control Certificate is earned by completing the following requirements:

· Attend and complete all loss control seminars in sequence and pass all tests with a cumulative score of 70% or higher.

- 830.5 Seminar I
- 831.5 Seminar II
- 832.5 Seminar III
- 833.5 Seminar IV

· Complete a 30-hour OSHA course.
· Complete an individual comprehensive project that is then approved by the Loss Control Internship Certification Panel.

Continuing Education

After becoming a CLCP, you must complete eight (8) hours of safety and/or loss control training each calendar year and pay an annual $50 professional fee to maintain CLCP status.

Certified Cooperative Communicator (CCC) Program

The Certified Cooperative Communicator (CCC) Program offers professionals in mass communication and marketing communication the opportunity to earn a credential that signifies professional competence in the communication profession.

The CCC certification is earned by completing the following requirements within 24 months of application:

· Complete CCC application. ($100 fee)

· Submit and pass a portfolio of work within nine months of becoming a candidate. ($100 fee)

· Pass CCC Exam. ($100 fee)

Continuing Education

After becoming a CCC, you must complete 1.0 continuing education units (CEUs) each year, and pay an annual $100 professional fee to maintain CCC status. CEUs can be earned in a variety of ways—courses, conferences, seminars, etc. CCCs can earn CEUs through events sponsored by NRECA, NRECA member systems, and other organizations, e.g., other associations, universities, organizations, etc.

Questions?
Corrections to your records?

Contact Angie Hylton, NRECA, ET9-201, 4301 Wilson Blvd., Arlington, VA 22203. (703) 907-5656 or angie.hylton@nreca.coop

For more information about certificates and certifications programs click on "Certificates & Accreditation" under "Conferences & Training" at www.cooperative.com.

CCD/BLC REQUIREMENTS

The Credentialed Cooperative Director (CCD) Certificate

The Credentialed Cooperative Director (CCD) curriculum consists of five courses designed to provide the basic knowledge and skills required of cooperative directors. Directors have several opportunities during the year to earn their CCD Certificate, including NRECA's Pre-Annual Meeting Training, Pre-Annual Directors' Conference training, Summer Schools, statewide association sponsored programs, and on-site training.

The **Credentialed Cooperative Director (CCD) Certificate** is earned by attending all five required courses and successfully completing a learning assessment for each.

CCD Required Courses:

2600.1 Director Duties and Liabilities
2610.1 Understanding the Electric Business
2620.1 Board Roles and Relationships
2630.1 Strategic Planning
2640.1 Financial Decision Making

The Board Leadership (BLC) Certificate

The **Board Leadership (BLC) Certificate** offers more advance courses and can be attained after earning the Credentialed Cooperative Director Certificate and then completing a total of 10 credits from the 900-level courses. Directors may attend BLC courses at any time but the BLC will not be awarded until the CCD program requirements are completed.

The credit value is indicated after the decimal point for each course. For example, course 951.2, provides two (2) credits.

Current Courses Being Offered:

901.1 Rules and Procedures for Effective Board Meetings
902.1 Understanding the Role of the Board Chair
903.1 The Role of the Board Chair in Conducting Effective Meetings
914.1 Cooperative Communications and Public Opinion - The Director's Perspective
915.1 Advocating the Cooperative Difference
917.05* Creating a Political Action Plan
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924.1 When Disaster Strikes - Continuity Management and Emergency Response Planning for Directors
925.1 Co-op Bylaws: Guiding Principles & Current Issues
929.1 Current Issues in Policy Development
930.1 Ethics and Governance: Implementing the New Accountability
933.1 The Duties, Responsibilities and Relationships of Electric CooperativeDirector and Operating Officers
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936.05 Management Search Fundamentals
938.1 Effective Boards - Why Some Succeed and Some Fail
951.2 Developing Effective Boardroom Decision Making
966.1 Understanding the New World of Power Supply
967.1 Fundamentals of Energy Risk Management for Directors
968.1* Advanced Rate Decisions: For Experienced Directors
969.1* Advanced Energy Risk Management for Directors Making Power Supply Decisions
970.1 The Role of Renewables in Power Supply
975.1* Capital Credits: Legal and Financial Issues
999.1 Introduction to Computers and the Internet

(* Check course description for any recommended prerequisite courses before attending)

(900-level courses not listed above are no longer offered but they do apply toward the certificate if they were taken after Jan. 1995)

Need more information - Visit Conferences & Training on Cooperative.com

For Program Content, Course Dates and Locations
Contact Janet Bowers at (703) 907-5622 or
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National Rural Electric Cooperative Association

3/20/2008

Chairman WAXMAN. Thank you very much, Mr. English.

Let me start off. It seems to me that what you said was an oversimplification. We face our constituents, but it looks like some of these co-op board members don't face anybody. The elections, as we heard in this Pedernales case, were rigged. Do you know if the elections in other co-ops are similarly undemocratic?

Mr. ENGLISH. Well, keep in mind I have nothing other than my own anecdotal information and the surveys that we have conducted, things that we have seen, because, again, the RUS would be the ones that should have that information.

Chairman WAXMAN. Let me ask you a question you might know. How many States where there are co-ops have regulations like that which was discussed earlier being proposed for Texas?

Mr. ENGLISH. As far as open meetings and things of that sort?

Chairman WAXMAN. Open board meetings and elections.

Mr. ENGLISH. I would have to supply that for the record. I don't have that handy.

Let me just say, though, I can say, Mr. Chairman, that in the last few years we have had over 40 percent of all the election co-op representatives, all the board members have turned over, so you have over 40 percent new board members that have come in in the last few years. If I recall correctly, that date is somewhere in the neighborhood of since 2001.

I was comparing that, I believe, with Members of Congress, and I don't think we have had near that kind of turnover, even with the elections of 2006, so I don't think you have had a similar turnover within the Congress.

Chairman WAXMAN. Turnover, by itself, doesn't really impress me if it is a rigged deal, because if the father can pass it on to the son or the uncle or someone else, it is just going to follow the same policies.

Mr. ENGLISH. And we have that in Congress. How many of our colleagues do we know, Mr. Chairman, that find themselves in similar situations.

Chairman WAXMAN. Let me move on, because it seems to me that you are indicating to us there is very little Federal oversight any longer by the Rural Utilities Service. It looks like in Texas there wasn't oversight at all that we can tell. Maybe there wasn't a way to have it. But if the co-ops were designed to be self-governing through a democratic process, I just think we have heard a good example of how that process does not work. The Pedernales Co-op is an example. Its board election process was rigged. They failed to have competitive elections for over 30 years, maybe 40. Meanwhile, the directors who were in charge were enriching themselves at the co-op expense.

Would you agree that the typical process that provides accountability at co-ops failed at Pedernales?

Mr. ENGLISH. What I would say, Mr. Chairman, is obviously the people down there were not happy with the situation. Obviously, the situation that developed within Pedernales went on for some time. Obviously, the people locally at Pedernales did not take action until recently. But let me just say——

Chairman WAXMAN. They couldn't. They couldn't take action.

Mr. ENGLISH. Well, to the contrary. They did. The system——

Chairman WAXMAN. They had to file a lawsuit.

Mr. ENGLISH. Sure.

Chairman WAXMAN. It took some enterprising reporters to go out and break the story. Finally some members of the legislature looked at it. But there are a lot of places where the press is not so vigorous because of all the cutbacks in journalism. There are a lot of places where people don't want to file lawsuits because it is so expensive. And there are a lot of places where the legislators think that the heads of the co-ops are just the powerful local people that are very prominent and maybe there is nothing going on because they haven't heard any complaints because there is no press reporting them.

Mr. ENGLISH. Let me just first of all say that I am going to defend the actions taken by the people in Pedernales in making a change in the leadership in that co-op. I want to defend, Mr. Chairman, their right to do so. I am going to defend the fact that they have a right to have as their representatives on their board who they may choose. And I will certainly agree with you that the process should be free and open and we should encourage as many people to participate as possible. An I will agree with you, Mr. Chairman, that went on far too long without those kinds of situations coming to bear.

Chairman WAXMAN. Have you looked at the transparency in other co-ops in your trade association? Does anybody look at that or know about it?

Mr. ENGLISH. Well, we look at the rules and regulations in which they operate, the by-laws in which they operate and what those by-laws provide. But this comes back again, Mr. Chairman, I make this point, to people. Now, for instance, here——

Chairman WAXMAN. It does come down to people, and I must say my view of human nature is if you give somebody the opportunity to go and take a lot of money and use it for their own purposes, there is unlimited ability to rationalize doing it.

Mr. ENGLISH. That is true.

Chairman WAXMAN. That is part of human nature. That is why you need some checks on this abusive power.

Mr. ENGLISH. If I could respond, Mr. Chairman.

Chairman WAXMAN. Sure.

Mr. ENGLISH. I would make the point that is absolutely right. We have seen it. I saw it here when I was a Member of this body. We saw those individuals taking advantage of the situation. We had rules and regulations and laws on the books. We had new rules that were proposed and change, things that came about, but we still had those individuals come through. You have always got to be vigilant.

As I say, those are the people, I think, that if there are criminal violations then we should prosecute. There is no excuse not to.

Chairman WAXMAN. OK.

Mr. ENGLISH. And I think, in fact, we have to recognize it is not an easy situation to go in and prevent someone from violating the law or doing wrong. We have tried many times in this body.

Chairman WAXMAN. But transparency could help.

Mr. ENGLISH. And we have an Ethics Committee in this Congress——

Chairman WAXMAN. Transparency could help.

Mr. ENGLISH [continuing]. That doesn't stop that sort of activity.

Chairman WAXMAN. I know. Does transparency help?

Mr. ENGLISH. Certainly, and I wholeheartedly agree.

Chairman WAXMAN. OK. Let me move on to Mr. Westmoreland, because he is next on the line of questioning and the red light is on.

Mr. ENGLISH. Very good. Great.

Mr. WESTMORELAND. Thank you, sir.

Mr. English, it could be the case that an elected official could be under indictment under Federal charges and still be re-elected by his constituents; is that not true?

Mr. ENGLISH. Well, that is my understanding, and that is always the case, and that is the delicacy, I think, of the problem that we are facing here. You have two bodies of elected officials. You have the Congress and you have the directors of local electric cooperatives. That is the reason I think there should be a certain amount of empathy.

Mr. WESTMORELAND. The membership can elect anybody they want to.

Mr. ENGLISH. That is the situation.

Mr. WESTMORELAND. Whether they are convicted felons or whatever. That is up to the membership to elect them.

Mr. ENGLISH. And it is up to the folks to correct the problem if they disagree with the representation they are getting, whether it is their Congressman or their local director at the local co-op. But there has to be, no matter whether you are talking about government or whether you are talking about privately owned electric cooperatives, under any circumstance the people are the ones who must take charge and deal with that problem.

Mr. WESTMORELAND. I have heard it said that the cooperatives' governance activities are not transparent, but I was looking through your written testimony here and I noticed that you had some IRS forms attached to it. Are these typically made public to the membership, these IRS forms?

Mr. ENGLISH. These are the new forms and I thought that the committee would like to see that. Obviously, they are very extensive, far more extensive than you have for any corporation in this country, even after Sarbanes-Oxley and Enron. Yes, they are, and each cooperative is required to make that available to any of their members who wish to look at it, and certainly it is available. I think it is even published on the Internet.

Mr. WESTMORELAND. So you are saying that really, as far as checks and balances, as far as the EMC goes you have actually the local control of the membership, you have the Rural Utilities Service, although under-funded and not really functioning as it should. It is there as a check and a balance.

Mr. ENGLISH. Right.

Mr. WESTMORELAND. And also you have the Federal Government in the form of the IRS that takes a look at your paperwork.

Really, do you know if all electric memberships have these annual meetings that I am accustomed to going to and having all this information printed, or is that——

Mr. ENGLISH. They are supposed to have annual meetings. They are supposed to have elections. And certainly these elections are supposed to be free and open.

Now, when we get into some situations, just as we have sometimes in Congress and other elected offices, the system doesn't always work the way it should. Any time that happens we ought to make corrections.

Mr. WESTMORELAND. I have seen situations in Congress, Mr. English, where they won't even take a vote out of fear of losing.

Mr. ENGLISH. I am not going to go there.

Mr. WESTMORELAND. I don't know.

Some have charged that electric cooperatives are no longer rural. Could you just give us some of the characteristics of what an electric cooperative is as far as average size, density, amount of space they cover, or population-wise?

Mr. ENGLISH. Well, we cover 75 percent of the land mass of the United States. We have 12 percent of the consumers in the country own electric cooperatives or are members of electric cooperatives. And obviously that is a tremendous amount of territory for a few people. We have nearly 43 percent of all the infrastructure on the distribution side is owned, so you have 12 percent of the population having to maintain and own nearly 43 percent of all the distribution infrastructure of this country.

Roughly the average size is around 21,000, give or take. The smallest is less than 200. Pedernales is the largest, I believe, at 230 I believe is the last thing I heard as far as the number of members that they have at that cooperative. Obviously these are very resource intensive entities in that they have to maintain all that infrastructure, so it is a heck of a struggle, but I think they have done extremely well. Most cooperatives have great service.

Mr. WESTMORELAND. Let me give you a report from Georgia.

Mr. ENGLISH. OK. Great.

Mr. WESTMORELAND. The agencies are doing well.

Mr. ENGLISH. OK.

Mr. WESTMORELAND. And having been a member of one for probably and different ones for probably the last 25 years, they do a good job in servicing their customers. They work hand in hand with the Southern company, Georgia Power, Oglethrope Power, other companies in providing Georgians with good electric service, dependable electric service, and I am proud to say that in Georgia our electric rates are probably 15 to 20 percent below the national average. I am glad to have the participation of all the power providers in the State of Georgia, and your organization is doing a good job.

Mr. ENGLISH. Thank you very much. That is usually the kind of testimonials we are used to hearing about electric co-ops all over the country, so I am happy to say that what you find in Georgia is not unusual in the rest of the country, and even the State of Texas.

Chairman WAXMAN. Thank you, Mr. Westmoreland. Your time has run out.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

Glenn, as a former colleague and friend, I am sorry we disagree on these issues, but it was actually his kind invitation to let me speak at the national convention that first led me to do enough research to understand some of these things. Now I know that your PAC gives as much money to politicians as Boeing Corp., so that has a lot of influence. It has a lot of influence in States, too. You pretty much draft whatever legislation you want and get exempted, you know, so there is no oversight.

But I am delighted my friend from Georgia is here, because we were talking about Cobb Electric earlier, and he was seeming to say that, well, things are fine, you are doing a fine job, everything is hunky-dory. Well, Cobb is one of the most notorious examples in all of America, because is it OK for a non-profit electric co-op to subcontract out its entire operation to a for-profit subsidiary secretly owned by co-op managers and still pretend to be a non-profit? That is a little bit like subcontracting out the entire Pentagon to Blackwater. This is an amazing thing. How can you pretend this is a nonprofit if it is really run entirely by a for-profit? What standards does the NRECA have if you think that is OK behavior?

Mr. ENGLISH. Is that the question?

Mr. COOPER. Yes.

Mr. ENGLISH. OK. Well, let me try to answer that. You had a number of questions that were tied up in it.

First thing, let me just say we are very proud of our PAC, and we have made contributions to friends, and you have received quite a few of those contributions along the way, and we were pleased to do it. You were previously very supportive of electric cooperatives.

Mr. COOPER. I still am.

Mr. ENGLISH. Well, we disagree on that for sure.

Mr. COOPER. I still am.

Mr. ENGLISH. I guarantee you we disagree big time on that one.

Now let me finish the question here. The issue you come down to is I could have some very serious disagreements with the way the Congress has been contracting out a whole number of services as far as——

Mr. COOPER. Mr. English, the question is——

Mr. ENGLISH. You asked me the question.

Mr. COOPER [continuing]. Standards that NRECA——

Mr. ENGLISH. Mr. Cooper, you asked——

Mr. COOPER. Mr. English, you are no longer a Member here.

Mr. ENGLISH. Let me finish my question.

Chairman WAXMAN. Both of you——

Mr. ENGLISH. Let me finish my answer.

Chairman WAXMAN. If you will cease for a minute, we can't have both of you talking. This is the time, as you may recall—or if you don't—this is a time when Members ask questions and expect answers to their questions.

Mr. ENGLISH. Mr. Chairman, if you——

Chairman WAXMAN. No, no.

Mr. COOPER. Let me rephrase my question. Would it be OK for every co-op in America to subcontract out its entire operation to a for-profit subsidiary secretly owned by co-op management and still

pretend to be a nonprofit? Is that tolerable behavior under NRECA guidelines?

Mr. ENGLISH. Let me just say this. I would not personally recommend that. That is not something I would do. But I am not an elected representative of the membership in that particular area of the State of Georgia. Those people, whatever business decisions they make, have to be held accountable. And as I understand it at the present time they are being held accountable, because there is serious disagreement down there among that membership, as you well know, raising these various issues. There may even be legal questions involved. That has been taken before the courts. That is the process that needs to be followed.

Now, what Glenn English thinks and what the directors in the State of Georgia think, I don't have their constituency. And when I was a Member of this body people in western Oklahoma may not have agreed with what the people in Tennessee thought, and you and I didn't always vote the same way. That is the same thing here.

Mr. COOPER. Mr. English, so there is no co-op misbehavior that would be so bad that would prevent them from being members of NRECA as long as a local vote ratified the decision?

Mr. ENGLISH. I will go back again. We have the same situation here. I don't know if the behavior of Members of Congress that prohibit them from being members of this body.

Mr. COOPER. Mr. English——

Mr. ENGLISH. NRECA is a trade association.

Mr. COOPER. I have limited time. Next question.

Mr. ENGLISH. NRECA is a trade association, and our members belong on that basis. It is up to their members to decide whether their conduct is appropriate or not.

Mr. COOPER. So you will take anyone. Mr. English, we mentioned in the first panel CFC, the lending arm of co-ops, was set up, according to its official biography, to tell Wall Street how rich co-ops are; meanwhile, NRECA's purpose is to tell Congress how poor you are. Which story is correct?

Mr. ENGLISH. Probably both. On one hand, CFC was set up in 1969 whenever it appeared that the administration at that time was going to do away with the REA program. In fact, if you recall, Richard Nixon did.

Mr. COOPER. Mr. English, how can you be rich and poor at the same time?

Mr. ENGLISH. If I can't complete my answer, Congressman, if you just want to make statements, that doesn't make much sense to ask me questions.

The point that I would make is this: electric cooperatives are very proud of the fact that our bond rating on Wall Street is very good. We are considered to be in great financial condition. In fact, in some cases we are in better condition than some of the big power companies of this Nation.

If you look at the cost of power because of the infrastructure that we have, because of the fact there is only 7 co-op members per mile versus 35 for an investor-owned utility, we have a huge amount of infrastructure we have to keep up. And we have some of the poorest people in this country that we must serve.

Percentage-wise, I would dare say that we have a larger percentage than anyone else in this Nation, and so from that standpoint I would point out that yes, electric cooperatives are representing some of the poorest members of this country and they are owned by those folks.

Mr. COOPER. Mr. Chairman, I see that my time has expired. I hope that we have time for another round of questions, but I see that my colleague is here from Iowa.

Chairman WAXMAN. We will give a second round to any Member who wishes.

Mr. Braley.

Mr. BRALEY. Thank you, Mr. Chairman.

Mr. English, I am here as a long-time member of the Tama Iowa Poweshiek Rural Electric Cooperative located in Brooklyn, IA, which is run by my good friend, Darryl Heatland, who went to church with me when I was growing up in high school, and I have to tell you that there is a real big disconnect going on between my experience and perception of how RECs are run and operated in Iowa and some of the information that Mr. Cooper has shared with the committee about other parts of the country.

I guess the opening comment that I would make is a comment that I would share with anyone in your position as a head of any type of a trade association or professional association, and that is: oftentimes where there is smoke there is fire. I think that all of those great rural electric cooperatives that I represent in Iowa, those 75,000 constituents of mine who depend upon RECs to take care of them, to take care of their power needs, to be there for them in the ice storm disaster that we faced in February 2007 where they responded with admirable dispatch all over my district, when we went through this terrible tornado that we just had, the largest tornado in the United States this year, and the RECs were out in full force taking care of my constituents, the flooding that we are dealing with right now, it is the type of constituent service that I would be proud of to have my staff performing.

But I also know that you are only as good as your weakest link as a trade association, and some of these concerns we are talking about are very disturbing. So what I would like to do is ask you at the outset, from your perception and the perception of the member co-ops you represent, what should be the No. 1 guiding principle of how those co-ops service the members that they take care of?

Mr. ENGLISH. First of all let me say, as I said before, unfortunately, as Members of Congress are well aware, you get tarred with the same brush. That is just a part of it. And you are dealing with a lot of people.

What we are supposed to be governed by are those seven cooperative principles. That is the basis on which we have our tax-exempt status with the Internal Revenue Service. It is the basis on which we make our claim that we are, indeed, different, and the basis on which we are a consumer organization.

But at the same time, we fully recognize and understand that when you bring people into a process, 7,000 directors, 1,000 managers, yes, your chances of running into somebody who doesn't

quite operate in the manner that we would like to see, then we all get tarred with that brush.

This is a trade association. We have no authority. We can encourage our members. We can provide our members with education. We can provide our members with what their peers think. But as far as being able to come down and mandate and say, you shall do such and such, we are not a corporation headquarters. That is the point that I was making to the chairman early on. Whenever we gutted the Rural Utilities Service—and we did it over a number of years after 1980—that took care of a lot of that regulatory basis on which I think members of this committee seem to be searching for. That was deregulation.

Mr. BRALEY. In the materials you provided the committee there is something called the Board Leadership Certificate.

Mr. ENGLISH. Right.

Mr. BRALEY. Which looks like a number of continuing education types of programs that are available to member co-ops to help them become the best and most effective type of cooperative that we expect from our co-ops in Iowa. Can you give us some sense of what type of participation you get from your member co-ops in those types of leadership training opportunities? And is it having the desired effect that the cooperatives would expect it to?

Mr. ENGLISH. Right. First of all, what we would encourage our members to do is get their credentials. We are looking for credentialed directors. That is their first step after they get elected. And we have good participation in that. We have over half of the cooperatives—and keep in mind we have over 40 percent new directors in the last several years—moving through that process.

We do, in fact, offer higher advanced training, which gets into power supply and a number of other more complicated issues. We encourage our directors to participate in that, as well.

But our real focus, and the focus, I think, on the hearing that we are talking about today comes under the grounds of the credentialed director and, quite frankly, having a good dose of common sense, and recognizing and understanding that whatever behavior you are going to be following—and I don't think any amount of education would have taken care of that under the example that we have seen before us today—that comes down to just plain, bottom-line common sense and recognizing and understanding that you have to be held to a higher standard, and you are going to be under scrutiny, and you had better be prepared to answer for it. That is what they are being required to do is answer for it.

Mr. BRALEY. And you also supplied us with these form 990's, Return of Organization Exempt from Income Tax forms, which do require organizations to put detailed information in on executive and board of directors compensation. Are you personally aware of what type of oversight the Internal Revenue Service has been performing on monitoring these forms to ensure their accuracy, their completeness, and to achieve the desired transparency that this law is supposed to?

Mr. ENGLISH. Well, the only thing I think I can say about that is this is a new form, and it is to a degree that we have never seen before and, as I said, no other business is being required to do. I can only assume by this that the IRS plans a much higher level

of scrutiny and involvement in the proper filling out of form 990's than we have had in the past.

Has everyone filled it out exactly as they should? As we heard some of the testimony before us, a lot of it gets done on the advice of accountants, and some of it gets done on the advice of attorneys. Quite frankly, I don't think some of them have gotten good advice.

Chairman WAXMAN. Thank you, Mr. Braley.

Mr. McHenry, do you wish to ask questions?

Mr. MCHENRY. Thank you, Mr. Chairman.

I am sorry. I have been kept away with other business today.

This hearing is interesting to most of us. My experience with my co-ops in North Carolina has been a pretty reasonable one. We have Duke Energy in North Carolina, and that consumed a lot of the attention of public policy when I was in the State House, but co-ops have been pretty well managed in my State in my experience in the State House. But this one is interesting to me, Mr. English, this hearing.

Mr. ENGLISH. It has been interesting to me, too.

Mr. MCHENRY. Can you give me some background on why we are here today? I mean, I understand Mr. Cooper has an experience in Tennessee, and that is sort of a little history on that?

Mr. ENGLISH. Well, I know Mr. Cooper and I have had our disagreement with regard to this issue, and I think it started with the issue in Tennessee. I think that is fair to say. And it has to do with the fact that cooperatives in Tennessee are unique and different from cooperatives elsewhere in the country. For instance, they buy their power from TVA, and with a longstanding contract that TVA has had, it has prohibited the payment of capital credits. What TVA co-ops are expected to do is to reduce their rate; in other words, to charge less for the power, as opposed to sending a check back to an individual for any margins or excess over and above the cost of doing business.

TVA has reiterated, in fact, I think back in the 1970's underscored again that this was the directive. I assume the reason for this is because they provide power both to municipalities and to electric co-ops and they want to keep it roughly the same as far as the cost for both entities. But anyway, that is the contract.

Mr. Cooper has disagreed with that, and he wants me to participate and tell him the cooperatives in Tennessee should pay those capital credits. Perhaps he wants me to tell TVA that they shouldn't require this contract. Whatever. But anyway, that is where it started out. Now it has ballooned and I think expanded to all the cooperatives all across the United States that we have a disagreement over.

Mr. MCHENRY. So is that regulated, this going back and——

Mr. ENGLISH. TVA?

Mr. MCHENRY. No. Co-ops distributing money that is in excess of their——

Mr. ENGLISH. The capital credits?

Mr. MCHENRY. Yes.

Mr. ENGLISH. That is a part of the requirements that you have for electric cooperatives through this process. Again, you go back to the form 990's and the requirements that they provide this information and make it available.

Now, the issue that I think we are into, as well, here before us today is this question of how much is available. Even Mr. Cooper agrees that the $31 billion that he talks about in the way of equity, that most of that is tied up in buildings and infrastructure and things of that sort. If you are talking about actual cash that all the cooperatives across the country have on hand, you are talking about roughly $3.8 billion.

This is a very intense industry from a resource standpoint, and this is about 45 days' operating expenses, which on an average on co-ops around the country, and it is my understanding that is pretty much in line with what is being recommended as any kind of prudent business practice.

Mr. MCHENRY. OK. So the Texas Legislature addressed this particular issue that is the subject of the hearing today, did they not?

Mr. ENGLISH. The Texas Legislature is focusing on the governance and open meetings, and I think they are looking elsewhere at how they can ensure that the kind of situation that took place at Pedernales won't happen again. As you heard them testify, they seem to feel that this is a local matter and that they have it under control.

I have to admit I personally have not run into situations like we had in Pedernales, and so it is rather unique, I think.

Mr. MCHENRY. And how are the co-op boards elected?

Mr. ENGLISH. They are elected by the same folks that elect Members of Congress, the same constituents, so that is where it comes from.

Mr. MCHENRY. Do they do a better job of electing Members of Congress?

Mr. ENGLISH. Well, I guess that is up for every Member to make judgment on that.

Mr. MCHENRY. I am just kidding.

Mr. ENGLISH. I have to say when I was a Member of this body there were times that I questioned the judgment of some in other parts of the country, but no one sitting on this panel.

Mr. MCHENRY. All right. Any other comments about this Tennessee experience of Mr. Cooper's?

Mr. ENGLISH. Mr. Cooper could probably do better to address that than anything else, but that is certainly where he and I personally had a disagreement.

Mr. COOPER. I would be happy to jump in if the gentleman would yield.

Mr. ENGLISH. So I am sure he will want to talk about that some more.

Mr. MCHENRY. Sure, I am happy to yield.

Mr. COOPER. I thank the gentleman.

Is Tennessee unique and different? In a way. We do have TVA. We are thankful for that. But Pedernales, the subject of this hearing, the largest co-op in America, had never paid a refund in 70 years, despite having a major surplus. So if the largest co-op in America could behave like ours in Tennessee, that got me worried.

Now, regarding the Tennessee case, co-ops in Tennessee have so much political power that one line in the 1935 power contract, the TVA Board is reluctant to take it out because they don't want to be unpopular with their distributors. The TVA IGs have repeat-

edly, since 1994, found that 50 distributors in the Tennessee Valley, A, have embarrassing amounts of money on hand and, B, are raising rates at the same time in violation of this one sentence in the contract that we have talked about.

So we have a double whammy in our area, but it is hitting the rest of the country, too, like with Pedernales.

Chairman WAXMAN. The gentleman's time has expired.

Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman.

It is good to see you.

Mr. ENGLISH. Indeed, Mr. Towns. It is good to see you, sir.

Mr. TOWNS. Happy to know there is life after this place.

Mr. ENGLISH. Well, it has been a long time since I have been back.

Mr. TOWNS. Let me just ask you, when a co-op's revenue exceeds its expenditures, it builds equity?

Mr. ENGLISH. Right.

Mr. TOWNS. Well, when a cooperative refunds in the form of capital credits to their customers, is this situation in Texas cooperative unusual? Is this unique? I mean, if this is——

Mr. ENGLISH. It is most unusual. It is most unusual. The overwhelming majority of our members refund capital credits. Really, the judgment in the case that has to be made, and, again, this gets back to that business of a decision of the local board, and a lot of it has to do with how conservative they are. I had one—and certainly Mr. Cooper is going to strongly disagree with this, because we have had this discussion before—I have had one co-op that has told me that they want to have 100 percent equity. That is probably going way beyond, well, I know it is going way beyond what the average co-op has, which is about 40, 41 percent. But that is a decision on their part, because they have very conservative directors, and it is their directors' idea, we don't want any debt, and we want to make sure that we can cover whatever cost we are without going out and borrowing a lot of money.

That is a local decision. It is a very conservative board. As long as that is made available to the membership that they represent, then obviously that is a local decision.

We have others that have far less, but it is a local decision by elected representatives who have been elected by their membership to make such judgments, just as Members of Congress have been elected to make judgments with regard to the budget and deficits and everything that Members of Congress deal with. It is similar.

Mr. TOWNS. Well, do you think they should be doing a better job of communicating to their members?

Mr. ENGLISH. Well, I think we all need to do a better job of communicating with the members. I think we can all do better on that.

Mr. TOWNS. Right. Would you agree that co-op members ought to have a say in what their co-ops are doing with the equity?

Mr. ENGLISH. I think they certainly should, and that goes, again, they need to participate in their local cooperative elections. They need to pay attention to the business that is taking place at their cooperatives. They need to pay attention to what is going on here in Congress. They need to participate in the election of Members of Congress. The election on an off-year for Members of Congress,

if I remember correctly, is about 36 percent, and the election nationwide for directors of electric cooperatives is about 31 percent. I think we both would agree that it ought to be three-quarters or better. We ought to have far more participation in the democratic process of government, and certainly in the process of co-op governance. That is something that we wholeheartedly agree.

One point I would make—and, Mr. Chairman, I want to lay this on the record, too—an awful lot of co-ops go to great lengths to try to encourage people to participate. I know of one electric cooperative—and it is a rather large electric cooperative—every year just brings folks in to make sure that they come into this thing. They will even give away a new car. It is a drawing. That is it. You have to be at the meeting. You come in, you sign up as a member, and they have a drawing. They give away scholarships to the local folks. I know of some others that give away old pickups that the co-op might have. Some of you may have experienced that. In others they give away a frying pan.

But they are trying to get folks in to participate in this process, contrary to what I think the impression has been created today that no one, no co-op wants people to show up at their meeting. Well, that is not true, and it is completely contrary to the experiences I have had in the last 14 years in working with electric cooperatives across this country. They go to great lengths on that.

I think there is no question we would like to see far greater participation, and I am sure that you would, too, in your District, people coming to the poll.

Mr. TOWNS. No doubt about it. Especially to vote for me.

Mr. ENGLISH. Especially. And I am sure they would, because they are smart folks up there. No question.

Mr. TOWNS. Let me ask you, what are you doing to encourage that participation? Are you doing any of that?

Mr. ENGLISH. The one thing I think that we are trying to do is to help our members improve their overall communications with their membership. One of the things that we are doing right now is to engage them in something known as, Our Energy, Our Future, which is to make three points. We are trying to get them to talk to you all, and the first point is to make sure that they are aware, not just election cooperatives, but the whole electric utility industry is pretty much out of capacity. We built up excess capacity in the late 1970's and early 1980's. We are out of that.

Second thing is to understand, from a standpoint of technology, that far greater investment needs to be made in technology so that we can meet any climate change objectives that the Congress may set. If we don't, then we are probably going to run into situations where we are not going to have enough power, we are going to have rates that are excessive, and that is a train wreck none of us want to see.

The third point is the fact that we also need to understand that electric rates, particularly those people that we serve—and I would suggest a lot of the folks that you serve—there is a real question in the future as to whether electric power in this country is going to be affordable to all Americans. Low-income people may not be able to live with the promise that was created in 1936 with the creation of the REA and affordable electric power.

Mr. TOWNS. Thank you very much.

Chairman WAXMAN. Thank you, Mr. Towns.

All Members have completed a round of questions, and some Members have requested a second round. Are you ready to go?

Mr. ENGLISH. Yes, I am ready. Ready, Mr. Chairman.

Chairman WAXMAN. All right.

Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

My good friend Mr. Cooper down there, I know that he wants this what is best for his constituents. It may not go along——

Mr. ENGLISH. Well, he won't be an elected official long if he doesn't.

Mr. WESTMORELAND. No, I understand, but I know that he wants to do that. I just hope he doesn't mess up what is going on in Georgia by trying to fix what is going on in Tennessee. In fact, the comment about the PAC is almost laughable, that because you have a PAC you can get anything you want up here. If that was true, big labor and trial lawyers would be getting anything they wanted.

Mr. ENGLISH. And if I recall correctly, that is bribery, is it not?

Mr. WESTMORELAND. Well, it is.

Mr. ENGLISH. And you are supposed to be prosecuted if you have bribes. Isn't that right, Mr. Chairman?

Mr. WESTMORELAND. Let me say this: I have never seen a voter turnout method like the EMCs that I am used to use, whether it is health screenings, giving away a pickup truck, rides for the kids, a whole variety. They spend a lot of money trying to get those people out to vote where I am from.

Let me ask you this. Mr. Cooper mentioned the Cobb EMC case. Were there any laws broken there?

Mr. ENGLISH. Well, that is the issue that I think there is between some members and some of the officials at Cobb. That is being dealt with, as I understand it, within the courts and within the membership, so at this point I have no information.

Mr. WESTMORELAND. But if it was a law broken, it is being dealt with in the court today, isn't it?

Mr. ENGLISH. It is being dealt with. Yes. That is right. It is in the courts.

Mr. WESTMORELAND. And that is what kind of system we have. We are a country of laws, right?

Mr. ENGLISH. Right.

Mr. WESTMORELAND. If you feel like there has been a law broken, then you have a remedy in the court system?

Mr. ENGLISH. Exactly.

Mr. WESTMORELAND. And that is exactly where this is being taken, I am assuming.

Mr. ENGLISH. That is the way I was always taught.

Mr. WESTMORELAND. Yes. And so I am assuming that if there are laws being broken somewhere, that they are being taken to court. I am not familiar with the situation in Tennessee, but from what I heard you say, it is a contractual agreement between the TVA and the electric membership cooperative that is at question about why they can't do these rebates or refunds.

Mr. ENGLISH. Got to lower the rate.

Mr. WESTMORELAND. They have to lower the rate for all users, and that is a contractual thing. And so if the EMC decided not to do that, that would be a contractual issue that could be taken to court.

Mr. ENGLISH. In fact, it is my understanding the issue has been taken to court. They had some folks take it to court that you all are not giving us back our capital credits. And it is my understanding it was thrown out of court.

Mr. WESTMORELAND. OK.

Mr. ENGLISH. The court didn't even take it up, or if they did the judge came down and said this is a contractual issue and——

Mr. WESTMORELAND. So there has been some type of adjudication or something in this case?

Mr. ENGLISH. There has been adjudication already on the matter, yes.

Mr. WESTMORELAND. And the case that we are having the hearing on today?

Mr. ENGLISH. Well, I think that would be a little unfair to Mr. Cooper, because I think what he is talking about and what we are having the hearing on is Pedernales, but that is, I think, a part of this discussion, yes. I think that is a part of what we are talking about.

Mr. WESTMORELAND. Yes, sir.

Mr. Chairman, I thank you for doing the second round. I appreciate it, and I yield back the balance of my time.

Chairman WAXMAN. Would you yield to me?

Mr. WESTMORELAND. I would.

Chairman WAXMAN. I just want to get something very clear. As far as Federal regulation of the electric co-ops, it is only the IRS requirements; is that correct?

Mr. ENGLISH. No. As it stands right now, anyone who is an RUS borrower also then comes——

Chairman WAXMAN. Anyone who is an RUS?

Mr. ENGLISH. Borrower. Borrows from the Rural Utilities Service.

Chairman WAXMAN. I understand that only 50 percent of the co-ops actually——

Mr. ENGLISH. No, you have about two-thirds of the co-ops have an RUS loan.

Chairman WAXMAN. OK. Then what regulation do they have under RUS?

Mr. ENGLISH. As I say, there is a multitude of different regulations pertaining to the loan, but also pertaining even to the point that if they feel the activities of the co-op—if the CEO, for instance, is carrying out activities—and I think you could probably stretch what was happening down in Pedernales—they would have the authority to remove the CEO.

Chairman WAXMAN. So they have regulatory power, but they also don't have the staff or resources to exercise it?

Mr. ENGLISH. Exactly. Now, let me take this just a——

Chairman WAXMAN. And you are not a regulator?

Mr. ENGLISH. I am not.

Chairman WAXMAN. You are the head of the trade association.

Mr. ENGLISH. Not unless you make me one, Mr. Chairman. Now, if you want to give me that authority, then we will talk some more.

Chairman WAXMAN. I don't think you'd want that authority. If you have to keep all the members of your trade association happy, you don't want that authority.

Mr. ENGLISH. That is true. That makes it a little more difficult.

Chairman WAXMAN. You answered my question.

Mr. ENGLISH. Let me add one point.

Chairman WAXMAN. Yes.

Mr. ENGLISH. There is one little part. That one-third that is not borrowing from the Rural Utility Service, during that period of time that I am talking about, most of those going into the early 1980's were borrowers. They dropped off because of the limitations that you had staff-wise. They could not get a timely loan. So you get big co-ops such as the Pedernales situation in which they are growing very rapidly, and they said, RUS has been cut back so far we can't get this in time to meet the needs to provide the electric power for our membership. They got out.

So the whole point is: if you and I had maintained those levels and kept RUS regulating like they should throughout the 1980's and 1990's, I doubt that we would be here today.

Chairman WAXMAN. Does RUS regulation, if it were ever enforced, preclude a co-op from taking money from the co-op and investing in hotels and other enterprises?

Mr. ENGLISH. Well, that is another little thing. Unfortunately, I have to take a big share of that, although you get a little piece. The big share comes back in 1987 on the Agriculture Committee Ed Jones, chairman of the subcommittee, Conservation Credit, we came up and figured out, hey, we have no money for rural development programs. We are out of luck. I mean, that is when we were having tight budgets and all that stuff.

So what we did at that time is, well, we have all these electric cooperatives scattered all around the country that are getting RUS loans. We ought to ask them to do more. So that is when we made the move in saying you guys ought to be involved in developing the economies of——

Chairman WAXMAN. So we don't stop it. In fact, you think we have encouraged those?

Mr. ENGLISH. We encouraged it. In fact, we have an Inspector General report that condemns us for not doing enough.

Chairman WAXMAN. You answered my question. I appreciate that.

Mr. ENGLISH. Yes.

Chairman WAXMAN. Mr. Cooper.

Mr. COOPER. I thank the Chair not only for holding this hearing but for your extraordinary patience.

I think the main NRECA argument is, well, there may be one bad apple. If we had had this hearing last year, they probably wouldn't have agreed even to one bad apple, but at least today we know there is one bad apple and it is called Pedernales.

Mr. ENGLISH. Don't put words in our mouth now.

Mr. COOPER. OK. From the limited research I have been able to do—and I wish there were more data. I wish there were more transparency. I wish there were more disclosure, because I believe

these are public power entities founded in the New Deal owned by the people, and information should be widely available. But the best I can tell, it is not one bad apple; it is at least 10 percent of the 930 co-ops in the country, and it may be a lot more than that. I hope that is not true.

I am sorry my friend from Georgia had to leave, but remember, very few co-ops tell you exactly the private property that you own. And I thought this was a country built on private property. I cited the NRECA's own material to point out that small co-ops are charging their customers an extra $220 a year, 2 months of light bills, just so they can remain small. All this is completely legal. That worries me.

So I think it would be a complete mistake for this committee or for Members to dismiss Pedernales as a rare aberration. For example, Pioneer, the co-op in Alabama hadn't had a board of directors election in 38 years. You were just talking about how there is great attendance at elections and stuff. How many decades does it take not to have a board of directors election before that should affect their co-op status? Are you willing to accept people that a half century or 100 years of no board of directors election? There has to be some minimal standard to join the NRECA.

Mr. ENGLISH. Well, there is an awful lot of accusations in there, and first one I would say is this: you are saying bad apples. You know, as I pointed out, any group you have bad apples. You have bad apples in the Congress, and we have had them all the way through. I can start ticking them off if you want me to name them. And I would dare say that we do not have any greater percentage of problems along those lines than you have in Congress. This is anybody, group of people elected by the general public, you are going to have bad apples.

Second issue, you are talking about the issue of public power.

Mr. COOPER. How many bad apples are there in co-op land?

Mr. ENGLISH. How many are there in Congress?

Mr. COOPER. I ask the questions.

Chairman WAXMAN. Would the gentleman yield to me?

Mr. ENGLISH. And if I could, the courts——

Chairman WAXMAN. Would the gentleman yield?

Mr. COOPER. I would be delighted.

Mr. ENGLISH. The courts have determined——

Chairman WAXMAN. Excuse me. Excuse me, Mr. English. He controls the time.

Mr. ENGLISH. OK.

Chairman WAXMAN. Look, I don't think this is a fair question to ask a man who is the head of the trade association. He is not the regulator. I think your question should be a rhetorical question, because he is not going to be able to give you an answer. He is not the regulator. If we had a regulator, we could find out what they would say.

Mr. ENGLISH. Well, you have one but you don't fund it.

Mr. COOPER. Mr. Chairman, a fair point, but I have met the regulator at RUS. He is a very nice gentlemen whose name is Jim Andrews. He is a former head of NRECA.

Mr. ENGLISH. That is not right either.

Mr. COOPER. This is a family organization.

Mr. ENGLISH. That is not right either. He was president of the Board of Directors at NRECA a few years ago. He was not the head of it.

My second point is——

Mr. COOPER. President of the board of directors——

Mr. ENGLISH. The courts have stated, Mr. Cooper, the courts have stated that it is not public power. Now, that is the courts have said that, not me. What they have said is privately owned. It is owned by the membership and it is privately owned. They may buy public power—in fact, they do from TVA—but they are not public power.

Mr. COOPER. Perhaps you can explain that to your members like Pedernales and Representative Rose and others.

Mr. ENGLISH. No one is here defending the management of Pedernales, Mr. Cooper.

Mr. COOPER. It is public power.

Mr. ENGLISH. No one is defending that.

Mr. COOPER. Would the gentleman yield?

Mr. ENGLISH. If you knew the experiences I had with Pedernales you wouldn't be asking me that question. You wouldn't even raise that.

Mr. COOPER. Would the gentleman yield?

Mr. ENGLISH. Certainly. Always yield.

Mr. COOPER. The co-op family is a very small one. It is a very precious one. There is a great bond of intimacy between co-op members because it is a very important institution in America. It is a little bit like a church. Word travels fast.

Mr. ENGLISH. That is going a little far.

Mr. COOPER. Word travels fast. Usually if something is going on in co-op country people hear about it. I would like to know when you first found out, you personally, that there were serious problems in Pedernales.

Mr. ENGLISH. In Pedernales? Well, let me just say this, that the relationship that I had with the former CEO was not close.

Mr. COOPER. But he was your largest member, right, or Pedernales?

Mr. ENGLISH. He was a member. There is no single member of NRECA that is going to dictate what our association does. It is governed by our resolutions.

Mr. COOPER. But he was your largest member.

Mr. ENGLISH. He was a large member, but no, as far—he was the largest distribution cooperative in the country. He was the largest member from the standpoint—he was not the largest dues-paying member.

Mr. COOPER. When did you first find out there were serious problems at Pedernales?

Mr. ENGLISH. When I first heard about serious problems was whenever I heard about the newspaper articles that were coming out about it.

Mr. COOPER. When did you first find out there were serious problems at Cobb?

Mr. ENGLISH. Well, I heard about the controversy at Cobb, because I think that has not been settled by the courts nor by the membership as to whether they are disagreeing.

Let me again go back to the point. What we are talking about here are policies—they are adopted by the board of directors—that the membership disagreed with. What we talked about with regard to what you and I, I think, would agree is excessive—staying at the Ritz Carlton and so on and so forth. I don't do that. But the point that it comes down to is that was board policy that allowed that. That was the direction of the directors. They allowed that to happen.

The accountability comes with regard to those directors with the membership, as it should, and those are the people that have taken action and those are the people that took action in Alabama and those are the people that, if they are going to take action, will take it in Georgia, as well.

Mr. COOPER. Mr. Chairman, I see that my time has expired, but one last question.

Mr. ENGLISH. I will yield the gentleman some extra time, Mr. Chairman, if you don't mind.

Mr. COOPER. I appreciate the former Member yielding.

I don't think it has been acknowledged in this hearing the fact that if you look at the NRECA's real Web site, the secret, password-protected one, they offer lots of legal or quasi-legal advice. For example, through the Electric Co-op Borrower Association and other entities, there are elaborate slide shows, for example, that tell you how to fill out the 990 form. In the earlier panel they talked about how in Texas some 40 percent of those forms are misfilled out.

So I think a trade association, to the extent it tries to give legal advice, should take some responsibility for practices, board practices and other practices that may not adhere to the high ethical standard that I think the average co-op member back home wants their co-op to adhere to, because these were not ever intended to be average. These were supposed to be idealistic organizations that did the most to serve the consumer interests by cutting their light bills, and not to have organizations that raised rates unnecessarily, as the TVA Inspector General has found that too many of ours have done.

So would the gentleman care to inform us on the slide shows and other information materials on the secret, password-protected Web site like this document that he refused to give to my office or to Mr. Watson or anyone else who inquired, even though this is superb legal research, it is extraordinarily well done, and it backs up the premise that co-ops need to behave in order to retain their tax-exempt status?

Mr. ENGLISH. Mr. Chairman, I am sorry that Mr. Cooper raised this issue and asked me this question. I was hoping we were going to be able to avoid this.

The reference that he made was with regard to a private Web site, and gave even a Web site that provides access to members' 401(k)'s and also retirement benefits. NRECA's counsel has advised me that Mr. Cooper is currently under investigation by the Federal Bureau of Investigation for his unauthorized access and downloading of information from NRECA's password-protected Web site, and that is in violation of the Federal Computer Fraud and Abuse Act. These abuses——

Mr. COOPER. Would the gentleman yield?

Mr. ENGLISH. These accesses occurred on a house.gov IP address on December 10, 11, 12, and 14, 2007, and in order to not jeopardize that investigation I would prefer not to answer any questions with regard to those matters that were downloaded.

Mr. COOPER. Would the chairman give me a moment to respond?

Chairman WAXMAN. Yes.

Mr. COOPER. I had authorization to use the Web site from someone who gave me their password and information.

Mr. ENGLISH. The only people that could give you authorization is myself or others at NRECA, a limited number. Like I said, this is a matter under investigation by the FBI. You can take it up with them.

Chairman WAXMAN. All right. I think we have explored this issue at great length, but I think there are still some matters yet to be resolved. We will continue to pursue what, to an urban guy like me, is a very interesting and surprising turn of events.

We I think have concluded the hearing for today and we stand adjourned.

[Whereupon, at 2:04 p.m., the committee was adjourned.]

[The prepared statements of Hon. Bruce Braley and Hon. Mark E. Souder follow:]

Statement of Congressman Bruce Braley
Committee on Oversight and Government Reform
Rural Electric Cooperatives: The Pedernales Experience
June 26, 2008

Thank you, Chairman Waxman and Ranking Member Davis for holding this hearing today on rural electric cooperatives and the Pedernales Electric Cooperative in Texas.

Reports of questionable practices at the Pedernales Co-op, including alleged excess compensation for the president and board members, unearned compensation for officials, and an undemocratic process of selecting its board, are very concerning. I am glad that the Committee is examining these alleged practices today, and glad to hear that the cooperative has undertaken reforms to address these issues.

The practices at Pedernales raise important questions about the practices at other rural co-ops in the United States. I am concerned by the Department of Agriculture Inspector General's findings that some utilities have been failing to invest in their communities, and by a USDA Inspector General audit which discovered the involvement of some top co-op officials in problematic financial arrangements during the sale of their cooperatives' capital assets.

However, the Pedernales Cooperative doesn't in any way resemble the Iowa cooperatives that I know. Forty rural electric cooperatives serve Iowa. In my district, seven co-ops provide power for all of their service territory. I have always known the cooperatives as responsible, prudent organizations with great concern for their communities. Several recent events in my district have reinforced this impression.

During the recent floods, which displaced thousands of people, damaged homes, businesses, and schools, and destroyed 20 percent of the state's cropland, the rural electric co-ops have been standing ready to help out once the waters recede. Earlier this spring, a tornado struck my district and killed eight people. In Parkersburg, the local co-op lost four miles of distribution line but restored it in only four days.

Two winters ago, brutal ice storms pummeled my district and co-op service territory was hit hard. Thousands were without power. I saw first-hand how the cooperative program works as dozens of co-op utility worker crews arrived within 24 hours from other states. Our co-ops restored service as quickly as possible under extreme conditions.

Successful emergency responses like these, to help so many families in urgent need, take prior planning and ready resources. I am thankful that the co-ops in Iowa's First District have been so well prepared to handle these types of disasters.

I'm also proud that cooperatives in my district have returned over $68 million in capital credits. Iowa has about 320 co-op directors and in the past ten years, over one-third of the directors have changed hands in open, democratic elections. In addition, Iowa cooperatives have a remarkable record of contributing to economic development efforts and alternative energy development.

It is important that Congress facilitates proper oversight of rural electric cooperatives to ensure that all cooperatives nationwide are following the good practices that I have seen of the Iowa co-ops. We must ensure that all co-ops are serving the best interests of their members and their communities through open, democratic elections, responsible management practices, and the appropriate distribution of capital credits to their members.

Thank you again, Chairman Waxman, for holding this hearing today. It is my hope that this hearing will help ensure that cooperatives nationwide, just as I have seen in Iowa, serve as a positive force in their communities.

MARK E. SOUDER
3RD DISTRICT, INDIANA

HOMELAND SECURITY COMMITTEE
SUBCOMMITTEE ON BORDER, MARITIME, AND GLOBAL COUNTERTERRORISM
REPUBLICAN LEADER

OVERSIGHT AND GOVERNMENT REFORM COMMITTEE

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June 27, 2008

Mark Souder Statement: June 26, 2008
Committee Hearing on Governance and Financial Accountability of Rural Electric Cooperatives: The Pedernales Experience

Mr. Chairman

REMCs are an integral part of Indiana. They provide power not just to thousands of private homes, but also to the hundreds of manufacturing plants in my district. Without the power they provide, our nation's manufacturing base would collapse and thousands of workers would be jobless. REMCs not only supply power at efficient rates but also utilize a democratic business philosophy that allows consumers to manage the co-ops and reap the benefits of their success. REMCs are truly a great American enterprise.

REMCs are the primary source of electricity to thousands of farms in my district, allowing our farmers to provide a safe and abundant food and fiber supply to our nation and the world. Without the reliable transmission of affordable electricity provided by the REMCs to our rural communities, our food supply will be further tightened and food prices will soar even higher.

Agriculture is not the only large industry in Indiana. The Hoosier state is the number one steel manufacturing state in the nation. We currently produce 24 percent of the nation's steel. One steel plant in my district uses more energy in a single day than a city of 50,000. REMCs are working to meet the growing energy demands of not only Hoosiers but all Americans. It is imperative that Congress doesn't get in their way. We must work with REMCs so they can construct power plants to meet our growing appetite for energy.

Coal is used to produce almost 50 percent of our nation's electricity, and in Indiana that number shoots up to 94 percent. We have over a 200-year supply of coal in the U.S. and REMCs need to be allowed to use that coal to responsibly produce electricity for all of us. Although we have all that coal, nuclear energy is another option that we should continue to promote. We need to address our future energy demands, not ignore them until we have to dig ourselves out of an even bigger hole.

Investigating corruption is important but this hearing seems to be throwing the entire REMC family under the bus because of one member in Texas. I believe that Mr. Cooper's criticisms of the REMCs are misplaced and probably should be directed at the

Tennessee Valley Authority. REMCs are being forced to buy power from the TVA and other power companies.

I have met with hundreds of REMC members in Indiana and I find them to be some of the best people in my district. The Kosciusko REMC which serves Kosciusko and parts of Fulton, Wabash and Whitley counties in Indiana serves approximately 17,300 meters, 16,300 of which are residential. This REMC has refunded capital credits in four of the last five years, totaling approximately $1.1 million.

Northeastern REMC which serves Whitley and parts of Allen, Noble, Kosciusko, Huntington, and Wabash Counties in northern Indiana serves approximately 26,500 meters. In the past two years, refunds have totaled over $1 million.

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