

OFFICE OF PUBLIC ACCOUNTABILITY

Date: May 16, 2016

Council File No. 16-0093

To: Honorable Members of the Rules, Elections, Intergovernmental Relations,
and Neighborhoods Committee



From: Frederick H. Pickel, Ph.D., Executive Director/Ratepayer Advocate

Subject: Recommendations of the OPA on Select Governance Questions for the
Department of Power and Water (Fuentes-Wesson-O'Farrell; C.F. 16-0093)

This report addresses three topics: 1) strengthening the Office of Public Accountability (OPA), 2) improving the Department of Water and Power's (DWP's) agility in contracting, and 3) greater consistency in rate reviews. More rapid technology developments, environmental change, and evolving competitive pressures within the utility sector drive the need for improved contracting agility and revenue consistency. DWP also needs more agility in hiring, but that topic is not addressed in this report.

1. OPA Resources and Access

OPA could use additional resources to perform the functions of its Charter and enabling ordinance in the form of a higher, minimum budget floor and staff that are exempt. Improved access to the books and records of DWP is also needed, so that OPA can have business records during business hours on business premises, in the few or infrequent instances when no mutually agreed scope and timing can be arranged with reasonable effort. The details of these requests will be expanded upon in a joint report with the CAO and CLA.

2. Contracting

OPA recommends that the City Council delegate to the Department of Water & Power (DWP) authorization levels for the Board and General Manager as follows:

(a) up to \$5 million

- Conditions to be established from time to time by the DWP Board by resolution of the Board, and then submitted to the City Council for its consideration.
- The Board could choose any parameters it finds appropriate, and change them as conditions merit. For example, it could exempt or include any type

of contracting, require any type of internal audit or monitoring, or set as a condition that the item was budgeted or within budget contingency levels it monitors more actively. It could decide what limits to place on individual organizational units or vendors it was comfortable with, and adjust parameters after it has more productivity information from the next stage of benchmarking.

(b) up to \$10 million

- For expenditures in an approved annual budget, after notice (not action) to the DWP Board and public on regular agendas.
- Notice provides due process to vendors who can then inform the Board about the competitive process. The Board can thus take an individual contract under advisement before it is signed, and be ensured of gathering all the relevant information before a commitment is made.

(c) up to \$15 million

- For materials expenditures in an approved annual budget with five or more responsive and responsible bidders taking no exceptions, provided installation or training services are less than half the total contract amount. Even this level is low based on DWP's size relative to other publicly owned and investor owned utilities.
- This higher level provides an inherent incentive to work toward this goal with those procurements that might meet this standard over time.

The absence of appropriate delegation to the Department level has, in OPA's opinion, the following negative consequences:

1. The imbalance between speed and oversight represents an ongoing and cumulative risk to reliable operations. The organizational culture is not allowed to use a more customary matrix of expenditure authorization, which has the potential to increase internal accountability and better talent. It depends too heavily on a single individual, which is a frail mechanism for a utility of this size.
2. It creates an imbalance in labor-management relations that impairs efficient trade-offs between resource options and slows the pace of utility capital deployment; and
3. It shifts management and board attention and impairs their roles, making it challenging to set generally applicable procurement policy, monitor gaps in industry practices, or invest adequately in a more up to date utility supply chain that is better prepared for the future.

These recommended contract levels should not be viewed in isolation from other recommendations OPA made with respect to governance issues in its July 1, 2015 report on the billing system. In particular, pairing these changes with an ability to hire within six months is critical to achieving a cohesive functionality. DWP's "fault lines", revealed by the billing system, show a utility that is falling further from rapidly changing industry standards, and needs help to restore its agility and responsiveness.

3. Regular Rate Reviews Needed

OPA recommends that the Department of Water & Power (DWP) should have a regular review of the costs of service and revenues every third year. A four year rate cycle is acceptable if there is a review and adjustment after two years.

Before initiating a rate review, DWP should at a minimum publish publicly and provide to OPA: (1) budgets with job numbers, (2) a corresponding financial model, (3) the calculations that transfer the model's identified line items into revenue collection mechanisms (e.g., base rates, surcharges), (4) a cost of service study, (5) a schedule for each class of customer with each rate component, by year and season, and (6) operative Ordinance draft language implementing its intended and proposed request. This recommended minimum starting point for a rate review can be changed by adding items, either before or during a review. Starting a rate review without publication of proposed rates is a worst practice, and it would help make the review more amenable to a schedule if all interested stakeholders start with the same disclosure.

A regular review, with observable rate changes at the end of the process, will improve public trust. A cycle that is not discretionary, but regular, will enhance financial stability, and minimize the tendency to obscure DWP's cash position or capital performance. Without regular rate reviews, management is required to make sub-optimal decisions that build negative consequences on top of each other, compounded by the passage of years and turnover in management. Making one "less bad" decision at a time, the utility can drift into a state of backlogged work and deferred maintenance, which will make for larger rate impacts in the long run.

cc: The Honorable Los Angeles City Council
The Honorable Eric Garcetti, Mayor
The Board of Water and Power Commissioners
Marcie Edwards, General Manager, Department of Water and Power
Sharon Tso, Chief Legislative Analyst
Miguel Santana, City Administrative Officer
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