Journal of Cooperatives

Volume 24 *2010* *Page 63 - 79*

Rebuilding Cooperative Leadership: The Case of Pedernales Electric Cooperative

John L. Park[1] John Siebert[2]

Contact:
John L. Park
Department of Agricultural Economics
Texas A&M University
College Station, TX 77843-2124
Tel: 979-845-1751
jlpark@tamu.edu

[1J]John L. Park is Roy B. Davis, Professor of Agricultural Cooperation. Texas A&M University
[2]John Siebert is Professor. Texas A&M University

Rebuilding Cooperative Leadership:
The Case of Pedernales Electric Cooperative

John L. Park and John Siebert

Abstract:

The Pedernales Electric Cooperative (PEC) is the largest rural electric cooperative in the US. In this case, readers learn about various principal-agent problems that occurred at PEC and the steps taken to correct such problems. Electric cooperatives are a vital part of the US electrical grid. Providing electricity to 40 million people in 47 states, these cooperatives serve 85% of the nation's land mass. This case follows the experience of PEC's former General Manager Juan Garza. Also, benchmark financial and operating information are provided. At the conclusion, readers are asked questions about the selection method for a new general manager and also about how this cooperative might improve its efficiency.

Key Words: Rural Electric Cooperative, Governance, Leadership, Cooperative Finance

The Case of Pedernales Electric Cooperative

Between 2007 and 2009, Pedernales Electric Cooperative coped with one controversy after another. Prior actions by this cooperative's board and CEO had culminated in negative media coverage concerning alleged mismanagement and even fraud. Pedernales Electric Cooperative (hereafter referred to as PEC or Pedernales) had even drawn the attention of Texas state legislators and, in turn, placed negative scrutiny upon all Texas cooperatives.

On January 4, 2008 a new General Manager, Juan Garza, had been hired to solve PEC's many legal and management problems. Prior to his service at PEC, Garza had built a strong reputation as the General Manager of neighboring Austin Energy. At PEC, he quickly proved himself as a reformer and also a champion of PEC's employees. During his tenure at Pedernales, Mr. Garza and the board implemented a wide array of reforms. Mr. Garza commissioned a third party consulting firm (Navigant Consulting Inc.) to conduct an internal investigation into various allegations and issued raised in a class action suit pending against PEC. The scope of the internal investigation included an examination of compensation, benefits and expenses related to the current and former board and management, the use and compensation of third party vendors and consultants, procedures for fixed asset purchases and construction and vendor/supplier contracts. The report also contained a comparison of PEC's electricity rates with other regional utilities and an analysis of PEC's operating costs. The results of the investigation were published in a 390 page report which was presented to the PEC board of directors and subsequently disclosed to the general public (Navigant).

The Navigant report paved the way for a number of reforms at PEC. Some of these reforms required changes to PEC's bylaws and articles of incorporation. These reforms were described as a "member's bill of rights" in PEC press releases. PEC's voting process was restructured to a strict one-member one-vote system. Residency requirements for board candidates were implemented and the board districts were revised to create more even representation. The board election process was also restructured and the nomination committee was eliminated. A PEC member could be nominated for the board election by submitting a petition with the signatures of 50 members. The number of board members was reduced and a leaner compensation package for the board was adopted. The cooperative also adopted an open meetings and records policy and implemented live streaming video of board meetings. An internal auditing function was created and a code of ethics and whistleblower policy was adopted. Acknowledging these changes Mr. Garza stated in his 2010 annual meeting address that " PEC is now recognized as a model for open government for all electric cooperatives."

In addition to implementing the internal investigation and addressing its recommendations, PEC had other tangible accomplishments during 2007-2009. The class action lawsuit pending against PEC was settled. Electrical rates were reduced three times during the 2009 fiscal year and the cooperative enjoyed an improvement in their bond rating. Despite these accomplishments the board of directors during their regularly scheduled June 2010 board meeting voted to terminate the employment agreement between the general manager and PEC.

While the board's rationale for initiating a management change can only be a matter of speculation , comments by PEC board chair Larry Landaker at the June 19, 2010 annual meeting suggest that the board was concerned over the cooperatives progress in reducing costs and electricity rates. Landaker's comments included:

The energy industry faces daunting challenges that threaten the economic model of all utilities. For 70 years we have enjoyed a protective fence around our market. Our customers are captive. They have no choice in electric providers. But technology or legislation or both may one day change that, just as cable changed television, just at the internet changed everything. An energy technology revolution is at our doorstep. How long will it be before someone leaps over that fence and steals our customers? We must make certain that our [electric] rates remain competitive and fair. The board is committed to maintaining PEC's hallmark customer care and the delivery of safe, reliable electricity. We want our employees to earn competitive wages and with great benefits. We plan to continue supporting the local communities we serve. If we are to sustain all these things, it is up to management and the board to find smarter and better ways of operating. PEC cannot operate in such a way the fealty is given only to the individual at the top. This has been our long history. PEC belongs to the member-owners. At our core, PEC exists for no reason other than to provide electric power to the owners - members - at the lowest price possible consistent with reliable and high quality service" (Landaker).

The atmosphere associated with such a management change could have been very poisoned. After all, this announcement came only two days before PEC's annual meeting which, coincidently, would also see two board seats filled by newcomers. Yet, the board and former general manager Garza both handled the situation with the utmost professionalism. Garza was positive in his remarks to the membership at the annual meeting as he commented on the state of the past year. He stated, in part:

"I will remind the employees here and all of those who want me to be reinstated that you have had your say today and that is appropriate in the new PEC. Now it is time to let the board of directors decide how this company should proceed for the future. A member elected board of directors now runs this cooperative, and it is up to that board to determine who should manage the cooperative. It is up to the employees to carry out the policy decision of the board and support whomever they choose as their general manager. In conclusion, let me say that my time here at PEC has been the joy of my life…(Garza)."

Compared to the turmoil that had preceded his appointment as PEC's general manager, this change was not viewed as a crisis. Garza had taken the cooperative a long way during his thirty months at the helm. Even so, the question remains: could things have been done any differently? Were the changes instituted at PEC correct at the time? The internal investigation suggested that PEC board had been too passive. Was the board now overreacting or was the pace of financial reform too slow. PEC's reforms had opened the board position nomination process. Was the turnover on the board a healthy sign of an engaged membership or could the continuity and stability of the board be at risk? PEC's reforms had also greatly increased member access to information. Was this transparency improving member control or could the cooperative inadvertently be providing its competitors with information they could use to the detriment of the cooperative?

History of Rural Electric Cooperatives

By the 1930s, urban areas of the United States had enjoyed the benefits of electrical power for 50 years, yet rural America remained in the dark. On farms and ranches across America, wood stoves, coal-oil lamps, and hand-pumped water were common. The costs of expanding electrical service to the relatively few customers in the countryside were simply too great for any one investor or company. Thus, President Franklin Roosevelt established the Rural Electrification Administration (REA) in 1935 in order to make electricity available to rural households. At that time, rural poverty was a serious concern. It was thought that electrification could do much to combat such poverty in rural areas where incomes were tied almost exclusively to agriculture. The subsequent Rural Electrification Act of 1936 authorized REA's Administrator to make loans for the construction and operation of generating plants, electric transmission and distribution lines, or systems for furnishing electric energy…. By 1953, more than 90 percent of U.S. farms had electricity…." This was primarily through the efforts of cooperatively owned utilities (Public Utility Reports, pgs. 14, 16).

Today, more than 900 rural electric cooperatives serve some 40 million people in 47 states covering 85% of the nation's land mass. In 1939, REA was reorganized under the oversight of the USDA where today its work is carried out by the Rural Development, Rural Electric Program, which provides:

"…loans and loan guarantees to finance the construction of electric distribution, transmission and generation facilities including system improvements and replacements required to furnish and improve electric service in rural areas, as well as demand side management, energy conservation programs, and on-grid and off-grid renewable energy systems. Loans are made to corporations, states, territories and subdivisions and agencies such as municipalities, people's utility districts and cooperative, nonprofit, limited-divided, or mutual associations that provide retail electric service needs to rural areas or supply the power needs of distribution borrowers in rural areas." (USDA, Rural Development, Electric Programs).

As of 2006, over $6 Billion dollars in lending volume was outstanding to 590 such borrowers (USDA, Rural Development, Utilities Programs). Most of these borrowers were RECs.

Starting PEC was not easy. After the REA first came into being, minimum population requirements prevented electrification from going forward. Lobbying by then U.S. Congressman Lyndon Johnson gave the Pedernales (or Hill Country area) an opportunity and, "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 to build nearly 1,800 miles of electric lines." The headquarters of PEC is located in Johnson City, Texas, the birthplace of President Lyndon Johnson (PEC).

Exhibit 1 profiles several of the largest investor-owned, publicly owned, and also cooperatively owned residential electric utilities. When compared to investor-owned and publicly owned electric utilities, RECs tend to be smaller. Pacific Gas and Electric (PG&E) is the largest investor-owned utility serving 4.5 million customers. In terms of customer count, PG&E is twenty-two times larger than the largest REC (which happens to be Pedernales). Also on the basis of customer count, the largest publicly owned utility is that of the City of Los Angeles. This utility is six times larger than Pedernales. Because publicly owned

Austin Energy and Pedernales share a boundary, Austin Energy is also included in exhibit 1. Austin Energy is moderately larger than Pedernales.

Exhibit 1. Ranking of the Largest Residential Electrical Utility Providers on the Basis of KWH Sold: Investor, Public, and Cooperative Ownership, 2008[a]

	Number of Consumers	Electric Revenue	KWH Sold	Average Retail Price [b]
	(000)	($000,000)	(000,000)	($/KWH)
Investor Owned				
Florida P&L	3,992	$6,214	53,141	$0.1169
PG&E	4,622	$4,156	31,415	$0.1323
SCE	4,232	$4,589	30,643	$0.1498
Comwlth. Edison	3,440	$3,284	28,389	$0.1157
Virginia E&P	2,024	$2,720	28,082	$0.0969
Publicly Owned				
Salt River Project	846	$1,233	12,775	$0.0965
Long Island	991	$1,871	9,512	$0.1967
San Antonio	612	$782	8,617	$0.0908
Los Angeles	1,264	$878	7,816	$0.1123
Memphis	366	$474	5,521	$0.0859
Austin [a]	356	$419	4,165	$0.1006
Cooperatives				
Pedernales	207	$376	3,231	$0.1164
Middle Tennessee	156	$253	2,863	$0.0884
Jackson	185	$255	2,839	$0.0898
Withlacoochee	181	$282	2,594	$0.1087
Cobb Electric	173	$249	2,431	$0.1024

[a] Even though it ranks only ninth in KWH sales among publicly-owned utilities, for purpose of comparison, Austin Energy has been added to this table.
[b] Calculated as Electric Revenue / KWH. Small errors exist due to rounding.
Source: Energy Information Administration.

Problems and Resolutions

In March 2010, the authors interviewed then General Manager Garza. Exhibit 2 provides Garza's summary of the major burning issues faced by the cooperative at the time of his hire. The numerous changes and reforms achieved during his two and one-half years at the helm are also shown in this exhibit. Many of these changes were initiated by the Board before his hire, but carried out during the time he served.

PEC's problems pertained to a long period of service by prior General Manager Bennie Fuelberg and PEC's Board President Bud Burnett. An Austin American-Statesman article quoted,

'They [PEC] have basically written the rules in such a way that it's really hard to allow any [board election] competition. The democratic process has been circumvented,' said [Beckie] Morris, a former wind industry and Pedernales Electric worker. 'The members are supposed to own the co-op, not the few at the top.' (Grisales, August 4, 2007)

During 2007 and 2008, PEC's problems seemed to appear in the newspaper on an almost daily basis, including numerous articles by Austin American-Statesman reporter Claudia Grisales. Initial media interest in PEC was sparked when a group of disgruntled members filed a class action lawsuit, seeking a $164 million settlement. News occurred that PEC had spent $4.6 million on advertising since 2003, and that PEC had losses of $14 million at its Envision (internet) subsidiary. A website called PEC4u.org even focused on many such matters. (Grisales, November 14, 2007).

As problems continued to surface, the controversy drew the attention of Texas State legislator Troy Fraser, and hearings were scheduled to examine PEC. What came to light was that business-to-business legal, insurance, and banking relationships (many of which had been established at the time of PEC's founding) had remained in place with little or no competitive bidding. Also, a conflict of interest came to light that PEC's co-general counsel, its insurance broker, and also one of its main banks, Cattleman's National, all had nearly the same ownership; in this case that of the Moursund family. Further, PEC board members were also serving on this bank's board (Grisales, August 17, 2008). A PEC bank account in the amount of $565,000 was recently discovered at Cattleman's National. This account earned no interest, had been on deposit since the 1980's and was having its statement forwarded, by general manager Fuelberg, to an accountant at the Moursund law firm (Editorial, August 8, 2008). This account pertained to the Texland Electric Cooperative venture. Later it was found that PEC Board President Burnett and PEC General Manager Fuelberg had paid themselves $271,600 out of this account. Also, PEC General Counsel A.W. Moursund was paid $735,610 out of the account (Grisales, October 23, 2008). These revelations led to an investigation by Texas Attorney General Greg Abbott. Garza relayed to the authors that these problems and others had been resolved during his time at PEC, but that the attorney general's investigation was on-going.

Exhibit 2. Major Changes at PEC During Juan Garza's administration: January 4, 2008 (hiring) through June 19, 2010 (departure).

Problem	At time of hiring	At time of departure
Director Compensation	Paid by the meeting. Could attend several meetings in one day.	Paid for no more than one meeting per day, regardless of how many meetings attended
Use of Consultants	Numerous well-connected, political lobbyists employed including Claude Thomas Winters.	All lobbyists terminated
Public Relations	PEC used to give the impression that it was hiding something...messaging the information. This became a repetitive theme in (negative) media coverage.	Austin American Statesman journalist Claudia Grisales given an office at PEC's headquarters. (She used it for two days, but could have used it for much, much longer. She still has full access to all PEC files and information.)
Election to Board	Proxy System and Nominating Committee existed which let the board self-perpetuate itself.	No proxies used and only 25 member signatures needed to run for a board seat in a district.
Number of Board Members	17 members	7 members
Board of Director Meetings	Closed to both the membership and news media	Open to all members and news media. All decisions voted in open session. (Executive sessions used for personnel matters and for litigation discussions.)
Member Class Action Lawsuit	$164 million class action lawsuit filed by PEC members.	Settled with $25 million in capital credits paid to members and $4 million to attorneys.

Source: Juan Garza personal interview, March 8, 2010.

Financial Benchmarks

Financial information on both U.S. rural electric borrowers and PEC is presented in exhibits 3 and 4. During the latest years available, the average REC in exhibit 3 had annual sales of $40 and $44 million, in 2007 and 2008, respectively. In contrast, for its latest two years PEC had annual sales of $546 and $578 million in 2008 and 2009, respectively. As can be seen, PEC was much larger than the average REC.

Exhibits 3 and 4 show the average REC's leverage (defined as total assets / total equity) was 2.49 and 2.53 in 2007 and 2008 respectively. For its latest two years, PEC's leverage equaled the much higher levels of 4.69 and 4.12 in 2008 and 2009, respectively. The average REC's return on equity (ROE) was 7.79% in 2007 and 6.98% in 2008. PEC earned 6.88% in 2008 and 18.91% in 2009. PEC's 2009 ROE performance was notably healthy.

However, in terms of electrical rates paid by members, PEC's rates were higher than that of the average REC. Exhibits 3 and 4, show that the average REC charged $0.0870/KWH and $0.0937/KWH in 2007 and 2008, respectively. PEC charged $0.1167/KWH and $0.1224/KWH in 2008 and 2009, respectively. Referring back to exhibit 1, 2008 information is presented regarding the largest investor owned, publicly owned, and cooperatively owned utilities. Among the fifteen other firms listed in exhibit 1, only four firms had a higher average retail electricity price than PEC's average price. Thus one can understand why PEC Board President Larry Landaker had reason to be concerned about the efficiency of PEC in terms of the rates it charges to members.

Garza Addresses TACC

On the morning of July 8, 2010, Juan Garza, addressed an assembly of cooperative managers from the Texas Agricultural Cooperative Council (TACC). Mr. Garza's recent experience as general manager of PEC had drawn the attention of cooperative managers as an example of restructuring a troubled cooperative. Furthermore, the cooperative council had been watching the case with some interest due to the potential political backlash challenging the cooperative business model. A crowd of more than ninety-five cooperative managers and professionals from the Texas Agricultural Cooperative Council (TACC) and professionals were in attendance.

Garza began with a brief recap of the events at PEC that led them to approach him regarding the position of General Manager. At that time of his recruitment to PEC, Garza was the General Manager of neighboring Austin Energy. Furthermore, he was being considered for the position of Austin's City Manager. Approached by then General Manager Fuelberg, he was intrigued by the PEC job, but apprehensive. According to Garza, he realized that a major factor leading to the problems at PEC was a lack of proper checks and balances.

Exhibit 3: Average Statistics for US Rural Electric Distribution Borrowers in 2007 and 2008.

Category	2007	2008
Income Statement		
Total Operating Revenue and Patronage Capital	$39,771,000	$43,775,000
Cost of Power	$26,745,000	$30,092,000
All other Costs and Expenses	$10,595,000	$11,375,000
Net Margins and Patronage Capital	$2,431,000	$2,308,000
Balance Sheet		
Total Assets	$77,899,000	$83,557,000
Total Liabilities	$46,676,000	$50,494,000
Total Equity	$31,223,000	$33,063,000
Operating Descriptors		
Number of Consumers	20,840	21,238
Megawatt Hour Sales	456,888	467,153
Distribution Miles	2,970	3,015
Summary Statistics		
MWH Sold / Consumers	21.92	22.00
MWH Sold / Distribution Mile	153.84	154.93
Customers' Gross Rate / KWH Sold [a]	$0.0870	$0.0937
(Net Margins and Patronage Capital) / KWH Sold [b]	$0.0053	$0.0049
Return on Assets[c]	3.12%	2.76%
Leverage [d]	2.49	2.53
Return on Equity [e]	7.79%	6.98%

Note: These statistics represent the averages of 587 and 582 different borrowers for the years 2007 and 2008, respectively.

[a] (Operating revenue and patronage capital) / total KWH sold
[b] Net income per KWH sold
[c] (Net margins and patronage capital) / total assets
[d] Total assets / equity
[e] (Net margins and patronage capital) / equity

Source: USDA, Rural Development, Utilities Program

Exhibit 4: Statistics for Pedernales Electric Cooperative, 2008 and 2009.

Category	2008	2009
Income Statement		
Total Operating Revenue and Patronage Capital	$546,353,212	$577,509,322
Cost of Power	$348,741,584	$327,940,525
All other Costs and Expenses	$180,738,158	$192,988,803
Net Margins and Patronage Capital	$16,873,470	$56,579,994
Balance Sheet		
Total Assets	$1,148,990,962	$1,235,186,908
Total Liabilities	$903,904,674	$935,971,455
Total Equity	$245,086,288	$299,215,453
Operating Descriptors		
Number of Consumers	227,890	232,753
Megawatt Hour Sales	4,679,864	4,717,713
Distribution Miles	16,503	16,770
Summary Statistics		
MWH Sold / Consumer	20.54	20.27
MWH Sold / Distribution Mile	283.58	281.32
Customers' Gross Rate / KWH Sold [a]	$0.1167	$0.1224
(Net Margins and Patronage Capital) / KWH Sold [b]	$0.0036	$0.0120
Return on Assets[c]	1.47%	4.58%
Leverage [d]	4.69	4.12
Return on Equity [e]	6.88%	18.91%

[a] (Operating revenue and patronage capital) / total KWH sold
[b] Net income per KWH sold
[c] (Net margins and patronage capital) / total assets
[d] Total assets / equity
[e] (Net margins and patronage capital) / equity
Source: PEC annual reports and ww.pec.coop

In his view, management was doing everything at PEC, which eventually led to a disgruntled membership, a class action lawsuit, and negative media attention.

Fuelberg informed Garza that the PEC board was preparing to appoint a new general manager, and inquired if he was interested in taking the position. Juan reflected that he could stay in his current position as general manager of Austin Energy, or continue to pursue the newly opened position of Austin's City Manager, or try this new opportunity. Being located in neighboring Austin, Garza had been exposed to many PEC employees and knew their quality to be very high. Following an all-day interview with the PEC Board, Garza accepted the job. As he stated, "I felt I would enjoy working with PEC and leading them to make needed changes".

Garza knew that his first job as PEC's new manager was to conduct an investigation into the allegations surrounding PEC. He stated that it was imperative that this was done by a third party reporting directly to the board and not to him. Originally, he planned that this could be accomplished for $500,000, but in the end, the constantly unraveling details cost more than $3,000,000 to investigate and document.

Next, he explained how he dealt with PEC's highly unfavorable news media coverage. He understood that the news industry thrived on the sensational; particularly news about people with something to hide. He concluded that abundant information would be like cholesterol. Consequently, he immediately provided the media access to information without any need for PEC employees to request his approval. Further, he opened board meetings to anyone, save for the discussion of highly sensitive or strategically important information including discussions of personnel matters, consultations with attorneys, certain competitive matters, and discussions of emergencies. To top it off, he provided Austin American-Statesman reporter Claudia Grisales with her own desk and computer inside PEC's headquarters. After these major steps, news media coverage quickly settled down.

Another burning issue facing Garza was the class action lawsuit against PEC. He felt that he would not be able to overcome current member and public perceptions until this issue was put to rest. Although lawyers suggested that the lawsuit was unlikely to prevail, Garza saw the potential for continued damage from bad press and therefore pushed for a settlement. The board did not support this idea, but the settlement went forward. $10,000 was awarded to the plaintiff, $4 million to lawyers, and $25 million to PEC members in the form of capital credit disbursements. The board agreed to this settlement. According to Garza, the news media "focused on the $4 million," a negative.

Garza also discussed problems with board governance. In particular, the PEC board had no checks and balances in place. Everything was being run by management. Therefore Garza changed policy to have the external auditor report directly to the board and he also initiated better processes for internal auditing as well. When he concluded his speech to TACC, it was obvious that Garza still held PEC and its employees in the highest regard.

Looking to the Future

Everyone in the audience clearly knew that PEC had been through a period of trauma. First, General Manager Fuelberg and Board President Burnett had run the cooperative in a secretive and authoritarian manner and the board had been lack in establishing oversight and controls. Next, repairing the damage had taken two and one-half years and cost additional millions. At this point the new PEC Board, headed by Chairman Landaker, faced the task of achieving a lower cost structure so as to provide competitive member electric rates. Much remained to be done at PEC.

Questions for Students

1. List all the things you can see that went wrong with the principal-agent relationship at PEC. (Note: Those who own businesses are referred to as principals. Those who are hired to run such businesses are referred to as agents.)
2. PEC's restructuring efforts have greatly increased the information provided to members and enabled more competition for board seats. What challenges could these changes bring to the cooperative? What should the board consider when selecting and working with the new manager?
3. What steps might PEC's board of directors and new management take to ensure that PEC is a successful cooperative in the future? Also, how would you measure this success?

Notes[a]

<u>Teaching Note for Rebuilding Cooperative Leadership: The Case of Pedernales Electric Cooperative</u>

This case can be used in a college agribusiness management class or a cooperative class. It is also well-suited for use in director training. To explain how the case might be used, this teaching note addresses the questions posed at the end of the

---

[a] Eisenhardt. K. "Agency Theory: An Assessment and Review." Acad. Mgmt. Rvw. 14 (Jan. 1989): 57-74.
USDA-RBCS. Cooperatives: What They Are and the Role of Members, Directors, Managers and Employees. RBS Cooperative Information Rpt. 11. June 2001. 30pp

case. Readers looking for additional information about PEC are urged to consult the cooperative's website at www.pec.coop.

Question #1: List all the things you can see that went wrong with the principal-agent relationship at PEC. (Note: Those who own businesses are referred to as principals. Those who are hired to run such businesses are referred to as agents.)

This question is ideally suited as an ice-breaker to initiate audience discussion and engagement with the case. Instructors can call for audience suggestions and make a list of problems on the board. Problems might be separated into different groups based upon whether the greatest responsibility lies with the cooperative's Board of Directors, its General Manager, and/or its membership.

Once a lengthy list of problems is created, the instructor can introduce the concept of the principal-agent problem. Namely, those who own business assets are referred to as principals. Due to practicality, principals often hire agents to manage their assets or run their businesses. In the case of PEC there are approximately 213,000 members who play the role of principals. Such large size reduces each individual member's share of assets and necessitates delegation to a board of directors and, in turn, to the hired management (Eisenhardt).

This particular principal-agent problem has developed over a long period of time. PEC began as a small REC in 1938. Initially, PEC was received enthusiastically by its members. For an extended period of time, the board and management appear to have gone unchallenged for possibly several reasons. First, PEC's members would have initially considered themselves lucky to even have electricity. Second, once electricity did begin to be taken for granted, this cooperative likely lacked the intense member scrutiny that routinely accompanies an agricultural cooperative. This differential level of attention would be due to the fact that an agricultural cooperative is usually responsible for a very large part of its farmer-members' sales and/or costs. Lastly, barriers to competitor entry are very large. This is due to both the prohibitive cost of constructing a competing electrical distribution network and the fact that Texas' electric deregulation did not apply to cooperatives. Hence PEC has not experienced the market tests that most agricultural cooperatives routinely endure.

Based on all of the above factors, PEC's members were asleep at the switch management as management and the board began to drift away from their mission. As the membership began to wake up to the abuses at hand, investigative reporting, and subsequently PEC's own investigations, brought many problems to light. Finally large and costly reforms came about.

Question #2: PEC's restructuring efforts have greatly increased the information provided to members and enabled more competition for board seats. What challenges could these changes bring to the cooperative?

What should the board consider when selecting and working with the new manager?

These questions highlight important issues on the proper balance of responsibility between the membership, management and board of directors in a cooperative. PEC must balance the member's right to information with the cooperative's legitimate needs to preserve confidential information from business competitors. The downside of a more accessible board election process is the possibility of greater turnover on the board. This will greatly increase the need for director education. PEC's must ensure that the directors understand the cooperative's complex operations and changing business environment. At this juncture in time, the board runs the danger of taking on too much responsibility for PEC's management. Exhibit TN-1 presents a table which categorizes the duties of a board of directors and the duties of management. PEC's directors need a general manager to whom they can and will delegate tremendous tactical responsibility. The exhibit emphasizes this fact by showing that the board is responsible for big-view, strategic matters and policies. On the other hand, the general manager must handle day-to-day decisions, which carry out the board's operational and organization policies. Achieving this synchronization with their new manager is of the utmost importance.

Question #3: What steps might PEC's board of directors and new management take to ensure that PEC is a successful cooperative in the future? Also, how would you measure this success?

Earlier in the case, PEC Chairman Larry Landaker is quoted as saying, "At our core, PEC exists for no reason other than to provide electric power to the owners - members - at the lowest price possible consistent with reliable and high quality service." Placing price and reliability as measures of success indicate that PEC has moved well beyond its numerous governance concerns and is now heading into a new direction.

This new direction poses great challenges. As one can see from exhibit 1, PEC's electric rates are relatively high. Also, debt (as measured by leverage) is relatively high as well. To climb out of this hole, detailed operational benchmarking targets will have to be identified and plans put in place to reach such benchmarks. For PEC's board to find a new general manager who has already demonstrated such a track record of achievement is criucial. Also important, given the political history, is that this new general manager have proven cooperative (and preferably REC) management experience.

Teaching Note References

Eisenhardt. K. “Agency Theory: An Assessment and Review.” Acad. Mgmt. Rvw. 14 (Jan. 1989): 57-74.

USDA-RBCS. Cooperatives: What They Are and the Role of Members, Directors, Managers and Employees. RBS Cooperative Information Rpt. 11. June 2001. 30pp.

Exhibit TN-1: Separation of duties, board of directors versus general manager

Board of Directors	General Manager
Have primary control	Has operational control
Strategic perspective	Tactical perspective
Develop operational and organizational policies	Follows operational and organization policies
Take control from manager	Advises board
Big view decisions	Day-to-day decisions
Provide direction	Acts in line with direction
Hire/fire manager	Hires/fires staff

Source: USDA-RBCS, p.20.

References

Editorial. “Secretive Dealings Hinder PEC Reform.” Austin American-Statesman. August 8, 2008. p. A-10.

Energy Information Administration. Electric Sales Revenue and Price. EIA-861. Table 6, Class of Ownership, Number of Consumers, Revenue, Sales and Average Retail Price by State and Utility: Residential Sector. www.eai.doe.gov/fuelelectric.html January 2010. (accessed May 2010).

Garza, J. “Commentary: Garza to the PEC Membership.” San Marcos Local News. June 21, 2002. www.newstreamz.com (Accessed on July 1, 2010)

Grisales, C. “Co-op’s Election Rules Under Fire.” Austin American-Statesman. August 4, 2007. p.A-1.

_______. “Family Long Held Sway Over Utility’s Business.” Austin American-Statesman. August 17, 2008. p. A-1.

_______. "Past Co-op Officials Got Nearly $1 Million From Failed Venture." Austin American-Statesman. October 23, 2008. p. B-1.

_______. "Pedernales Execs Plan to Step Down." Austin American-Statesman. November 14, 2007. p. A-1.

PEC. 2009 Annual Report. Johnson City: Pedernales Electric Cooperative. 19pp.

_______. 2008 Annual Report. Johnson City: Pedernales Electric Cooperative: 19pp.

_______. Facts and Figures. www.pec.coop (accessed August 3, 2010)

_______. PEC Appoints Luis Garza Interim General Manger. Press release. June 19, 2010.

_______. www.pec.coop/About/History.aspx (accessed December 2008).

Public Utility Reports. Electric Cooperatives, On the Threshold of a New Era. Vienna, VA: Public Utility Reports, Inc. 1996.

USDA, Rural Development, Electric Programs. Committed to the Future of Rural Communities. www.usda.gov/rus/electric/index.htm (accessed December, 15, 2008).

Landaker, L. "Guest Column: About the Garza Firing." San Marcos Local News. June 29, 2010. www.newstreamz.com (Accessed on July 1, 2010)

USDA, Rural Development, Utilities Programs. 2008 Statistical Report, Rural Electric Borrowers. Information Publication 201-1. December 2009.