Chapter 3
Decisionmaking and Operational Problems Under the Current Structure

As indicated in the previous chapter, DWP’s governance structure is complex, divided, and cumbersome. Many operational and management decisions must be reviewed sequentially by different city bodies, including the commission, the CAO and other mayoral staff, the city attorney’s office, and the city council and CLA. This structure was put in place deliberately to provide extensive checks and balances for a government department that had a monopoly on providing essential water and power services. Delays in making or implementing business decisions were of less concern and have had little adverse impact on DWP revenues or profitability during the monopoly era. That is changing as electricity restructuring moves forward in California and pressure builds to open the Los Angeles market to direct-access competition.

This chapter discusses some of the problems evident under the current governance structure that could seriously hamper DWP in a more competitive environment. They include

- a multilayer reporting structure for the general manager;
- constraints and delays in hiring managers, professionals, and skilled workers;
- constraints and delays in obtaining effective legal representation;
- cumbersome procurement and contracting procedures;
- constraints in negotiating customer contracts; and
- DWP financing of other city operations.
A Multilayer Reporting Structure for the DWP General Manager

While the charter states that the DWP general manager works under the “instruction of his or her board” of Water and Power Commissioners (Old Charter, 1997, Section 80(a)), he or she also reports to the mayor and council. In fact, the commission appears to have the weakest reporting relationship on such important matters as staffing, negotiating with customers, and resolving legal disputes. This complex and divided reporting structure severely limits the general manager and top-level DWP staff in their ability to make and implement operational decisions in a timely way. In sharp contrast, CEOs of IOUs, as well as some successful municipal utilities (described in Chapter 4), report to a single strong governing board.

Recruiting and retaining an experienced general manager is difficult today for any municipal utility because of the much larger salaries, stock options, and other incentives offered by private firms. Recruiting at DWP faces the additional burden of the multilayer reporting arrangement for the general manager. As DWP’s current general manager, S. David Freeman, puts it: “Everybody’s in charge and nobody’s in charge. I don’t have a Board of Directors . . . I have two Boards and a Mayor. And sometimes there’re differences of opinions among them.” (Metro, 1998; Freeman, 1998.)

Hiring and Other Personnel Problems

Hiring at DWP is complicated by the fact that nearly all the department’s more than 7,200 employees fall under the city’s civil service system. This means prospective employees generally must pass a civil service exam before they can be hired—a procedure that can add weeks or months to the hiring process. Such delays are especially painful when trying to hire technically skilled workers, who are in great demand from other employers and often will not wait to qualify under the city’s civil service rules. In our interviews, we heard that these problems had arisen in DWP’s efforts to hire skilled workers for the Valley Steam Plant, as well as staff for information technology and marketing positions. In contrast, we were told, other utilities that are
subject to union agreements but not civil service rules can hire people with similar skills within a few weeks.

Management and professional staff hiring at DWP is also hampered by the relatively low salaries and rigid job categories that the civil service system applies to all city departments. DWP is highly constrained in its ability to promote or offer financial incentives to superior performers or to demote or dismiss poor performers. In a dynamic economy, such civil service constraints outweigh the benefits of job protection for those with salable skills.

Only 15 DWP positions (in addition to the general manager and the chief financial officer) are exempt from civil service rules. Filling these positions is today a two-step process. First, the council must pass a resolution by two-thirds vote, “which sets forth the educational experience and other professional requirements of the position(s),” as well as “the circumstances . . . that preclude filling the position(s) through the civil service system.” (Old Charter, 1997, Section 111.) Once a candidate has been selected, he or she must be formally approved by both the mayor and council. This process can take several months or longer. As a consequence, DWP often finds itself unable to compete effectively in hiring top-flight managers and professionals with experience in the electric utility business.

The new charter simplifies the approval process by replacing the council resolution with a recommendation by the mayor proposing the qualifications for the exempt position. If the council does not veto the recommendation by two-thirds vote within 10 council meeting days, it is deemed approved (New Charter, 1999, Section 1001). While this should shorten the time involved, it does not change the basic requirement for both mayor and council approval of every DWP exempt position.

**Constraints and Delays in Obtaining Effective Legal Representation**

As described in Chapter 2, DWP’s legal matters are handled by the city attorney’s office. The department cannot hire or choose its own
legal staff, except in special circumstances approved in writing by the city attorney and the council.

While the city lawyers assigned to DWP can and do handle routine department matters effectively, they often do not have the expertise to deal with the growing number of complex energy and environmental issues. According to those we interviewed, obtaining the necessary approvals to hire outside counsel takes several weeks at best, which can seriously impede the department in negotiations or other time-sensitive legal matters. Moreover, the city lawyers assigned to DWP report to, and owe their allegiance to, the city attorney. DWP management cannot replace or reassign them if it does not like their work. City attorney staff are thus not as responsive to DWP priorities and urgency (e.g., working at night to finish a contract or filing) as attorneys working directly for the department or in private practice would be. And in some cases, the views of the city attorney, an elected official who represents the city as a whole, may be at variance with DWP’s views.

Two legal issues that illustrate these problems, cited by DWP General Manager David Freeman, involve disputes with Owens Valley over air quality and with Montana Power over an energy supply contract. After becoming general manager late in 1997, Mr. Freeman sought to settle the long-standing Owens Valley conflict, contrary to the position then held by the city attorney staff representing the department. A settlement was reached in July 1998 after DWP received permission to hire outside counsel with expertise in air quality issues. The Montana Power dispute also required specific expertise, which the city attorney staff lacked. According to department sources, Montana Power’s lawyers “did not take us seriously” until DWP brought in outside counsel. In both cases, obtaining permission took several months and required the personal intervention of the general manager.

**Cumbersome Procurement and Contracting Procedures**

Like all city departments, DWP must abide by complex procurement and contracting practices designed with many checks and balances to minimize abuses and serve other public objectives. For good
political reasons, procurement is generally slower, less flexible, and more expensive in the public than in the private sector. However, DWP purchases more goods and services than other departments do, so its burden arising from operating under city procurement regulations is commensurately greater. While this burden has not been critical in a monopoly environment, it will hinder DWP’s ability to compete with more-agile for-profit firms. Primary concerns include the cost and delay built into current contracting procedures, and the demands on suppliers over and above those required by other utilities.

A standard DWP procurement for less than $150,000 goes through the following steps:

- Requisition by a DWP unit.
- Preparation of a bidding document.
- Formal request for bids sent out (and advertised if the requisition is for more than $25,000).
- Responses to questions from potential bidders.
- Opening, recording, and posting of bids.
- Technical evaluation by requesting unit.
- Nontechnical evaluation by Procurement Department.
- Recommendation for award by Procurement Department.
- Award decision by DWP management if under $150,000.
- Notification of the successful bidder.
- Contract drafting and signing.

Procurement in the for-profit world goes through similar steps, but the process is much less formal and more flexible than at DWP. Firms, for example, usually negotiate with prospective suppliers for better prices and terms, but under city contracting procedures, DWP cannot negotiate and must award the contract to the “lowest and best regular responsible bidder.” (DWP, 1999a.)

For amounts above $150,000, the process becomes even more complex. All DWP purchases above $150,000 must be formally approved by the Water and Power Commission. In effect this means they must also be approved by the mayor’s staff (in order to go on the commission agenda, per ED39) and by the council (through the Prop. S process). Between 200 and 300 DWP procurements each year go
through this extended review process, and the commission must con-
sider an average of about a dozen contract awards at each of its meet-
ings.

This multilayered approval process costs both the department and
the commission considerable time and money. The requesting DWP
unit must write a formal letter recommending and justifying the pro-
curement. Increased time is allotted for advertising, bidding, and eval-
uation. The DWP Procurement Department must then prepare a well-
documented contract-justification package for approval by the
commission (and possible review by the mayor and council). The item
must be placed on the agenda of a regular commission meeting, which
occurs every two weeks. After commission approval, DWP must wait
eight council meeting days to see whether the council will take up the
item under Prop. 5. Overall, assuming no further Prop. 5 review, DWP
staff estimates that it takes 90–120 days to award a contract of more
than $150,000, about twice the time it takes to award a smaller one.
The actual dollar costs are difficult to document, but, based on DWP
staff accounts of the added time to prepare a commission procurement
package and manage the process, we estimate that the additional cost
to DWP runs $2 million to $3 million a year.

Another constraint arises from an ordinance requiring that once
the DWP annual budget is passed by the council, any transfers among
internal budget accounts greater than $35,000 (or 1 percent of the ac-
count, up to a maximum of $100,000) must be individually approved
in writing by the mayor. The city also places a number of compliance
requirements on DWP contractors. Before receiving an award, DWP
contractors must obtain a City of Los Angeles Business Tax Registra-
tion Certificate and certify compliance with (among others) affirmative
action and equal opportunity programs, the Los Angeles Child Support
Obligations Ordinance, the Los Angeles Living Wage Ordinance, and
the Los Angeles Service Contract Worker Retention Ordinance. Sup-
pliers to corporations, including potential competitors of DWP, gen-
erally do not have to comply with these city requirements.
Constraints in Negotiating Customer Contracts

DWP's industrial and commercial customers are the most likely to respond to competitive offerings, because their average rates now are higher than those offered by SCE in surrounding areas. However, customer surveys repeatedly find that power reliability is even more important than price for most businesses and that DWP retains its superior reputation for reliability. DWP still must remain price competitive and be able to respond quickly to competitors’ efforts to woo customers away.

Until recently, the department’s ability to negotiate with customers was constrained by the need for council approval of every such arrangement. Consequently, at DWP’s request, the council passed an ordinance giving DWP authority to offer discounts of up to 5 percent to customers who sign long-term contracts for up to 10 years. DWP recently announced that 22 large customers—including the Los Angeles Unified School District, McDonald’s Corporation, Robinsons May, Kaiser Foundation Health Plan, Anheuser-Busch, and the Getty Center—have signed such long-term contracts (DWP, 1999c).

Many at DWP, and especially the general manager, believe that when competition comes to Los Angeles, the department will need considerably more flexibility to negotiate with customers than the council ordinance now provides. In their view, the currently permitted contract terms are too restrictive for DWP to meet competition as it may develop. Under a number of competitive scenarios, DWP would lose revenue from business customers, which would put strong pressure on the mayor and council to either reduce DWP payments to the city or raise residential electric rates or do both.

DWP Financing of Other City Operations

Beyond transferring 5 percent of gross operating revenue to the city general fund, DWP subsidizes street lighting and the energy needs of other city departments. It also subsidizes a variety of city services and operations. These costs, which translate to higher electricity rates, may not be fully sustainable under competition.
City use of DWP-owned real estate at below-market price represents one important category of subsidy. Like other large utilities, DWP owns hundreds of valuable real estate parcels, both developed and undeveloped, which it has purchased with its own revenues. Some of the land and buildings owned by DWP are no longer needed for the department’s business. An investor-owned utility would lease, sell, or otherwise dispose of such surplus real estate and invest the proceeds in more directly productive uses. At present, however, DWP must offer its surplus properties for other city uses before they can be sold or leased. Either under formal resolution or informal guidance from the council, many such parcels are claimed by other city departments at significantly less than market rates—sometimes for leases of $1 per year. One such example is DWP’s lease of some 62 acres in Chatsworth at $1 per year to the Los Angeles Police Department for use as a firing range. In total, nearly half of the 39 DWP properties listed as surplus in May 1999 have been requested for other city uses (DWP, 1999b). Such transfers save money that would otherwise come from city taxes, but they also represent millions of dollars each year in added costs to DWP and its ratepayers.

DWP’s large cash flow also makes it an easy resource for elected officials to tap for funds for budget balancing and other purposes. In the fiscally constrained environment since passage of Proposition 13 by California voters, the department has been asked on a number of occasions to make “supplemental transfers” to the city from sales of assets such as fuel oil or land (McCarley, 1996). Other DWP contributions range from paying for colorful promotional street banners to subsidizing city-sponsored dinners and other events. Although these subsidies benefit the city, they also constitute an added (and hidden) tax on ratepayers and an added burden on DWP in a competitive electricity market.

**Overall Problems of Governance for DWP Competitiveness**

Each problem described above stems from or is exacerbated by DWP’s complex structure of governance. Together, problems can in-
teract to add cost and extend the time required to make decisions or carry out normal business processes. For example, hiring a new marketing manager to one of DWP’s 16 exempt positions requires a council resolution and then mayor and council approval of the person selected. If the position is not exempt, the individual must be hired within an established civil service job category and pass a standard civil service examination. The process can easily take several months, which makes it very difficult for DWP to recruit from outside. As a consequence, DWP’s marketers are mostly longtime engineering staff with little or no marketing training or experience in competitive industries.

As another illustration, negotiating a new customer contract must stay within the limits set by council ordinance. Drafting it may take a good deal longer than it does for other utilities, because the DWP does not control its own legal staff. Changes from the standard contract format may need approval from the commission, the council, and the mayor (under ED39), which can take weeks or months. While such delays might not be a major concern to a monopoly, they can make the difference between winning and losing a customer in a competitive market.

Perhaps even more important, the general manager and other DWP managers spend most of their working time negotiating approvals within the current divided governance system. As David Freeman describes his experience, “It’s hard to understand how inhibiting to entrepreneurship and enterprise this governance system is. It takes forever to get permission to do almost anything.” (Metro, 1998.) Unlike for-profit firms, where managers increasingly look outward to customers and competitors, DWP management primarily focuses inward to the commission, the staffs of the mayor and council, and other city officials.