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September 29, 2011

Mr. Norman Gordon
Mounce, Green, Myers, Safi, Paxson & Galatzan
P. O. Box 1977
El Paso, Texas 79950-1977

Mr. Charlie McNabb, City Attorney
Office of the City Attorney
2 Civic Center Plaza, 9th Floor
El Paso, Texas 79901

Re: El Paso Electric Company Rate Review

Gentlemen:

During its September 13, 2011 meeting, the City Council announced its intent to issue a show cause ordinance to review El Paso Electric Company's (EPE or the Company) rates and to set a date for considering temporary rates. By this letter, EPE requests assurance from the City that the City and its representatives will cease employing unlawful, irregular, and unbalanced procedures in reviewing EPE's rates. Item 1 below summarizes EPE's concerns and puts them in context. Items 2 through 4 describe the concerns in more detail. Item 5 discusses two alternative processes that would address the Company's concerns.

1. The Role of the City In Utility Ratemaking

The City's regulatory authority powers are governed by mandatory procedures and criteria designed to ensure the integrity of the rate review process, including the protection of EPE's rights. The City has determined it is now acting as a regulatory authority under the Public Utility Regulatory Act (PURA). Accordingly, the City must comply with the duties and

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expectations of a regulatory tribunal. But on this point the City has fallen short and severely disadvantaged and prejudiced EPE.

The City Attorney has advised EPE that the Company cannot meet with or talk to the Mayor or Council members pending resolution of this rate matter; and that such communications would violate policies or ordinances of the City prohibiting *ex parte* contacts and off-the-record communications with decision-makers in electric utility rate matters. These admonishments would be consistent with a view that, like the Public Utility Commission of Texas (PUCT) and the State Office of Administrative Hearings (SOAH), the City is administering an adjudicatory process and sitting as a regulatory tribunal when exercising its regulatory authority to consider electric rates. In such a tribunal process, decision-makers must avoid the appearance of bias and conflicts of interest; the deliberations and decisions of the regulatory authority concerning basic fact and policy matters must be entirely open and must take place in a public meeting; and private, off-the-record communications between the members of the tribunal and advocates, of whatever interests and employ, violate fundamental notions of procedural due process. In short, because the City has invoked principles applicable to a regulatory tribunal to deny EPE the rights it would otherwise enjoy in a legislative process, the City cannot selectively or inconsistently apply these principles to prejudice and disadvantage EPE alone. No one should be denied basic rights because of an unprincipled and selective application of procedural safeguards, and private, unknown and off-the-record communications between advocates and a tribunal are fundamentally unfair.

With this background, EPE vehemently objects to the troubling lack of even-handedness and the clear bias that have marked the Council's actions in this matter. Advocates opposing EPE meet privately with Council members and explain what actions the City acting as a regulatory tribunal should take respecting EPE rates. Neither EPE nor the public know what is said, or by whom, in these meetings, and there is no record of what information is exchanged. Meanwhile, EPE is denied access to the Mayor and Council and can communicate with the regulatory tribunal only through the filter of the City's attorney advocate, Norman Gordon. In addition, Council member Niland purportedly develops her own off-the-record "analysis" of

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rates using information not provided to EPE, prejudices the issues and launches a grass roots campaign against EPE on Facebook. Several members of the tribunal make it clear in open meetings that the tribunal is just deferring to the recommendations of Mr. Gordon, who at the direction of the City, explains those recommendations behind closed doors in sessions from which both the public and EPE are excluded.

In short, there is not even the most remote appearance of due process: political positions of some members of the regulatory tribunal are already staked out before a hearing is had or evidence taken; conflicts of interests taint the proceedings; and the minds of the decision-makers are irrevocably closed, having been influenced by off-the-record communications by advocates and other special interests. Because of these procedural irregularities, it seems apparent that any opportunity for EPE to be heard or to participate in a hearing before the City at this point in the process would be illusory and, frankly, altogether pointless. However, while it is too late for Council to remove the taint of what has occurred, EPE urges the City to cease the unlawful, irregular and unbalanced process going forward.

2. Bias

EPE is alarmed at the lack of objectivity and the tactics undertaken to sway public sentiment before even a page of evidence has been taken. On September 11, 2011, Council member Niland posted the following call to arms on her Facebook page: "We must advocate to get rates competitive with peer cities. Send an email to the PUC if you support this cause." In an interview with KFOX14 News on September 12, Ms. Niland disparaged EPE by claiming that EPE had been "gouging" the community. On September 13, Council member Niland told News Channel 9, "I have done a preliminary investigation into the fact that I believe that El Paso Electric is over-charging therefore over-earning and we need to make sure our city can be economically competitive. . . . [W]e're looking now and there are a lot of cases where they are over charging and over earning."

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A press report¹ recounts that Ms. Niland has compiled an 85-page report titled “Analysis of El Paso Electric Co. 2010 Rate Change.” She identified it as “a compilation of material I studied.” However, El Paso Inc. reported that this report actually stated “Comments by Jobe Materials, LP regarding the effect of El Paso Electric Co. 2010 Rate Change.” In advance of the Council’s September 13 meeting, Ms. Niland distributed the report “to city executives, council members and others” — but not to EPE, although EPE did manage to obtain a copy of the report on the morning of Council’s September 13 meeting. Ms. Niland apparently relied on the study and appears to have encouraged others to do so. A review of the referenced Jobe Materials study obtained by EPE shows that it included 3 pages of analysis including the impact of a power factor adjustment on Jobe Materials, and 82 pages of extraneous materials mostly from EPE’s tariff manual. This “report” is biased and does not explain that the power factor charges that Jobe Materials incurred were due to its inferior power factor, and that, without the power factor adjustment, Jobe’s operation would be supported by other customers on account of the inferior power factor. Moreover, according to a Campaign Finance Report filed with the City Clerk on May 5, 2011, Ms. Niland received a \$1,000 campaign contribution from Stanley P. Jobe on May 4, 2011.

Those familiar with fundamental regulatory principles know that allowing decision-makers to perform a dual investigative and adjudicative role in the same matter is problematic; and this is especially so if the dual roles create the risk that decisions might be based on evidence outside the record. See *American Cyanamid Co. v. Federal Trade Commission*, 363 F.2d 757 (6th Cir. 1966). At the Council meeting on September 13, Ms. Niland read prepared remarks indicating, among much else, that she believed EPE was overearning by 200 basis points. There was no explanation of the analysis and no written record memorializing the analysis behind it, other than the 85-page “report.” An important conclusion such as this should **follow** a hearing and evidence, not far precede them.

¹ See the September 12, 2011 edition of “El Paso Inc.” available at http://www.elpasoinc.com/news/local_news/article_b45fcde6-dd95-11e0-81b1-0019bb30f31a.html.

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In her September 15, 2011 electronic newsletter to constituents, Council member Niland falsely accused EPE of “over charging the ratepayer” even though the rates charged by EPE are legal and authorized by the appropriate regulatory body. In fact, they were arrived at after negotiations in which the City, represented by Mr. Gordon, was a full and active participant.

Council member Niland’s September 19, 2011 electronic newsletter to constituents not only issued another call to arms but also flatly stated her predetermined vote, although there has been no hearing and no evidence has been taken:

“The City Council meeting to be held on October 4, 2011 will be the meeting in which we formally start the process of having El Paso Electric file a rate case. We the regulatory body, City Council, can set temporary rates to provide relief to all customer classes. If you support this initiative and would like to help, please reach out to the District 8 office or send complaints to the Public Utility Commission of Texas.

<http://www.puc.state.tx.us/>

email: customer@puc.state.tx.us

or call 888-782-8477.”

At the Council meeting on September 13, several Council members recognized Ms. Niland for her efforts and others made it clear they were following the lead they had received from Mr. Gordon.

3. Open Meetings Requirements

Having decided to sit as a regulatory tribunal, Council members must be fair and impartial in all respects, conducting proceedings in the same unbiased manner as the officers of the PUCT and SOAH conduct their rate hearings. Like the procedures followed by the PUCT and SOAH, the deliberations of Council must be entirely open and in public; communications to Council members regarding EPE’s rates by attorneys with advocacy responsibilities before the regulatory tribunal must be made in open meeting, in the presence of EPE’s representatives and the public, and only after reasonable, prior notice is provided to EPE. All data and evidence in the possession of Council regarding this rate review must be shared with EPE and other parties, if any.

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The agenda for the Council's September 13, 2011 meeting listed the EPE matter as part of the regular agenda. Yet when the matter came up, the Council immediately moved it to executive session, behind closed doors, taking Mr. Gordon with them. When the Council re-emerged, Mr. Gordon recommended what the Council should do. The meeting minutes show that the Council approved "the recommendations presented by" Mr. Gordon. It was clear, however, that Mr. Gordon had already given a presentation and made his recommendations to the Council behind closed doors.

The Texas Open Meetings Act requires every meeting of a governmental body to be open to the public, with certain narrowly-drawn exceptions. One exception is where the governmental body consults with its attorney in private to seek *legal* advice about pending or contemplated litigation or a settlement offer. Thus, a governmental body may hold an executive session to hear its attorney's advice, but only the attorney's *legal* advice or advice about a specific pending or contemplated legal proceeding — not the attorney's advocacy of the merits of a particular position in a proceeding that does not yet exist. For example, in executive session a city council may seek the attorney's advice on the legal issues raised by a proposed contract. But the council may not use the closed session to shield discussion of the merits of the contract or other non-legal matters merely because its attorney is present. Moreover, the governmental body may not discuss policy issues unrelated to legal questions.

What EPE objects to and is harmed by are closed Council meetings with an opposing attorney, who is playing dual advocacy and advisory roles, discussing what the Council should do in matters over which the Council will also be the ultimate decision-maker in a tribunal, as opposed to a legislative, process — *e.g.*, whether, as a regulatory authority, the Council *should* institute temporary rates or *should* launch a rate review. These are clearly questions of public policy and fact, not legal questions. The Council's deliberations on these issues must be done openly. The Open Meetings Act was intended to require governmental bodies to publicly discuss such matters rather than decide them in a meeting behind closed doors. Texas law does not shield such a discussion.

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The problem here is greatly aggravated by the fact that the City has apparently employed Mr. Gordon in two separate capacities: as both an advisor to the City and an advocate in opposition to EPE before the City as a regulatory tribunal. The situation is like that of a judge who employs an attorney who (1) in closed quarters, advises the judge about cases, but (2) in open court, acts as an advocate on behalf of one party, arguing to the judge the merits of those very same cases. In that situation, the opposing parties would be at a huge disadvantage. Granted, they would be on an equal footing with the judge's attorney in open court, with the opportunity to be heard and to respond. Yet they would be clueless and voiceless when the attorney meets with the judge behind closed doors. This is an enduring issue, one that repeats itself, and which should be corrected by the City's employing Mr. Gordon strictly as an advisor to the City and not acting additionally as the City's litigator and advocate in opposition to EPE. As a court has ruled, "the assignment of a single assistant attorney general to perform such a dual role [as both prosecutor and counselor to the tribunal] would impair at least the appearance of fairness of the tribunal." *Hladys v. Commonwealth of Virginia*, 366 S.E.2d 98, 100 (Va. 1988).

4. Attorney/Council Communications

The City Attorney has been adamant that communications outside open meetings between EPE and Council members and the Mayor are prohibited. In addition, the City Attorney has maintained that EPE may not communicate about EPE's rates with anyone on the city staff other than the City Manager, the City Manager's designee, Mr. Gordon, and the City Attorney. On the other hand, the City Attorney and Mr. Gordon, who (i) are advocates for lower rates on behalf of City management, contrary to the interests and legal position of EPE, and (ii) represent the City against the Company (witness Mr. Gordon's September 13, 2011 recommendations to proceed with the rate case), retain the unfettered right to privately communicate with and have full access to the Mayor and City Council. This situation results in the Mayor and Council receiving their information about EPE from intermediaries with a direct conflict of interest against EPE, and in violation of the very same prohibition on *ex parte* communications that the City applies to EPE.

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Mr. Gordon is an experienced attorney, but it is well known that EPE and most utilities in the State would strongly disagree with the rate and regulatory policy positions he advocates. The City should not expect or require Mr. Gordon to be both a litigator and confidential advisor regarding legal matters. It should be noted, moreover, that if the City views rate-setting as an adjudicative and not a legislative process, then the City must be even-handed in its approach; in addition, if this is an adjudicatory proceeding, as the City appears to contend, the City should not expect attorneys playing the role of advocates in the proceeding to consult with the Mayor or Council members behind closed doors, unless there is notice and an opportunity for all interested parties to attend the meetings in question. See Tex. Comm. on Prof'l Ethics, Op. 587 (2009) and Op. 604 (2011).

The City has decided to classify rate reviews as adjudicatory proceedings to which *ex parte* communication prohibitions apply to EPE. EPE urges that the City apply this policy uniformly to all parties (including the attorneys who advocate before the City in this and similar types of proceedings) so that all parties are bound by the same rules and are not unfairly prejudiced or disadvantaged. To do otherwise violates EPE's due process rights by applying *ex parte* prohibitions discriminately to prevent access to select parties while allowing unfettered access to opposing parties. The City has already used Mr. Gordon as its legal advisor. As a result, the City should seek to employ separate legal counsel to represent the City as an advocate.

5. Alternative Processes

Finally, pursuant to the direction the City Council gave to City staff, EPE suggests an alternative to the expensive and problematic show cause process; namely, that EPE instead freeze base rates by agreeing that it will not file a rate case before May 1, 2013. This means base rates will be frozen for almost three and a half years, from July 1, 2010 until late 2013, even though the Company will have invested \$600 to \$700 million in infrastructure improvements to serve its customers during that period. By making this commitment in light of EPE's analysis that it could support a rate increase now, EPE not only delays its ability to earn a return on recently completed projects, including a multi-million dollar investment in a power plant that

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will lower the fuel bills of our customers below what they would otherwise be, but the Company also reduces unnecessary rate case expenses. Even though EPE believes it can (and will if required) justify a rate increase at this time, if accepted this alternative process would permit the Company to do what it prefers to do: defer the filing of a rate case due to the current economic situation in the country and the significant expense of a rate case, which would place an additional burden on the Company's customers during a tough economic time. If, however, the Company is drawn into a rate case by the City, the Company will seek a rate increase that could result in a duplication of costs due to the expected need to file a rate case in 2013 to reflect EPE's next generation plant addition in rate base.

In the alternative, should the City decline the Company's suggestion of a base rate freeze in favor of a rate proceeding, the Company urges the City to work with the Company to establish a process going forward that will satisfy the legitimate due process concerns of all parties, while preserving the rights of parties to obtain a speedy and final determination of rates without unnecessary regulatory lag. Such a process could also minimize rate case expenses, customer confusion, and regulatory uncertainty. With these concerns in mind, the Company proposes that the Company commit to file a rate case with the PUCT and all local regulatory authorities in Texas no later than 120 days from October 4, 2011, which is February 1, 2011. The City would, for its part, drop its show cause action and expeditiously deny the Company's February 1, 2011 rate request without a hearing. This process will prevent duplicative rate case expenses at the City and thereafter at the PUCT, and also allow all parties to resolve their rate dispute in a forum where the due process rights of all participants are well defined and well known. A process similar to this has been followed by most other cities in Texas, including the City of Houston.

6. Conclusion

In conclusion, this proceeding is important not only to EPE but also the community at large. The process must be fair and impartial; however, the City's previous actions outlined in this letter have not complied with this requirement. Therefore, EPE urges the City to respond to this letter, in writing, by providing assurances for each of EPE's concerns outlined above,

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detailing how the City intends to remedy the procedural irregularities that have thus far tainted the proceeding, and responding to EPE's suggested alternative processes.

Sincerely,

/s/ Casey Wren

Casey Wren
Attorney for
El Paso Electric Company

cc: The Honorable John F. Cook, Mayor
City Representative Ann Morgan Lilly
City Representative Susie Byrd
City Representative Emma Acosta
City Representative Carl L. Robinson
City Representative Dr. Michiel Noe
City Representative Eddie Holguin Jr.
City Representative Steve Ortega
City Representative Cortney Niland
Ms. Joyce A. Wilson, City Manager
Mr. David Stevens
Mr. Steven L. Hughes