

Date of Hearing: April 10, 2019

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Cecilia Aguiar-Curry, Chair

AB 689 (McCarty) – As Amended March 21, 2019

SUBJECT: Municipal Utility District Act: nonstock security.

SUMMARY: Allows specified municipal utility districts to acquire nonstock security in private entities. Specifically, **this bill**:

- 1) Allows a municipal utility district (MUD) meeting the requirements of 2), below, to take by grant, purchase, gift, devise, lease, or otherwise acquire and hold nonstock security in a corporation or other private entity.
- 2) Allows the board of such district to sell or otherwise dispose of the nonstock security when, in its judgment, it is in the best interests of the district to do so.
- 3) Applies the provisions of this bill only to a district that has owned and operated an electrical distribution system or electrical generating facility for at least eight years and that contains a population of 250,000 or more persons.
- 4) Defines “security” to have the same meaning as defined in section 25019 of the Corporations Code.

EXISTING LAW:

- 1) Provides, pursuant to the California Constitution, that the Legislature shall not have power to authorize the state, or any political subdivision thereof, to subscribe for stock, or to become a stockholder in any corporation whatever. Provides limited exceptions for: irrigation districts for narrow purposes; and, counties, cities and other political corporations or subdivisions of the state who join together for the payment of workers’ compensation, unemployment compensation, tort liability, or public liability via an insurance pooling arrangement, as specified.
- 2) Prohibits, pursuant to Government Code Section 1090 (Section 1090), members of the Legislature and state, county, district, judicial district, and city officers or employees from being financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.
- 3) Prohibits, pursuant to the Political Reform Act (PRA), a public official from making, participating in making, or in any way attempting to use his or her official position to influence a governmental decision in which the official knows or has reason to know that he or she has a financial interest.
- 4) Provides that the common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or laws of this state, is the rule of decision in all the courts of this state.

- 5) Defines, pursuant to in section 25019 of the Corporations Code, “security” to mean any note; stock; treasury stock; membership in an incorporated or unincorporated association; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; viatical settlement contract or a fractionalized or pooled interest therein; life settlement contract or a fractionalized or pooled interest therein; voting trust certificate; certificate of deposit for a security; interest in a limited liability company and any class or series of those interests (including any fractional or other interest in that interest), except a membership interest in a limited liability company in which the person claiming this exception can prove that all of the members are actively engaged in the management of the limited liability company; provided that evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company; certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under that title or lease; put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof); or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; any beneficial interest or other security issued in connection with a funded employees’ pension, profit sharing, stock bonus, or similar benefit plan; or, in general, any interest or instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. All of the foregoing are securities whether or not evidenced by a written document. “Security” does not include: (1) any beneficial interest in any voluntary inter vivos trust which is not created for the purpose of carrying on any business or solely for the purpose of voting, or (2) any beneficial interest in any testamentary trust, or (3) any insurance or endowment policy or annuity contract under which an insurance company admitted in this state promises to pay a sum of money (whether or not based upon the investment performance of a segregated fund) either in a lump sum or periodically for life or some other specified period, or (4) any franchise subject to registration under the Franchise Investment Law (Division 5 (commencing with Section 31000)), or exempted from registration by Section 31100 or 31101.
- 6) Authorizes, pursuant to the Municipal Utility District Act (MUD Act), the formation of a MUD and authorizes a MUD to acquire, construct, own, operate, control, or use works for supplying the inhabitants of the district and public agencies with light, water, power, heat, transportation, telephone service, or other means of communication, or means for the collection, treatment, or disposition of garbage, sewage, or refuse matter.

FISCAL EFFECT: None

COMMENTS:

- 1) **Bill Summary.** This bill allows a MUD to take by grant, purchase, gift, devise, lease, or otherwise acquire and hold nonstock security in a corporation or other private entity, and allows the board of such district to sell or otherwise dispose of the nonstock security when, in its judgment, it is in the best interests of the district to do so.

This bill applies only to a MUD that has owned and operated an electrical distribution system or electrical generating facility for at least eight years and that contains a population of 250,000 or more persons.

This bill is sponsored by the Sacramento Municipal Utility District (SMUD).

- 2) **Author's Statement.** According to the author, “AB 689 would allow SMUD the opportunity to realize a return on its investment in the products and services that SMUD helps to develop. This has the dual benefit of lower(ing) rate increases for ratepayers and pushing forward green technologies.”
- 3) **Background.** According to SMUD, the district “recently adopted one of the most aggressive integrated resource plans (IRP) in the country that puts SMUD on the path to net-zero carbon emissions by 2040. In order to meet the net-zero goal, as well as the state’s clean energy goals, substantial investment will be needed in new technologies, grid modernization, energy resources, customer sited solutions, electric transportation, and related initiatives.

“SMUD expects to spend \$6 billion between 2020 and 2040 to meet our IRP carbon reduction goals, which will result in rate increases over the next several years to cover the needed new investments. New technological advances will be imperative to reaching our aggressive goals. Accordingly, the time is ripe to ensure that we can recoup the intellectual property and support SMUD brings when we partner with private sector companies to develop these needed technologies. Monetization of SMUD’s intellectual value through security interest in these companies is a prudent way SMUD can help offset some of that \$6 billion cost, bringing direct value back to our customers.”

SMUD reports that, for many years, it has worked with private companies via contractual arrangements to help develop new energy products, services, and programs – such as rooftop solar, energy storage, or data analytics – that assist SMUD in meeting its clean energy mandates under state law and its IRP goals. SMUD asserts these contractual arrangements have typically included either direct payment to SMUD for its trade secrets, intellectual property and other resources, and/or royalty agreements. When these companies take their products into the marketplace, they extract value from SMUD’s contributions. SMUD argues that direct payments and/or royalties can impose limitations on the potential return SMUD could realize, or can sometimes be impractical or infeasible, depending on a company’s commercialization strategy.

For example, SMUD reports that it provided a company with market research and product development expertise for a software product that helps customers determine the financial viability of rooftop solar. The software now includes a similar evaluation for an electric vehicle purchase and energy storage installation. In addition, “years ago, SMUD invested time and resources with a small company to develop a new software product that analyzes meter data to compare customer usage. If SMUD had held a security interest in that company, our customers would have recouped a substantial return for our time and intellectual property when that company sold for millions.”

SMUD argues that allowing it to hold nonstock security will result in no additional risk to SMUD’s investments or ratepayer dollars. “Through an optional nonstock security, SMUD would not be required to provide any upfront cash payment for the equity and would not have

to spend money to exercise the equity. SMUD would only receive the economic benefits if the partnering company succeeds but would not suffer any losses if the company does not succeed.”

- 4) **California’s Conflict-of-Interest Laws.** Two conflict-of-interest laws specifically govern the allowable conduct of government officials when they act in their official capacity: Section 1090, and the PRA. Section 1090 generally prohibits public officials or employees from having a financial interest in any contract made by them in their official capacity, or by any body or board of which they are members. Contracts that are made in violation of Section 1090 can be voided by any party to the contract except the officer interested in the contract. The PRA prohibits any state or local public official from using his or her official position to influence any governmental decision in which the official has a financial interest, or that will have a material financial effect on a member of the official's immediate family.

In addition to Section 1090 and the PRA, the common law doctrine also governs conflicts of interests. The common law doctrine, codified in the Civil Code, provides that the common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or laws of this state, is the rule of decision in all the courts of this State. The common law includes a prohibition against self-dealing.

- 5) **Policy Considerations.** The Committee may wish to consider the following issues:
- a) **Potential Conflicts of Interest.** California has robust conflict of interest laws governing that generally target the potential misuse of power by a government official for that particular official’s personal financial gain. While this bill does not appear to violate these particular laws, a question remains regarding potential conflicts of interest for board members, other officers, or employees of a government agency that this bill would allow to hold a direct, financial interest in a private corporation. To what degree could decisions of the public agency be influenced by considerations regarding the financial success of the private company? Are the state’s existing conflict of interest laws sufficient to guard against these potential conflicts? The Committee may wish to consider these questions.
- b) **Stockholding and the California Constitution.** Article XVI, Section 6 of the California Constitution states:

“The Legislature shall not have power to authorize the state, *or any political subdivision thereof, to subscribe for stock, or to become a stockholder in any corporation whatever.*”

This section provides only limited exceptions to this general prohibition for: irrigation districts for narrow purposes; and, for counties, cities and other political corporations or subdivisions of the state for the payment of workers’ compensation, unemployment compensation, tort liability, or public liability, as specified. The Committee may wish to consider whether this bill poses a conflict with this Constitutional provision and to what degree it could invite litigation if it becomes law.

- c) **Slippery Slope.** While this bill is limited to a MUD that “has owned and operated an electrical distribution system or electrical generating facility for at least eight years and that contains a population of 250,000 or more persons,” the Committee may wish to consider the extent to which approval of this measure could invite similar legislative proposals from the thousands of local agencies in this state.
- d) **New Authority.** The authority this bill proposes has never been granted to any local agency. Typically, when the Legislature grants a completely new power – especially on that represents this degree of precedence – it requires a feedback mechanism by which it can evaluate the relative success or failure of the new power. The Committee may wish to consider whether this bill should provide such a mechanism.
- e) **Terminology and Definitions.** This bill allows a MUD meeting the description in the bill to acquire “nonstock security” in a private entity. While existing law provides an exhaustive definition of “security,” which the bill cross-references, “nonstock security” is a term not used elsewhere in California law and is not defined in the bill. It is unclear what kinds of instruments would meet this definition. The Committee may wish to consider whether more precise definitions and terminology should be provided in this bill.
- f) **Language vs. Intent.** This bill allows a MUD meeting the description in the bill to acquire nonstock security in any private entity and to dispose of it when its board decides it is in the best interests of the district to do so, with no additional parameters. SMUD states an intent to acquire nonstock security in companies with which it partners to achieve SMUD’s purposes. SMUD also claims that this bill will benefit its ratepayers. Finally, SMUD asserts that the bill will result in no additional risk to SMUD’s investments or ratepayer dollars. The Committee may wish to consider if this bill should be amended to be consistent with these stated objectives.
- 6) **Committee Amendments.** In order to address some of the policy considerations raised above, the Committee may wish to adopt the following amendments:

12773. (a) For purposes of this section, “security” has the same meaning as defined in Section 25019 of the Corporations Code.

~~(b) This section is only applicable to a district that has owned and operated an electrical distribution system or electrical generating facility for at least eight years and that contains a population of 250,000 or more persons.~~

~~(e) A district meeting the requirements of subdivision (b) may~~ *(b) The Sacramento Municipal Utility District is authorized to operate a pilot project to allow the board of directors of the district to take by grant, purchase, gift, devise, lease, or otherwise acquire and hold nonstock security in a corporation or other private entity. The board of directors of the district may sell or otherwise dispose of the nonstock security when, in its judgment, it is in the best interests of the district to do so.*

(c) Before exercising the authority described in subdivision (b), the district’s board of directors shall do all of the following:

(1) Make the following findings:

(A) The acquisition furthers the purposes of the district, pursuant to the Municipal Utility District Act.

(B) The acquisition is in the interest of the district's ratepayers and the public.

(2) Establish a policy governing acquisitions that shall include, but not be limited to, the following:

(A) Procedures for preventing conflicts of interest, in addition to the requirements of Article 4 (beginning with Section 1090), Chapter 1, Division 4, Title 1 of the Government Code.

(B) Procedures for determining how much of an acquisition to accept in lieu of, or in addition to, other forms of remuneration, in order to ensure the district secures a reasonable return on any intellectual property or other resources it provides the private entity.

(C) Procedures governing the approval process for accepting any acquisitions.

(3) Post the policy described in paragraph (2) on the district's internet website.

(4) Adopt a resolution at a regular meeting of the board stating the intent of the board to exercise the authority described in subdivision (c).

(d) The authority described in subdivision (b) shall be limited to a total of three acquisitions. Any profit or other gain earned by these acquisitions shall be used to reduce rates for the district's ratepayers.

(e) This section shall remain in effect only until January 1, 2025, and as of that date is repealed.

SEC. 2. *The Legislature finds and declares that a special statute is necessary and that a general statute cannot be made applicable within the meaning of Section 16 of Article IV of the California Constitution because of the unique needs of the Sacramento Municipal Utility District regarding nonstock security interests in private entities with which the district partners to further its purposes.*

- 7) **Arguments in Support.** SMUD, sponsor of this bill, states, "This (bill) will provide SMUD the ability to monetize our intellectual value and investment in companies with which we partner on innovative products and services. AB 689 will help SMUD spur innovation to meet our aggressive climate change and clean energy goals, while creating an opportunity for new revenue streams in an electric utility industry that is experiencing significant change... Passage of this bill will provide SMUD the opportunity to realize a return on its investment in the products and services that we must work to develop, which will assist in stabilizing SMUD's rates associated with (integrated resource plan) investments, bring economic development to the region, and spur innovation to assist in achieving the state's climate goals."

8) **Arguments in Opposition.** None on file.

9) **Double-Referral.** This bill is double-referred to the Banking and Finance Committee.

REGISTERED SUPPORT / OPPOSITION:

Support

Sacramento Municipal Utility District [SPONSOR]
California Electric Transportation Coalition
California Municipal Utilities Association
California Special Districts Association
City of Sacramento
Clean Power Campaign
DBL Partners
Natural Resources Defense Council
Sacramento Black Chamber Of Commerce
Sacramento Metropolitan Chamber Of Commerce
Valley Vision

Opposition

None on file

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