

Senate Committee on Government Organization

**82nd Texas Legislature
Interim Report**

December, 2012

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Senate Government Organization Committee

December 30, 2012

The Honorable
David Dewhurst
Lieutenant Governor of Texas
P.O. Box 12068
Austin, Texas 78711


Dear Lieutenant Governor Dewhurst:

The Senate Committee on Government Organization hereby submits our interim report, including recommendations to the 83rd Legislature.


Respectfully submitted,



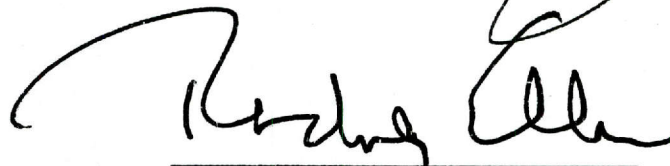
Senator Judith Zaffirini, Chair



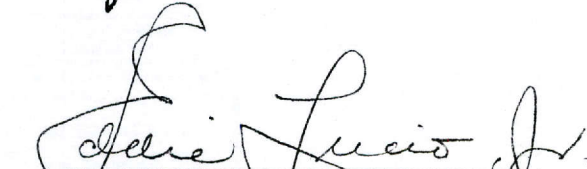
Senator Glenn Hegar, Vice Chair



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Legislative Budget Board
LBJ School of Public Affairs, The University of Texas at Austin
Railroad Commission of Texas
Texas Attorney General's Office
Texas Commission on Environmental Quality
Texas Department of Information Resources
Texas Education Agency
Texas Health and Human Services Commission
Texas Office of the Comptroller
Texas State Auditor's Office

Patsy Spaw, Secretary of the Senate
Scott Caffey, Senate Committee Coordinator
Rick DeLeon, Senate Sergeant-at-Arms
Texas Legislative Council
Senate Research Center
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Successful hearings and report development were made possible by the leadership of the Committee members and their dedicated staff whose names are listed below:

Rachel McClure, Sarah Brownstein, Gonzalo Serrano, Isabel Casas, and Will Krueger, representing Senator Zaffirini, Chair (appointed October 4, 2013)
Jessica Schleifer, Jay Bartlett, Jennifer Reif, and Tina Tran, representing Senator Rodney Ellis, Chair (from February 5, 2003 to October 4, 2012)
Peter Winckler, representing Senator Glen Hegar, Vice Chair
Doug Clements, representing Senator John Whitmire
Louie Sanchez, representing Senator Eddie Lucio Jr.
Travis Broussard, representing Senator Jane Nelson
Stephanie Leavell, representing Senator Steve Ogden
Anna Paulson, representing Senator Brian Birdwell
Hasan Mack, representing Lieutenant Governor David Dewhurst

Because he chaired the Committee until October 4, 2012, Senator Rodney Ellis and his Committee staff deserve credit for developing the agenda, planning the hearings, and writing the first draft of the Interim Committee Report. After he became Chair of the Senate Committee on Open Government, the last Government Organization hearing was held, and the report was finalized by the new Committee staff members, namely, Rachel McClure, Director; Sarah Brownstein, Policy Analyst; Gonzalo Serrano, Clerk; and Isabel Casas, Assistant Clerk.

The Committee also appreciates the numerous stakeholders for their participation throughout the interim, especially those who provided testimony during public hearings. We hope the results of these efforts will be useful and insightful for those who share our interest in this important arena.

Executive Summary

The Senate Committee on Government Organization (GO) is a standing committee of the Texas Senate. During the interim between legislative sessions it is responsible for addressing charges assigned by the Lieutenant Governor and preparing recommendations to address problems or issues that are identified. Its goal is to ensure that Texas state operations, programming, information resources, infrastructure, asset management, and services make the most effective and efficient use of taxpayer money. The charges assigned to GO for the 2011-2012 legislative interim are the purpose of this report.

Charge One evaluates the utility of cost-effectiveness analysis (CEA) in state agency rulemaking processes. Based on the testimony provided as well as numerous reports on the subject, GO concluded that the costs associated with requiring state agencies to conduct CEAs as part of their rulemaking process would outweigh by far the benefits reaped by undertaking this analysis and would run counter to the mission of agencies. It recommends that agencies consider using this tool on a case-by-case basis.

Charge Two examines cybersecurity efforts in state agencies. Findings indicate that the Texas Department of Information Resources, in partnership with public and private cybersecurity stakeholders, is proactive in addressing cybersecurity threats at state agencies. GO recommends designating cybersecurity leadership authority, expanding cybersecurity efforts to support agency assessments, and educating the state workforce about prevention and management of cybersecurity threats.

Charge Three considers the state bidding and contract management processes. GO found that there have been numerous studies, reviews, and reports regarding the state's contract management system to ensure that the state achieves the best value for each dollar spent. GO recommends broader implementation of the existing procurement purchasing, procurement monitoring, and greater oversight of major state contracts.

Charge Four looks at the performance of Energy Savings Performance Contracts (ESPCs). GO concluded that the entities responsible for reviewing and authorizing ESPCs have systems for processing ESPCs equitably and effectively. GO encourages agencies to make use of this funding mechanism.

Introduction

In 2012 the Senate Committee on Government Organization (GO) held two interim hearings and invited fifteen witnesses to provide testimony. These witnesses represented a cross-section of government organization stakeholders, including heads of state agencies, state agency counsels, senior agency administrators, and cybersecurity and good governance experts. Invited witnesses were requested to provide written testimony prior to each hearing to allow the senators to become familiar with their testimony and prepare appropriate questions. Public testimony also was encouraged and included in the agenda. This report is the result of their testimony, senators' questions, and relevant research.

The focus of the report is on the following interim charges that were assigned by Lieutenant Governor David Dewhurst to the Senate Committee on Government Organization on February 6, 2012:

1. **Cost-effectiveness Analysis.** *Investigate the costs and benefits of cost-effectiveness analysis in state agency rulemaking and consider the development of cost-effectiveness standards for all state agencies.*
2. **Cybersecurity.** *Examine ways to ensure the protection of state information and electronic data from unauthorized access and cyber threats.*
3. **State Bidding Process and Contract Management Protocols.** *Study the state bidding process, auto-renew clauses in contracts, and contract management protocols to ensure truly competitive bidding and the highest-quality service for taxpayers at the best price.*
4. **Energy Savings Performance Contracts.** *Evaluate state policy regarding energy savings performance contracts and determine whether policy changes are needed to ensure that state agencies and institutions of higher education obtain their contractually guaranteed savings so that all contract costs are recovered.*
5. **Legislation Oversight.** *Monitor the implementation of legislation addressed by the Senate Committee on Government Organization, 82nd Legislature, Regular and Called Sessions, and make recommendations for any legislation needed to improve, enhance, and/or complete implementation.*

These charges reflect the breadth of processes and issues that state agencies face and the scope of the Committee's work. Each affords opportunities to shed light on the complexities inherent in state agency systems and to evaluate deeply their effectiveness and efficiency with state funds. The findings and recommendations in this interim report add to a long line of Government Organization achievements and demonstrate how continued emphasis on this topic strengthens Texas' reputation as a leader in fiscal responsibility.

Charge One. Cost-effectiveness Analysis

Investigate the costs and benefits of cost-effectiveness analysis in state agency rulemaking and consider the development of cost-effectiveness standards for all state agencies.

Background/Legislation

The State of Texas long has tried to strike a balance between the need for regulation and the burden new rules and laws place on citizens, local governments, and businesses. As the state's economy and infrastructure continue to change, the tools that government uses to meet the needs and challenges for citizens and stakeholders also should change.

Existing processes for both new state laws and agency rules incorporate fiscal analyses that provide information about the fiscal impact of a proposed rule or law. In an effort to explore the appropriateness of a new fiscal tool, the Committee considered the costs and benefits of adding a cost-effectiveness analysis (CEA) to the agency rulemaking process.

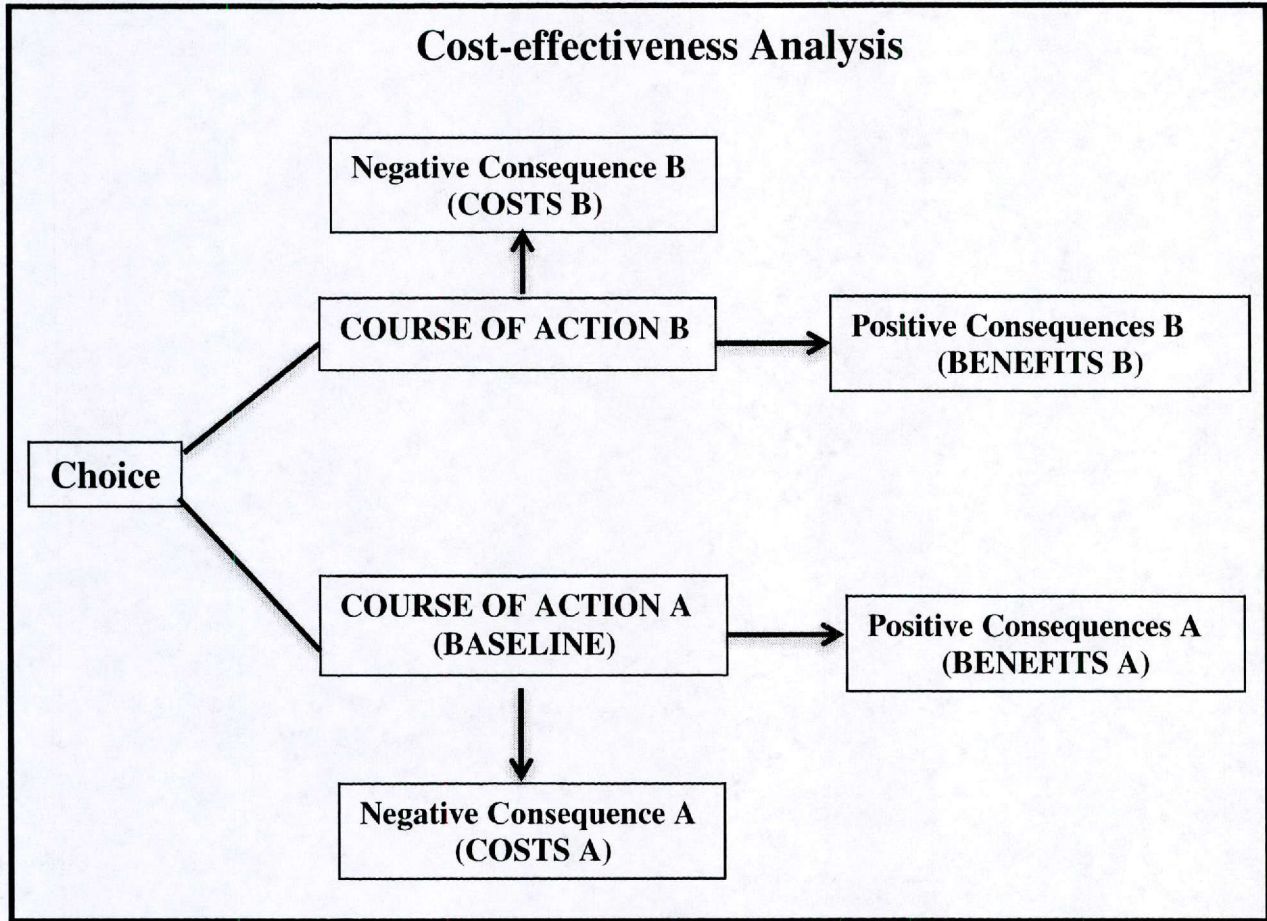
CEA

Cost allocation, CEA, and cost-benefit analysis represent a continuum of types of cost analyses that evaluate impact. They range from fairly simple program-level methods to highly technical and specialized investigations.

CEA was created in the 1970s as a tool for health care decision-making, primarily to avoid controversy regarding valuation of health-related outcomes in dollars. CEA can help agencies evaluate whether the improvement in health care outcomes justifies the expenditures relative to other choices.

By definition, CEA is comparative, while cost-benefit analysis usually considers only one program at a time. CEA asks, *Which of these alternatives is the cheapest or most efficient way to get this benefit?* Another important difference is that while cost-benefit analysis always compares the monetary costs and benefits of a program, CEA often compares programs on the basis of some other common scale for measuring outcomes (*e.g.*, number of students who are graduated from high school, infant mortality rate, test scores that meet a certain level, reports of child abuse).

Generally, a cost-effectiveness study is appropriate when an agency's goals or outcomes cannot be quantified or monetized easily, or when it has multiple competing goals (see graph).



Uwe Reinhardt, *Cost-effectiveness Analysis and U.S. Healthcare*, New York Times, March 13, 2009.

Agency rulemaking process

In an effort to review current cost analysis procedures, the Committee sought the assistance of the Texas Legislative Council to narrow down the list of the more than 200 state agencies. Prioritized agencies had a large number of chapters in code, comparatively larger budgets, and higher numbers of employees. Agencies with significant regulatory power whose rules impact many Texans also were included in the list. Finally, agencies with a current media presence on issues relating to rulemaking were prioritized for review.

The Committee worked with nineteen agencies to review current cost analysis procedures in rulemaking and data reflecting the number of rules proposed in the last fiscal year. No state agencies currently make use of CEAs in the rulemaking

process. All agencies follow the Administrative Procedures Code and conduct a small business or environmental impact statement when developing a fiscal analysis per the requirements in Government Code, Chapters 2001 and 2006.

To standardize the process of determining economic impacts on small business, the 2007 Legislature (via House Bill 3430) required state agencies to prepare an Economic Impact Statement on small business and a Regulatory Flexibility Analysis that considers alternative methods of achieving the purpose of a rule if the rule will have an adverse economic effect on small business. HB 3430 also required the Attorney General to develop guidelines to assist agencies in their efforts to determine a proposed rule's potential impact and identify alternative methods.

Testimony

The Senate Committee on Government Organization heard testimony regarding this charge on November 29, 2012. The hearing included invited and public testimony from the following persons:

Invited Witnesses

- Nichole Bunker Henderson, Deputy Chief, Administrative Law Division, Texas Attorney General's Office
- Cristina Martinez Self, Office of General Counsel, Railroad Commission of Texas
- Steve Aragón, Chief Counsel, Texas Health and Human Services Commission
- Lisa Dawn-Fisher, Associate Commissioner, School Finance/Chief School Finance Officer, Texas Education Agency
- Caroline Sweeney, Deputy Director, Office of Legal Services, Texas Commission on Environmental Quality

Public Witnesses

- Kathleen Hartnett White, Director, Armstrong Center for Energy & the Environment, Texas Public Policy Foundation
- Tom "Smitty" Smith, Texas Director, Public Citizen
- Karen Hadden, Executive Director, Sustainable Energy and Economic Development (SEED) Coalition

Findings/Analysis

With limited state revenue and sustained economic recession, it increasingly is important to have a rules process that is transparent and efficient in using state resources. During the November 29, 2012, Committee hearing, representatives from five state agencies provided testimony related to the application of cost-effectiveness analysis (CEA) in their agencies' rulemaking processes.

Cost of CEA

There is an opportunity cost to requiring state agencies to conduct CEAs. To benefit from CEA findings, agencies must dedicate considerable resources, rely upon specialized skill sets, and access complicated or inexistent data. The search for data needed to make reliable estimates could double or triple costs to agencies. Where resources or information are unavailable, agency personnel struggle to develop thorough, reliable studies and to perform informative analyses. What's more, should agencies be required to dedicate the required resources to CEAs, their ability to meet their core agency charges will be compromised. This is exacerbated in the case of smaller agencies with fewer than twenty staff members that most likely do not have the expertise in-house and would need to contract with analysts outside the agency for CEAs. Finally, in recent years, state agencies have confronted significant reductions in funding. If limited funding is directed away from agency services and programming, and they are no longer able to respond swiftly or at all, public confidence in the agencies will deteriorate.

Benefits of CEA

The benefits of well-elaborated CEAs are indisputable. They afford agencies the opportunity to analyze critically the tradeoffs of options. If there are options that are equally feasible, agencies can consider creative responses. CEAs also enhance engagement between agencies and the public. By informing members of the public what the impact of any given rule will be on their operations, a CEA elicits a response from members of the public and allows them to make deliberate business choices based on the communicated explanation of the rules.

Standards for CEA

Were state agencies to decide to make use of CEAs in their rulemaking processes, certain standards guiding the development of the CEAs would be necessary. They would need to balance clear definitions and targeted guidelines with a degree of flexibility built into their design to take into account variances in agency size, availability of data, constituent populations, specificity requirements, and type of agency.

Applicability of CEAs

A thorough consideration of the feasibility of using CEAs indicates that while they are no longer constricted to clinical use and have demonstrated efficacy as a decision-making tool, their use outside the fields of medicine and health care is limited. This may be due to “technical shortcomings associated with the generation of economic evidence capable of supporting sector-wide priority-setting in health, including data unavailability, methodological inconsistency across completed economic evaluations, and the limited generalizability or transferability of findings to settings beyond the location of the original study” (Cost-Effectiveness and Resource Allocation, *Generalized cost-effectiveness analysis for national-level priority-setting in the health sector*, 2003).

In addition to a generalized lack of available data, differences in methods used by researchers to capture and measure their data have resulted in difficulties synthesizing and interpreting cost-effectiveness findings. What's more, studies encompassing all state agency sectors and settings have not been undertaken and are slow and costly. To conduct CEAs, results from the sectors and settings that do exist would have to be utilized. CEA findings, however, specifically costs, do not apply to different contexts, often because of varying health, economic, cultural, political, environmental, behavioral, and infrastructural systems. As a result, CEAs have limited use outside of the setting where data are derived.

Recommendations

In response to its charge to "investigate the costs and benefits of cost-effectiveness analysis in state agency rulemaking and consider the development of cost-effectiveness standards for all state agencies," the Senate Committee on Government Organization makes the following recommendation:

01. At this time the Committee does not recommend requiring all state agencies to use in their rulemaking processes the comparative cost-effectiveness analysis (CEA) model primarily used by the health care industry. Agency boards and heads may consider using this tool based on their needs and standards if it will be cost-effective, applicable, and appropriate.

Charge Two. Cybersecurity

Examine ways to ensure the protection of state information and electronic data from unauthorized access and cyber threats.

Background/Legislation

Cyberspace reaches almost all Texans. It includes our energy grids and power plants, dams, water supplies, gas and oil production, transportation and distribution systems, public health and police systems, banking, technology and telecommunication systems, and military installations. Texas state government uses electronic personal and financial information to deliver services through the Internet to its more than 25 million citizens.

Cybercrime and intrusions cost millions of dollars, damage our critical infrastructure, and undermine Texans' confidence in our information systems. Of the 270 million customer records that were exposed in 1,791 nationwide events since 2009, three percent impacted Texans (Texas Cybersecurity, Education and Economic Development Council, *Building a More Secure and Prosperous Texas*, Preliminary Report, December, 2012). The average cost per lost or breached record is \$194 (The Ponemon Institute, *Cost of Data Breach Study*, March, 2012).

Many security breaches in Texas state agencies are the result of human error. According to the Texas Department of Information Resources (DIR), only seven percent of the 139 health information breaches reported since 2009 involved hacking. When sensitive or confidential information is made public, or when malicious cyber-attacks occur, the accessed information is at risk.

Although not widely publicized, cyber attacks occur routinely. The Texas Department of Homeland Security reports that in fiscal year 2009, "State entities reported a daily average of almost 575 security incidents, including malicious code execution, unauthorized access to data, and service disruptions. Most of these attacks are blocked, prevented, or result in only minor disruptions." (Texas Department of Homeland Security, *Texas Department of Homeland Security Strategic Plan 2010-2015*, May, 2011).

State Cybersecurity

Efforts to secure critical state infrastructure began in 2001 with the creation of the State Infrastructure Protection Advisory Committee (SIPAC) assessment commissioned by the Texas Attorney General. SIPAC reviewed and made recommendations to protect Texas' critical infrastructures, specifically focusing on emergency management, state agencies, and higher education. The Texas Department of Homeland Security is one example of an advancement that resulted from the SIPAC report.

Between 2004 and 2011 Texas legislators and agencies made steady progress in their cybersecurity efforts. State agencies and institutions of higher education first were required to follow cybersecurity standards that were included in the Texas Government Code in 2004. In 2005 the 79th Legislature enacted House Bill 3112, ensuring a statewide enterprise approach to information resources management and cybersecurity. In 2009 the 81st Legislature strengthened DIR's cybersecurity program by authorizing the agency to develop rules regarding vulnerability testing of network hardware and software. Finally, in 2011 Senate Bill (SB) 988 authorized the formation of the Texas Cybersecurity, Education and Economic Development Council to expand public cybersecurity efforts to incorporate and support the private sector and to boost cybersecurity education in Texas.

Texas DIR Cybersecurity

DIR has a multi-prong approach to strengthening cybersecurity at the state. It includes the efforts listed below:

- *Network Security Operations Center (NSOC)*, which prevents an average of 75 million incidents monthly and provides services to Texas state agencies, local governments, public education systems, and special districts;
- *Statewide Information Security Advisory Committee (SISAC)*, which provides guidance and secures government information assets and technology;
- *Third Party Cybersecurity Assessments*, which provide cybersecurity assessments of state agencies. Fifteen assessments have been completed, five assessments are in process, and ten remain to be completed; and
- *Texas Cybersecurity, Education and Economic Development Council (TCEEDC)*, (See below).

TCEEDC

Created by SB 988 (2011), TCEEDC is a public-private partnership, comprising nine members from across government, academia, and industry. It is charged with

improving the infrastructure of the state's cybersecurity operations and examining strategies to accelerate the growth of cybersecurity as an industry in Texas. TCEEDC submitted a report to key stakeholders with findings and recommendations in December, 2012.

Cybersecurity in Other States

The National Association of State Chief Information Officers and Deloitte & Touche, LLB, compile an annual review of state cybersecurity efforts nationwide. The 2012 report concludes that state struggles predominantly include gaining adequate budgets and stakeholder buy-in for cybersecurity, protecting states' assets from external threats, and ensuring cybersecurity competency among staff. DIR's budget trends are consistent with 44 percent of states, in that they have remained unchanged over the last year. Texas has demonstrated continued legislative commitment to cybersecurity through the creation of the TCEEDC.

Testimony

The Senate Committee on Government Organization heard testimony regarding the cybersecurity charge on November 29, 2012. The hearing included invited testimony from the following persons:

- Karen Robinson, Executive Director, Department of Information Resources
- Angel Cruz, State Information Security Officer, Department of Information Resources
- Sam Segran, Council Member, Texas Cybersecurity, Education and Economic Development Council

Findings/Analysis

Cybersecurity is becoming increasingly important as more state, private, and public systems live, work, and play in cyberspace. The Department of Information Resource's (DIR) multi-prong approach will be critical in the state's efforts to stay one step ahead of cybersecurity breaches. Continued emphasis should be placed on supporting and expanding DIR's cybersecurity role, considering enforcement options, enhancing public-private partnerships, and initiating public outreach and education. DIR will provide recommendations about the state of cybersecurity in Texas in the *State of the State* report, which will be released when additional state agency reviews are completed. In addition, the recommendations in the Texas Cybersecurity, Education and Economic Development Council (TCEEDC) preliminary report, some of which will be referenced here, provide valuable opportunities to address statewide themes of risk and vulnerabilities.

DIR's Role

DIR has made great strides to secure state agencies' information resources. The National Association of State Chief Information Officers (NASCIO) created security program taxonomy to understand what states should be focusing on in the development of cybersecurity plans. In early 2012 DIR Chief Information Security Officer Angel Cruz remapped the design of the state's plan to align it with NASCIO's framework. Specific points of focus include identifying vulnerabilities and taking preventative action before incidents occur. To that end, DIR is continuing agency risk assessments, cybersecurity policy development, securing the workforce, and raising awareness. One recommendation, which is supported by TCEEDC, is that the Legislature should review and update the Texas Administrative Code sections regarding DIR's duties and powers so that the agency effectively can lead implementation of state infrastructure improvement activities.

One of DIR's primary cybersecurity activities is to facilitate third-party assessments of state agencies. These assessments equalize cybersecurity readiness across state agencies and help DIR identify generalized and agency-specific vulnerabilities. With fifteen assessments completed, DIR has received guidance on trending results that have resulted in tangible changes. Two examples include the creation of a privacy committee and the development of a response template for all agencies to use.

Despite DIR's best efforts, human error remains a challenge, and the need to respond proactively persists. Sam Segran, TCEEDC member, testified that as

computer hackers become increasingly savvy, oversights by employees or clients play a greater role in the security breaches that various state agencies have experienced in the last several years. Ensuring that each agency has adequate policies and procedures in place that are followed by all employees can help mitigate some of these threats. Basic cybersecurity training also can help ensure that employees follow new standards as they are updated.

Enforcement Options

While DIR can facilitate technical assessments and make recommendations to agencies, the onus is upon state agencies to comply with resulting recommendations.

One of the primary barriers to DIR's capacity to ensure a high level of cybersecurity preparedness across state agencies is the lack of cybersecurity enforcement. Angel Cruz sought the opinion of a recognized national consultant regarding the effectiveness of penalties, punishments, or sanctions for state agencies that do not comply with security standards or that do not mitigate security vulnerabilities. The experts indicated that the state's sanctions and penalties do not meet industry standards.

Other states typically document and measure compliance or mitigation using scorecards or other means that provide transparency regarding the agency's security posture. Accordingly, in cases of insufficient security policies and inaction after a breach, penalties should be considered. Agencies should be required to have thorough and enforceable policies that prevent a breach and be prepared to act quickly to remediate a breach if one occurs.

Public-Private Partnerships

To confront the complex, interrelated challenges facing the state's cybersecurity, the knowledge and contributions of both public and private sector experts are necessary. While DIR has made a concerted effort to enhance partnerships among state agencies, institutions of higher education, and the private sector, Sam Segran of TCEEDC stressed the need for more widespread public-private partnerships, specifically in relation to developing statewide cybersecurity strategies (including policy, response, industry economic development, and citizen awareness programs). He also noted, "While there are several examples of innovation and cyber excellence throughout the state, these efforts are mostly localized rather than programs to expand to regional or statewide models." The state should pursue participation from a wide range of perspectives, including state agencies, critical

infrastructure industries, profit, non-profit and faith-based organizations, and public school districts.

Public Outreach and Education

An additional benefit of increased public-private partnerships is access to an expanded network for information sharing. With this expanded network, DIR's ability to reach out to the public is enhanced. TCEEDC recommends adopting the Community Cyber Security Maturity Model (CCSMM) as a statewide guide. The CCSMM was designed by the Center for Infrastructure Assurance and Security post-9/11 to benchmark a community's cyber maturity, provide a roadmap toward greater cybersecurity, and provide a common reference point for greater communication and planning across communities. Although seven states (Texas, California, Delaware, Illinois, Massachusetts, Nevada, and North Carolina) have completed early stages of CCSMM implementation, the initiative was terminated in Texas due to unforeseen limitations of the model. Although early indications of the model's success are positive, the long-term impact has not been determined because the model is in its infancy.

Recommendations

In response to its charge to "examine ways to ensure the protection of state information and electronic data from unauthorized access and cyber threats," the Senate Committee on Government Organization makes the following recommendations:

01. The Legislature should designate an agency to lead the implementation of state cyber infrastructure improvement activities effectively.
02. The Legislature should consider continuing to prioritize equalized cybersecurity preparedness across the state by funding the next twenty state security assessments.
03. The Legislature should prioritize enhanced IT security staff training and workforce awareness offerings.
04. Each state agency should be required to adopt relevant and adequate cybersecurity policies and procedures that are followed by each employee.
05. Each state agency should utilize existing cybersecurity training, guidance, and cybersecurity program offerings from the Department of Information Resources (DIR).
06. Consistent with the recommendation of Texas Cybersecurity, Education, and Economic Development Council, DIR should consider resuming adoption of the Community Cyber Security Maturity Model.

Charge Three. State Bidding Process and Contract Management Protocols

Study the state bidding process, auto-renew clauses in contracts, and contract management protocols to ensure truly competitive bidding and the highest-quality service for taxpayers at the best price.

Background/Legislation

Texas has a dynamic procurement process that has evolved slowly with the advent of the Internet. In 1994 the Legislature initiated the challenge of modernizing the state's system for the procurement of goods and services.

Since that time, legislative committees in both chambers have been repeatedly charged with reviewing and recommending changes to the state's procurement system. The state also has hired independent consulting companies to review the procurement process, but their recommendations rarely have become law.

Interestingly, while Texas law governs certain aspects of contracting for state agencies, different statutory standards govern practices, processes, and strategies for the various types of purchase and contracts.

Texas Procurement Process

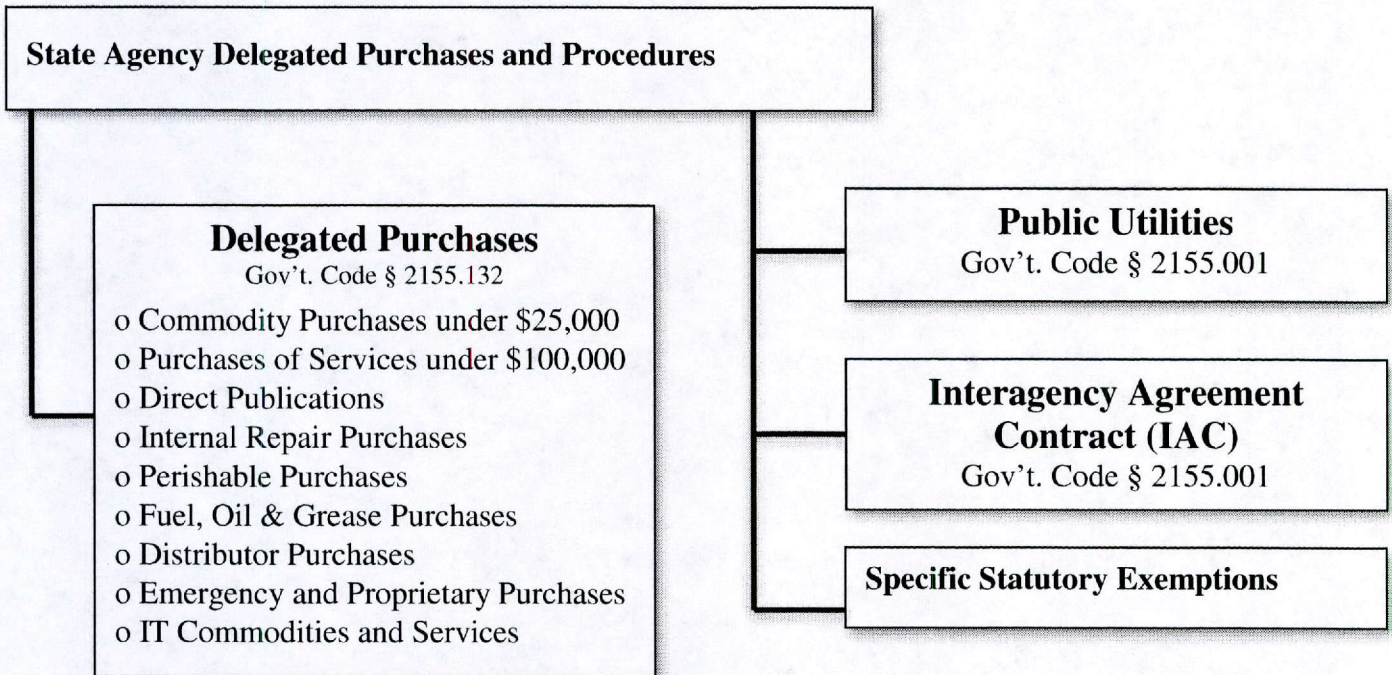
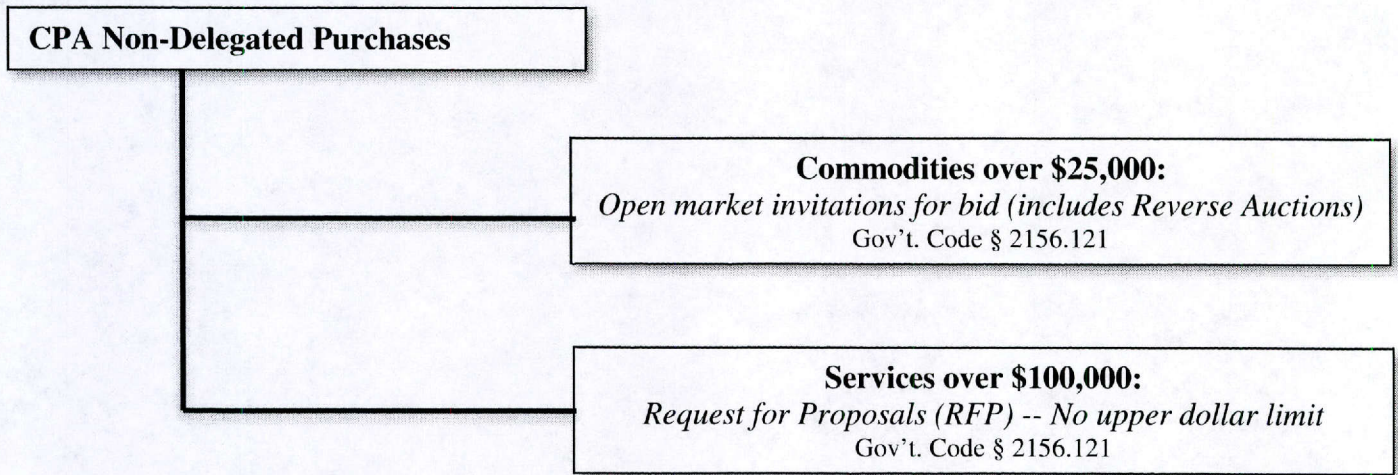
The Texas Comptroller of Public Accounts (CPA) has designed several guides, including the *State of Texas Procurement Manual* and the *Contract Management Guide*, to assist agencies with the procurement process. The procurement manual contains standard procedures for implementing the requirements of Texas statutes and delegated purchasing authority. It is a necessary resource to ensure the application of consistent and sound business practices in state purchasing. The *Contract Management Guide* provides suggestions and best practices to improve statewide contracting.

The Comptroller also trains and certifies all state agency purchasing personnel, consistent with Government Code §2155.078. Institutions of higher education are subject to appropriate provisions in the Texas Education Code §51.9335 or §73.115.

To support state operations and shorten the procurement cycle for purchasers, state law grants purchasing authority to the CPA, the Council of Competitive Governments, and the Department of Information Resources to establish contracts

for commonly used goods and services for state agencies and local governments. Statewide contracts include Go DIRECT contracts for IT/IS goods and services and CPA Term and TXMAS contracts for other goods and services. For items not on an existing statewide contract, Government Code Chapters 2155-2161 and CPA agency rules provide additional information on CPA purchasing oversight and contract responsibilities, as well as the purchasing authority delegated to state agencies.

The following charts, adapted from the CPA’s procurement manual, illustrate delegated authority and specific government code references (see graph).



Testimony

The Senate Committee on Government Organization heard testimony regarding this charge on April 23, 2012. The hearing included invited testimony from the following persons:

- Ron Pigott, Director, Texas Procurement and Support Services, Texas Office of the Comptroller
- Chucks Amajor, Director, Texas Council on Competitive Government and the Strategic Sourcing Division, Texas Office of the Comptroller
- Martin Zelinsky, General Counsel, Texas Department of Information Resources
- Sherri Greenberg, Director, Center for Politics and Governance, LBJ School of Public Affairs

Findings/Analysis

The legislature has demonstrated a clear interest in improving state contracting. Numerous interim committees and legislative agencies including the State Auditor's Office, the Sunset Advisory Committee, and the Legislative Budget Board, have investigated procurement and contracting-related issues. In the last two decades there have been more than 10 reviews and audits of procurement and contracting practices, resulting in at least seven reports, two of which were conducted by third-party contractors. These reviews have resulted in continual organizational changes to statewide procurement programs and contract management.

While some efforts to create statutory guidelines for agency purchases and for some contract planning and management have been successful, most contract decisions remain delegated to individual agency authority. What's more, a 2007 study found that less than three percent of total state spending was coordinated by the authorized agencies. Existent decentralized procurement activities have led to a duplicative, largely untracked, and enormously complex purchasing system.

Recommendations

In response to its charge to "study the state bidding process, auto-renew clauses in contracts, and contract management protocols to ensure truly competitive bidding and the highest-quality service for taxpayers at the best price," the Senate Committee on Government Organization recommends that the Legislature apply broader implementation of the state's centralized procurement policies and protocols to improve the efficient use of state resources, improve oversight and management of contracts, and reduce risk from high-risk contracts.

Charge Four. Energy Savings Performance Contracts

Evaluate state policy regarding energy savings performance contracts and determine whether policy changes are needed to ensure that state agencies and institutions of higher education obtain their contractually guaranteed savings so that all contract costs are recovered.

Background/Legislation

Energy Savings Performance Contracts

An energy savings performance contract (ESPC) allows state agencies, institutions of higher education, public school districts, and local governments to complete energy-saving improvements within an existing budget by financing them with money saved through reduced utility expenditures. In Texas \$200 million has been invested in ESPCs, resulting in 2,174 job years created and an estimated 28,507 annual tons of carbon avoided.

Entities make no up-front investments because they finance projects through guaranteed annual energy savings. They typically finance the cost of the improvements through the state's Master Lease Purchase Program and are responsible for ensuring that these contracts conform to statute. The State Energy Conservation Office (SECO) and the Texas Higher Education Coordinating Board (THECB) are responsible for establishing guidelines and for approving these contracts for state agencies and higher education institutions, respectively. The Bond Review Board (BRB) approves requests for Master Lease Purchase Program financing.

Contractors guarantee the savings that will be achieved as a result of implementing the energy savings measures in the contract. If the actual energy savings achieved after installation does not meet the savings guaranteed, the contractor is obligated to reimburse the difference to the agency or higher education institution. By statute, the guaranteed savings must be equal to or greater than the total costs of the contract.

ESPCs Nationwide

From the late 1990s to July, 2009, more than 460 ESPC projects were initiated by nineteen federal agencies in forty-seven states, with a combined value of \$5.7 billion. These projects resulted in savings of more than 18 trillion Btu annually,

equivalent to the energy used by a city of more than 500,000 persons or to the carbon emissions of nearly one million cars for one year.

Texas Administrative Code

The first legislation related to the incorporation of energy conservation measures into contracts occurred in 1991, when the 72nd Legislature adopted House Bill 39, which provided for higher education institutions to enter into contracts for energy conservation measures. In 2011 the 82nd Legislature adopted Senate Bill (SB) 5, which allowed institutions of higher education with credit scores of AA- or higher to forego BRB oversight of ESPCs. ESPCs submitted by state agencies still must be approved by the BRB. SB 5 codified the goal of lowering agencies' energy use by five percent each year. These contracts are one way to achieve this goal. Currently, ESPCs are authorized under Texas Government Code §2166.406 for state agencies and Texas Education Code §51.927 for institutions of higher education.

State Auditor's Office

In 2008 an audit was performed by the State Auditor's Office (SAO) to determine the effectiveness and accountability of existing ESPCs. At that time nine state agencies and institutions of higher education had entered into fifteen ESPCs with total calculated costs of \$203.1 million. Detailed audits at Texas Woman's University, the Parks and Wildlife Department, and the Health and Human Services Commission verified a combined savings of \$14.1 million through reporting year 2007. The remaining audits were not as successful. Thirteen contracts with calculated costs of \$172.1 million did not result in guaranteed savings that were sufficient to recover the costs of the associated projects. While sufficient energy savings may be achieved to pay for the costs of the contracts over their duration, the guaranteed savings of these thirteen contracts was \$27.6 million less than the projected cost of the associated projects.

The report concluded that SECO's and THECB's oversight processes were not capable of ensuring that guaranteed energy savings would cover the cost of ESPCs. It also found that the two agencies' procedures did not ensure that all costs were considered when contract applications were submitted for approval.

With few exceptions, the BRB, Texas Public Finance Authority, and THECB agreed with the findings for their agencies. Management responses from several state agencies and higher education institutions indicated the need for enhanced guidance and oversight by SECO and the THECB to ensure that contracts complied with the Texas Government Code and Texas Education Code.

SECO

By 2012 SECO Director Dub Taylor confirmed that the recommendations resulting from the SAO audit had been addressed and applied to ESPC processes. He expressed confidence in SECO's readiness to accept and process more performance contracts and noted that no new contracts had been filed since the SAO Audit was published. Given that 80 percent of utility requirements for state agencies are generated by ten agencies, Taylor suggested that there is a great deal of room for efficiency and conservation improvements and that ESPCs are an effective tool for making these improvements.

BRB

In May, 2012, BRB Executive Director Robert Kline stated that the BRB also has implemented the improvements cited in the SAO audit and that they are ready to handle more contracts. He confirmed that no new contracts were considered through the new BRB review process since the audit.

THECB

In May, 2012, THECB Finance Director Thomas Keaton verified that recommendations based on SAO findings were implemented at THECB. He highlighted a strong communication pathway that was established between THECB and SECO. This partnership provides for the leveraging of SECO's technical competencies for analysis of higher education performance contracts.

Testimony

The Senate Committee on Government Organization heard testimony regarding its bidding and contracting charge on April 23, 2012. The hearing included invited testimony from the following persons:

- John Young, Audit Manager, Texas State Auditor's Office
- Robert Wood, Assistant General Counsel, Texas Office of the Comptroller
- Thomas Keaton, Director, Texas Higher Education Coordinating Board

Findings/Analysis

Based on the 2008 audit, the State Energy Conservation Office (SECO), Bond Review Board (BRB), and the Texas Higher Education Coordination Board (THECB) have modified their accounting practices and streamlined their application and reporting of energy savings performance contracts (ESPCs). At the Senate Committee on Government Organization's request, the State Auditor's Office (SAO) reviewed SECO's implementation of recommendations based on *An Audit Report on Energy Savings Performance Contracts at Selected Agencies and Institutions of Higher Education* (State Auditor's Office Report No. 09-001, September, 2008). SAO determined that SECO's revised procedures for reviewing proposed ESPCs adequately address the inadequacies cited in the audit report.

Most agencies and institutions of higher education that were queried responded that if managed well, ESPCs can be an effective vehicle for financing equipment upgrades. Without this mechanism, the efforts of state agencies and educational institutions may be compromised by inefficient equipment. Since the 2008 SAO audit, however, state agencies have not made use of ESPCs, perhaps because they are unaware that they can and that they are encouraged to use this tool. Although the SAO's findings were addressed and resulting recommendations were implemented, there was no formal communication to agencies to that effect. As a result, SECO, THECB, and BRB have yet to test their guidelines and adjustments. The next ESPC should be monitored closely and guidelines adjusted to hone and perfect the process.

The lack of clear communication to state agencies that ESPCs are an available financing option points to broader issues that need to be addressed. Although the emphasis has been on improved management and oversight of ESPCs, there also is an opportunity for greater communication and collaboration among state agencies, institutions of higher education, public education districts, local government, industry groups, public energy managers, and energy service companies. Specifically, these entities could work continually to improve and update standards of accountability, awareness, performance, and transparency.

Recommendations

In response to its charge to "evaluate state policy regarding energy savings performance contracts and determine whether policy changes are needed to ensure that state agencies and institutions of higher education obtain their contractually guaranteed savings so that all contract costs are recovered," the Senate Committee on Government Organization makes the following recommendations:

01. The State Energy Conservation Office (SECO), working with stakeholders, should convene a stakeholder group that includes public energy managers and energy service companies that focuses on continually improving and updating standards of accountability, performance, and transparency to increase confidence of public sector energy managers in Energy Savings Performance Contracts (ESPCs).
02. SECO and the Texas Higher Education Coordination Board (THECB) should highlight ESPC success stories on their websites and relevant communication materials.
03. By way of encouraging state agencies to make use of the ESPC mechanism for funding, the Legislature should require SECO or THECB to review the Measurement and Verification of Savings report provided by the contractor and provide an analysis to state agencies, institutions of higher education, and the Legislative Budget Board for a period adequate to determine performance and then discontinue the review.

Conclusion

The Senate Committee on Government Organization (GO) was charged by Lieutenant Governor David Dewhurst to address a wide variety of government organization topics, ranging from cost-effectiveness analysis in rulemaking to cybersecurity to energy savings performance contracts, in particular, and contracts and bidding, in general. These charges were the focus of two public hearings at which more than twenty witnesses testified. Their testimony was vital to the development of this report, which also reflects additional research and interaction with agency personnel and stakeholders.

Despite the significant variation in the charges, one theme was constant: Effective government organization strengthens the glue that holds the state together. It ensures efficiency and efficacy at all levels of state government. A close examination of state agency programming and operations provides the legislature the opportunity to gauge how well policies perform when implemented. It also maintains the transparency needed to demonstrate to taxpayers that their dollars are being put to the highest and best use. The benefits of government organization, which include guaranteeing government transparency, fiscal responsibility, and operational efficacy, far outweigh the investments.

It is vital that the state highlight the good work being done across state agencies and point to efforts to make improvements where necessary. The state has made significant strides related to efficient government organization over the last decade, including streamlining duplicative services, making information technology at the state competitive, ensuring transparency and access to state agencies and services, and consolidating and managing state assets. If Texas wants to remain nationally competitive, responsive to its constituency, and fiscally trustworthy, a strong investment in government organization is required.

