Report to the City of San Diego concerning Electric and Gas Distribution Systems

July 16th, 2020
Environment Committee
Introduction – Franchise Team Members

Erik Caldwell – Deputy Chief Operating Officer
Fritz Ortlieb – Deputy City Attorney
Lee Friedman – Program Manager
Howard Golub – JVJ Pacific Consulting
James Kelly – JVJ Pacific Consulting
Nancy Hughes – NewGen Strategies & Solutions
Bill Monsen – MRW Consulting
Gary Leatherman – Advisian Consulting
What is a Franchise?
San Diego Electric and Gas Services - History

1920 – 1970
San Diego Electric and Gas Services - History

1970 – 2020
## Value of SDG&E Electric and Gas Distribution Infrastructure Serving the City

<table>
<thead>
<tr>
<th>Cost Approach</th>
<th>Electric Distribution</th>
<th>Gas Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reproduction Cost New Less Depreciation (RCNLD)</td>
<td>$2,784,463,000</td>
<td>$1,109,630,000</td>
</tr>
<tr>
<td>Original Cost Less Depreciation (OCLD)</td>
<td>$1,585,378,000</td>
<td>$489,601,000</td>
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### Value of SDG&E Electric and Gas Distribution Infrastructure Serving the City

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<tr>
<td>Perpetual Franchise Assumption</td>
<td>$2,237,751,000</td>
<td>$652,898,000</td>
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<td>One-Year Franchise Assumption</td>
<td>$208,333,000</td>
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## Value of SDG&E Electric and Gas Distribution Infrastructure Serving the City

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<tr>
<td>Value</td>
<td>$2,086,955,000</td>
<td>$632,523,000</td>
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## Value of SDG&E Electric and Gas Distribution Infrastructure Serving the City

<table>
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<tr>
<th>Estimated Range of Value</th>
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### Estimated Capital Costs to Sever Electric Systems from SDG&E

<table>
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<tr>
<th>Type</th>
<th>Lower Bound Estimate</th>
<th>Upper Bound Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric Distribution</td>
<td>$189.5 million</td>
<td>$899.2 million</td>
</tr>
<tr>
<td>Electric Transmission</td>
<td>$0</td>
<td>$1.5 billion</td>
</tr>
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### Estimated Capital Costs to Sever Gas Systems from SDG&E

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<th>Type</th>
<th>Lower Bound Estimate</th>
<th>Upper Bound Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Gas</td>
<td>$219.2 million</td>
<td>$2.45 billion</td>
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</table>
Presentation by Howard Golub, Managing Member JVJ Pacific Consulting, LLC
The 1970 franchises for gas and electric services are set to expire January 17, 2021

This presents San Diego with major opportunities but also difficult decisions:

- Whether to form a community owned electric or gas utility, or
- Whether to grant franchises to provide gas and electric services, and, if so, the terms and conditions of new franchises
JVJ recommends the City issue franchises for free and open competition by responsible bidders.

If the new proposed franchises are not accepted without material changes, JVJ recommends City proceed to form community owned gas and electric utilities.
San Diego is the largest city in California granting an electric franchise and the second largest granting a natural gas franchise. This makes these franchises extremely valuable.

As a Charter City, San Diego has broad discretion on terms to include in new franchises. However, a City may not regulate matters over which the Legislature grants regulatory power to the California Public Utilities Commission (CPUC).

Franchises are permits to use the City’s public streets and rights-of-way. They are real property and the City can charge the franchise holder the reasonable value of the franchises.

Market reality is that qualified utilities will not accept a franchise if not profitable to them.
Franchise Recommendations are based on experience and industry knowledge and:

- Discussions with City Leadership & City Attorney’s Office
- Input from stakeholders
- Review of current industry structure and regulatory requirements
- Review of other franchise agreements
- Consideration of comments from respondents to Request for Expressions of Interest (RFEI)

Recommendations structured holistically to balance various considerations
Terms to be covered are as follows:

- Length of Franchise
- Compensation to City
- Surcharges Imposed on San Diego Residents & Businesses
- City Policy Objectives
- Relocations, Undergrounding & Other Operational Protocols
- Safeguards
  - Quadrennial Performance Audits
  - City Right to Purchase
- Audits, Dispute Resolution & Other General Provisions
Recommended Term: 20 Years

- Consistent with modern city franchise lengths
- Creates opportunity for competition
- City’s right to municipalize remains intact
Annual Electric Franchise Fee: 3%
- Unchanged from 1970
- Annual franchise fees are high compared to other CA cities, but in line with other major cities across the country.
- Generated $57 million in 2019

Annual Gas Franchise Fee: 3.5%
- Increase of ½ percent
- Generated $7 million in 2019
- ½ percent increase would generate additional $1.2 million annually
- New revenue could support City sustainability efforts
- Likely result in increased surcharge of ~$25 million over 20 years
- Increased surcharge outweighed by recommendation to decrease electric surcharge (~$110 million projected ratepayer relief over 20 years)
Compensation to City: Minimum Bid (Invitation to Bid)

- Electric Franchise: $54,000,000; Gas Franchise $8,000,000 = $62 million

- This is a *minimum* bid; highest responsible bidder awarded the franchise

- Minimum bid amount balances need to generate competition while protecting the City in the event of a single bidder

- Recommend the City allow for up to a 10 year payment plan

- Strongly Recommend the City not allow the minimum bid to be included in franchisee's utility rates
Compensation to City: Other compensation

- Arrange utility’s purchases so that the City collects sales tax

- City right to use otherwise unused space on utility infrastructure (poles, trenches, conduits etc.) at no cost

- City right to use otherwise unused utility real property within City at no cost

- City right of first refusal to purchase utility real property within the City put up for sale
Eliminate 0.35% of the Electricity Surcharge imposed on San Diego residents and businesses

In 1972 CPUC approved (over City’s objections) SDG&E’s request for a 1.9% surcharge on electricity and a 1.0% surcharge on natural gas rates within San Diego

In 2002, the 1.9% surcharge was increased by 0.35%

Eliminating the 0.35% surcharge should save electricity consumers within the City about $110 million over 20 years

The City will lose approximately $3.3 million in franchise revenues over the same 20 year period by eliminating the surcharge

The financial risk to the City could be higher, but might be mitigated by franchise language or appropriate action at CPUC or in the courts
- Require an updating mechanism and a detailed biennial report comparing franchise fees

- If adjustments based on the reports are necessary, utility shall promptly file request with CPUC to adjust 1972 surcharges
JVJ Pacific Consulting, LLC – Joint Policies Guide

- Require utility to work with City to develop a Joint Policies Guide to include at a minimum:
  - Policies to reduce GHGs as established in the Climate Action Plan (CAP)
  - Equity
  - Environmental justice for communities of concern

- Joint Policies Guide to be developed within 12 months of grant of franchise and sent to Council for formal adoption.

- Corporate officer to consult with City at least annually

- Joint Policies Guide to be updated every four years and progress on the policies shall be subject to annual review.

- Requires good faith consideration by the utility to petition CPUC to permit the City to manage certain public purpose program funds
▪ Retain, but improve, the provision requiring the utility to relocate at its expense, and eliminate “loopholes”

▪ Utility to proceed to promptly relocate, at its own cost, with disputes to be resolved later

▪ Utility be required to provide the City with as-built diagrams to the extent that the utility is permitted to do so by law

▪ Operational protocols to be established in Biennial Permits replacing the Manual of Administrative Practices (last updated 1986)

▪ Biennial permit process forces periodic review and allows for opportunity for both City and utility to consider improvements
Quadrennial performance audit. Results of this audit should be provided to City Council and publicly reported. Could require the following (at a minimum) be reviewed:

- Cooperation & compliance with Joint Policies Guide (CAP goals, equity goals, etc.)
- Customer service/reliability/rates
- Adherence to franchise requirements

Right to Purchase through appraisal process

- City always has right to municipalize through the condemnation process, however, condemnation can be expensive, lengthy and a deterrent in itself to City ownership
- Proposed process protects utility's right to fair compensation, but reduces the time/cost of acquisition, converting a theoretical right into a practical and powerful safeguard
Dispute resolution process:
- Step 1: meet & confer amongst senior representatives
- Step 2: non-binding mediation
- Step 3: litigation or declaration of forfeiture

If litigation becomes necessary, include provisions for liquidated damages
The City has a clear right under the California Constitution and under the City Charter to form electric and gas utilities to serve consumers both inside and outside the City.

Community-owned electric utilities (including municipalities, utility districts, irrigation districts and tribal utility authorities) serve about one quarter of all electricity consumers in California.

In 1970 the City consultant concluded that a city owned utility was in the best interest of the City, but that then current interest rates made acquisition infeasible.

Interest rates today are extremely low, but interest rates aren’t the only relevant factor.
California Electric Utility Rates

Average Electric Rate ($/kWh)

Source: U.S. Energy Information Administration forms EIA-861 and EIA-861S (www.eia.gov/electricity/data/eia861/)
California Gas Utility Rates

Customer costs under the EDU are lower than under SDG&E Base Case (most probable of the scenarios examined) and in the Low Cost scenarios for all purchase price assumptions examined.

Customer costs under the EDU are higher than SDG&E in the High Cost scenario for all purchase price assumptions examined.
Similar policy considerations, which led to San Diego Community Power (SDCP) (CAP objectives; local control; renewable energy) would also apply to a city owned electric distribution utility.

Responsibilities for procuring an electric supply and related business risk are similar to SDCP.

City responsible for operating and maintaining electric distribution facilities.

City control of about ~$120 million per year in state mandated public purpose program charges which could be used for projects.

If City were to form a community owned electric utility, SDCP could not provide retail commodity electric service to customers within the City.
Customer costs under the GDU are less than SDG&E service for all cost scenarios and acquisition cost assumptions.
The City is responsible for natural gas procurement

City could operate in a manner consistent with the CAP

City responsible for operating and maintaining natural gas distribution facilities

City control of approximately $17 million per year in natural gas public purpose program funds
There are cogent arguments in favor of developing community owned electric and natural gas utilities, but not recommending that step now.

Implementing such a plan involves major policy and business issues:
- Formation of utility management team
- Recruitment of qualified utility workforce
- Major commitment of City senior management and City Council time to formation process
- Condemnation process is slow and costly

If the City’s only alternative is continuation of current franchise, we would recommend commencing the process of forming community owned electric and natural gas utilities.
## Terms

<table>
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<tr>
<th>Terms</th>
<th>1970 Franchise</th>
<th>Recommended Franchise</th>
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<tbody>
<tr>
<td><strong>Length of Term</strong></td>
<td>50 Years</td>
<td>20 Years</td>
</tr>
<tr>
<td><strong>Minimum Bid</strong></td>
<td>$50,000 for each Gas &amp; Electric Franchise</td>
<td>$54 million for Electric</td>
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<tr>
<td></td>
<td></td>
<td>$8 million for Gas</td>
</tr>
<tr>
<td><strong>Electric Franchise Fee</strong></td>
<td>3.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td><strong>Gas Franchise Fee</strong></td>
<td>3.0%</td>
<td>3.5% (additional revenue could support sustainability efforts)</td>
</tr>
<tr>
<td><strong>Surcharges for Electric</strong></td>
<td>1.9% (1972) + 0.35% (2002)</td>
<td>Eliminate 0.35% surcharge. ~$110,000,000 in ratepayer relief over 20 years</td>
</tr>
<tr>
<td><strong>Utility Undergrounding Program (UUP)</strong></td>
<td>Standard CPUC undergrounding, to be increased to 4.5% over time; 2002 UUP modified to be 3.53% surcharge</td>
<td>Continue UUP as established in 2002</td>
</tr>
<tr>
<td><strong>City Right to Purchase</strong></td>
<td>Condemnation process</td>
<td>Appraisal process (Condemnation process still available)</td>
</tr>
<tr>
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<tr>
<td>Joint Policy Guide</td>
<td>None</td>
<td>Cooperative agreement to achieve policy goals set by Council (CAP, equity, environmental justice, etc.)</td>
</tr>
<tr>
<td>Dispute Resolution</td>
<td>None</td>
<td>Meet &amp; confer; non-binding mediation; litigation (liquidated damages/attorney’s fees)</td>
</tr>
<tr>
<td>Administrative Practice</td>
<td>Manual of Administrative Practice (cooperative agreement, updated yearly)</td>
<td>Biennial permit process w/ increased oversight and information sharing</td>
</tr>
<tr>
<td>Third Party Performance Auditing</td>
<td>None</td>
<td>Require performance audits every 4 years. Findings presented to Council and to public</td>
</tr>
<tr>
<td>Remedies and Forfeiture</td>
<td>Franchise termination, municipalization</td>
<td>Franchise termination, municipalization, liquidated damages, right to purchase</td>
</tr>
<tr>
<td>Severability Provisions</td>
<td>None</td>
<td>Severability clause to protect integrity of franchise and City interests</td>
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City released a Request for Expressions of Interest on 1/21/2020 and received several stakeholder responses and interest from three potential bidders (link to responses here)

- San Diego Gas & Electric
- Indian Energy, LLC
- Berkshire Hathaway Energy

City conducted three franchise fee workshops:

- Rancho Bernardo Library 2/12/20
- Malcolm X Library 2/18/20
- Otay Mesa Nestor Library 2/19/20

City presented, by request, at several additional boards and committees, and, while committees were in session, made monthly updates to the Environment Committee members
Process for Franchise Award – Invitation to Bid
REQUESTED ACTION:

- Accept the consultant reports and draft a Resolution of Intent on Committee’s preferred terms and conditions of the franchise agreements
Process for Franchise Award – Requested Action & Timing

- **February:** Collect feedback from RFEI & Community Outreach
- **March-May:** Draft Franchise Fee Agreement
- **June/July:** Draft proposed Agreement presented for public review and input at Committee/Council
- **July:** Franchise Agreement released as Invitation to Bid (ITB)
- **August:** Receive responses to ITB and prepare to bring bids forward to City Council
- **September/October:** Present recommendation of proposed franchise agreement to City Committee/Council
- **October-January:** Receive CPUC approval (if necessary)
THANK YOU!

Q&A