



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Lori Mitchell

SUBJECT: SEE BELOW

DATE: November 21, 2022

Approved

Date

12/1/2022

SUBJECT: ORDINANCE TO AMEND TITLES 2, 4, AND 26 AND ADD TITLE 28 TO THE SAN JOSE MUNICIPAL CODE TO ESTABLISH A MUNICIPAL UTILITY FOR ELECTRIC SERVICE

RECOMMENDATION

Approve an ordinance amending Titles 2, 4, and 26 and adding Title 28 to the San José Municipal Code to establish a municipal utility for electric service.

OUTCOME

Approval of the amendments to Titles 2, 4, and 26, and addition of Title 28 to the San José Municipal Code will establish a municipal utility for electric service.

BACKGROUND

On August 29, 2019, the City Council held a Study Session discussing general options to improve the resilience, reliability, efficiency, and cost of electric service in the downtown San José area, including the possibility of forming a City of San José owned public utility.

On February 10, 2020, the City Council authorized the City Manager to file a Wholesale Transmission Service Interconnection Application to Pacific Gas and Electric Company to begin exploration of the option to provide City electrical service to the Downtown West Project.

On May 25, 2021, as part of a supplemental memorandum related to the Development Agreement for Google's Downtown West Project, the City Council was provided information regarding the initial legal, regulatory, and economic feasibility as well as the potential benefits and risks of City-provided electric service to new developments such as the Downtown West Project.

On September 16, 2022, the City Council held a Special Meeting to discuss the benefits and risks of providing San José electric service to new developments with a case study for the Downtown West Mixed-Use Development. The City Council unanimously accepted a memorandum from Mayor Liccardo, which recommended accepting the case study and directed the Administration to return by December 2022 with additional information and proposed changes to the San José Municipal Code (Code) to enable the City to provide electric service to new developments.

ANALYSIS

Summary of Municipal Code Revisions

Under Title 2, Part 42, of the Code, the Director of Public Works is the Chief Engineer for City owned facilities. State law requires that the Local Regulatory Authority of a Publicly Owned Utility providing electric service certify that the facilities operated by such utility conform to California Public Utilities Commission standards for safe and effective operations. The City Council will be the Local Regulatory Authority for the City's municipal electric utility, which will be named "San José Power," as explained below. The ordinance amending the Code will address the state law mandate by adding the following general functions, powers, and duties to the Director of Public Works:

1. Develop, maintain, and update design and construction standards for San José Power's electric utility system;
2. Supervise and manage the design and construction of all work or improvements of the San José Power electric utility system as approved by the City Council;
3. Develop and negotiate agreements and obtain any permits and licenses as necessary to design and construct the San José Power electric utility system; and
4. Direct the engineering and construction of San José Power's electric utility system.

Title 2, Part 46, of the Code establishes the Community Energy Department and assigns functions, powers, and duties to the Director of the Community Energy Department. The ordinance amending the Code will change the name of the Community Energy Department to the "Clean Energy Department" to reflect the establishment of two new divisions: an electric utility division to administer San José Power, and a community energy division to administer San José Clean Energy. In addition, the ordinance will add functions to the Director of the Clean Energy Department for the operation of San José Power.

Title 4 of the Code is amended to establish the San José Power Operating Fund. All monies derived from the operation of San José Power, including but not limited to revenues from sale and delivery of electricity, payments from other entities, and any financing proceeds associated with the electric utility shall be deposited in the San José Power Fund. Monies in this fund shall only be expended for costs to operate and finance the utility and shall be appropriated on an annual basis through the budget process, along with appropriate reserves established and maintained as directed by the City Council.

Title 26 of the Code provides the necessary framework for San José Clean Energy to procure electrical energy for the residents and businesses of San José. The electricity is currently distributed to customers through facilities owned and operated by an Investor-Owned Utility (IOU) under a franchise granted by the City. The ordinance will amend Sections 26.10.106 and 26.20.010 of the Code to reflect the department name change from the Community Energy Department to the Clean Energy Department.

The ordinance will add Title 28 to the Code for the formation of a City owned electric utility named San José Power, with the following characteristics:

- The utility will provide full electric service to service areas within the City's boundaries. A full-service electric utility includes power procurement, distribution, metering, and billing services for select new developments.
- The Clean Energy Department will manage the operations of the San José Power electric system, which is defined as a network of components owned and operated by the City to provide electric service to customers, and includes but is not limited to generation, transmission, and distribution infrastructure.
- San José Power will also be subject to a Risk Management Policy, which may be combined with the policy applicable to San José Clean Energy.
- The City Council will set rates for San José Power by resolution that will be noticed to customers in a newspaper of general circulation at least fifteen days in advance of the City Council meeting and directly to the customer with the customer's regular electric service bill if a bill is due before that meeting.
- The Clean Energy Department will manage all regulatory and compliance obligations as well as the metering and billing operations.

Future City Council action may include approval of the following:

1. Rules and Regulations for operation of San José Power;
2. Design and construction standards;
3. Service areas;
4. Power procurement and risk management processes;
5. Facility Transfer Agreements with developers prior to assuming ownership of developer constructed distribution facilities;
6. Transmission Interconnection Agreements with Transmission Owners and Operating Agreements with the California Independent System Operator prior to activation of distribution facilities; and
7. Tariffs and rates based on a cost-of-service study to determine revenue requirements and ensure recovery of those revenue requirements from customers without reliance on the City's General Fund.

Benefits and Risks of City Electric Service

The case study titled, *Benefits and Risks of Providing San José Electric Service to New Developments – A Case Study of the Downtown West Mixed-Use Development*, dated August 24, 2022 and developed by Flynn Resource Consultants Inc., summarized the benefits and risks of the City providing electric service. The case study demonstrated the opportunity for the City to partner with developers to achieve the shared objectives of providing reliable, resilient, carbon-free power to customers within a new development at a competitive cost compared to traditional IOU service. The base case in the case study estimates rate savings for City electric service is in the range of 15 to 25 percent. This is in line with demonstrated experience from small and large public utilities throughout California.

Rate savings for City electric service customers versus IOU customers come from two principal sources. First, the cost of City electric service is lower because a City owned electric utility will charge cost-based rates without payment of state and federal taxes or shareholder returns. Municipal utilities are non-profit entities. IOUs typically earn a five to eight percent rate of return on investments and pay shareholder dividends. A City electric utility would not earn a profit or pay shareholder returns. However, City electric utility costs do include a payment to the City's General Fund in-lieu of taxes and fees to mitigate the lost franchise fees, utility taxes, and property taxes that would be associated with IOU service. Second, the rates for use of the IOU distribution system are rapidly increasing due to deferred maintenance and significant investments in wildfire hardening.

Stress testing in the case study identified the following three most critical uncertainties around the comparison between City electric service and IOU service: 1) the accuracy of the load forecast; 2) uncertainty around future IOU benchmark rates and how costs are recovered; and 3) staffing levels to operate and maintain a relatively small electric utility.

In addition to the potential cost savings for customers, the City will have the ability to adopt applicable design standards and rules and regulations. This will allow for advanced microgrids in new City developments that could accommodate more onsite clean distributed energy resources and improved reliability and resiliency.

Quantification of these benefits and the risks associated with the provision of San José Power service to individual new developments will be determined on a case-by-case basis. City Council will review and approve new service areas for San José Power after its establishment. Thus, the service territory of the utility could be expanded at any time to provide electric service to new developments.

CONCLUSION

Amending Titles 2, 4, and 26 and adding Title 28 to the Code allows for the formation of San José Power. This action allows the option, but not the obligation, to provide City electric service to any new developments.

EVALUATION AND FOLLOW-UP

The Community Energy Department will bring forward additional recommendations for consideration to allow for a City-operated electric utility with a microgrid, providing a cleaner and more reliable electric grid.

CLIMATE SMART SAN JOSE

The recommendation in this memorandum aligns with one or more Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

This memorandum, along with the proposed ordinance, will be posted on the City's Council Agenda website for the December 13, 2022 Council meeting.

COORDINATION

This memorandum has been coordinated with the Public Works, Finance, and Environmental Services departments, the City Attorney's Office, and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

The contents of this memorandum were presented to the Clean Energy Community Advisory Commission on November 3, 2022. The Commission issues its recommendation as follows:

The Commission expresses appreciation for the work to define the costs and benefits of City municipal electric distribution service to new developments in the City of San José but is concerned the work to define the costs and benefits of City municipal electric distribution service to new developments in the City of San José, as presented to the Commission, is incomplete. We would like to note that the Commission was not provided the August 24, 2022 memorandum to City Council regarding Downtown West Project.

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The Commission recognizes that the City Council asked the staff to propose an ordinance at the December 6, 2022 City Council meeting to allow the formation of a City owned municipal utility. We recognize the proposed ordinance does not commit the City to take further steps to operate a municipal utility.

The Commission expresses no views on the merits of the Downtown West Project or the merits of creating a municipal utility, but strongly advises the City Council to seek an independent review of the opportunities and risks before proceeding at this time.

CEQA

Not a Project, File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

/s/

LORI MITCHELL

Director, Community Energy

For questions, please contact Lori Mitchell, Director of Community Energy, at (408) 535-4880.