



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Lori Mitchell

SUBJECT: SEE BELOW

DATE: April 7, 2023

Approved

Date

4/18/23

SUBJECT: AMENDMENTS TO THE SAN JOSE MUNICIPAL CODE TITLE 2 AND TITLE 26, AND COUNCIL POLICY NO. 1-23 ENERGY RISK MANAGEMENT POLICY

RECOMMENDATION

- (a) Approve an ordinance amending Section 2.04.4620 of Chapter 2.04 of Title 2, and Title 26 of the San José Municipal Code to provide the Community Energy Department the authority to efficiently procure and contract for the purchase and sale of power products and to ensure timely collection of revenues.
- (b) Adopt a resolution approving revisions to Council Policy 1-23, “Energy Risk Management Policy” to specify the delegated contract authority for the purchase and sale of power products; and establish the procurement procedures for the purchase of power products.

SUMMARY AND OUTCOME

Approving the recommendation enables the Community Energy Department (CED) to efficiently procure the power products needed to serve San José Clean Energy’s (SJCE) customers as well as meet applicable regulatory requirements and the City’s clean power content goals. The recommendation aligns with best practices in the utility industry.

The proposed amendments to the San José Municipal Code and Energy Risk Management Policy (ERMP) authorize the City Manager, or Designee, to enter into short-term and medium-term agreements for the purchase and sale of power products and master power purchase agreements that adopt standard terms for buying and selling power. The proposed amendments also authorize the Director of Community Energy, or Designee, to enter into short-term agreements.

The proposed amendments provide that City Council approval is required for long-term agreements. These agreements have important policy implications that drive SJCE’s power mix,

risk profile, and costs. City Council approval of long-term power purchase agreements will also ensure that the public will have the opportunity to provide input and shape SJCE's power mix. In the coming years, long-term agreements will represent over 65% of SJCE's power supply portfolio.

Approval of proposed amendments related to noticing provisions of rate changes will result in timely collection of revenues for SJCE while ensuring customers receive ample notice of rate changes and product offerings.

BACKGROUND

The San José City Council unanimously approved the formation of SJCE in May 2017¹. The City Council amended Title 2 of San José Municipal Code to add a new department, CED, in August 2017². The City Council added Title 26 to the San José Municipal Code for the operation and management of SJCE in November 2017³. The City Council approved the ERMP in May 2018. SJCE launched service to most businesses and residents in February 2019.

SJCE purchases power products to meet customer load and related requirements, while the Investor-Owned Utility (IOU) in the City of San José's service area continues to deliver electricity, maintains powerlines, responds to power outages, and provides customer billing. Title 26 established parameters for rate setting and power procurement for SJCE.

The ERMP outlines the objectives of the SJCE program and addresses key risks arising from participation in energy markets and controls to mitigate such risks. The ERMP may be amended by resolution of the City Council. The ERMP establishes a Risk Oversight Committee to advise on SJCE's risk management program. The ERMP mandates adoption of Energy Risk Management Regulations, which set forth in more detail the risk management roles, strategies, controls, and authorities to form a comprehensive energy risk management program.

The current authority allows the Director of Community Energy to contract daily for up to \$500,000 in power products. The Director of Community Energy has never entered into any agreements pursuant to this authority. The Director has requested contracting authority from the City Council several times a year to meet load requirements, regulatory requirements, and to enter into long-term agreements during the initial start-up years of operations. The City Council last increased the contracting authority of the Director of Community Energy to negotiate and execute agreements on February 28, 2023⁴.

In March 2019, the City Council amended Title 26 to allow SJCE to adjust rates without requiring written notice to customers or a finding of extraordinary circumstances if certain

¹ [May 16, 2017 City Council Minutes](#)

² [Ordinance No. 29978](#)

³ [Ordinance No. 30028](#)

⁴ [Resolution No. RES2023-45](#)

conditions are met⁵. These conditions are applicable for product offerings when rates are set at or below IOU rates, and when the rate change follows an IOU rate change. The conditions require that the new rate is consistent with previous City Council resolutions (i.e., the new rate will be the same percentage above or below the IOU rate that City Council approved) and is, inclusive of the Power Charge Indifference Adjustment. The conditions also require the rate change to be no more than five percent⁶.

On December 6, 2022⁷, SJCE adopted a cost-of-service model for rate-setting which means that SJCE's current rates are not based on a percentage of the IOU rates. In the future, SJCE may need to bring back a product and a rate that is based on the IOU rates, such as GreenValue, which was priced at parity with IOU rate.

On April 6, 2023, the Risk Oversight Committee advised that a recommendation to amend the Title 26 and the ERMP be considered by the City Council.

ANALYSIS

Procurement and Contract Authority for Power Products:

CED staff identified important limitations in the power contracting authority currently set forth in Title 26. The current contract authority is inconsistent with electric utility practice of procuring power in forward markets. Procuring power in forward markets typically reduces volatility and provides more cost certainty which stabilizes rates.

Markets for power supply agreements having different term lengths possess different characteristics. For example, as illustrated in **Attachment A - Characteristics of Different Power Markets – Contracting Timeframe**, short-term power markets for energy, capacity, and renewable power products tend to be very fast-paced and require that bidding, commitments, and contracting take place within days of each other as sellers typically do not hold prices for more than 30 minutes.

Staff recommends several amendments to Title 26 and the ERMP to remove the procurement and contract authority for the Director of Community Energy to enter into short-term agreements up to \$500,000 per day and replace it with procurement authority to purchase and sell power products that is more aligned with standard industry practices. These changes are summarized below:

- City Council must approve long-term agreements (10 years or more) for the purchase and sale of power products. In the coming years these agreements will represent more than 65% of SJCE's power supply portfolio.

⁵ [Ordinance No. 30233](#)

⁶ [Ordinance No. 30233](#)

⁷ [Resolution No. 80804](#)

- City Manager, or Designee, is authorized to negotiate and execute on behalf of the City, without the prior approval of City Council, short-term (three years or less) and medium-term agreements (more than three years and less than 10 years) for the purchase and sale of power products.
- City Manager, or Designee, is authorized to negotiate and execute on behalf of the City, without the prior approval of City Council, master power purchase and sale agreements consistent with the form previously approved for use by the City Council for the purchase and sale of power products. Master purchase and sale agreements set forth the general terms that will apply to individual transactions made pursuant to the agreement, whereas individual purchases and sales under the agreement set forth terms, quantities, and price. Any purchases or sales pursuant to such agreements are subject to term limitations.
- City Manager, or Designee, and Director of Community Energy, or Designee, are authorized to negotiate and execute short-term agreements.
- Agreements must be for the purpose of meeting forecasted load, minimizing risks, stabilizing power costs, complying with regulatory obligations, or City Council goals and must meet the requirements approved by the City Council in the ERMP. The ERMP includes requirements for procurement authority limits, competitive bidding, and counterparty credit evaluation.

The proposed contract authority is aligned with prudent industry practice to procure power in forward markets, through a combination of short-, medium-, and long-term agreements, with the bulk (at least 90%) of load covered at least six months to a year in advance. Forward procurement ensures that there are sufficient power plants available to meet load and reduces exposure to the significant price volatility in the day-ahead and real-time electric markets.

Community choice aggregators like SJCE and all electric utilities must buy all power products needed to meet customer load. If CED does not buy enough electricity to meet customer loads in the forward markets, the California Independent System Operator will buy the amount outstanding and bill CED for that amount. CED also has legal and regulatory requirements to buy certain products such as Resource Adequacy. Failure to procure these products in forward markets can result in penalties.

Medium-term agreements are essential to stabilizing costs and limiting exposure to short-term market disruptions. Authorizing the City Manager, or Designee, to negotiate and execute medium-term agreements mitigates risk and helps to stabilize costs. Authorizing the City Manager, or Designee, and Director of Community Energy, or Designee, to negotiate and execute short-term agreements enables CED to buy power efficiently in the fast-paced short-term electricity markets and ensures that the Department always has the authority needed to buy power to meet load.

California Senate Bill 350 requires procurement of at least 65% of the required renewable power from long-term agreements with a term of 10 years or more⁸. To continue meeting state law and regulatory requirements, as well as achieving the City's carbon neutrality goals at reasonable

⁸ [Senate Bill 350](#)

prices, CED will continue to seek City Council approval for long-term power purchase agreements with new and existing clean power plants.

Since the start-up phase of SJCE, CED has entered into 17 long-term power purchase agreements and supplemented those with short-term agreements. **Attachment B - Current and Anticipated SJCE Energy Portfolio** - depicts the City Council-approved current energy portfolio and its constitution of long-term and short-term agreements. As of February 28, 2023, SJCE purchased over 75% of the expected needs for each of the next two calendar years. The power portfolio is composed primarily of long-term power purchase agreements with a duration of 15-20 years that cover around 50-60% of the expected energy needs from 2025 through 2036. In the coming years, SJCE anticipates long-term agreements comprising most of the power supply portfolio in line with state law requirements.

Under the proposed procurement authority, most of the customer load will be met by long-term agreements approved by the City Council, followed by medium-term agreements approved by the City Manager, or Designee. The remaining balance of the portfolio would be met by short-term agreements approved by the City Manager, or Designee, and Director of Community Energy, or Designee (Attachment B). The estimated distribution of agreements as a percentage of forecasted load in future years is:

- long-term agreements – 50%-70%,
- medium-term agreements – 15%-20%, and
- short-term agreements – 5%-20%.

The procedures for the procurement of short-, medium-, and long-term agreements of power products are included in the proposed revisions to ERMP to memorialize current power product procurement practices. The purchase of power products is subject to a separate procurement process than the procurement of other goods and services due to the real time nature of the energy market and the short timeline that suppliers hold pricing. The ERMP describes procedures for procurement through competitive bidding and procurement where competitive bidding is not practicable such as procurement with deliveries within one week or less and balance-of-month, unique services, joint solicitations, and public agency procurement.

Rates and Charges:

Staff recommends deleting the provision limiting the number of rate increases allowed. Currently, the San José Municipal Code allows two rate increases per fiscal year absent extraordinary circumstances. This limitation impacts the competitive position of SJCE compared to the IOU. IOUs change rates multiple times a year. Removing this limitation will enable SJCE to timely recover its costs and maintain competitive rates. Pursuant to the adopted cost-of-service model for rate setting, SJCE only charges customers what it costs to provide electric generation service and build financial reserves. Financial reserves are a best practice and used to provide rate stability against future increases in power supply costs and added fees from the IOU such as the Power Charge Indifference Adjustment.

Title 26 currently requires that rate increase notices to be sent to SJCE customers in regular bills or a separate letter at least 30-45 days before City Council's consideration to increase rates. When rates are set as a percentage of the IOU rate, this process requires staff to speculate on IOU rates and added fees to achieve competitive pricing as the IOU rate is often not known this far in advance. Staff recommends setting the notice requirement to no less than 15 days to allow for more timely cost recovery and so staff can use the latest information available related to IOU rates. This is in line with industry best practices to keep customers informed of rate changes and still gives customers ample time to provide feedback to SJCE.

Staff also recommends adding an additional requirement to post the notice on SJCE's website and at City Hall at least 15 days prior to the rate hearing. This will increase transparency around SJCE's rate-setting process. The revisions in Title 26 also clarify that noticing requirements are not applicable for any proposed decrease in rates.

SJCE does not currently have a product offering for which rates are set with reference to IOU rates; however, SJCE may bring back rates that are tied to the IOU in the future such as the GreenValue product that was priced at parity with the IOU rate. The current noticing requirement is restrictive and has resulted in lower revenues and reserves as SJCE cannot currently change rates quickly enough to keep up with IOU rate and added fee changes.

Notwithstanding a proposed increase in rates, the proposed Ordinance would allow for an exemption from noticing requirements for product offerings for which rates are set with reference to IOU rates provided certain conditions are met including: the rate increase (1) follows and corresponds to rate change by IOU, (2) continues to be same percentage above or below IOU rates, (3) is inclusive of Power Charge Indifference Adjustment and franchise fee surcharge, and (4) is not more than 10%.

Under the proposed Ordinance, staff recommends discretion to add late charges and return customers to IOU service as well as to give customers 90 days, instead of 30 days, to bring their accounts current. SJCE is currently required to add late charges to bills and return customers to IOU service if they do not bring their accounts current within 30 days of receiving a late payment notice. This can be burdensome for the residents and businesses of the City as the economy recovers from the economic impact of the pandemic. The proposed revisions will add more flexibility to address customer arrearages. SJCE will develop policies and fine/fee schedules for collections and returning non-paying customers to IOU in collaboration with the Finance Department.

Other amendments:

Other amendments in the San José Municipal Code and ERMP include:

- Setting limitations on the proposed authority for the City Manager, or Designee, and Director of Community Energy, or Designee (**Attachment C - Contract Authority Limits**);
- Defining procurement procedures for purchase and sale of power products;
- Setting an annual timeline for establishing rates, tariffs, and charges for SJCE;

- Quarterly reporting to the City Council summarizing number and cost of medium-term and short-term agreements;
- Revising the minimum credit rating for SJCE counterparties from BBB+ to BBB-;
- Clarifying that the Risk Oversight Committee advises CED;
- Requiring the City Manager or designee approval, instead of Risk Oversight Committee approval, for counterparties below BBB-; and,
- Other drafting improvements and addition of definitions.

Climate Smart San José Analysis:

The recommendation in this memorandum aligns with one or more Climate Smart San José energy, water, or mobility goals. Procurement of power products is needed for SJCE to meet its financial and regulatory requirements and to meet the City's renewable power content goals.

EVALUATION AND FOLLOW-UP

No further evaluation and follow-up is required at this time.

COST SUMMARY/IMPLICATIONS

The recommended action is expected to create efficiency in power procurement and timely collection of revenues in future years. Immediate and long-term cost savings are not quantifiable.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the City Manager's Budget Office, and the Finance Department.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the May 2, 2023 City Council meeting.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

HONORABLE MAYOR AND CITY COUNCIL

April 7, 2023

Subject: Proposed Amendments to Municipal Code and Council Policy

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CEQA

Not a Project, File No. PP17-005, Adjustment to Fees, Rates, and Fares without changes to or expansion of services and File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/

LORI MITCHELL

Director, Community Energy

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

ATTACHMENTS

Attachment A – Characteristics of Different Power Markets – Contracting Timeframe

Attachment B – Current and Anticipated SJCE Energy Portfolio

Attachment C – Contract Authority Limits

Attachment A

Characteristics of Different Power Markets – Contracting Timeframe

		RFO* Issued to Bids Received	Commitment	Agreement Signed
Short-Term (≤3 years)	Energy	3 days	30 minutes	3 days
	Capacity	7 days	30 minutes to 1 day	2 weeks (Bilateral outreach requires extremely expedited timeline)
	Renewables	10 days	30 minutes to 3 days	2 weeks (Bilateral outreach requires extremely expedited timeline)
Medium-Term (> 3 years & < 10 years)	Energy	1-2 weeks	1-2 weeks	2-4 weeks
	Capacity	7 days	1-5 days	2-4 weeks
	Renewables	30 days	30 days	2-6 weeks
Long-Term (≥ 10 years)	Energy	3 weeks	3-6 months	12-24 weeks
	Capacity	30 days	30 days	12-24 weeks
	Renewables	30 days	30 days	12-24 weeks
<i>*Note: RFO stands for Request for Offer</i>				

Attachment B

Current and Anticipated SJCE Energy Portfolio

Figure 1 illustrates the City Council-approved current portfolio and its constitution of long-term (10 years or more) and short-term agreements (three years or less) as of February 28, 2023.

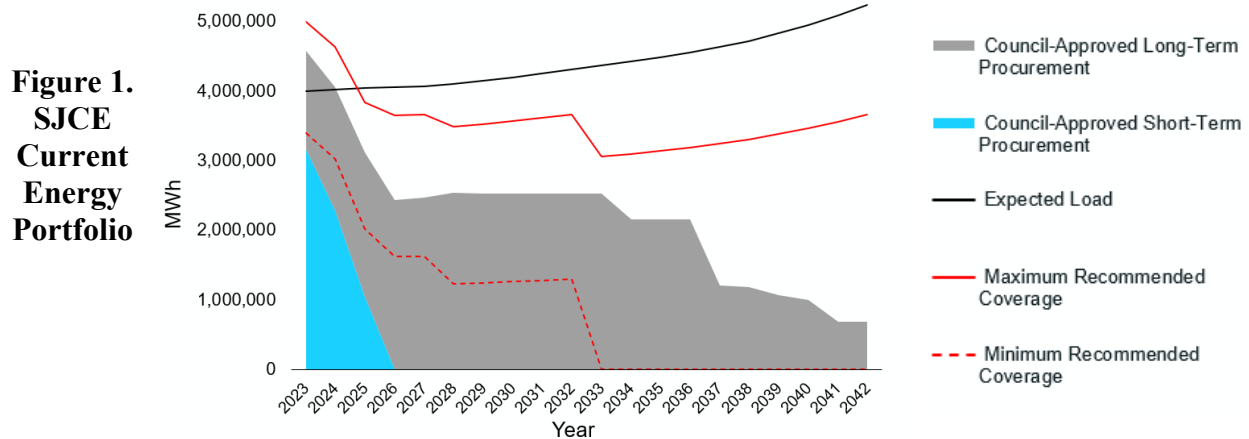
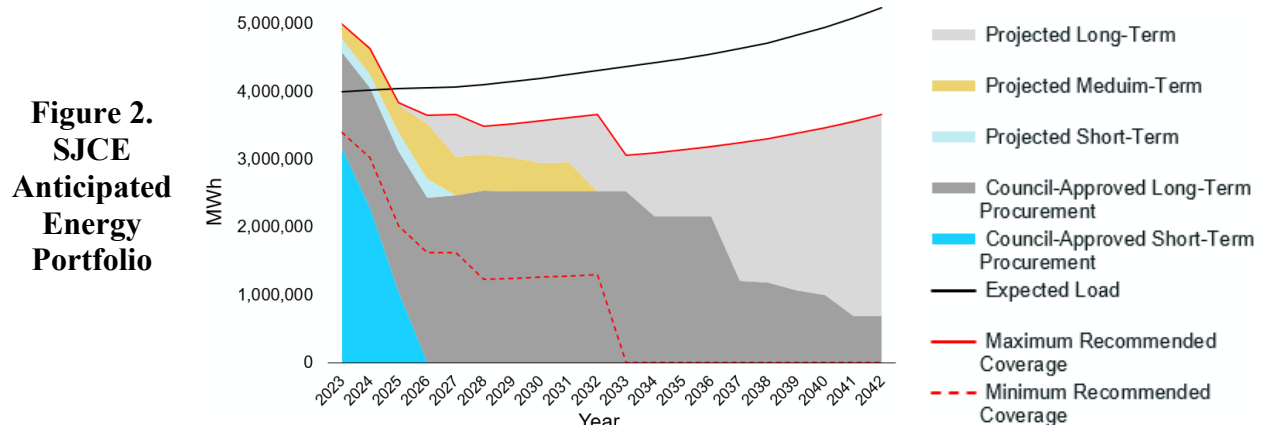


Figure 2 illustrates the proportion of long-term (10 years or more), medium-term (more than three years and less than 10 years) and short-term agreements (three years or less) that SJCE anticipates executing and the corresponding proposed procurement authority. The darker fill areas represent currently procured quantities of short-term agreements (dark blue) and long-term agreements (dark gray), both authorized by the City Council. The lighter fill represents the projected quantities for long-term (light gray), medium-term (yellow), and short-term agreements (light blue). SJCE's energy risk hedging strategy sets maximum and minimum procurement "coverage" levels (red line in the figures), reflected as a percentage of expected load, for future years to mitigate market price volatility risk. CED anticipates SJCE's long-term agreements comprising the majority of the agreements in line with state law requirements.



Attachment C

Contract Authority Limits

The proposed revisions in San José Municipal Code lay out the following limits on the authority of the City Manager and Director of Community Energy:

The purchase and sale of power products shall be for the purpose of meeting forecasted load, minimizing risks, stabilizing power costs, complying with regulatory obligations or local goals and shall comply with the ERMP.

The annual power product costs may not exceed the annual power product expenditure budget approved by the City Council in the Adopted Budget process for that fiscal year. If the agreement is for more than one year, the commitment must be subject to the future appropriation of funds, and payment obligations must be paid solely from the San José Clean Energy Operating Fund.

ERMP further stipulates the period between the initial delivery date and the agreement execution date for each authority level, as outlined in the Table below.

Contract Authority	Agreement Type by Term	Term/ Duration of the Agreement	Initial Delivery Date from the Agreement Execution Date (No later than)
City Council	Long-term	10 years or more	As approved by the City Council
City Manager	Medium-term	More than 3 years and less than 10 years	5 years
City Manager or Director of Community Energy	Short-term	3 years or less	3 years