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REPORT TO HONORABLE MAYOR AND COUNCILMEMBERS

PROPOSED FRANCHISE AGREEMENTS FOR GAS & ELECTRIC SERVICES: LABOR PROVISIONS AND OTHER POTENTIAL LEGAL ISSUES

INTRODUCTION

On August 6, 2020, the City Council (Council) will consider a resolution of intent regarding the key terms of the City of San Diego's (City) prospective franchise agreements for gas and electric services. The City entered into 50-year franchises for gas and electric services with San Diego Gas & Electric (SDG&E) in 1970. The franchises are set to expire in January 2021.

On July 16, 2020, City staff, with assistance from two consulting groups, presented recommendations to the Council's Environment Committee for new proposed franchise agreements. The Committee passed a motion to draft a resolution of intent for consideration by the Council, which includes all the potential franchise terms listed in the term sheet titled "Consultant's Proposed Terms" (included in the Committee's backup materials), and two additional terms:

1. The prevailing bidder shall for ten years after the sale¹ and subject to the provisions of any existing collective bargaining agreement:

To the extent legally permissible, use reasonable efforts to hire and retain all employees who had been employed by the electrical or gas corporation immediately before the sale whose principal place of employment was transferred to the new owner; and

To the extent legally permissible, use reasonable efforts to provide no less than the wages, benefits, hours and other terms and conditions of employment provided to these employees by the electrical or gas corporation before the sale, including any previously negotiated increase in wages.

2. Modify the terms of payment to allow for bidders to meet the Minimum Bid by delivering a combination of cash and services during the life of the agreement. Services could include infrastructure and/or capital improvement projects that would otherwise be paid for by the City, such as: undergrounding, street lights, energy

¹ As the provisions are currently drafted, these employment requirements only apply in a case where the franchises are awarded to another utility operator after a sale from the current franchisee, SDG&E. Thus, if SDG&E were to be the prevailing bidder, it appears it would not be required to comply with these provisions.

efficiency, EV chargers for the City, solar on City facilities, utility box beautification, median improvements, sidewalk repair, tree trimming, and exploring adding a Climate Equity Fund.

This Report addresses the legality of these two additional terms, as well as other legal issues that may arise with respect to the new franchise agreements.

ANALYSIS

As currently worded, the two additional franchise terms recommended by the Committee likely violate San Diego Charter (Charter) section 103, which requires an opportunity for “free and open competition” before the grant of franchises. However, the City has a strong public safety interest in continuity of service, and can insist that any new franchise holder take reasonable actions to retain the employees of SDG&E necessary to ensure the safe and efficient operation of the gas and electric franchises. With respect to the second term, the Charter likely prohibits the City from accepting a combination of cash and services up front.

I. REQUIRING THE PREVAILING BIDDER TO USE REASONABLE EFFORTS TO HIRE AND RETAIN SDG&E EMPLOYEES FOR A PERIOD OF TEN YEARS AT THEIR CURRENT WAGES FOLLOWING THE GRANT OF THE FRANCHISES LIKELY VIOLATES THE MANDATE FOR FREE AND OPEN COMPETITION UNDER CHARTER SECTION 103

The granting of franchises is governed by Charter section 103, which in relevant part provides:

Such grants shall be made by ordinance adopted by vote of two thirds (2/3) of the members of the Council and only after recommendations thereon have been made by the Manager and an opportunity for *free and open competition* and for public hearings have been given (emphasis added).

The invitation to bid in this matter will include a variety of documents, including the proposed franchise agreements. In general, an invitation for public bids must be sufficiently detailed, definite and precise so as to provide a basis for full and fair competitive bidding upon a common standard *and must be free of any restrictions tending to stifle competition. Konica Bus. Machines U.S.A., Inc. v. Regents of Univ. of Cal.*, 206 Cal. App. 3d 449, 456 (1988) (emphasis added). As noted above, the Charter specifically requires free and open competition in the case of franchise grants.

As a charter city, the City must act within the limitations and restrictions set forth in the Charter. *City of Grass Valley v. Walkinshaw*, 34 Cal. 2d 595, 598 (1949). *See also Domar Elec., Inc. v. City of Los Angeles*, 9 Cal. 4th 161, 170 (1994). The Charter is the City’s constitution, and the City, acting through its officers and employees, must comply with it. *Miller v. City of Sacramento*, 66 Cal. App. 3d 863, 867 (1977) (“A City charter is like a state constitution but on

the local level; it is a limitation of, not a grant of power.”) *See also City & Cnty. of San Francisco v. Patterson*, 202 Cal. App. 3d 95,102 (1988) (the charter is to the city what the state constitution is to the state). The Council cannot act in conflict with the charter. “Any act that is violative of or not in compliance with the charter is void.” *Domar Elec., Inc.*, 9 Cal. 4th at 171.

In the instant case, a requirement to use reasonable efforts to hire and retain all existing SDG&E employees at no less than their current wages, benefits, hours, and terms and conditions of employment for ten years may deter other firms from bidding on the franchises. For example, prior to submitting a bid, it would be very difficult for a non-incumbent firm to know with any certainty the current wages and benefits of SDG&E employees. It would not be feasible for competing bidders to evaluate their costs for operating the franchises without knowing the employment costs of its potential future workforce. Thus, the bidders would have difficulty determining whether they could profitably operate the franchises. The likely result would be fewer qualified firms would be willing to submit proposals in such a case, which seems to defeat the objectives of free and open competition, as required by Charter section 103. *Baldwin -Lima-Hamilton Corp. v. Superior Court*, 208 Cal. App. 2d 803, 821-822 (1962). It also gives the current franchisee, SDG&E, an unfair advantage, as SDG&E already employs the individuals whose jobs the City wishes to protect and has ready access to their wage information.

Moreover, as worded in the Committee’s motion, these employment provisions only apply in the case of a sale; therefore, it appears SDG&E would not have to comply with them if it retains the franchises. Based on the above, it is likely a court would find the requirement for the successful bidder to use reasonable efforts to hire all current SDG&E employees at not less than current wages, benefits, hours, and terms and conditions of employment violates Charter section 103’s mandate on free and open competition. As a result, the award of the franchises could be voided in such a case.²

Nevertheless, the City has a strong interest in ensuring that, if there is a change in the holder of the gas and electric franchises, the new entity has a workforce with the appropriate skills, training, and knowledge of the existing gas and electric facilities and equipment, such that it can effectively, safely, and reliably continue providing services to its customers in the City. From a practical perspective, it is likely that current SDG&E employees will have the required skills and knowledge to effectively continue operations. Therefore, there is a rational basis for the City to insist that any new franchise holder take reasonable actions to retain the employees of SDG&E necessary to ensure the safe and efficient operation of the gas and electric franchises.

Thus, our Office suggests the following provision(s) be included in the franchise agreements:

Subject to any existing collective bargaining agreements, the prevailing bidder shall use reasonable efforts³, as determined by the City, to hire and retain all employees who had been employed by

² This means the City would have to reopen the bid process close in time to the existing franchise expiration date.

³ Although the term “reasonable efforts” is not a mandate that the prevailing bidder hire all former SDG&E employees, when read in conjunction with more specific language requiring employees be provided the same wages, benefits, hours, and terms and conditions of employment for a period of 10 years, such a provision could be viewed as restricting the prevailing bidder’s freedom to make its own hiring decisions. Thus, a court could find the language anti-competitive.

the electrical or gas corporation within 180 days before the sale who are necessary for the continued safe and efficient operation of the gas and electric franchises.

Removing the ten-year term and references to current wages, hours, and other terms and conditions of employment for all employees from the franchise agreements mitigates against the possibility the invitation to bid could be viewed as anti-competitive or favoring SDG&E, while still addressing the City's compelling interest in maintaining a strong workforce capable of reliably operating the gas and electric franchises.

II. OVERLY RESTRICTIVE LABOR PROVISIONS COULD CONVERT THE CITY TO A "JOINT EMPLOYER" AND SUBJECT THE CITY TO LIABILITY FOR EMPLOYEES' NEGLIGENT ACTS AND THE FRANCHISE HOLDER'S VIOLATIONS OF STATE AND FEDERAL EMPLOYMENT LAWS

Under California Wage Order No. 5-2001, section 2(H), an "employer" is one "who directly or indirectly, or through an agent or any other person, employs or exercises control over the wages, hours, or working conditions of any person." The California Supreme Court has provided three alternative definitions for what it means to "employ" someone for purposes of Wage Order No. 5-2001: "(a) to exercise control over the wages, hours or working conditions, *or* (b) to suffer or permit to work, *or* (c) to engage, thereby creating a common law employment relationship." *Martinez v. Combs*, 49 Cal. 4th 35, 64 (2010). A joint employer is vicariously liable for the torts of employees, as well as for the violation of state and federal labor laws. *See, Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474 (2014) (concluding a franchisor will be liable for sexual harassment claims if it has control over the operations of the franchised locations); *Salazar v. McDonald's Corp.*, 944 F.3d 1024 (9th Cir. 2019) (generally discussing joint employer's potential liability for wage and hour violations).

Applying the above definitions, a court could conclude that the City is an employer because, through the language proposed by the Environment Committee, it has control over the wages, hours and working conditions of the employees by requiring the franchise holder to hire all SDG&E employees at no less than their current wages, benefits, hours, and terms and conditions of employment, and to retain them for a period of ten years. As a result, a court could find the City is a joint employer with the franchise holder and the City could be subject to increased liability for the acts of these employees and the franchise holder's violations of applicable employment laws. This is the type of liability the City should be endeavoring to eliminate, or at least minimize, through the terms of the franchise agreements.

Again, removing language from the franchise agreements requiring the prevailing bidder to hire all SDG&E employees at current wages, hours, and other terms and conditions of employment, makes it less likely a court would find the City to be the employer of the individuals because the City would be distancing itself from control over these employees. Instead, the new franchise holder would have sole responsibility for negotiating these terms with its new employees.

III. ALLOWING BIDDERS TO PROVIDE A COMBINATION OF CASH AND SERVICES TO MEET THE REQUIRED MINIMUM BID FOR THE FRANCHISE LIKELY VIOLATES THE MANDATE FOR FREE AND OPEN COMPETITION UNDER CHARTER SECTION 103

As discussed above, Charter section 103 states that franchises may only be granted after there has been an opportunity for free and open competition. The essence of free and open competition requires that all bidders are on an equal footing, under the same objective rules. The requirement of a Minimum Bid in cash would ensure that all bidding parties were judged equally and in the same currency.⁴ The ability to offer a combination of cash and services would create difficulties in quantifying the value of in-kind services with enough precision to ensure an equal playing field.

Additionally, as with the labor provisions, we would advise that no bid terms provide the incumbent with an unfair advantage. The ability to offer in-kind services may favor the incumbent who has held franchises from the City for nearly a century, and is in a better position to provide and be aware of projects and services of interest to the City.

IV OTHER LEGAL ISSUES

The Council will be considering significant policy objectives in connection with the proposed franchises. We expect that the Council may wish to discuss subjects like greenhouse gas reduction, solar distributed generation mandates, net metering, feed-in tariffs, electric storage, transportation electrification, rate-based energy program funding, and similar subjects. It is permissible to discuss these subjects because they impact the terms the City will develop. However, bear in mind that the State Legislature and the California Public Utilities Commission have jurisdiction over gas and electrical corporations. Therefore, while the City awards the franchises, state law may limit the City's ability to require certain terms.

Additionally, the Committee discussed the potential exploration of a Climate Equity Fund. If that idea is further developed, our Office can advise on any legal considerations, after we have an opportunity to research the issues.

Other legal questions may arise that require further analysis and will be very dependent on the specific factual scenario. Our Office stands ready to provide additional analysis on these issues, as needed.

⁴ The Minimum Bid amount must be securely delivered to the City in full with the bid. This may take the form of cash or other secured equivalent of cash, such as promissory notes secured by an irrevocable letter of credit from a bank acceptable to the City. The Mayor recommends that if a bidder does not wish to pay the entire Minimum Bid amount in cash up front, it may alternatively elect an installment plan based on secured promissory notes, with interest, spread over a period of up to ten years. It is a policy decision whether to provide bidders the option to pay the Minimum Bid amount in installments. If permitted, all bidders must be allowed to elect this option to ensure a fair competition.

CONCLUSION

A provision in the franchise agreements requiring the successful bidder for the gas and electric franchises to use reasonable efforts to hire all existing SDG&E employees at not less than current wages, benefits, hours, and terms and conditions of employment for a period of ten years likely violates Charter section 103, which requires a “fair and open competition” prior to the grant of a franchise. In such a case, a court could void the award of the franchises.

Additionally, such language could unintentionally create a situation in which the City is deemed a joint employer with the franchise holder, thus subjecting the City to increased liability for negligent acts of the franchise holder’s employees and the failure of the franchise holder to comply with applicable employment laws.

Notwithstanding the above, the City has a strong interest in insisting that any new franchise holder use reasonable actions to hire and retain existing SDG&E employees to ensure continued safe and efficient operations of the gas and electric franchises. Our Office’s proposed language discussed above protects this interest, while mitigating against the possibility the provision could be seen as anti-competitive or exposing the City to liability as a joint employer.

Similarly, a provision in the franchise agreements allowing a combination of cash and services to meet the Minimum Bid would likely violate Charter section 103. Our Office stands ready to provide additional legal analysis as needed.

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