

DATE ISSUED: December 5, 2001

REPORT NO. 01-256

ATTENTION: Honorable Mayor and City Council
Docket of December 11, 2001

SUBJECT: Gas and Electric Franchise Agreements

SUMMARY

Issue - Should the City Council:

- (1) Adopt ordinances amending the gas and electric franchises with San Diego Gas and Electric Company (SDG&E) to:
 - (A) Continue with the current franchise fee consisting of 3% of gross receipts;
 - (B) Implement an undergrounding surcharge of 4.5% of gross receipts minus any rate-embedded underground funds; and
 - (C) Change the definition of gross receipts to include paying the franchise fee on revenue collected on all surcharges?
- (2) Approve a Memorandum of Understanding with SDG&E incorporating an "Advice Letter" to the California Public Utilities Commission (CPUC).
- (3) Support the approval of each request in the "Advice Letter".
- (4) Adopt ordinances to amend San Diego Municipal Code, Chapter 6, Article 1, Division 5, *Underground Utilities Procedural Ordinance*.
- (5) Adopt new Council Policy 600-8, *Underground Conversion of Utility Lines by Utility Company*.
- (6) Amend the Fiscal Year 2002 Annual Appropriation Ordinance by \$525,000 in the operating budget and \$8 million in the Capital Improvement Program to provide necessary funding for City incurred costs of implementing proposed underground program changes in Fiscal Year 2002.
 - (7) Extend negotiation period to January, 2003 to allow for any potential delays in approval by the CPUC.

Manager's Recommendation -

- (1) Adopt ordinances amending the gas and electric franchises with San Diego Gas

and Electric Company (SDG&E) to:

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 - (B) Implement an undergrounding surcharge of 4.5% of gross receipts minus any rate-embedded underground funds; and
 - (C) Change the definition of gross receipts to include paying the franchise fee on revenue collected on all surcharges?
- (2) Approve a Memorandum of Understanding with SDG&E incorporating an “Advice Letter” to the CPUC.
 - (3) Support the approval of each request in the “Advice Letter”.
 - (4) Adopt ordinances to amend San Diego Municipal Code, Chapter 6, Article 1, Division 5, *Underground Utilities Procedural Ordinance*.
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 - (6) Amend the Fiscal Year 2002 Annual Appropriation Ordinance by \$525,000 in the operating budget and \$8 million in the Capital Improvement Program to provide necessary funding for City incurred costs of implementing proposed underground program changes in Fiscal Year 2002.
 - (7) Extend negotiation period to January, 2003 to allow for any potential delays in approval by the CPUC.

Other Recommendations - None.

Fiscal Impact - It is estimated that continuing the current franchise fee of 3% of gross receipts is approximately \$41.8 million annually. This is the estimate included in the FY 2002 Budget. The undergrounding surcharge is estimated to generate approximately \$8.5 million in FY 2002 in addition to the \$10 million currently in embedded rates for undergrounding.

The full year impact of the undergrounding surcharge in FY 2003 is estimated to be approximately \$34 million in addition to the \$10 million currently in embedded rates for undergrounding.

The City is going to phase in the undergrounding program over the next several years. The budget to implement the program in FY 2002 is \$ 8.5 million.

BACKGROUND

FRANCHISE AGREEMENT:

SDG&E currently operates under a 50 year City franchise that was granted in 1970. The franchise agreement provided that the Franchise Fee for the last 20 years of the agreement would be negotiated (or arbitrated) at the end of the first 30 years. The franchises provide that such negotiations would not last longer than six months plus an additional six months.

At the end of the initial six month negotiation period, the City and SDG&E mutually agreed to extend the negotiation period an additional six months to July 17, 2001 as provided for in the franchise. In June, 2001, the City Council (by Ordinance No. 0-18956 and 0-18957) and SDG&E agreed to amend the franchises to extend the negotiation period to January 17, 2002.

FRANCHISE FEES:

Under the franchises approved by the City Council in December 1970, SDG&E agreed to pay a franchise fee to the City equivalent to 3% of its gross receipts from the sales of both natural gas and electricity within the City for the first 30 years with the fees for the remaining 20 years to be determined during the renegotiating period.

The 3% franchise fee paid to the City of San Diego is 1.9% higher than the average of all franchise fees of 1.1% paid by SDG&E within its territory. Thus, in 1972, SDG&E petitioned the California Public Utility Commission (CPUC) for approval to implement a 1.9% electricity surcharge and a 1% gas surcharge on all SDG&E customers within the City of San Diego service territory. In July 1972, the CPUC granted this request and this surcharge was added to City's customers' rates.

From the date that the surcharges were approved by the CPUC in 1972 through the end of 1990, SDG&E included the 1.9% electric and 1% gas surcharge revenues when determining the amount of gross receipts for which they paid the City of San Diego's 3% franchise fee.

On approximately January 1, 1991, SDG&E changed its accounting and no longer included the 1.9% electricity surcharge and the 1% gas surcharge in its calculation of gross receipts. Thus, a dispute arose between the City and SDG&E as to whether or not these surcharge amounts should be included in the definition of gross receipts and be subject to the 3% franchise fee.

The settlement agreement of April 1995, between the City of San Diego and SDG&E, provided that SDG&E would pay 1.5% on all surcharge revenues collected and would continue to pay 3% franchise fees on all other gas and electric revenues. This agreement provided for the City to immediately collect all back surcharge franchise fees from 1991 through 1994. This formula would remain in effect until the renegotiation of the franchises in the final 20 years of the franchises.

UNDERGROUND UTILITY PROGRAM:

Section 9 of the electric franchise requires SDG&E to budget 1/2% of its gross receipts of 1969 for undergrounding of overhead lines in 1970 and to increase the budgeted amount each year

thereafter by 1/2% to a maximum allocation of 4.5% of gross receipts annually for undergrounding of facilities. This maximum of a 4.5% allocation was reached in 1979.

Rising fuel costs to SDG&E that began in 1974 and which the CPUC allowed to be passed on to the ratepayer caused a greater than expected amounts of undergrounding allocations to accumulate. SDG&E sought relief from the undergrounding allocations from the CPUC in 1976 and 1978. On both occasions the City Council went on record and passed resolutions opposing the reductions. On both occasions the CPUC denied the requests.

In 1979, SDG&E again sought relief from the CPUC for undergrounding allocations that were growing rapidly. In response to that appeal, the City Council in February 1980, concerned about impacts of the underground program on the City budget, ratepayers and property owners, passed a resolution for a staged reduction of underground allocations for the years 1981 to 1984 to reach a level of 2% of gross receipts and to direct the City Manager to work on amending the electric franchise to require 2% allocation from 1984 and thereafter. In return, SDG&E would assume all conversion costs of City owned street lighting and traffic signals that would need to be converted as part of any conversion projects; would convert 12,000 street lights from low pressure sodium to high pressure sodium; and would upgrade an additional 3,000 streetlights to a more modern system. In addition, SDG&E would assume the energy and maintenance costs of the entire street light system. The CPUC disallowed the provision for SDG&E to assume the streetlight energy and maintenance costs and this provision was not pursued.

In 1984, the City Council passed a resolution to set a fixed allocation amount for the five years, 1985 through 1989. Council had directed the City Manager to establish an allocation amount that was reasonable in the demands it created on the City budget, property owners and ratepayers. The Council also directed the City Manager to enter into an agreement whereby the City would take ownership of streetlights converted to underground. It was determined that the energy expenses for City owned lights was roughly a fourth of those costs that the City paid to SDG&E in energy costs for company owned lights. Changes were also made to the Council Policy to not allow transmission (69 KV) conversions until all distribution systems were underground and that undergrounding must be completed uniformly throughout the City. The City Manager was instructed to investigate the possibility of using 8209 (20A) funds for performing the customer conversions.

In 1986, the City of San Diego and SDG&E had been in a multi-year litigation over the City's 1973 re-zoning of 240 acres owned by SDG&E in the Penasquitos reserve south of Carmel Valley Road and west of Interstate 5. In 1976, the City lost a \$3 million dollar reverse condemnation judgement but managed to get it overturned on appeal. SDG&E ultimately appealed to the U.S. Supreme Court, who heard the case and dismissed the appeal for lack of final judgement at the trial court level; SDG&E promptly set the case for retrial. In May of 1986 while awaiting retrial of the case, the City of San Diego and SDG&E agreed to settle the case. The City agreed to purchase the 240 acres for \$2.5 million dollars and set the five year reduced allocation level for undergrounding for the years 1990 through 1994. SDG&E dismissed the suit and both parties agreed to not bring future actions.

In 1995, the City had been in dispute since January 1991 with SDG&E regarding back franchise

fees on City of San Diego surcharge revenues, gas transportation fees and in general what constitutes the basis for gross receipts for which SDG&E agreed to pay a franchise fee of 3% on. In addition, the 1986 five year agreement for reduced underground allocations had ended on December 31, 1994. Thus, in April 1995, the City of San Diego and SDG&E agreed that SDG&E would complete \$33 million in "pipeline projects," those currently in process. In addition, SDG&E agreed to complete another \$55 million in undergrounding projects which would be allocated in yearly increments through 2000. SDG&E agreed to meet strict yearly construction expenditure requirements and to complete all expenditure requirements by December 2002. The agreement totaled \$88 million in required undergrounding expenditures and the City waived all previously unexpended undergrounding funds which were unexpended, with the exception of those identified "pipeline" projects. SDG&E also agreed to pay half (1.5%) of the 3% franchise fee on the disputed additional surcharge revenues and SDG&E agreed to immediately pay back franchise fees on the disputed surcharge revenues for the previous four years. SDG&E also agreed to pay the 3% franchise fees on transportation revenues of gas and electricity which had also been in dispute. It was agreed that the term of this agreement would expire at the time of the renegotiation for the franchise fee for the final 20 years of the franchises.

DISCUSSION

The City Manager and SDG&E have been discussing the franchise fee and implementation of the full 4.5% undergrounding allocation obligation in Section 9 of the electric franchise. A discussion of these items is provided below.

FRANCHISE FEES:

The proposed changes to the franchises would continue the 3% franchise fee, and would change the definition of gross receipts to include paying the franchise fee on all revenues collected from any surcharges implemented by CPUC or statute.

With the revised definition of gross receipts, the existing 1.9% electric surcharge embedded in rates will be increased to 2.25% and the existing 1.0% gas surcharge will be increased to 1.03%. In addition, an undergrounding surcharge would be paid directly to the City with the quarterly remittance of franchise fees. The undergrounding surcharge would only apply to the electric portion of revenues and would be in addition to the current electric surcharge. The collection of this surcharge would begin in January 2002 with the first quarterly remittance due in the May 2002 payment to the City, assuming approval of the CPUC in October, 2001.

The amount of the surcharge would be the required 4.5% (estimated to be \$ 44 million per year) of gross receipts minus any amount of undergrounding allocations which may be embedded within the electricity rates. The embedded amount is 1.15% (approximately \$10 million). Thus, if the surcharge were implemented today, the undergrounding surcharge would be 3.53% of

gross receipts (estimated to be \$34 million per year). Combined with the 2.25% electric surcharge, the total electricity surcharge to City of San Diego customers of SDG&E would be 5.78% and would be displayed in the same manner on electricity bills that the current 1.9% is displayed. SDG&E would pay 3% franchise fees on all of these surcharge revenues.

CPUC APPROVAL:

Before any such surcharge can be enacted and in order to facilitate this surcharge, the City of San Diego will need to support and advocate an “Advice Letter” submitted by SDG&E to the CPUC supporting such action. The CPUC would need to approve any additional surcharge on ratepayers.

The surcharge will capture the obligation to pay the franchise fee on surcharge revenues. The franchise amendment includes changing the surcharge to include these revenues and approval for the increase in the surcharge is included in the “Advice Letter”.

SDG&E will submit an “Advice Letter” to the CPUC for a January 2001 implementation to increase the current electric surcharge from 1.9 to 2.25%, increase the gas surcharge from 1.0 to 1.03% and collect an undergrounding surcharge of 3.53%. The “Advice letter” to the CPUC would advocate that in order to meet the City’s objective of increasing the current amount of undergrounding being done in San Diego above what was previously agreed to, SDG&E will support the City by submitting an “Advice Letter” to the CPUC asking to increase the electric surcharge on the residents of the City of San Diego from 1.9% to 5.78% conditioned on the City using 3.53% of the additional surcharge solely for undergrounding projects within its geographic territory, with the remainder of the .35% to be an increase to the 1.9% electric franchise fee surcharge with 1.15% embedded in rates.

UNDERGROUND UTILITY PROGRAM:

An undergrounding program is proposed which will maximize the value of the undergrounding surcharge. Initially SDG&E shall act as project manager over all undergrounding projects including design, engineering and construction with the City reserving the right to assume this responsibility if it so desires. This proposed program includes the following recommendations:

1. SDG&E will expend the City’s pro rata allocation of SDG&E’s CPUC authorized capital budget of 1.1% embedded in rates for Rule 20 capital projects (currently approximately \$10 million per year) to fund all City requests for any Rule 20 A, B and/or C projects. All work will be done pursuant to the proposed City Council Policy 600-8, Underground Conversion of Utility Lines by Utility Company, San Diego Municipal Code, and the Memorandum of Understanding.
2. Rule 20A projects will be allocated separately from non- Rule 20A projects. Expenditures for Rule 20A projects will be reported by SDG&E quarterly along with other expenditure reports. Rule 20A allocated projects are limited to those streets that meet the criteria for Rule 20A. Non-authorized expenses for 20A projects such as City owned street lighting and pavement resurfacing costs will be paid for with surcharge revenues.

3. The calculated underground surcharge revenues for 2001 will be spread out in 19 equal annual amounts over the remaining 19 years of the franchise agreement.
4. The surcharge that comes to the City will be used solely for utility undergrounding activities. These surcharge revenues would pay for additional undergrounding projects which would include those projects not meeting Rule 20A criteria. The surcharge revenue would be used for the following underground expenditures:

Design, trenching, substructures, conduit and cable	72%
Pavement resurfacing of trenched streets	12%
Street Light and traffic signal conversions	6%
Lateral customer conversions	4%
Environmental monitoring costs	1%
City and SDG&E construction management costs	5%

5. SDG&E would be required to: (A) meet all project defined milestones, (B) provide the City Manager with quarterly expenditure reports of all undergrounding activities, and (C) report to Council (or committee) semi-annually. In addition, SDG&E will provide a yearly overhead utility inventory, and provide information to City staff or consultants to perform periodic value engineering studies to improve future project efficiency.

IMPLEMENTATION:

In order to implement the proposed Undergrounding Program and retention of 3% franchise fee, it will be necessary to adopt the following:

- (1) Ordinances amending the gas and electric franchises with San Diego Gas and Electric Company
- (2) Memorandum of Understanding with SDG&E incorporating an advice letter to the CPUC.
- (3) Adopt ordinances to amend San Diego Municipal Code, Chapter 6, Article 1, Division 5, *Underground Utilities Procedural Ordinance*.
- (4) Council Policy 600-8, *Underground Conversion of Utility Lines by Utility Company*.

These documents will provide for the procedures and obligations of not only the City and SDG&E as it pertains to the franchise, but to all parties involved with the undergrounding program, including other utility companies and private property owners. These documents also provide for the following:

- (1) All utilities with facilities within the City of San Diego must provide yearly inventories

of the location of all overhead facilities.

- (2) Once per year the City Council will adopt a prioritized Master Plan for undergrounding all existing overhead systems.
- (3) Once per year the City Council will allocate projects according to the allocation level. All projects allocated will be completed within 30 months unless an exception is granted.
- (4) Undergrounding will no longer be limited to streets that meet 20A criteria.
- (5) Private property owners will have a choice to allow SDG&E to convert their electric service instead of hiring a private contractor.
- (6) Twice per year City staff will report to Council the status of the underground program.
- (7) Joint trenches will be required for all utilities within an underground conversion project when technically feasible.
- (8) Defined project milestones for all utilities and other affected persons will be set by the City Manager at the time of public hearing. Failure to meet scheduled milestones will be subject to possibly include a schedule of fines.
- (9) All utilities will provide monthly progress reports and schedules in a format prescribed by the City Manager.
- (10) All underground conversion projects will receive new pavement resurfacing, new pedestrian ramps, damaged tree replacements and new street lighting at the conclusion of each project.

RAMP UP PLAN:

Due to the magnitude of the undergrounding program and to allow sufficient time to hire and train staff and design the significant increase in projects, it will take time to fully implement this program. Following is a chart showing projected allocations by fiscal year:

Fiscal Year			
		23.0*	23.0*

	26.0	10.0	36.0
	26.0	10.0	36.0
	26.0	10.0	36.0
	26.0		26.0
	* 23 million in overallocati		

EXTENSION OF NEGOTIATION PERIOD:

The City and SDG&E agreed to an extension for the current negotiation period through January, 2002. The proposed amendment would extend the negotiation period to January, 2003 to allow for any potential delays in approval by the CPUC.

ALTERNATIVES

- Do not approve this proposal.
- Approve other or modified proposal.

Respectfully Submitted,

George Loveland

Senior Deputy City Manager

Note: The attachments are not available in electronic format. Copies are available for review in the Office of the City Clerk.

Attachments

City Council Policy 600-8
Municipal Code Revisions
Electric Extension Ordinance
Gas Extension Ordinance
Memorandum of Understanding
Advice Letter