

**San Francisco
Local Agency
Formation Commission**

ITEM NO. 2

City Hall
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MINUTES
Special Meeting
Thursday, August 15, 2002, 9:00 a.m.
City Hall, Room 263

Chairperson: Commissioner Gonzalez; Vice Chairperson: Commissioner McGoldrick
Members: Commissioners Ammiano, Hall and Schmeltzer
Alternate: Commissioners Peskin and Fellman

Clerk: Monica Fish

SPECIAL AGENDA

(There will be public comment on each item)

1. Call to Order and Roll Call

The meeting was called to order by Chairperson Gonzalez at 9:14 a.m.

Members Present: Chairperson Commissioner Gonzalez, Commissioners Ammiano, Hall Schmeltzer and Fellman.

Member Absent: Vice-Chairperson Commissioner McGoldrick.

Gloria L. Young, Executive Officer, Donald Maynor, Esquire, and Nancy Miller, Esquire were noted as present.

Gloria L. Young, Executive Officer announced that Vice-Chairperson McGoldrick is not able to attend today's meeting because he is out ill and apologizes for not being able to attend.

2. Approval of Minutes for the Commission Meeting of July 26, 2002 (Action Item).

Commissioner Hall moved to approve the meeting minutes; duly seconded.

No public comment. Public comment closed.

The July 26, 2002 meeting minutes were approved with no objection.

3. Public Hearing on the Final Energy Services Study.

Gloria L. Young, Executive Officer stated that the office sent out approximately 500 mailings of the notice of this meeting to various agencies and individuals that had indicated their interest in anything relating to public power issues. We got mailing lists from the Department of the Environment and the San Francisco Public Utilities Commission. Today is an opportunity for the public to comment on this Final Plan. Legal counsel and the Executive Officer are available to discuss next steps in addition to the final Energy Services Study. All of the public hearings that we have had with respect to public power have been transcribed, so there is enough information between the Energy Plan and those public hearings if the Commission desires for us to propose recommendations to you for future steps.

Donald Maynor, Esquire stated that this LAFCo group has done a terrific job in gathering information over the past nine months. The Commission may wish to make findings or recommendations drawing from the public hearings and the consultant's report. LAFCo would draw their own conclusions and recommendations if that is something they might want to do. Ms. Fellman is familiar with the PUC process—they will oftentimes go through a lengthy gathering process and then the Commission will make findings and conclusions.

Chairperson Gonzalez asked Mr. Maynor to write down what that would look like. Would that be in a convened meeting of the LAFCo that the Commission would articulate findings, or would the Commission direct Mr. Maynor to make preliminary findings that would either support or not support?

Mr. Maynor stated that the Commission could direct the Executive Officer to prepare draft findings and recommendations and then the Commission could add or modify those as necessary.

Chairperson Gonzalez asked Mr. Maynor if he could give the LAFCo an idea of what kind of findings he has in mind.

Mr. Maynor stated that a lot of information was gathered during the public hearing process. For an example, we learned from different people about the importance of conservation and energy efficiency in San Francisco. One of the things that PG&E said they wouldn't do is perform extensive energy audits. That would be something that you would find that that was not going to occur by PG&E; that was not going to occur by the state. You might draw the conclusion and make a recommendation that that might be something that should be done in San Francisco.

Commissioner Gonzalez asked are the findings factual findings of things that come out of the hearings, or are they recommendations to another body? The point that you just made would appear to be a recommendation to a future LAFCo because LAFCo could undertake further inquiry of the type that you are discussing.

Mr. Maynor stated what he had in mind is that the Commission has gathered a lot of information from different sources including your consultants. By making findings and recommendations, you would draw your own conclusions from what you have heard. The other option is to continue and do additional studies. That is another way of taking the information and going to the next level. It is not a requirement that you do it. LAFCo has the ability to take the information and draw its own conclusions from it.

Chairperson Gonzalez asked Mr. Maynor who the primary audience would be for the findings.

Mr. Maynor stated that the public would be the primary audience. The idea would be LAFCo went through a process, gathered information, what did they conclude? The conclusion may well be the record itself and the consultant report. Or, if you wish to draw conclusions yourselves and make them formally the findings of the Commission, you could do that as well. It is not something you have to do. It is just a possible additional step that you may wish to take.

Commissioner Ammiano stated that a representative of R. W. Beck is willing to do a presentation on the Final Energy Services Study.

Commissioner Schmeltzer stated that she recalled that the Commission discussed adopting findings at the last meeting, although it's not in the minutes. She thought there was a discussion about potential draft findings being prepared for this meeting or at the next meeting.

Gloria L. Young, Executive Officer stated that Commissioner Schmeltzer was correct, and a discussion was held about pulling out findings. We recognized recommendations were in Exhibit C, so our legal counsel Nancy Miller, Esquire started an effort at pulling out findings. I had discussions with Mr. Maynor about whether or not there were other recommendations from the public hearings, that the hearing transcripts are quite long, and whether or not they needed to look through the transcripts to pull recommendations. Rather than give the Commission an incomplete document today that was already reflected in the Plan, we thought we would come back and get a real sense from the Commission whether they wanted to look at other recommendations. That would take more time than pulling the information that is already in the report. During the public hearings, there were a number of recommendations made as to whether or not code should be changed within the City. A discussion was held as to whether there should be more effort in energy conservation that the Commission might want to make recommendations to the City and County departments to pursue. That would mean taking a closer look

at those public hearings and the comments that were made from a variety of utility directors from other cities, and then coming back to the Commission with findings. We haven't had a chance to do that.

Commissioner Schmeltzer stated that is broader than what the Commission discussed doing. Part of why we had all those people come in and discuss these wide-ranging issues was so that we could discuss the types of things that another agency could do if the City were to become a public power provider. As far as findings, our study is about the services the City would provide and the next steps to get there, rather than how that entity should run its day to day operations. I was expecting to see something based on the report for today. Does anybody else remember this conversation?

Chairperson Gonzalez stated he remembered it being a relatively short conversation.

Ms. Young stated it was very short and that when they went back and talked about it, that's how it became an issue that got broader. It made more sense to come back, have the public hearing today, to give you the information that we had pulled out. Most of that is already there, but was pulled out in a separate document. If you wanted it broader, to give you the opportunity to make that decision.

Commissioner Fellman stated the work that they have been doing on LAFCo has focussed on preparing this analysis, which the Commission is looking at in final form today. I did not attend the last meeting when this discussion was held. There are observations already in the report laying out the pros and cons of the different paths that the City could take. The Commission does have the San Francisco Public Utilities Commission already looking at some of these issues, and it would be my sense that we would not want to unnecessarily duplicate what their findings are, but rather either expand or comment on what they are doing. Before the Commission determines whether we want findings or recommendations, the Commission should have a conversation about what the next step is for the LAFCo and what role the LAFCo wants to play with respect to the City and County's energy policy, given that we are concluding the first phase of that role.

Chairperson Gonzalez stated that he agrees with Commissioner Fellman. However, the previous discussion that we had about this was not so substantive that a decision was made and moved on. To the extent of what our future charge is--the exercise of trying to look at findings or recommendations may help us decide what our future charge is. The Commission could direct their attorneys to look into that and ultimately reject draft findings that are put together because we think they're duplicative or we don't think accurately reflect the work that the Commission has done.

Commissioner Ammiano concurred with Chairperson Gonzalez's remarks. The discussion wasn't that substantive last time.

Commissioner Hall asked what the process is of preparing findings of the staff reports. Who does that and what is the timeframe?

Ms. Young stated LAFCo would direct their request through me and I would work with the Attorney's Office because some of those findings do have a legal aspect and they would bring it back. It is the same as any department that a study is made and out of that study, recommendations are usually generated. There are recommendations in the report that can be pulled out in a separate document that you can look at and make a determination.

The question became wider because the question was whether to include the comments and recommendations that may have been made during the public hearings and pull those in as well. What is reflected in the report is that we have had a series of public hearings, but not necessarily spelling out each one of those recommendations.

Nancy Miller, Esquire stated typically when LAFCo's receive a study like this, you can do one of a couple of things. You can formally adopt/approve the study. Since the study has a number of alternatives in it, you could take the next step which is if there are actually alternatives you want to choose, recommend, or make findings about, you could pull those out of the document and make those your findings. In other words, you have a couple of alternates on many of the chapters that the consultants gave you, different ways that the City could operate or do things better. Or, third, you could accept the report, take no further steps other than to disseminate it to the public. Then, if you have ballot measures then the public can take that study and use it to make their decision when they move on to the ballot box. When we were talking, it was a brief conversation about recommendations, which is a step that is available to you, but you certainly don't have to take it.

Chairperson Gonzalez stated I was thinking about this less from the point of view from the ballot box and more of the point of view of the future configuration of LAFCo that may not include the current members here. If for some reason the LAFCo wanted to pick up and continue work and the current members were not here, there is something to be said for the institutional memory that findings help accomplish.

Commissioner Fellman asked Chairperson Gonzalez to elaborate what those findings would look like. Are you suggesting that we pick a path out of the recommendations or that we further delineate what the two paths are?

Chairperson Gonzalez stated that his thought on these kinds of findings could be two-fold. One would be to reach a factual conclusion about something given the testimony that was heard earlier. The other issue would be articulating possible future courses of action. It is like saying there are certain things that we have done and certain things that we did not do. I think it is sometimes helpful to make sure that whoever comes after you is aware of things that you did not do. They can move

forward with that understanding that there may be certain things that they may want to explore that we didn't flush out.

Mr. Maynor stated I was thinking of drawing out the most important points from this process and identifying those, making conclusions or recommendations. Then you can verbalize those. Or, you can simply adopt the report and the recommendations in it as your own. That could be a simple set of findings. I didn't want to spend a lot of time to find out that was not the direction that the Commission wanted to go in.

Commissioner Hall stated that the Commission needs some type of document that shows what the Commission touched on, what this group is satisfied with, what we didn't emphasize, what came out of it that maybe future groups may want to take a look at. Some kind of document that summarizes where we have been so that future groups coming in may emphasize an area of this past study that this Commission didn't emphasize. I don't want to go on studying this forever—there are a lot of other areas of governance that I would like to look at.

Commissioner Schmeltzer stated that part of why we had a brief conversation last time was because we did not know how these findings would look like. The idea was we were going to get some draft findings so we can see if that was the direction that we wanted to go in. There is no problem summarizing what we have done. I don't see why that should take an extraordinary amount of time and effort to summarize who has been before the Commission and two or three points that they covered. The main focus and the main thing that the Commission did was put together this report and work with the consultants on going back through all of the testimony from those hearings and put together something. It seems that the Commission should, as far as findings, use that as the basis for what the Commission is summarizing and proposing in the future for this body whether it is us or somebody else.

Mr. Maynor stated we didn't want to presume that this was an extensive set of findings. You could make it a simple set capturing a few points from the report or you can make it more extensive. It was really an option that the Commission had, and we felt it would be useful to get the Commission's direction on it.

Commissioner Fellman stated she is familiar with the Public Utilities Commission's and the California Public Utilities Commission's process. What they typically do and we do before them is have a series of hearings when there is an issue. In this case, it would be similar to an order instituting investigation where there would be a policy determination. At the end of it, their objective is to come up with a policy recommendation. That is what I am struggling with if indeed we are going to have findings in the sense of summarizing what has been done, showing what issues have been addressed. I recommend that the Commission adopt this report. I would like to hear from Ms. Miller whether it would be appropriate and we take the next step and make recommendations, or provide policy guidance to the City and County's process based on the record that we have and our report.

Ms. Miller stated that in terms of recommendations, what I would recommend is that the summary is very easy to do because of where we have been and where we are now. One of the things that we were looking at initially was whether to form a Municipal Utility District, and there are significant legal constraints on you. I think one of the recommendations that I put in Exhibit C that is already in the report now is that it doesn't work for San Francisco because you have to go outside the City in order to form it. That type of recommendation would be that you would work within your current SFPUC. That it makes sense for you not to form a separate Municipal Utility District with some outside entity, at least not at this time. The current language in the Charter limits the San Francisco Public Utilities Commission's ability to respond to a changing energy market. That should be something that should be looked at by the PUC and by your potential future LAFCo studies. There was also a recommendation regarding utility surplus funds and how they might better be expended. Also there was a recommendation that San Francisco has the necessary authority and Charter provisions to operate a municipal utility so you could expand the powers of the San Francisco Public Utilities Commission. There were a couple of other recommendations in Exhibit C that were fairly minor about the way that you have experienced staff on your San Francisco Public Utilities Commission. There is no need to go out and create an additional new entity in order to function. Then there was a recommendation regarding energy efficiency programs, building codes, conservation, etc. Those are the kinds of recommendations that we were thinking of initially before the draft study had been actually prepared.

You have a lot of other recommendations that your consultants have made that are much more specific about transmission, generation, that kind of thing, which you could also incorporate or not. You could simply adopt the study and say here's the history where we've been, this is what we decided to do with the study, the areas that we decided to look at and leave it much more generic in terms of your recommendations or findings. It is really up to the Commission. You have a massive report with a lot of detail and analysis in it. You don't want to summarize it all over again because you already have it. You could do a few things from where you've been which was originally the utility idea, which I don't believe is a good idea. I believe expanding your current authority and going forward with the current department is something you could take and make some recommendations regarding. That is up to the Commission.

Commissioner Fellman asked if it is the role of LAFCo then to make recommendations on how the City and County would proceed with dealing on the bureaucratic side.

Ms. Miller stated depending on how aggressive you want to be. It certainly is within your power and authority to make recommendations regarding government organization. If you have recommendations regarding improving government efficiencies, the structure of government, added powers or lesser powers are all part

of your charge. You are a unique LAFCo in that you are a City and County. But, still you have that charge and you certainly have that authority. Other LAFCo's do it.

Commissioner Hall stated Ms. Miller was correct. There are a lot of areas, and I am not familiar with each one because I came in late on this Commission. There are a lot of areas that we could recommend improvement or forward recommendations within the current PUC structure that we have studied as a result that the Commission has come to know about as a result of this study. That's a prudent safe way of going not knowing if we are going to have a new Municipal Utility District or not. That seems to be a question that needs to be decided by the voters, but we can strive to improve as a result of this study the existing conditions or parameters that the PUC is working under. Should a Municipal Utilities District become a reality at least we get something out of this study.

Ms. Miller stated you could still have a Municipal Utility. Originally, it was the district idea. Given your uniqueness, it seems that you should rather have your own utility if you were going to do it.

Chairperson Gonzalez asked to move on to the presentation of the Energy Services Study and finish this conversation on the future agenda items.

Mr. Ken Mellor, R. W. Beck introduced himself and stated that Jim Davidson from Henwood Energy Services was also present to address questions that may pertain to his section of the report. Mr. Mellor stated that he has a potentially lengthy presentation which encompasses the same kinds of material that were presented at the first public hearing and then some new material that covers the activities that took place since the first public hearing and this public hearing. He proposes to discuss the highlights of the first part of the material and will dwell a little bit longer on the material that came out of Section 6 of the Report, which was a section that was added after the first public hearing.

San Francisco LAFCo Energy Services Study

There are three participants in the Energy Services Study, R. W. Beck, Henwood Energy Services, and Flynn Resource Consultants.

Report Purpose & Industry Structure

The purpose of this study was to look at options San Francisco might have in terms of energy services. There were three key elements that the three participants were asked to look at. The first was rates and pricing. The second was reliability. There had been shortages and concerns about reliability both in terms of cost and physical reliability of energy supply. The third was local control.

Study Addresses. The report was actually broken into sections with one section on the wholesale power market costs. For the most part, this was intended to be a study that was qualitative, not quantitative. There is an exception on the wholesale market prices where there was a fair amount of quantitative information. Transmission issues that are important to the City and County of San Francisco were discussed. Then looking at various ways that energy could be distributed to the consumers in the City, and finally an element on conservation and energy efficiency and renewable resources.

Governance & Ownership Options. There was some governance options that were looked at. The first was just continuing with Pacific Gas and Electric Company as the supplier. Another was looking at the San Francisco Public Utilities Commission and expanding their role in the energy business. The third, which you have been discussing was the potential for a new Municipal Utility.

Industry Structure. One of the reasons that this came up in the first place was that there has been a lot of turmoil in the electric industry. PG&E is currently in bankruptcy and looking for ways to get out of that. They have a lot going on at the Federal Energy Regulatory Commission, and there is still a lot going on there. There are also activities going on at the Public Utilities Commission particularly with regard to direct access. That is the ability for the end-use consumer to select the provider of the commodity. That could be over lines owned by PG&E or somebody else, but their ability to choose their energy supplier.

Power Supply

2000-2001. In terms of power supply, the report looked at what happened in 2000-2001. There is a fairly long list and discussion of the events that led up to the turmoil in the market.

Near Term Outlook – Events. The report also contains a near-term outlook. Essentially what the report says is that things have stabilized, prices in the wholesale markets are down right now, and there are reasons given in the report for that.

Long Term Outlook. In terms of long-term outlook, one of the concerns raised in the report and this gets to some of the issues in the City and County is that there is a potential for a locational marginal cost pricing. That means that different regions of the state if they are in congested areas would pay higher prices. That is addressed at a fair amount of length in the report, and it is clearly a threat to the City and County of San Francisco. We also talked about environmental effects of the existing power plants in the City and then what can happen with technological change, new distributed generation and other activities that could come along that would offset some of those needs. There in that section is a discussion of what are the loads, what are the current generation resources,

what are the issues facing San Francisco as far as the fact that the loads exceed the local resources.

Wholesale Generation Risk Factors. On the power supply side, key risk factors – one of the things we discuss in the report is the value of integrated planning. Right now what is happening in the industry is the investor-owned utilities have been forced to divest their generation. They have had to turn the control of their transmission over to the California ISO and then they have their distribution companies. They no longer have the ability to integrate the planning that takes rates, loads, all of those kinds of things and looks at the package, and says here is the best thing we can do because there are tradeoffs all the way through. We discussed that a lot in the report and is one of the values of getting in to a public power situation where they still have fully integrated services. They have their own generation, own transmission, own distribution, own conservation programs and they can balance those, and they can change their rates and influence how people use energy. When you can do that integration, it provides value. I am mentioning that here, not just in this part, it comes up time and time again in this report, and so you will see integrated planning throughout this discussion.

Options for San Francisco. In areas of power supply, we looked at options at continuing to rely on PG&E and the California ISO for transmission, developing renewable resources and distributed generation. You can do that even under the current structure. You can rely on developers to go in at places like Potrero and upgrade or replace that plan. There are a lot of ways you can look at this. The fact is that one of the issues that comes out of the bottom end of this is, do you have local control, how much can you influence those activities? That is one of the things that you get into as you get into finally the issues of governance and what kind of overall utility structure you want.

Transmission issues

There are issues of these congestion charges that I mentioned earlier. The City has less reliable electric service than most of the rest of the state. That's because of geographic conditions. That's because investments were not made. It's very difficult to site and build a transmission line. It's also very difficult to own and operate a generation in a congested area. All of those things have worked to your disadvantage. So, San Francisco is more at risk than most of the rest of the state in terms of physical reliability of power supply. That is one of the issues we have addressed throughout the report. There are potential transmission additions that will help. But even with those, they are not likely to offset the need for additional generation in the area and for continued emphasis on conservation and load management and the other things that help offset the need for generation.

Transmission Opportunities

In terms of what the City could do with transmission—it could develop transmission itself, invest in it and turn it over to the California Independent System Operator to manage to schedule. It can create a control area and that's if it goes fully into the electric business and actually separate itself from the California ISO and control its own transmission rather than depending on the ISO to do it. It can develop targeted transmission investments where it goes out and helps to get a line built that needs to be built. Sometimes it's not just the investment, it's whether you support the construction building of and siting of a line, the environmental issues and all of those things. If a public agency supports those things, it often helps the process along. To the extent that you actually invest in it, you can make sure specific line segments are built. You can turn it over to the California Independent System Operator to operate, and you could recover your costs of doing that because they would pay you your revenue requirements for owning that section of the line. All of those are opportunities that the City could take.

Electric Retail Service Issues & Options

Current Service Providers. Going to the retail services. Two current issues going on. One is the PUC is providing service to municipal loads, the airport, and PG&E is providing the services to the rest of the City.

Service Options. We looked at various service options. One includes aggregation. One is integrated distribution services. That is where the City would actually own the distribution system. The third is spot municipalization. This would be in a new development area where instead of having the developer turn the distribution system when it is built over to PG&E, it would turn it over to the City, and the City would then be the service provider in that small area. We have a fairly substantive discussion of that in the report.

Facilitator of Aggregation. There are a number of ways that the City can be an aggregator. Right now there are some restrictions on that because the Public Utilities Commission has stopped new direct access or aggregation services, but there is legislation on the Board and it is likely to come back and again be an alternative. If it becomes an alternative, then there are two different aggregation models.

Facilitator of Aggregation ACWA Model

One is where you facilitate aggregation. This is the model of facilitated aggregation. The big issue here is that the contract is between the energy service provider--that is somebody else out there that has control of the electric energy and the end user. So it bypasses the City, but the City has facilitated it by going out, issuing requests for proposals, signing contracts, saying here are the standard terms and conditions of what you as an energy service provider will

provide to the customers. All we can do is help that contract process, but we are going to get out of the way so you or the City doesn't have any risk in doing that.

Electric Retail Services & Options.

Aggregator as an Energy Service Provider. The second aggregation process is where you take risk.

Energy Service Provider ABAG Model

This is the model that is used by the Association of Bay Area Governments when they were doing this, and they actually contracted with the service provider. Here you can see that the City goes out and contracts with generators, market players. They are the risk-taker. They then have another contract with their end-users, and they are right in the middle of it. It is a much riskier method of aggregation. Essentially it accomplishes about the same result.

Community aggregation – AB 117 Migden. Community aggregation is just a spin on the other aggregation approaches. There has been legislation that would allow aggregation by public agencies where instead of the public agency having to go out and convince somebody to shift from service to the public agency, they would automatically shift unless they wanted to opt out. That means that the assurance that a public agency becoming a community aggregator would have an immediate large set of customers would be much greater than the current system where the City would have to go out and solicit customers to come and join the system. That legislation also goes on and protects the current service providers by making sure that there will be exit fees for a customer to make the shift. They will have to pay for Department of Water Resources commitments to long-term power supply, to the utilities who have stranded investments or debts that have occurred during the chaotic period. So there are protections in there which will make this less financially attractive to the end-use consumer. That is in the legislation.

Integrated Distribution Services. This option is looking at actually providing distribution services and we looked at all of the different approaches including retaining PG&E, having the PUC do it, a new municipal utility, spot municipalization, or some combination of those.

Comparison of Distribution Services between Public Utilities and IOUS

We've included some comparison. We are not going to go through all of these, but what we have done is to show where things are similar between a publicly-owned and investor-owned utility. This one happens to show that and what it in a sense says is that the operation maintenance of a distribution system would be much the same whether it were public or private--the reliability, and it's not always true. In fact, in the case of PG&E more recently, they have had some

problems. In the case of PG&E more recently, they have had some problems. But they use the same standards, they use the same reporting techniques. Typically, what we see across the country is that there is not a lot of difference in terms of distribution system reliability whether it is a publicly-owned system or a privately-owned system. You will get the people who have a philosophical bent one way or the other who will argue that it is not quite that. The public power folks in Washington D.C. will say public power is more reliable, and the Edison group would say no, it's the other way around. Safety, the same thing. All of the utilities in California, public or private, adhere to the same general orders. They are published by the Public Utilities Commission. They don't have to subscribe to them, but they do because they know if there were an accident they would have a liability if they didn't. So you will find the same safety standards in place for either publicly or privately-owned utilities.

Very briefly, publicly-owned utilities have lower cost of financing. Historically, they have been about twenty percent lower in terms of price from an investor-owned utility. Part of that is that they have had some advantages that are going away or have gone away. A good example is access to government power, Westernary Power Administration, Central Valley Project have large generation facilities in California. The public power entities have had an advantage in being able to acquire that. But because there is none of that left, a new public power agency wouldn't have that advantage unless something new comes along or others drop off. One of the other things is exemption from taxes. Investor-owned utilities pay income taxes, property taxes, and the publicly-owned utilities don't. In some cases, there are offsets because if they are not paying property taxes to the City, then the City loses the revenue stream. In any analysis, you have to look at those tradeoffs. In terms of income taxes, there is a substantial advantage to the publicly-owned utility.

In terms of regulation, the publicly-owned utility is self-regulated. That contributes to local control. The investor-owned utility is regulated by the California Public Utilities Commission. They're both for their transmission regulated by the Federal Energy Regulatory Commission. Public Purpose Programs—all publicly and privately owned utilities in California have about 2.8 to 3% of their revenues go to public purpose programs. Those are for low-income assistance, resources, research and development. They all pay about the same percentage of rates for that, but the investor-owned utilities payments are made to either the Public Utilities Commission or the California Energy Commission and then they are distributed to state-wide type programs. The publicly-owned utilities control those funds locally, can spend them locally and have a lot more control over whether more go to low-income assistance than research and development or whatever category they want.

Electric Retail Service & Options

Impact of Alternatives – Aggregation Facilitation. As we've looked at these various alternatives, the one at looking at aggregation facilitation, our conclusions are that there is not a very large price impact and at the last hearing, we said that unless Hetch Hetchy power was available and the public comment is, why wouldn't it be? That would be an option for the City as to whether they made it available or not depending on what governance structure you had. I would also note that out of about a six-billion kilowatt hour load in the City of San Francisco, about a half a billion kilowatt hours are available from Hetch Hetchy after you take the other commitments. Either service is already provided to the Airport and other municipal loads or required deliveries to the Modesto and Turlock Irrigation District that are there because of the fact that their water rights were taken by the City early on and federal legislation, the Raker Act guaranteed them energy for their pumping loads and their agricultural systems. So, when you are all done, only maybe eight percent or less of the total load in San Francisco would be available to be supplied from Hetch Hetchy so the cost differentials there when you start mixing eight percent of a lower cost resource in isn't going to change the outcome a whole bunch. No change in reliability, but greater local control.

Impact of Alternatives – Aggregator as Electric Service Provider (ESP). If instead of just being the facilitator, you are actually the risk-taker as an aggregator, still not a very large price impact. We are talking in the neighborhood of two to five percent at most. No change in reliability and still more local control.

Impact of Alternatives – Full Municipalization. If you go to full municipalization, then you start getting into substantial differences. The amount of price benefit that a consumer might get if you were to fully municipalize will be dependent in large part on the things I mentioned earlier. Those are the non-bypassable charges where those charges represented by the commitments already made by the Department of Water Resources in terms of long-term power supply contracts, any amount that the courts or the regulators find that the existing customers would have to pay back to PG&E for the debt they incur during the tough period. There is a ten percent rate-reduction bonds that were issued, and the customers switching would probably continue to have an obligation to pay off those bonds. So there are a number of issues there that would determine how big a price advantage you might see. I'm guessing 20 percent would probably be a pretty tough target to meet. No change in reliability and substantially more local control. One of the areas that you get into in local control and distribution systems is aesthetics. How fast you underground systems, what those systems look like and so, sometimes local control can have a big impact in those concerns. We talked a little bit about the ability to control public benefit funds.

Conservation, Energy Efficiency & Renewable Resources. You also as a fully integrated publicly-owned utility would have a lot more potential to look at

conservation programs, energy efficiency programs, and you can get into that integrated planning that I mentioned earlier. I want to continue to stress that as to its importance.

Conclusions

San Francisco is at Risk. The general conclusions from the analysis of generation, transmission, and distribution fall back in a large part to the generation and transmission areas where our concern is that San Francisco is at risk. You've got limited transmission in the City. You have unreliable, inefficient, old generation in the City. You have a regulatory structure that is changing and that will potentially subject the City to price variations because of the transmission constraints coming into the City, and so you have that potential which will then lead to price volatility, and the City would be penalized by those transmission shortcomings.

San Francisco Has Some Competitive Advantages. We've also concluded the City has some competitive advantages. The fact that you have an existing system there with Hetch Hetchy, you have broad public support for doing more than you are doing. You already have aggressive programs for solar photovoltaics, conservation, all of those things. You have local involvement. Those are some of the ingredients that really help when you move more and more towards public participation in the utility system.

Options to Consider. Some of the options that we have suggested include looking at participating in local generation. I know that the public doesn't want any local generation, but to the extent that you are a participant in it, you have more control over the siting, the emissions, and the noise. Whatever factors are of a concern to the public, then you have more control. You can also take the value of that resource and because in that participation you can use tax-exempt financing, you can have a lower cost resource than you would expect to get from the market.

We've also suggested that you could participate in transmission. You can do that in a variety of ways. If you do that, it would enhance both physical and price reliability in San Francisco. To the extent that there is more transmission built, it would offset the need for local generation and reduce the longer-term concern for the congestion pricing that will take place. We think that as soon as regulations and legislation change, that you will have options to be an aggregator. Those are not bad options. We think that could always be kept on a list of those things that the City could do. It could be any one of the forms of aggregation.

We also think that you are in a fairly strong position to fully go into the fully integrated public power business. We've listed different ways you could do that so you wouldn't have to go all the way, you could go to spot municipalization. I've said spot municipalization a few times without saying anything about the

negative aspects of it. I would like to just say that we do not encourage spot municipalization in the report.

Commissioner Hall asked Mr. Mellor to elaborate on spot municipalization and the potential in San Francisco.

Mr. Mellor stated because San Francisco is built out, the only logical places it would happen is in very large new shopping mall development or in a redevelopment zone or area. If you have a whole new system being put in and a lot of cities have new subdivisions going in all of the time or new shopping centers--the concept is when those go in, the developer usually puts in the main infrastructure. They do the trenching, the conduits, the utility comes in and pulls the wires and puts in transformers. A large part of it is built by the developer of the shopping center or whatever it is. They then deed it to PG&E. When they deed it to PG&E, they pay a 34 percent gift tax because PG&E looks at it on their books as a gift that they have to pay IRS for, and the amount is 34 percent. When the developer turns over a million dollar investment that they have made in that system, they also pay PG&E \$340,000 for the opportunity to do so. The idea that a lot of cities have adopted is instead of having them turn it over to the investor-owned utility, they turn it over to the City, and the City then becomes the owner of that system. The 34 percent tax is avoided, and the City then operates and maintains the electric system in that little area. It is called a spot municipalization. The problem is that reliability of that system in that there are little spots all over the system all interconnected with a larger PG&E system, which you don't control. The PG&E system is generally looped that is they feed from different directions. The spot is likely to have one feed. So, if a feed goes down, then you have the problem where PG&E can pick up and serve from the opposite direction.

Commissioner Hall stated, and at the same time the City assumes liability for the system.

Mr. Mellor stated, but PG&E has liability for the system. I don't worry so much about that as to ultimately the economics. It sounds real good because you are avoiding 34 percent of the capital cost, but that 34 percent is really only about maybe 40 or 50 percent of the investment in that system. PG&E invests the other 50 percent for meters, transformers, service drops, all those things in the wires. When you come down to it, there are a lot of consultants out selling this concept. There are cities saying, how can we lose? Well, we're concerned that they can lose. Any of these options need evaluation beyond what has been included in this report.

Next Steps

Clarify Strategic Direction. This gets into a discussion of Section 6 in the report which was the addition that was made after the first public hearing. What we

have suggested here is the first next step and you were discussing it earlier today and that is, what is the policy direction? You need to have a strategic direction or the City needs to have a strategic direction and the role that LAFCo plays in that probably you could play a key role at the outset or you could wait until the City does it. Ultimately, it is going to come back to LAFCo for your approval if there is a change in the sphere of influence in the City. Any change that takes over an activity from another service provider is going to come back to you folks. Ultimately, you are going to get involved. The question is do you get involved now, or do you get involved later. Somewhere, if any of these changes are going to come about, somebody needs to sit down and get some strategic direction. That can be the PUC. We're familiar with the Charter amendment. That may be the thing that causes something to happen. You have got a lot of service delivery options. Some of those will come about just because of changes in regulations and legislation.

If Delivery Includes Distribution Service

We were asked at the public hearing to give a set of steps that would be required if in fact the City were to go into the distribution business. This is a list of steps. First is clarify costs and time to proceed. Look at the PG&E franchise to see what it says about the ability of the City to do any of these things, to buy it out, what's the term of the franchise, perform a pre-feasibility study. This is not a feasibility study. A pre-feasibility study would look at approximation of costs and benefits of going into any one of these activities. But a full municipalization, it would be development of a business case. A lot of scenarios looking at different sets of assumptions and coming up with a pre-feasibility study. Decide to what extent the rate payers are going to benefit. If they do, then you can go back and perform a system valuation. That means going out and looking at the physical facilities that the City would acquire from PG&E and putting a value on those facilities so you know what the cost of buying out the system is. I would note that there will be a lot of argument about that valuation because the City would want to do it one way and PG&E would want to do it another way. The typical difference is three to one different. PG&E's estimate of the value of their system would typically be somewhere in the 2 1/2 to 3 times as high as what the City would think is fair price. That is just based on experience. After the valuation, it would probably come back to LAFCo for approval as to the sphere of influence. There may or may not be a vote depending on how this is done. Based on what I have seen in San Francisco, there is likely to be a vote. Then there would be an offer to purchase the system from PG&E. Typically, they would say no way. You would then go into condemnation and once that was done, you would finally implement the system. A very long process, and not an inexpensive process.

Ownership Considerations – IOU

Pros. These are just some ownership considerations, again something that was asked for at the public hearing. Some will argue that the investor-owned utilities

are more efficient because of the profit motive. We have looked at numbers and what we generally find is that they are not. In fact, some of the very small publicly-owned utilities are very efficient in terms of their operations. Investor-owned utilities have more flexible employee-compensation programs. Public agencies just have trouble with compensation and being competitive. They have more flexible access to capital. It is more expensive capital. But they have more flexibility in terms of whether they get it from shareholders or from debt from common stock, preferred stock or whatever. They are more agile generally. They can make decisions and move more quickly. They don't have open meeting laws, the Brown Act. They don't have Public Records Acts to contend with. In a competitive situation, that can be relatively important. They have less restrictive purchasing and hiring practices. Those are some of the advantages that the Investor-Owned Utilities have.

Cons. On the other side of it, they have been forced to unbundle their systems. They are no longer integrated, and I think that is huge in terms of their long-term potential for success. They have much reduced local involvement. They have fewer incentives to be socially responsible. I am not saying that PG&E is not socially responsible, but the bottom line doesn't incent them to be socially responsible. If they are, it's typically because the regulators have caused it. They have a higher cost of capital, probably by 20 or 30 percent higher. That's an important factor, and they have the taxes that we talked about earlier.

Ownership Considerations – Public

Pros. Moving to a public side, they have retained vertical integration and planning. They have the ability to use tax-exempt debt after the original system purchase. They cannot use tax-exempt financing to acquire the distribution system from PG&E. They avoid most taxes and franchise fees. Local control is a big issue. I have mentioned preference power. Before that is federal power. They do have access to it, but the access is getting more and more limited. They have freedom for green-power and balanced portfolios and all of those kinds of things that are important to local agencies.

Cons. On the con side, they are less agile. We worked with almost all of them, and they clearly are less agile. Sometimes we see social concerns overriding good business outcomes. I see it particularly in rate design, where instead of having rates that are based on costs, you start getting social engineering. It's part of the advantage of local control. But sometimes, it results in bad business decisions. Open meeting laws, public records acts are confining. They are more risk-averse. In some cases, that is good. In some cases, it costs them money. If you insure everything you are paying a premium every time you insure, and so that risk adversity causes sometimes people not to do things that they would in another business environment. They find it harder to attract and retain employees. They typically have restrictive purchasing and contracting practices.

We've witnessed that in San Francisco. The cities would lose franchise fees unless they pay in lieu of a franchise fee and the same thing with property taxes.

SFPUC Price Advantage 2005

I said that our analysis was not quantitative, and it wasn't. I put this together based on grabbing some approximate numbers out of the air. You will not find any tables or anything supporting this. What I tried to do here is show what the economic advantage might be of public power versus investor-owned utility power. First in 2005 and then I will show it to you in 2015. This is based on if PG&E has 10 cents of revenue, how does that break down, and what I am trying to show is how much is based on power. So the top part of the bar on the left-hand side shows the power supply costs. The next shows the non-by-passable charges related to debt and some other things. In addition to that, you have the non-by-passable charges of the orange part which is Department of Water Resources. So you can see that they make up a big chunk of the total of the PG&E bill. Then you get down into the transmission costs which is the gray. The black is public benefits and the bottom is the distribution charges.

I have shown if you were going to go to a PUC ownership of the system, what the likely charges would be based on different circumstances. In the first one, is where you pay the book value of the system to PG&E, and you pay the full amount of those what I call non by-passable or restructuring charges. It says you could get about a one cent advantage by doing that. The next bar shows what could happen if you could avoid 30 percent of those non-by-passable charges. Then it looks like you get a 15 percent advantage. Then I've gone back and said, what happens if instead of paying one times book, you pay two times book. You can see how important it is as to how much you pay PG&E for the distribution system. So that little orange box on the top is showing that element of it. You could see if you paid three times book, you would get back very close to what you would be paying PG&E. It's just to give you a sense of where these numbers fall out. Again, no tables behind these. Take them for what they are.

Commissioner Fellman stated I just have a quick question on your assumption on being able to avoid 30 percent of the non-by-passable charge. Was that just one of these grabs from the air?

Mr. Mellor stated correct. We've had some thought that went into that. It's not totally that but it's pretty much that. This kind of thing is going to end up in the courts. It depends how the courts view—let's just take for example the PG&E debt that they are trying to recover. How much of that should be offset by previous year's profits? How much of that was because they had the opportunity to go into a market that they didn't? They didn't hedge. They didn't do the kinds of things that they should. How much of that is inflated? When you look at that there are people who say wait a minute, there is double accounting there. So there are a lot of issues that say that PG&E debt may not be all there. On the

Department of Water Resources side which is an even better chunk, you daily read in the paper that they are renegotiating contracts. If they are renegotiating contracts and continue to renegotiate contracts, shouldn't that fall out so there is a smaller chunk there? Shouldn't some flexibility be given to a new public agency where a lot of that cost is in markets. There are ways that they can use those resources, sell off surpluses to get rid of some of those commitments. There is reason to believe that you shouldn't have to pay 100 percent of either one of those charges. What the right number is and what the courts would ultimately decide is well beyond our capability.

SFPUC Price Advantage 2015

The last table shows the PUC price advantage in 2015. It is doing essentially the same kind of thing, showing the power supply costs, distribution costs at the bottom. You will note by 2015, all of those non-by-passable things are out of there, and you can still see that there is about a 15 percent advantage in the best case and some advantage in two times book purchase. That just gives you some idea of quantification of what this thing might be worth. I would say this isn't totally an economic situation. It's not just can you save a cent a kilowatt hour. It's can you increase the reliability of the system in terms of generation, in terms of transmission? Do you want local control? Do you want control over your conservation, energy efficiency programs? All of those things should be factors in whatever future direction you take.

Public Comment

Jeff Hunt, San Francisco resident, stated, Chairperson Gonzalez I liked your idea for laying out the plan with both sides of how steps go so that there is a setup for future panels to see what progress you have made and change direction or follow direction. There were a couple of points that were made during the presentation that I wasn't completely clear on. One of which being the costs of PG&E's debt being passed on to the customers if a new authority that was created. Because if you changed your electricity provider – I know right now you can change over to some other green alternatives, and you don't have to pay a fee for that. I don't understand why if a new public authority was created, that fee would be transferred to the public.

Mr. Mellor asked Mr. Hunt to repeat his question.

Mr. Hunt restated that he was asking about the franchise fees and the debt load that would be passed on to the community when you can change your electric provider right now and you don't pay a fee for that. Why that would be done—is that because of the franchise that is set with the City currently?

Mr. Mellor stated, the franchise fee is based on the distribution system. What a franchise fee is for is paying the City for the right to use public rights of way. Typically, even though the franchise payment is based on their two-formula. The

one most frequently used is a percentage of gross revenues. But, those payments are still made.

Commissioner Schmeltzer stated that wasn't Mr. Hunt's question. He wants to know why since individual consumers can change their electricity provider without having to continue paying PG&E's debt, why a new public agency would be assigned a portion of PG&E's debt.

Mr. Mellor stated, individual consumers won't be able to. Individual consumers, if the PUC re-allows or re-institutes direct access, there will be what they call exit fees, which are to cover those factors.

Commissioner Fellman stated, the answer has to be more fundamental. Consumers can't switch right now. The State Public Utilities Commission is taking away the consumer's right to switch to a green provider. If you didn't switch before, most of the green providers have turned their customers back to PG&E. Secondly, even when we could switch as consumers, we still had to pay the debt of PG&E at that time which was what Mr. Mellor was talking about, which is what we call competition transition charges. So, presumably in March of 2002, PG&E would have ended up debt-free. That was the whole purpose. We have always been in the position as consumers of paying PG&E's debt. I think what we are saying now is that will continue to be our responsibility as consumers in the future.

Mr. Mellor stated, I would note that there are negotiations underway right now that would impose retroactive fees to those people who are currently getting direct access that will take away a lot of the economic advantages of direct access.

Commissioner Fellman stated, and those are mostly industrial and commercial customers, not residential customers.

Mr. Mellor stated, in fact residential customers have almost been forced off direct access.

Commissioner Schmeltzer stated, this was a topic that was discussed during some of the public hearings we had a few months ago when the representative from the California PUC was here. There were some direct questions for her about those exit fees and how that was going to be handled.

Don Eichelberger, San Francisco Green Party and Abalone Alliance Clearinghouse stated that he hasn't had a chance to see the revised report. All I know about is what I have heard in the discussion today, and I am looking forward to seeing it. I was hoping that it would be somewhere available, but I guess I haven't found it.

Ms. Young stated the Energy Services Study was available on the Internet.

Mr. Eichelberger stated I haven't looked to see it. I wanted to get back to something earlier about the power of this Committee. When I had the initial last hearing, I put in a written proposal. Bottom line I was looking for--it looked like we had a preliminary indication that we had some advantage to public ownership and it was just a matter of quantity. I put in a strong call for a more quantitative analysis. Apparently, that hasn't been done, except touched on a little bit in this new Section 6. But it still seems to show some advantage, and I'm not sure what role this LAFCo would have in terms of taking a position on the current Charter amendment that's going for a vote. It sounded like you could make any kind of statement or support. I am wondering if there is a possibility of a statement of support from the LAFCo on this Charter amendment, which would give the powers to enter long-term contracting, to do all of these kinds of things, support integrated management and everything that the report claims are positive things. He is looking for an endorsement.

Ms. Miller stated the LAFCo may not support or oppose a political measure as a public body or spend any resources toward that end.

Commissioner Ammiano stated I have a question for Mr. Mellor—that is the conclusion that social concerns can result in bad business practices. Are you referring to environmental justice concerns? What specifically were you alluding to? What is a bad business practice?

Mr. Mellor stated I have actually given you an example of the one that I have found most prevalent and that is in rate design. We had many public agencies prior to restructuring of the electric utility industry, that because of the social concerns and in part the public pressure from residential consumers, residential consumers were being heavily subsidized by industrial and commercial consumers commercially, principally. When deregulation came along, new energy service providers could come in and compete with the rates that included that subsidization. It meant that the utility was very vulnerable to the loss of those customers because they were charging substantially more than they should from the industrial customers for the benefit of the residential consumers. That ended up to be a fairly poor business decision and caused them to go back and make huge adjustments in their rates.

Commissioner Ammiano stated that doesn't necessarily have to follow and there are so many variables. If we have community aggregation, that conclusion is based on things that are extremely fluid and also don't speak to the common sense of whatever the local mindset is. We just have to be careful about making a generalization that social concerns automatically result in bad business decisions. I find all of those terms relative, and I appreciate that you are specific in and around the rates. Nobody wants to be blinded by that so that the utility goes belly-up or something. I would just exercise caution about those kinds of things.

Mr. Mellor stated, I hope I didn't get it out of perspective. It was only a caution. I worked for 23 years for the second largest publicly-owned utility in California. I was a CFO. I am sensitive to the issues.

Commissioner Gonzalez stated I think it is interesting following the pros and cons you can in many cases see that the point that the Commissioner Ammiano made this idea that the social concerns may override good business outcomes. If you looked at the con of a private utility, you are dealing also with the lack of social responsibility or responsiveness. Obviously, to the extent that a publicly-owned utility, we are going to engage in let's say rate design to the benefit of a certain constituency group or however that class of individual is going to be defined. You have to be careful and you have to quickly respond to changes in the market or you are going to suffer as a result of it. I think you were giving an example that perhaps the publicly-owned utility didn't move quickly enough to see the change in landscape and reality of what they had done visa vie the rate design. I think it is a good point.

Mr. Mellor stated I think you are right. What I was trying to do is give both sides and be fair. You could take any one of these things, and somebody will argue that's not right. But I was trying to paint the general picture of what the attributes were of the public and private ownership.

No further public comment.

Public comment closed.

Commissioner Fellman stated all the consultants really did a good job on this. They were responsive. I feel that we had at the beginning of this process a lot of issues on the table. After the workshops, we had a wide-ranging array of information, concerns. They were able to distill it into a report that we have before us today that is very clear about what the issues are, pros and cons, and looks at three very different alternatives for the City and County of San Francisco on its energy use. It makes suggestions and recommendations about what would make the most sense for our City and County. I just want to commend them for the job they did on this report.

Commissioner Schmeltzer stated in answer to a point raised by a gentleman, one of the things that this report did in distilling this information was identify what will be involved in doing some of these next steps. In particular, looking at what a pre-feasibility and feasibility studies would involve for the City, the time it would take, and the approximate price was something that was discussed at the first public hearing because that item was raised. So there was a discussion about the limits of what this study could do given the budget and the timeframes involved, and that also identified how that could be done in the future.

Chairperson Gonzalez stated, Ms. Miller, I wanted to ask you about some of the issues related to governance, the legal discussion. You discussed the possibility of a Municipal Utility District, and there are a couple of things on Page 11 of the Appendix C. Specifically, the conclusion that without a state law amendment, the City and County would have to join with another public entity outside of the City and

County in order to form a district. I am not sure that I agree with that, and I am not sure that the law supports that. I think that was the interpretation of the prior City Attorney that we had, but I think that there were a couple of things that occurred after that determination. There was an opinion issued by the counsel at the legislature indicating that even if the voters in Brisbane had rejected the MUD, it would still have been formed without Brisbane. There was a lot of discussion about how the City and County could partner with some other utility district, possibly within the confines of the City and County in order to form a Municipal Utility District even under existing law. There were a lot of implications you could look to. I think it would be interesting to see if the City could partner up with for instance Treasure Island. Or whether or not we could make a determination that we have unincorporated territory because of tied property or something like that.

Ms. Miller stated it is a very good question. It is an issue that a lot of time was spent on initially when LAFCo was formed. The reason that I came to that conclusion is that while I appreciate the opinion of legislation counsel, they are just one opinion, and there are opinions from the Attorney General that say the opposite. The easiest thing to do in that scenario is to simply make a change in the law, which is to allow a City and County to form one. You are the only one in the whole state, and obviously they weren't thinking about the City and County of San Francisco when they drafted that legislation. I noted that when the measure went to the ballot, it included Brisbane. Out of the caution that there would be a lot of litigation, and PG&E would be the first one to bring it challenging the formation. You are correct. There are probably lawyers that would differ with that opinion. I think that most would say that you need a separate public entity. I looked at the Treasure Island issue. I also looked at the unincorporated area because you include the Farallone Islands, but all of that property is included in your description of the City and County so you can't really separate it out easily.

Chairperson Gonzalez asked what is the process whereby a municipality unincorporates territory?

Ms. Miller stated that would be from a cessation and you apply to LAFCo and you basically ask that a portion of your property be succeeded. The only problem is if a County were to do that, you have to go to the state legislature and that's your problem. You are really defined as a City and County. It's the County definition that is the troublesome part.

Chairperson Gonzalez stated I do think that contained in one sentence here is really a huge discussion. To the extent that I don't think it was the intent of the legislature to exclude San Francisco from being able to consider a Municipal Utility District, etc. You could just as easily have said the best way is to do the state law amendment as you suggest, but you could have also said, really there is no reason why there shouldn't be support for that given that the whole City and County thing seems to be an oversight if anything.

Ms. Miller stated I should have said that because I believe that is true. I believe that would not be a major amendment. I believe it would be a quick amendment. However, I also think that given your Charter powers and your unique stature as a Charter city, that you have the powers to create your own utility anyway. In other words, through your internal powers, you can do that, which you've got with the San Francisco Public Utilities Commission. There are some limitations on it, but you do have the ability to create your own Municipal Utility.

Commissioner Hall stated within the existing PUC.

Ms. Miller stated within the existing PUC and within your existing Charter.

Chairperson Gonzalez stated now you are using the term Municipal Utility in a general public power sense, not in a sense of the state law related to Municipal Utility Districts.

Ms. Miller stated that is correct. They are two separate entities. In terms of their powers and what they can do, they are very similar.

Chairperson Gonzalez stated the question or whether or not there are advantages to the independence of a MUD as opposed to the SFPUC is very significant, particularly when you get to the issues of capital reinvestments and what happens in a municipality. Particularly, in difficult budgetary times when everybody is looking for money to spend. Although I think I agree generally with what is being put out there, which is to pursue amending our current PUC to try to incorporate a public power mandate, I nevertheless do think that there are some unique advantages to having a Municipal Utility District defined under state law.

Ms. Miller stated that there is truth to that. I think the easiest way to deal with that issue in San Francisco is to probably change the statute rather than try to set it up and be sued and then go to court for the next six years over that issue. Given the controversial nature you are going to have in this City over trying to set up a utility from taking over the private investment utility. They'll fight you. It is best to tear down the number of issues on which they'll fight.

Chairperson Gonzalez stated I also think that part of the discussion here presumes that simply because we take a course of action that we generally agree on, there is a certain assumption that we have the ability to choose and be successful in that choice. It could very well be that the first course of action that we take is unsuccessful in which case we might be looking at something like a Municipal Utility District.

Ms. Miller concurred.

4. Discussion and action regarding the transition from outside legal counsel to the City Attorney's office support to the San Francisco Local Agency Formation Commission. (Continued from the June 28, 2002 meeting.)

Gloria L. Young, Executive Officer stated that the packet contains an engagement letter that is before you for discussion. It is a letter of agreement between the City Attorney's Office and me on behalf of the LAFCo for you to look at and determine whether or not you wish to enter into the relationship with the internal counsel. I will bring your attention to a couple of points. One, is there is a clause in the agreement. First of all, it has several points in it. It reflects the letter that we received from the City Attorney, Dennis Herrera, with respect to the conflict of interest issue. It also indicates in the letter an agreement with the internal counsel that in fact if outside legal counsel is required, that LAFCo have the ability to approve that prior to outside counsel being sought after. Thirdly, there is a clause which indicates that there will be a distinction between the services of internal counsel for LAFCo whose members are also members of the Board of Supervisors. So that we recognize the fact that as members of the Board, that would not effect the cost that is paid by LAFCo. There will be a need to identify those issues as we go through it to make sure that when legal counsel is meeting with Board members, that there is a distinction between work being done for LAFCo versus work being done for the Board of Supervisors. Both the Deputy City Attorneys, Theresa Mueller and David Campos, are here to answer questions, and also our outside legal counsel.

Chairperson Gonzalez stated, Ms. Mueller, I want to ask about the conflict provisions. I guess I am having a problem with the conclusion that in the event that there is a conflict between the Board and the LAFCo, the City Attorney would be representing the Board and LAFCo would seek other counsel. This goes back to the whole question of what a City Attorney is and who the City Attorney represents. The City Attorney as I understood your office's position represents the public, the individual people in San Francisco. When your office gives advice, it gives advice in keeping with that charge. If you happen to give advice that favored the LAFCo in the event there was a dispute between the LAFCo and the Board, it doesn't make sense to me that you would then go represent the Board and LAFCo would have to seek its own counsel. It seems to me that what you would do is continue to give consistent advice based on your charge to represent the public, the City and County of San Francisco. There ought to be a mechanism like the mechanism that we approved, and I believe it was Proposition E, which allowed for a department or Commission that was not satisfied with the opinion delivered by the City Attorney to seek essentially independent counsel through the mechanism described in that Charter amendment. What am I missing in what I am saying?

Theresa Mueller, Deputy City Attorney stated I am not sure you are missing anything necessarily. The LAFCo already has the ability to seek independent counsel, so unlike a City department which is bound by the Charter and the Charter gives the duty to provide legal services exclusively to the City Attorney, that does not apply to the LAFCo. We don't have to have that provision such as Proposition E. You could

always go get independent counsel. On the conflict issue, I think you are right that our office would always attempt to be providing consistent advice to both the LAFCo and the Board, but because the LAFCo is a separate legal entity created by state law, it may be able to sue the Board or the City in some capacity or vice versa. In that case, as you know the ethical rules for lawyers do not really permit us to represent both entities. Because of our Charter duty, our first obligation in that kind of case has to be to the City and County as the legal entity, not to the legal entity of the LAFCo.

Chairperson Gonzalez stated the ethical concern that you raised comes up in an instance where the LAFCo sued the City. The hypothetical that I posed to you is if there was a dispute between the LAFCo and the City, it seems odd to me that the conclusion here in the agreement is automatic that you would be representing the City without regard to what your opinion is of the merits of the dispute. It could very well be that the LAFCo has no intention of suing the City because we agree with the City Attorney's position.

Ms. Mueller stated in which case, I don't think we have a conflict as envisioned by this letter. I think the letter really envisions the situation not necessarily where we have differences of opinion because we have those all of the time, even between City departments. But, where we have an actual legal conflict where we are in a position where we can't represent opposing parties to a dispute.

Chairperson Gonzalez stated I am just trying to imagine a scenario whereby the City Attorney gives LAFCo an opinion about something and the Board wants to do something differently. We want the City Attorney to go out and enforce your opinion about something.

Ms. Mueller asked, we being the LAFCo or the Board?

Chairperson Gonzalez stated the City Attorney. You wanting to defend the LAFCo.

Ms. Mueller stated, we agreeing with the LAFCo position?

Chairperson Gonzalez stated but the Board wants to do something different. So we say to you, we want you to go deal with this issue. We want you to stop the Board from doing whatever it is they think they can do.

Ms. Mueller stated I think what would happen in that case is that if we believed the Board's position to be not lawful, we would have to advise them of that. But ultimately, as you know there are cases where the Board instructs the City Attorney to do something, we don't always agree with it. It is pretty rare.

Chairperson Gonzalez stated, you may disagree, but you are not engaging in unlawful activity. Arguably, the City Attorney would simply say I'm not going to do that.

Ms. Mueller stated then if the LAFCo wanted to sue the Board for doing that based on the earlier advice that the Board couldn't do it, then there would be a conflict, and we couldn't represent both sides ethically.

Chairperson Gonzalez asked, why wouldn't it be incumbent on the Board to get its own counsel, particularly where the Board's disagreeing with the City Attorney's conclusion?

Ms. Mueller stated because we don't believe the Charter allows the City Attorney to do that.

Chairperson Gonzalez asked, what part of the Charter are you referring to?

Ms. Mueller stated, I don't have the provision in front of me, but the City Attorney's first duty is to represent the City and County of San Francisco, and that entity legally is embodied in its' Board, its' Mayor, and its' ordinances and its' laws.

Chairperson Gonzalez stated but the case law related to that charge speaks to when you say the City and County of San Francisco, you are talking about the people that make up that entity. Your primary duty is not the same as a private attorney that is paid by an individual client to go and gage in certain legal practices on the client's behalf. Clearly your relationship is different than that.

Ms. Mueller stated of course. I think we're talking about a situation that is hard for me to imagine unfolding in the way you are describing it. As you know, I think it's pretty rare that the Board wants to take an action and decides to take an action after the City Attorney says it is illegal. I don't think that usually happens. Usually, the conflict is worked out before then. But, it has to be clear that the City Attorney under the Charter represents the City and County as a legal entity as its' first charge. The Charter doesn't give the City and County the obligation to represent the LAFCo. If we are in a situation where such a choice must be made, then the choice the City Attorney has to make is to represent the City and County.

Commissioner Hall asked, assuming that their position is legal and you can defend it?

Ms. Mueller stated, yes.

Commissioner Hall stated then the conflict really doesn't exist unless they have a position that you could defend. If you can't defend it, there is no conflict.

Ms. Mueller stated except as you know, lawyers have different interpretations of the law. You've already been discussing an example of that today, and it was very prominent the last time that we represented the LAFCo.

Commissioner Hall stated I think what she is really saying is that it is unlikely that the situation would arise and if it did, you would automatically be bound by the Charter to represent the Board and advise them as to the legality of the issue.

Ms. Mueller stated I think that's right. A situation like that may or may not then result in an actual legal conflict where the LAFCo needs its own counsel. Ms. Miller may want to comment on this as she has more experience representing LAFCo's. I would also be happy to request additional advice from the people in our office who do ethics and conflict work.

Commissioner Schmeltzer stated I would like some comments on a more possible conflict scenario. If there was a proposal that came out of LAFCo to create a district or create a local agency that the Board of Supervisors was against, how do you see a scenario like that potentially unfolding?

Ms. Mueller stated it does seem like a more likely scenario that the LAFCo would want to pursue a policy option that the Board was against. Assuming the LAFCo had the legal ability to pursue it, then that might be a case where the LAFCo would prefer to have independent counsel. It's hard for me to say now that that is the kind of case where the City Attorney would withdraw. That will be a decision made based on the facts of a particular case, but it certainly could happen in a case like that. It does seem like a more likely event. Although, I don't think that is very likely either.

Chairperson Gonzalez asked what is the primary advantage to having the City Attorney as our counsel? If there is a possibility that we are going to be called upon to get outside counsel, build a relationship, get up to speed on issues to engage in either policy decisions counter to what the Board wants to do or litigation counter. I am interested in knowing what the primary advantage is.

Ms. Mueller stated I don't think that is a question I can answer. That's a policy decision that this body has to make. What we have said is that if you believe there is an advantage to having us as your counsel, we are willing to do it. We have tried to address something that was a very large problem last time.

Chairperson Gonzalez stated the policy decision is the choice, you're right. It is our choice. It is the policy decision. But the question of whether or not your office wants to be our counsel. Obviously, you should be able to answer what advantages it is for us. Why should we do it? Do you want to do it? These things seem relevant.

Ms. Mueller stated I think it is two different questions what the advantages are and do we want to do it. Yes, we want to do it for a number of reasons. I think most of you sitting up there are our clients already, and we work with you already on many of the same issues that the LAFCo is considering now. Probably, on the same issues that you will be considering in the future. That makes sense to us. To the extent that you are looking at the efficiency of how the City runs, how the City accomplishes its goals, we have a lot of knowledge and experience in that area, and we think that

is a real benefit for you. There is some efficiency in having the same counsel for your position as a Board of Supervisor's member and your position as a LAFCo member since the City and County is the same entity. As to the advantages, I think you have to identify what those are. I don't find any disadvantages to your current counsel. I like them both. I think they have done great work for you. We will be happy to work with them to transition. But, if you don't feel like that is the position that you want to be in, and you don't see the advantages of the City Attorney representing you, then that's the decision you have to make.

Commissioner Fellman stated with respect to the LAFCo legal positions that Ms. Miller generally comments on, the Cortese-Knox-Hertzberg. Do you have expertise in your office on that subject?

Ms. Mueller stated we do. We certainly don't have Ms. Miller's level of expertise because the LAFCo was a new entity to the City and County as of last year. But, we have people in the office who already have spent a considerable amount of time getting familiar with those laws because we had to do that. I think we will be able to provide that kind of advice.

Commissioner Hall asked were you saying there is certain economies of scale or efficiencies that the City Attorney would bring us in the process because many of these issues are splinter issues that you are already working on. I agree with that. I don't think that precludes us from any one part disagreement from going out and seeking outside counsel if that need be.

Ms. Mueller stated not at all.

Commissioner Hall asked can you elaborate a little bit more on the efficiencies of scale or cost that we might save using the City Attorney? We don't have to reinvent the wheel each time we are asking you a question.

Ms. Mueller stated, that is correct. There is some advantage because of our knowledge of how the City works substantively.

Commissioner Hall asked Ms. Young, what is our current rate that we are paying our outside counsel?

Ms. Young stated we are currently paying between \$250 and \$325 per hour.

Commissioner Schmeltzer asked is that different based on the attorney or based on the service?

Ms. Young stated based on the attorney.

Commissioner Ammiano stated I will have to leave as I have a community meeting. This issue won't die and I would like to kill it. We have put a lot of time into

discussing this, and we need to bite the bullet. It will be a judgement call. I really do appreciate Ms. Mueller being here and putting up with the scrutiny. It seems it is a little bit overwrought. I thought there was one solution where we came up with a hybrid. I think Ms. Fellman might have suggested it. If we need a vote today, I don't want to hurry up people's deliberation on this, but at the same time we have talked a lot about it, and I would like to be here for that vote. If there is not going to be a vote today, I would hope this won't be continued to the next meeting and the next meeting. We should just move.

Chairperson Gonzalez stated that is fine. I think the question of whether or not we want to have a time period set whereby we would deal with the question of whether or not we want as a LAFCo to deal with findings. That seems like something we would finish out with our existing counsel. So, we could set up a time period for that. I think there is a general sense among this group to have the City Attorney represent the LAFCo. I don't share that opinion. I have no problem losing that vote. On the time issue, any suggestions?

Commissioner Schmeltzer stated I think it makes sense to continue with our current representation for findings. I think that's what we discussed and what Commissioner Ammiano alluded to that as far as finishing out what we are doing on this report, it makes sense to continue with the folks who are most familiar with this.

Commissioner Fellman stated I suggest in a practical sense that we have Ms. Miller and Mr. Maynor present draft findings at our next meeting and that we discuss it then. In the meantime, that we enter into the agreement with the City Attorney's Office starting in September. I think that is what we talked about a September or October timeframe recognizing that our current counsel will end their representation with the conclusion of our deliberations and if we get to adoption of findings on the report.

Commissioner Hall asked, why do we have to make the determination on this today? I agree that we need the existing counsel on the findings.

Commissioner Fellman stated there isn't a time concern. The one consideration that I would put forward is that as we move into next steps, there is going to be new issues that will be coming up. It would be good to have whoever is going to be working with us on the next steps in place so we don't have a loss of representation.

Commissioner Hall stated I think we maybe should decide what the next steps are before we decide who is going to represent us. That is my opinion. I think we need to keep existing counsel through the conclusion of what we have been working on the last six months. I think we need to have a discussion where this local agency is going to go and what we are going to be looking at before we decide who we want to represent us. Generally, I agree, I think the City Attorney should. There may be a topic here that I want to start looking at that I don't see the advantage of having the

existing City Attorney. I don't know why we are in such a hurry to make that decision today.

Ms. Young stated this was a recommendation by the Commission itself. When we first brought this before you—Commissioner Ammiano raised this issue. The timeframe was nothing magic. It was based on the fact that we anticipated by September that the public hearings would be complete. I was also directed to work with the outside counsel to enter into an agreement with them on a month to month basis that would allow us to continue to use their services. I was directed to come back with a negotiated agreement with the legal counsel for you to look at the beginning of August, first of September. That was just a timeframe looking at the completion of the Energy Study and next steps pieces. That was anticipated to be done by September. We do have a current agreement with both the counsels that we entered into a month or a half ago.

Commissioner Hall asked and there is no financial loss by not deciding today?

Ms. Young stated, absolutely not.

Commissioner Hall asked, can we hypothetically use the City Attorney on one study, one project, one field of action and use outside counsel on another?

Ms. Young stated, if you wanted to use the City Attorney's Office, the Commission would have to agree to this engagement letter or make recommendations to it. But, we would have to enter into some kind of relationship with them formally. As I have said before, we have the ongoing relationship with our outside counsel.

Commissioner Hall asked is the ongoing relationship costing us money if we were going to go to an entirely different study?

Ms. Young stated we only pay as we need their services. That's very limited.

Commissioner Hall stated I don't see any need to move ahead in finalizing or signing the agreement today.

Public Comment

No public comment

Public comment closed.

Chairperson Gonzalez stated if I understand correctly, we're going to be trying to get counsel and Ms. Young to put together draft findings that we can consider, take a look at them, and see if it is something that we want to approve or not. We're not prejudging it and we'll keep counsel through that process. I think we should decide what kind of work the LAFCo would be doing in the future in the event the LAFCo is

going to continue to meet. If so, depending on what it is we are going to be focused on, we would make a decision about representation at that time. Ms. Young, thank you for providing the information related to the scope and powers of the LAFCo.

5. Discussion regarding the San Francisco Local Agency Formation Commission's Future Work Plan and Fact Sheet. (Continued from the July 26, 2002 meeting.)

Chairperson Gonzalez asked Ms. Young, can you give us an idea of what the time period would be for the LAFCo to consider draft findings? I do think that along with that there ought to be a decision and formal vote at the next future meeting on the Energy Services Study report that was brought to us.

Ms. Young stated we could have that available at your next meeting. It is my understanding that Commissioner McGoldrick has asked that we not meet as a LAFCo during the Board of Supervisor's vacation because several of you are planning to be gone. If we had a meeting after the Board of Supervisors returns, which is September 17th, we would definitely have the recommendations in a couple of weeks. If you wanted to meet afterwards, we could look at having a LAFCo meeting the first week that we get back either the week of September 16th or the following week of September 23rd.

Chairperson Gonzalez stated, then if you can agendaize the agreement for adoption or discussion.

Commissioner Schmeltzer asked, so we could get the recommendations to review before the meeting?

Ms. Young stated yes, we can make that available to you and agendaize the item. If you have comments, then you can get back to us. The other option is whether or not the Commission wants to use the Committee process or you want to discuss the recommendations as a whole body. We did set aside a Committee that worked on the Energy Services Study process. We could use that Committee to run those by and have discussions about that prior to bringing it to the full Commission.

Chairperson Gonzalez stated I would just as soon meet as an entire body.

Ms. Young stated that is the way we will do it. On the issue of the Fact Sheet, you have the information before you. It was before you at the last meeting. I would just remind the Commission that I was requested by Commissioner Hall to meet and discuss this Fact Sheet. We did in fact have that opportunity to meet.

Commissioner Hall can talk about our conversation from his perspective. From the Executive Officer's perspective, it was a desire on Commissioner Hall's part to look at other areas that LAFCo could get involved with in terms of looking at efficiencies that could be gained in other organizations and pursuing what that could possibly mean. I have had conversations with our legal counsel, Nancy Miller, who has extensive background in LAFCo's looking at other areas other than what this

Commission has been concentrating on for the last two years. So we can take advantage of her being here today to give you some of that information. I did give you in bold print in the document some examples of what that might look like.

Commissioner Hall asked Ms. Miller for a synopsis of what LAFCo can and can't do.

Ms. Miller stated what you can't do is make any land use decisions. You can't make findings that relate directly to land use or regulate land use. Other than that in terms of governmental services and the way government service is provided, you have fairly broad powers to look at and comment and make certain recommendations.

Commissioner Hall asked on land use, you are not talking about the governance of that land use? Are you talking about the acquisition or the exchange or sale of land use?

Ms. Miller stated zoning. You can't regulate land use. You don't have that power. That's reserved to your City and County.

Commissioner Hall asked if we were to look into the whole Treasure Island Authority—is that considered land use?

Ms. Miller stated not the function. You just couldn't do anything having to do with attempting to regulate land use or saying we're now going to attempt to put a commercial development there. You could certainly make recommendations regarding revenue or different kinds of services, but you don't have the power to determine what land use goes on Treasure Island. You can make recommendations regarding that. Depending on the type of agency it is will give me a better idea of what type of power you have over it. If it's a development agency that was created pursuant to the Charter or pursuant to state law, you may have some ability to provide a service review of that entity, which is one of your charges by law. You review service that is being provided in your jurisdiction by the different government entities and make recommendations how to better do it, additional services that could be provided.

Commissioner Hall stated so the classic example would be to look at Treasure Island?

Ms. Miller stated I think so, but I don't know what type of governmental entity it is. I thought it was a joint powers authority. Since it is not, I would assume that you would have jurisdiction over that.

Ms. Young stated I believe this was discussed before. I think it's a matter of being able to look at the efficiencies. It is a part of that area that talks about initiating studies around whether or not agencies are formed that provide services to the City and County. It is my understanding that Treasure Island Development Agency is

that kind of agency so you could look at it with respect to whether it is providing efficiencies and services.

Commissioner Hall stated general governing issues as relates to the entity.

Ms. Young stated as opposed to saying that the Treasure Island Development Agency will be maintained as a high commercial or whatever.

Ms. Miller stated general governance issues, service reviews, having to do with the way service is delivered, provided, paid for, contracts. You have the ability to review government contracts.

Commissioner Hall stated accountability of non-profits, that type of thing.

Ms. Miller stated not non-profits. They have to be governmental entities. But sometimes, governmental entities contract with non-profits. Contracts relating to personnel. I'm dealing with one in Sacramento right now having to do with the City of Sacramento. It has to do with fire protection services, and personnel is one of those things that we are looking at.

Commissioner Hall asked, could we review or audit spending relating to certain homeless programs?

Ms. Miler stated yes.

Commissioner Hall asked, to what extent?

Ms. Miller stated many homeless programs are funded by federal funds. To the extent that a lot of those are grant monies, you don't have the ability to audit their grants. But, how they provide the service, the government structure and overhead.

Commissioner Hall stated, how those services are provided to the City as a result of the contract.

Ms. Miller stated that was right.

Commissioner Ammiano stated I think there is some unclarity about eminent domain. I know that the Board of Supervisors is in power to do that. But, there was a question about LAFCo during the MUD issue particularly.

Ms. Miller stated you do not have the power of eminent domain.

Public Comment

No public comment. Public comment closed.

Chairperson Gonzalez stated I do think because of the broad powers here we should continue and have a discussion. I can see a lot of benefits to having some kind of efficiency or auditing function. Commissioner Hall was outlining some of the areas that we could all certainly get involved in.

Commissioner Hall stated we had a lot of discussion at the Rules Committee and at the Board about an Auditor General. Some of those areas that we talked about, I thought that maybe this is the ideal agency or Commission to take up some of those issues. We don't need an Auditor General. We already have the ability to do more than what the Auditor General can do right now. I would like this Commission to have some dialogue about where we might want to go in the future. I say that because of the members on this Commission. I think we're in a good position to look into some of the governance issues of local government. I would look forward to this continued dialogue as to where we might want to go in the future once this study is sufficiently concluded.

Chairperson Gonzalez concurred.

6. Future Agenda Items.

Chairperson Gonzalez stated that this item has been discussed already.

Public Comment

No public comment. Public comment closed.

7. Public Comment on Items not on the Agenda.

No public comment. Public comment closed.

8. Adjournment.

The meeting of the San Francisco Local Agency Formation Commission adjourned at 11:32 a.m.

(Presentations are available at the Clerk of the Board's Office, Room 244, City Hall.)