



PUBLIC WORKS DEPARTMENT

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CITY COUNCIL STAFF REPORT

Meeting: December 17, 2019

Subject

Consideration of an amended and restated agreement for lease of the Cupertino Municipal Water System with San Jose Water Company (SJWC); finding that the action is not a project under and exempt from CEQA.

Recommended Action

1. Conduct a Public Hearing to consider an amended and restated agreement for lease of the Cupertino Municipal Water System with San Jose Water Company; and
2. Adopt the Draft Resolution approving an amended and restated agreement for lease of real property (water system) with San Jose Water Company.

Discussion

There are three water service areas in Cupertino (Attachment A).

- One area (shown in green) is served by a water system owned and operated by San Jose Water Company; and
- One area (shown in purple) is served by a water system owned and operated by California Water Service Company; and
- One area (shown in blue) is served by the Cupertino Municipal water system that is owned by the City of Cupertino but is leased for operations by SJWC.

The Cupertino Municipal Water System was leased to SJWC in October 1997 for a term of twenty-five (25) years. As the lessee of the Cupertino Municipal Water System, SJWC is responsible for all operations of the system including repair, maintenance, operation, customer service/billing, emergency service and water quality testing. Furthermore, SJWC has the responsibility to operate the Cupertino Municipal Water System in a manner similar to that in which it operates its own systems and to maintain the Cupertino Municipal Water System in accordance with customary utility standards.¹

The Council is considering adoption of Resolution 19-XXX (Attachment B), which would approve an amended and restated lease (Attachment C) ("Amended Lease"). The

¹ SJWC provides potable water service to over one million customers in the greater San Jose area. The water system leased to SJWC includes approximately 4,500 Cupertino customers.

Amended Lease has been agreed to and signed by SJWC. It will require SJWC to make certain capital investments in the Cupertino Municipal Water System worth \$5 million and simplify the procedure for SJWC to set water rates. As proposed, SJWC will be able to independently adjust rates as long as they do not exceed the rates authorized by the California Public Utility Commission (CPUC) and in effect on SJWC's own water system within Cupertino.

Since the beginning of the lease term in 1997 through 2016, the water rates charged to customers of the Cupertino Municipal Water System with service provided by SJWC were equal to the water rates authorized by the CPUC for SJWC's privately-owned system in Cupertino. Additionally, these rates were found to be similar to the rates of nearby municipal water agencies. Because SJWC has committed to expending the needed dollars to make capital investments in the Cupertino Municipal Water System and there has been a long history of a comprehensive CPUC review process that has resulted in water rates being similar to nearby municipal agencies, the amended and restated lease agreement will no longer require the City Council to independently regulate rates. Instead, the City Council will use the CPUC review process as a proxy for its own review and allow the rates authorized by the CPUC on SJWC's own system in Cupertino to establish a regulatory cap or maximum that SJWC can charge to customers connected to the Cupertino Municipal Water System. This change simplifies the procedure for SJWC to set rates while still ensuring that the water rates imposed by SJWC remain just, reasonable, and nondiscriminatory.

The last rate increase authorized by the City Council was in September 2016 and was retroactive to January 2016. Since this time, SJWC raised rates to customers of their privately-owned water system in 2017, 2018 and 2019 by 3.83%, 4.22% and 4.55% respectively. Since January 2017, customers of the Cupertino Municipal Water System with service provided by SJWC have had a lower cost of water compared to the SJWC-owned and operated water system. The expected increase in water service rates will bring the water rates of customers of the Cupertino Municipal Water System to parity with the customers of the water system both owned and operated by SJWC. The expected increase in rates will not be retroactive and customers of the Cupertino Municipal Water System will not be asked to return the savings that have been realized since 2017 due to the lower cost of water as compared to the customers of the water system owned and operated by SJWC.

In January 2019, customers of the Cupertino Municipal Water System received a refund for overbilling that occurred by SJWC for the time period of June 2011 to December 2016. An additional refund to customers for overbilling that occurred during the time period of November 1997 to May 2011 will be made by SJWC. The timing and amount for this second refund are not known at this time. The amount of the first refund for the typical residential customer was \$3.77.

Stakeholder and Public Input on Amended Lease

During the week of November 5th, approximately 4,500 written notices were mailed via U.S. mail to customers and property owners served by the Cupertino Municipal Water System. The City also prepared a Frequently Asked Questions page for its website to help inform the public about this topic.² At the writing of this report, two emails have been received by staff in response. The notice and log of correspondence is included in Attachment D. If needed, a supplemental memo will be submitted to City Council prior to the December 17th public hearing to report on any additional public comments received. To date, while there has been some concern expressed about the possibility that approving the Amended Lease could lead to a rate increase by SJWC, the vast majority of customers have not expressed opposition to the consideration of the Amended Lease.

Sustainability Impact

No sustainability impact.

Environmental Impact

Adopting Resolution 19-XXX, approving an Amended and Restated Agreement for Lease of Real Property (Water System) with San Jose Water Company, is not a project under the requirements of the California Environmental Quality Act of 1970, together with related State CEQA Guidelines (collectively, “CEQA”) because it has no potential for resulting in physical change in the environment. In the event that the Resolution is found to be a project under CEQA, it is subject to the CEQA exemption contained in CEQA Guidelines section 15061(b)(3) because it can be seen with certainty to have no possibility that the action approved may have a significant effect on the environment. In this circumstance, the water system lease is being amended and restated to clarify the standards of operation of the system and the procedures for establishing water rates, which are technical changes concerning the general administration of the lease of property and do not commit the City to any definite course action; accordingly there is no possibility that adopting this Resolution will have a significant effect on the environment. Environmental review will be conducted as necessary for any changes to the water system that may be agreed upon in the future.

Fiscal Impact

Per the provisions of the original lease agreement and the proposed amended and restated agreement between the City and SJWC, all monies for services rendered by SJWC are the property of SJWC. Accordingly, there is no fiscal impact to the City regarding an amended and restated lease agreement of the Cupertino Municipal water system with respect to water rates.

If the proposed changes to the lease are approved, SJWC is expected to increase water rates that will result in a bill increase of approximately 13.8% for a typical residential customer consuming 11 units of water per month beginning December 18, 2019 with no retroactive collection. SJWC has an increase scheduled for 2020 that has been authorized by the CPUC that will be effective January 1, 2020. The amount of this increase is

² Available online at <https://www.cupertino.org/Home/Components/News/News/3669/26>

approximately 3%. Customers were informed of the potential rate impacts of amending the lease via the public hearing notice. As noted above, doing so will mean that all of SJWC's customers in Cupertino will pay the same amount whether they are connected to the leased system or the system owned by SJWC.

In early 2016, the City completed an inspection of the water system and notified SJWC that additional capital improvements were needed to maintain the system to industry standards. The proposed changes in the Amended Lease require SJWC to deposit with the City and expend \$5 million on water system capital improvements before the agreement expires in October 2022. The specific improvements have not yet been identified, but there is a process in the Amended Lease to timely agree upon and initiate the work. Any funds not expended on projects will remain with the City.

Prepared by: Roger Lee, Director of Public Works

Reviewed by: Dianne Thompson, Assistant City Manager

Approved for Submission by: Deborah Feng, City Manager

Attachments:

A – Water Service Map

B – Draft Resolution

C – Amended & Restated Lease w/ Exhibits

D – Notice to Customers Served by the Cupertino Municipal Water System and Correspondence Log

E – 1997 Lease Agreement with San Jose Water Company