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REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

SERVICE LEVEL AGREEMENTS – WATER, SEWER, AND ENVIRONMENTAL SERVICES DEPARTMENT

INTRODUCTION

On the City Council Docket for Tuesday, June 22, 2004 is Item 330, In the Matter of the Service Level Agreement for the Water Department, Metropolitan Wastewater Department, and Environmental Services Department. This Report addresses the general legality of Service Level Agreements [SLAs] whereby the business type activity funds of the City (also known as "enterprise funds") pay for goods or services provided by departments supported by the General Fund or other funds.

BACKGROUND

The Water Utility, Wastewater Utility and Environmental Services Departments [Departments] have, from time to time, entered into SLAs with other departments of the City for the provision of goods or services to the Departments. The Departments operate as "business type activity" departments of the City. In other words, revenues generated by each of the Departments are used to pay for the costs of providing services, including operations and maintenance.

The Water Utility is governed by San Diego City Charter section 53 which provides that "[a]ll revenues of the Water Utility shall be deposited in a Water Utility Fund." The section further provides that the City Council "shall include in the annual appropriation ordinance . . . provision for operating and maintenance costs; replacements, betterments, and expansion of facilities; payments necessary for obtaining water from the Colorado River; and other contractual obligations; [and certain reserves]." Finally, the section provides: "Only after providing the requirements for Water Utility purposes as set forth above may the City Council . . . provide for the transfer to the General Fund . . . any excess revenues accruing to the Water Utility Fund. Such [transferred revenue] shall be available thereafter for use for any legal City purpose. All such surplus funds so transferred shall be credited on the accounts of the City as a reimbursement credit for the monies paid by the City each year [for bonds], costs of services and facilities furnished to the water [sic] Utility by other City departments and funds, [estimated loss of tax

revenue because of public ownership], together with a reasonable profit on the City's investment in the water system."

The Sewer Utility has no similar charter provision, but is governed by certain provision of the Municipal Code. Section 64.0403 provides for the creation of a "Sewer Revenue Fund" into which all revenues of the wastewater system are to be deposited. The section further provides: "(b) All revenues shall be used for the following purposes only: (1) Paying the cost of maintenance and operation of the City's wastewater system. (2) Paying all or any part of the cost and expense of extending, constructing, reconstructing, or improving the City's wastewater system or any part thereof. (3) . . . . (4) . . . ."

The Environmental Services Department also has no controlling provision in the City Charter; however, Municipal Code section 66.0129 (c) provides that "All revenues collected . . . shall be used exclusively for the acquisition, development, construction, operation, closure or administration of City waste management facilities, and systems."

ANALYSIS

The City Attorney's Office has been asked from time to time about the legality of transfers from the enterprise funds to the other departments and funds of the City. Attached hereto are a number of memoranda addressing a variety of issues relating to such transfers or payments, including payments for general governmental services, tipping fees, mitigation expenses, right-of-way fees, and legal expenses.

It first must be pointed out that nothing in the language of the Charter or Municipal Code prohibits the payments or transfers as set forth in the SLAs, provided that the payments and transfers have a relation to the operation or maintenance of the Departments. In fact, the plain language of the applicable sections provides that such expenses are properly charged to the Departments. Our memoranda have acknowledged over the years the general principle that each Department should operate on a self-sustaining basis. In other words, the revenues for each Department should pay for all goods and services received by the Department, much as a successful private business operates (hence the moniker "business type activity"). This concept mirrors that which requires the other departments and funds of the City to pay for services received from the Departments, such as water and sewer service, and trash disposal.

We highlight here just a few of the memoranda touching on these issues. In a Memorandum dated April 5, 1982, we opined that mitigation expenses for sewage contamination in Mission Bay were a legitimate expenditure of funds from the Sewer Utility. Similarly, in a Memorandum of Law (No. 90-75) dated June 27, 1990, we opined that the payment of legal expenses for the opposition to the proposed SDG&E/SCE merger was legitimate (based upon an appropriate proration) due to the nexus of energy charges to the provision of water and sewer service. In a 1996 Memorandum of Law (No. 96-26) we opined that the payment of right-of-way charges was a legitimate expense for the Water and Sewer Utilities (provided an appropriate formula was utilized in determining the amount of the charge) due to the expense to the General

Fund that would otherwise accrue for street maintenance. That memorandum included as attachments several prior memoranda discussing the legality of transfers for tipping fees and as an in-lieu property tax. Finally, a 1966 memorandum approved the legality of reimbursements for General Fund bond expenditures and general governmental services.

The common thread in each of these memoranda is whether the subject transfer or charge had a nexus or relationship to the purpose of the department or utility from which the funds are transferred. Where there is a nexus, the charge may properly be classified as an expense related to the operation or maintenance of the utility or department. Put another way, it would seem entirely appropriate to us that, if a private business may charge against its own revenues for certain expenses, the Departments would also have the ability if not obligation to pay the other departments and funds of the City for similar expenses. It would also seem entirely appropriate to us that the Departments pay for goods and services received from the other departments and funds if the Departments would otherwise be required to obtain such goods or services from the private sector, paying the appropriate expense out of its revenues. Such a practice is perfectly legal, if not required, and (at least with regard to legal services) may be more cost effective to the Departments when compared to the expense of obtaining similar goods or services from the private sector. In sum, the Departments should no more be subsidized by not paying for goods or services received than should the Departments subsidize other funds or departments of the City by not charging for goods or services.

We hasten to point out that this Report addresses only the general legality of the payments or transfers as embodied in the SLAs; we do not purport to opine on the appropriateness of each line item or specific transfer. That inquiry is fact specific to each charge, in particular its nexus to the purpose of the Department making the payment.

CONCLUSION

As a general matter, SLAs represent a legal charge against the revenues of the enterprise funds of the City because those funds derive a benefit from the other departments and funds of the City. The Departments are designed to be self-sustaining, and appropriate charges for goods or services received from the other departments or funds of the City are not prohibited by the City Charter or Municipal Code.

Respectfully submitted,

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City Attorney

LJG:ljg
RC-2004-15
Attachments (4)
cc: City Manager