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REPORT TO THE HONORABLE  
MAYOR AND CITY COUNCIL

USE OF WATER UTILITY FUNDS TO PARTICIPATE IN THE SAN DIEGUITO  
RIVER VALLEY REGIONAL OPEN SPACE PARK JOINT POWERS AUTHORITY

### INTRODUCTION

As part of the Fiscal Year 2010 budget adjustments and the Fiscal Year 2011 budget adopted by the Mayor and City Council in December, the City suspended its contribution to the San Dieguito River Valley Regional Open Space Park Joint Powers Authority (JPA). Suspending the City's contribution saves the General Fund \$73,771 for the remainder of this fiscal year, and \$295,084 in Fiscal Year 2011. Report to City Council No. 09-167, Attachment 1 at p. 2. As an alternative to the General Fund, officers of the JPA and a member of the City Council have asked whether any water utility funds could be used to pay the City's contribution to the JPA.

### DISCUSSION

#### I. BACKGROUND

The JPA was created in 1989 through a joint exercise of powers agreement among the City, the County of San Diego, and the cities of Del Mar, Escondido, Poway, and Solana Beach. San Diego Resolution R-273718 (June 12, 1989). The purpose of the JPA is "to acquire, plan, design, improve, manage, operate and maintain the San Dieguito River Valley Regional Open Space Park." Joint Exercise of Powers Agreement, Document No. RR-273718, at §1. The JPA was established for an initial term of twenty-five years, with the opportunity to extend it for another fifty years. *Id.* at §2. The members of the JPA may contribute funding to the JPA, but such contribution is not a requirement of membership. *Id.* at §14(c).

The Water Fund had been used as a source of the City's contribution to the JPA until 2006. Since then, the General Fund has been used to pay the City's contribution. The change was due in part to a report from the San Diego County Grand Jury criticizing the City's use of water utility funds to pay for park and recreational activities. *Service Level Agreements Equal Back Door Funding*, Report of the San Diego County Grand Jury (April 25, 2006). The County Auditor and Comptroller explained to the Grand Jury that if water utility funds are not used for

their defined purposes, it would be a “hidden tax” in violation of Proposition 218, the City Charter and the San Diego Municipal Code. *Grand Jury Audit of the City of San Diego Water Department Service Level Agreements*, Office of Audits & Advisory Services, Report No. A06-019 at p. 4 (2006).

## II. LEGAL RESTRICTIONS ON THE USE OF WATER UTILITY FUNDS

### A. The City Charter and Proposition 218

All revenue of the water utility must be deposited into the Water Fund. San Diego Charter § 53. Water utility funds are held in trust to guarantee sufficient revenue to provide water service through a self-sustaining, financially independent water utility. City Att'y MOL No. 2006-6 at pp. 6-7 (March 16, 2006). Though Charter section 53 allows the City Council to transfer any “excess revenue” of the water utility to the General Fund for any legal City purpose, this language in Section 53 is preempted by Proposition 218 to the extent a transfer exceeds the cost of services provided to the water utility by General Fund departments.

Proposition 218 amended the California Constitution in 1996 by adding articles XIII C and XIII D. Section 6 of article XIII D imposed new requirements for new and existing property-related fees and charges. These requirements include a restriction that the revenue from the fee or charge not exceed the cost to provide the property-related service. Cal. Const. art. XIII D, §6(b)(1). Nor may revenue from the fee be used to pay for governmental services available to the general public, such as police or library services. Cal. Const. art. XIII D, §6(b)(5). Metered water rates are property-related fees subject to these restrictions. *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006). Provisions in the City Charter are preempted if they conflict with the California Constitution. *Howard Jarvis Taxpayers Ass'n v. City of San Diego*, 120 Cal. App. 4th 374, 385 (2004).

If the City's water rates generate “excess revenue” available to the General Fund under Charter section 53, the revenue would exceed the cost to provide water service in direct conflict with Proposition 218. The “excess revenue” provision of Charter section 53 is therefore preempted by Proposition 218 and has no force or effect. *See Howard Jarvis Taxpayers Ass'n*, 120 Cal. App. 4th at 385. Therefore, the City cannot collect “excess revenue” through its water rates, much less transfer it to the General Fund for other purposes. Water rates can be used to pay General Fund departments only for services they provide to the water utility, as such expenses are part of the cost of providing water service to customers and are not a transfer of excess revenue. *See City Att'y Report 2004-15* (June 21, 2004) [concluding that enterprise funds may pay General Fund departments for goods and services received]. The amount charged to the water utility must be quantified and calculated not to exceed the cost of services provided by the General Fund. *Howard Jarvis Taxpayers Ass'n v. City of Roseville*, 97 Cal. App. 4th 637 (2002) [overturning a flat fee of 4% of the utility's budget, similar to a franchise fee, given to the city's general fund for the utility's use of the right-of-way].

The effect of the cost of service restrictions on water rates is to limit the use of water utility funds to purposes related to the construction, operation, and maintenance of the City's water system. If the City can afford to use water utility funds for any other purpose, it implicitly

means the City is collecting more revenue than necessary to provide water service. The cost of service restriction in Proposition 218 is intended to prohibit diverting ratepayer funds to pay for unrelated projects or services. City Att'y MOL No. 2008-12 (August 4, 2008).

### **B. California Government Code Section 66013**

Water capacity fees are subject to a similar cost of service restriction. The City charges a one-time capacity fee for new or larger connections to the City's water system to offset the capital cost of expanding the system. SDMC § 67.0203. Capacity fees are not subject to the requirements of Proposition 218. *Richmond v. Shasta Community Services District*, 32 Cal. 4th 409, 428 (2004). Capacity fees, though, still cannot exceed the cost of providing the service pursuant to state statute, unless the amount is approved by a two-thirds vote of the electorate. Cal. Gov. § 66013(a); City Att'y MOL No. 96-40 (August 6, 1996). The City's water capacity fees have not been submitted to a vote of the electorate, so they may only be used for their intended purpose.

### **C. The Master Installment Purchase Agreement**

In addition, the City's water bond covenants require these and all other sources of water utility funds to be used for the construction, operation, and maintenance of the City's water system. As a condition of obtaining public financing of capital improvements to the water system, the City agreed to hold all water utility funds in trust to be used solely for (in order of precedence): (1) operation and maintenance of the water system, (2) installment payments on parity obligations, (3) any deficiency in required reserve funds of the water system, (4) installment payments on subordinate obligations, and (5) any other lawful purpose of the water system. *Amended and Restated Master Installment Purchase Agreement*, (MIPA) §5.02 (January 1, 2009). Water utility funds, called "system revenues" in the MIPA, are defined as "all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Water System." MIPA § 1.01. Use of any water utility funds for any purpose unrelated to the water system would violate the terms of the MIPA.

This Office has issued many opinions over the years explaining that there must be a factual nexus between the expenditure of water utility funds and (by analogy) sewer utility funds and the construction, operation, and maintenance of the water or sewer systems. City Att'y MOL 90-75 (June 27, 1990) [concurring with a proportionate use of water and sewer utility funds to oppose a merger of two major gas and electric utilities that could result in higher energy prices for the water and sewer utilities]; City Att'y MOL 2001-12 (July 12, 2001) [rejecting the use of sewer utility funds for a permanent sound wall to block noise from rush-hour traffic]; City Att'y MOL 93-22 (February 22, 1993) [rejecting the use of sewer utility funds for improvements to Sunset Cliffs Natural Park]; City Att'y MOL 95-07 (January 24, 1995) [cautioning against the use of sewer utility funds to pay for street repaving beyond that portion impacted by sewer pipe replacement]; City Att'y MS 2002-1 (January 28, 2002) [concurring with the use of sewer utility funds as a reward for the capture and conviction of those vandalizing the sewer system]; City Att'y Report 91-53 (November 13, 1991) [agreeing with the use of water utility funds to maintain fences, roads, and restrooms open to the public when such facilities are necessary for water utility purposes].

### III. USE OF WATER UTILITY FUNDS TO CONTRIBUTE TO THE JPA

#### A. The Relationship Between the JPA and Water Utility Property

The purpose of the JPA is “to acquire, plan, design, improve, manage, operate and maintain the San Dieguito River Valley Regional Open Space Park.” Joint Exercise of Powers Agreement, Document No. RR-273718, at § 1. This has been expanded by the JPA into a Mission Statement posted on its website:

To preserve and restore land within the Focused Planning Area of the San Dieguito River Park as a regional open space greenway and park system that protects the natural waterways and the natural and cultural resources and sensitive lands and provides compatible recreational opportunities, including water related uses, that do not damage sensitive lands.

To provide a continuous and coordinated system of preserved lands with a connecting corridor of walking, equestrian, and bicycle trails, encompassing the San Dieguito River Valley from the ocean to the river's source.

<http://www.sdrp.org/about.htm>. The JPA also lists five San Dieguito River Park (Park) Goals: preservation of open space, conservation of sensitive resources, protection of water resources, preservation of the natural floodplain, retention of agricultural uses, and creation of recreational and educational opportunities. *Id.*

According to the JPA, the City owns 21,566 acres within the approximately 80,000 acre Park planning area.<sup>1</sup> Of the City-owned property, the Public Utilities Department owns 17,416 acres including property within the Multi-Habitat Planning Area (MHPA), Cornerstone Lands, and Lake Hodges.<sup>2</sup> The City's policy is to manage its property within the Park consistent with the Park plan. Council Policy 700-14.

Given the amount of property the water utility owns within the Park, the question has been raised whether it is appropriate for the water utility to pay the City's contribution to the JPA. The JPA asserts that its activities directly benefit water utility assets by managing water utility property and protecting water quality.<sup>3</sup> The JPA estimates that approximately \$1.2 million of its \$1.5 million annual budget (excluding grant funds) is associated with managing water utility property.<sup>4</sup> The JPA therefore believes it is appropriate for the water utility to pay the City's contribution.<sup>5</sup>

The City may, in its discretion, allow public access to water utility property provided it does not compromise the value or usefulness of the property for water utility purposes. City Att'y MOL 94-50 (June 7, 1994). This does not necessarily mean, though, that water utility

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<sup>1</sup> Email from Susan Carter to Thomas Zeleny, *et al.*, dated December 10, 2009.

<sup>2</sup> Memorandum from Jim Barrett to Councilmember Lightner dated December 11, 2009.

<sup>3</sup> Email from Susan Carter to Thomas Zeleny, *et al.*, dated December 10, 2009.

<sup>4</sup> Email from Dick Bobertz to Stephen Heverly dated December 14, 2009.

<sup>5</sup> Email from Susan Carter to Stacey LoMedico dated December 8, 2009.

funds may be spent on providing public access or accomplishing the mission and purposes of the JPA. The JPA's activities must relate to the construction, operation, and maintenance of the water system, not for park and recreation or other purposes even if it occurs on water utility property.

Many of the activities of the JPA relate to preservation of open space rather than water utility purposes. Restoring endangered habitat, protecting archaeological and cultural resources, building and maintaining trails for public access, and encouraging agriculture are all noble public purposes, but they are not water utility purposes. Using water utility funds for such activities would violate Proposition 218, the Government Code, and the MIPA.

### **B. Protection or Improvement of Potable Water Quality and Supply**

More persuasively, the JPA also focuses attention on its efforts to protect water quality and supply as one of the key purposes of the JPA and benefit to water utility assets.<sup>6</sup> The JPA explains that it removes water-thirsty invasive plants, trash and debris, controls erosion to reduce sediment, and helps identify potential sources of pollution of the watershed. The JPA also identifies recent City and water utility planning documents acknowledging some of these activities benefit water resources.<sup>7</sup> The missions of the JPA and the water utility overlap to some extent when it comes to water quality and supply.

There is a distinction, though, between water quality and *drinking* water quality. The water utility is concerned with drinking or potable water quality. Water quality in general is the responsibility of the Storm Water Department funded by the General Fund. Conceptually, improving water quality may also improve drinking water quality, depending on the volume and nature of the particular pollutants and the effectiveness of the water utility's treatment processes.

Lake Hodges is not currently a source of drinking water for the City, but it may be later this year when the County Water Authority links Lake Hodges to its regional distribution system as part of the Emergency Storage Project. Water utility funds could be used to compensate the JPA for those activities that protect or improve the City's drinking water quality or supply. There is considerable disagreement between the JPA and the water utility as to whether the JPA's activities benefit either one. This Office does not have the scientific knowledge or expertise to resolve this complicated factual issue, but we note it is our understanding that the water utility's existing water treatment facilities can accept and treat Lake Hodges water to potable water standards.

### **C. Maintenance of MHPA Property and Cornerstone Lands**

The water utility has other responsibilities as an owner of property within the MHPA, including Cornerstone Lands. Cornerstone Lands were identified during development of the Multiple Species Conservation Program (MSCP) as essential building blocks for creating a viable habitat preserve system. The water utility owns approximately 3,400 acres of Cornerstone Lands within the JPA's planning area, maintained in an undisturbed natural condition to serve as

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<sup>6</sup> Email from Susan Carter to Thomas Zeleny, *et al.*, dated December 10, 2009.

<sup>7</sup> Memorandum from D. Wayne Brechtel to Thomas Zeleny dated January 27, 2010.

a watershed for Lake Hodges. Water utility funds could be used to compensate the JPA for performing obligations required of the water utility as a property owner.

The water utility's obligations with respect to Cornerstone Lands are described in the Cornerstone Lands Conservation Bank Agreement. These obligations are tied to creation of a funding source to compensate the water utility:

The San Diego City Charter restricts the use and disposition of Water Utility assets. The Water Department must be compensated for any title restrictions placed on the Cornerstone Lands and for any financial burdens which do not directly benefit the City's water utility rate payers. Therefore, to meet the policy objectives of the MSCP and comply with the City Charter, the City of San Diego intends to enter into a Conservation Land Bank Agreement with the wildlife agencies for the Cornerstone Lands.

*City of San Diego MSCP Subarea Plan* (Subarea Plan), § 1.2.5 (March 1997). The water utility is to be compensated for the restrictions and obligations placed on its property by receiving conservation credits which can be sold to others in the county needing mitigation. *Id.*

The water utility has yet to receive any compensation for Cornerstone Lands within the Park. Cornerstone Lands are placed into a Conservation Bank in phases, with the Lake Hodges area being designated as phase 2 or phase 3. *Cornerstone Lands Conservation Bank Agreement*, § 4(a) at n.1. Phase 2 cannot start until the sale of the last conservation credit attributed to phase 1. *Id.* at §3(b). According to the Public Utilities Department, there are still unsold phase 1 conservation credits.

Until the Cornerstone Lands are included in the Conservation Bank through a conservation easement, the water utility's obligations are passive. The water utility must not discharge or release any hazardous substances, sell, lease, or develop any Cornerstone Lands without the permission of wildlife agencies, and otherwise must maintain the biological value of the properties. *Id.* at § 5(a). These obligations do not require any affirmative action or expense of the water utility, consistent with the directive of the MSCP Subarea Plan that water utility ratepayers not be financially burdened by programs that do not benefit them.

Phase 2 commences with the conveyance of a conservation easement over the Cornerstone Lands and the receipt of 1,000 conservation credits. *Id.* at § 4. If the Lake Hodges area is in phase 2, upon conveyance the water utility must manage and conserve the Cornerstone Lands in perpetuity, the cost of which is paid by an endowment to be established through the sale of conservation credits. *Id.* at § 5(b). The interest and earnings of the endowment fund must meet or exceed the per acre management cost estimate set forth in section 7.3.2 of the MSCP Plan. *Id.* at § 5(b)(2). The endowment is designed to ensure that ratepayer funds are never used to manage the Cornerstone Lands.

Until the endowment is funded through the sale of conservation credits, there are not any obligations imposed on the water utility's Cornerstone Lands that the JPA can be compensated to perform. The water utility's current obligation is essentially to leave the Cornerstone Lands

alone until they are incorporated into the Conservation Bank. After the endowment is funded, the water utility will have an affirmative obligation to manage and conserve the Cornerstone Lands, and the JPA could be compensated from the endowment to perform that obligation.

The Subarea Plan includes additional general and specific management policies and directives applicable to property in the MHPA. General management directives address public access and recreation, litter and trash, invasive plants and animals, flood control and other management issues. *Subarea Plan*, §1.5.2. Specific management policies and directives for the Lake Hodges and San Pasqual Valley include restricting public access and recreation to designated areas, removing itinerant worker camps, gradually replacing non-native vegetation, and protecting certain endangered habitat by installing fences. *Id.* at § 1.5.9.

To the extent these MHPA obligations require the expenditure of funds, they are obligations of the General Fund<sup>8</sup> even if the activity occurs on water utility property. As with the Cornerstone Lands, water utility funds cannot be used to implement MHPA policies and directives that do not benefit water ratepayers. Therefore the JPA cannot be reimbursed from water utility funds for implementing MHPA policies and directives unless they assist the water utility in improving drinking water quality.

#### **IV. THE SAN PASQUAL LAKE HODGES RECREATIONAL TRUST FUND**

On April 10, 2000, the City Council directed the City Manager to establish a San Pasqual Lake Hodges Recreational Trust Fund (Trust Fund) within the Water Department's Enterprise Fund as a condition of approving the construction and operation of the Hodges Golf Improvement Center (Golf Center) on water utility property. San Diego Resolution R-292939 (April 10, 2000). The resolution does not specify what the Trust Fund is supposed to be used for, but both its name and testimony at the hearing indicate it is for recreation and cultural preservation. Twenty-five percent of the proceeds from the Golf Center lease are being placed in the Trust Fund.

The water utility must receive fair market value for the sale or lease of water utility property. City Att'y MOL No. 2005-10 (May 13, 2005) [determining the JPA must pay fair market value for water utility property near Lake Hodges]. Such revenue must be deposited into the water utility fund and used for water utility purposes. San Diego Charter § 53. While the Trust Fund is within the water utility fund, recreation and cultural preservation are clearly not water utility purposes. Use of the Trust Fund is subject to the same restrictions as other water utility funds.

The opinion of the General Counsel to the JPA is that the Trust Fund may be used to pay for the cost of projects or activities that benefit Water Department assets or to cover recreational activities on water utility properties.<sup>9</sup> The General Counsel explains the Trust Fund is a

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<sup>8</sup> Long-term funding for MHPA management is supposed to be provided through a regional, voter-approved mechanism. *Implementing Agreement to Establish a MSCP for the Conservation of Threatened, Endangered and Other Species in the Vicinity of San Diego, California*, §11.2 (1997). The funding mechanism has yet to be established.

<sup>9</sup> Memorandum from D. Wayne Brechtel to Dick Bobertz dated December 18, 2009.

contractual obligation to which the water utility consented and cannot now disregard. Because San Diego Charter section 53 allows the water utility to pay its “contractual obligations,” the General Counsel concludes the Trust Fund may be used to compensate the JPA for its activities.

The JPA’s General Counsel is partially correct. As water utility funds, the Trust Fund could be used to compensate the JPA for activities that support the construction, operation, and maintenance of the City’s water system. However, the term “contractual obligations” must be interpreted in the context of San Diego Charter section 53:

All revenues of the Water Utility shall be deposited in a Water Utility Fund. The Manager shall include in the annual budget the estimated expenditure and reserve requirements of the Water Utility Fund. The City Council using such estimates as a basis shall include in the annual appropriation ordinance for the Water Utility Fund provision for operating and maintenance costs; replacements, betterments, and expansion of facilities; payments necessary for obtaining water from the Colorado River; *any other contractual obligations*; reserves for future expansion of water utility plant; reserves for future water purchases . . . .

San Diego Charter §53 (emphasis added). The purpose of section 53 is to ensure that water utility funds are used only for water utility purposes. If “contractual obligations” were interpreted to encompass obligations and activities unrelated to water utility purposes, an exception would be created that would swallow the rule. “Contractual obligations” under section 53 are limited to obligations or activities that further water utility purposes.<sup>10</sup>

Furthermore, the Trust Fund is not a contractual obligation. The creation of the Trust Fund was added by the City Council during the hearing on the General Plan amendment and Conditional Use Permit to allow the construction and operation of the Golf Center. The JPA’s General Counsel indicates the water utility consented to the Trust Fund, but we are not aware of any authority for the proposition that a contractual relationship can be formed between a municipal utility and its legislative body. There must be at least two separate parties to form a contract. Cal. Civ. Code § 1550; *See Yosemite PortlandCement Corp. v. State Board of Equalization*, 59 Cal. App. 2d 39, 41-42 (1943) [It is of the essence of a contract that there be two contracting parties of separate identity]. We are unaware of any written contract regarding the Trust Fund between the City and the JPA or any other entity.

At the City Council hearing in 2000, the JPA indicated its primary concern was whether the Golf Center was an appropriate land use for the area. There was a Mitigated Negative Declaration (LDR No. 98-0466) and a Mitigation, Monitoring and Reporting Program for the Golf Center, so there should not be any unmitigated environmental impacts that are not the responsibility of the Golf Center. If there are, however, using the Trust Fund or other water utility funds to mitigate those impacts would be appropriate because they are caused by the water utility activity of leasing its property for the Golf Center. If there are not any unmitigated

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<sup>10</sup> San Diego Charter section 53 does not prohibit the water utility from *receiving* funds by leasing otherwise idle property to others for recreational purposes, like the Hodges Golf Improvement Center, provided the water utility receives fair market value and uses the revenue to fund water utility activities. Section 53 prohibits the City from *spending* water utility funds on recreational and other unrelated activities.



environmental impacts, then we recommend the Trust Fund be dissolved and its funds made available to the water utility, as there are no other purposes for which the Trust Fund could lawfully be used separate and apart from other water utility funds.

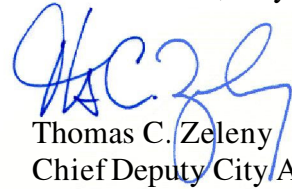
### CONCLUSION

Collectively, the City Charter, Proposition 218, the California Government Code and the MIPA require all revenue of the water utility to be used only for the construction, operation and maintenance of the City's water system. This includes revenue the water utility receives from the Golf Center lease and deposits into the Trust Fund. Water utility funds could be used to compensate the JPA for those activities that protect or improve drinking water quality or supply, but we defer to the water utility as to whether those activities can be identified and quantified.

Water utility funds cannot be used to compensate the JPA for managing property within the MHPA, because that is an obligation of the General Fund. After the Cornerstone Lands in the Lake Hodges area are placed into the Conservation Bank, however, the water utility could compensate the JPA to manage those properties. The cost of management would be paid from an endowment established in the water utility fund through the sale of conservation credits, rather than using ratepayer money.

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