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**MEMORANDUM OF LAW**

DATE: February 3, 2011  
TO: Roger Bailey, Public Utilities Director  
FROM: City Attorney  
SUBJECT: Restrictions on the Use of the Dedicated Reserve from Efficiencies and Savings

**INTRODUCTION**

At recent Independent Rates Oversight Committee (IROC) meetings and subcommittee meetings, questions have been raised as to what are proper uses of funds from the Dedicated Reserve from Efficiencies and Savings (DRES). This memorandum discusses the legal restrictions on the use of DRES funds.

**QUESTION PRESENTED**

What are the legal restrictions on the use of DRES funds?

**SHORT ANSWER**

Funds in the DRES can only be used for water and sewer utility purposes. To the extent that funds in the DRES can be traced back to rate increases adopted by the City pursuant to Proposition 218, the use of those funds is further limited to the purposes described in the notices of the proposed rate increases mailed to ratepayers.

**ANALYSIS**

**I. ESTABLISHMENT OF THE DRES**

The DRES was created by the Mayor in 2007 as part of his plan to safeguard water and wastewater funds.

At the Mayor's direction, the City's Chief Financial Officer has created a "Dedicated Reserve from Efficiencies and Savings" (DRES) that will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvement Program (CIP) or operations and maintenance of either system.

The DRES will track funds that can be used for accelerating CIP project schedules, creating further efficiencies or other actions that will help to offset the need for any future rate increases in these systems. At the end of each fiscal year, any savings not required to comply with established policies or legal documents will be transferred into the DRES. At the end of four years, any funds transferred into the DRES and not used for capital improvements will be used to lower future rates necessary for the water and wastewater systems.

Press Release, Office of the Mayor, *Mayor Sanders Details Plan to Safeguard Water and Wastewater Ratepayer Funds* (Feb. 15, 2007), <http://www.sandiego.gov/mayor/news/2007.shtml>

The intended purpose of the DRES is to accelerate capital improvements, increase efficiencies, and offset future rate increases. The DRES was identified as one of the safeguards of ratepayer funds that would be implemented when the City increased water and sewer rates in 2007. *See* Report to City Council Nos. 07-039, 07-040 (Feb. 21, 2007). The DRES has not been adopted as a Council Policy or incorporated into the San Diego Municipal Code, but the DRES has been approved by the City Council as a component of the current City Reserve Policy. San Diego Resolution R-303941 (July 29, 2008).

Preliminary information presented to IROC on October 18, 2010, indicates there may be balances of about \$10 million in the DRES of the water fund and about \$50 million in the DRES of the sewer fund. The source of these funds includes lower than expected CIP costs and savings from the operation and maintenance of the utilities. A portion of these balances may be attributable to, or derived from, water or sewer rate increases adopted by the City pursuant to Proposition 218.

## II. PROPOSITION 218

Proposition 218 amended the California Constitution in 1996, imposing new requirements on municipal water and sewer rates. An agency proposing to increase water or sewer rates must first provide written notice to its customers describing the reason for the fee, the amount of the fee and how it was calculated, and the date, time, and location of a public hearing on the proposed increase. Cal. Const. art. XIII D, § 6(a)(1). Revenue derived from new, existing, or increased fees cannot be used for any purpose other than that for which the fees were collected. Cal. Const. art. XIII D, § 6(b)(2). The City has published and mailed several notices to its customers since the passage of Proposition 218 describing the reasons for water and sewer rate increases.

The City's water and sewer funds, including funds in the DRES, can only be used for water and sewer utility purposes. *See* City Att'y Report 2010-6 (Feb. 24, 2010). If some of the funds in the DRES can be traced back to recent water or sewer rate increases adopted pursuant to Proposition 218, the use of those funds is further limited to the purposes described in the notices the City mailed to ratepayers. Funds in the DRES attributable to water and sewer rates adopted prior to Proposition 218 did not require mailed notices and therefore may be used for any water or sewer utility purpose. *See* City Att'y MOL No. 2008-12 (Aug. 4, 2008).

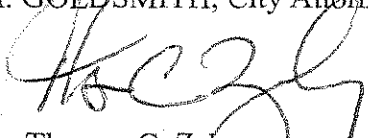
Proposition 218 does not prevent the DRES from being used for its intended purpose. For example, funds in the DRES designated for CIP purposes in the notices mailed to City ratepayers can be applied to future CIP projects to reduce the amount of future rate increases. Funds in the DRES attributable to CIP savings from water and sewer rates adopted prior to Proposition 218 can be used for any water and sewer utility purpose, including offsetting future rate increases. The use of DRES funds will only be improper if they are attributable to a rate increase adopted pursuant to Proposition 218 and are used for a purpose different than was described to ratepayers in the City's notice, such as using rate increases identified as being for CIP projects to offset the increased cost of water purchased from water wholesalers. Before reprogramming funds in the DRES, the City should refer to its prior notices to confirm the proposed uses are consistent with the purposes of the rate increases presented to ratepayers.

**CONCLUSION**

The use of DRES funds is restricted by Proposition 218. To the extent funds in the DRES can be traced back to rate increases adopted by the City pursuant to Proposition 218, the use of those funds is limited to the purposes described in the notices of the proposed rate increases mailed to ratepayers.

JAN I. GOLDSMITH, City Attorney

By



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TCZ:mb

ML-2011-02

cc: Mayor and City Council  
Independent Budget Analyst  
City Clerk