

MEMORANDUM OF LAW

DATE: December 2, 1994

TO: Milon Mills, Director, Water Utilities Department

FROM: City Attorney

SUBJECT: Funding of Reclaimed Water Retrofitting Costs

By memorandum dated October 10, 1994, you have requested our opinion on whether any legal issues arise from the San Diego Water Utilities Department or the Metropolitan Wastewater Department (collectively referred to herein as the "Department") providing financial assistance to future reclaimed water customers for retrofitting their existing irrigation systems. Specifically, you question whether any of the following financing plans present any legal infirmities:

1. The Department pays all or a portion of the cost to retrofit a customer's irrigation system for reclaimed water without any reimbursement or recovery of the capital cost for the retrofit from the customer.
2. The Department pays all or a portion of the cost to retrofit a customer's irrigation system for reclaimed water, but is repaid for that cost by the reclaimed water customer through the reclaimed water rates for a specified period of time.
3. The reclaimed water customer pays all of the cost to retrofit the customer's irrigation system for reclaimed water, but recovers the capital cost for the retrofit from a discounted reclaimed water rate for a specified period of time.
4. The Department provides a low interest loan to a reclaimed water customer for the purpose of retrofitting the customer's irrigation system.

BACKGROUND

On July 27, 1988, the United States and the State of California filed suit against the City of San Diego for alleged violations of the Clean Water Act, 33 U.S.C. Section 1251 et seq. ("Act"), its National Pollution Discharge Eliminations System ("NPDES") permit, sewer overflows, and irregularities in the City's pretreatment program that regulates industrial waste.

United States et al v. City of San Diego, U.S. Dist. Ct. Civil Case No. 88-1101-B. As a result of the lawsuit, the City negotiated a Partial Consent Decree with the United States and the State of California. The Partial Consent Decree, which required the construction of six (6) water reclamation plants, was lodged with the federal court on January 30, 1990.

Although the District Court did not enter the Partial Consent Decree, it deferred approval on June 18, 1991 and thereafter entered a series of interim orders requiring the City to construct a water reclamation program. The most recent interim order, entered on August 26, 1994, required the City to construct the North City water reclamation plant.

The City pursued legislative relief from the Act from its congressional delegation. On October 8, 1994, the United States Congress adopted H.R. 5176, allowing the City to reapply for a waiver from secondary treatment standards required under the Act. This bill has been signed into law. In order to obtain a waiver pursuant to this new legislation, however, the City must commit to reclaiming 45 million gallons of sewage per day ("MGD") by the year 2010.

At present, the City is designing a water reclamation plant in North City as well as an optimized conveyance system to meet the requirements of both the current interim court order and H.R. 5176. In order to use the reclaimed water produced at the North City plant, a customer's existing potable water irrigation system will have to be retrofitted. The retrofitting may require improvements to a customer's existing irrigation system, such as the installation of backflow prevention devices, separation of the reclaimed water system from the potable water system, the identification of reclaimed water system components by marking and tagging, and the installation of signs to inform the public that reclaimed water is being used. Additionally, retrofitting an existing irrigation system will require an assessment and evaluation of existing facilities and their design, plan checking, construction/installation, inspection, and testing of the required modifications.

According to the Department, the cost of retrofitting will vary greatly due to the different site conditions of potential water reclamation customers. The Department estimates, however, that the cost to retrofit an existing irrigation system will be approximately two thousand dollars (\$2,000) per irrigable acre.

Given the cost to retrofit, the Department has concluded that without a financial incentive the Department will have difficulty in acquiring water reclamation customers. The primary financial incentives being considered are outlined above. In essence, the Department proposes to subsidize all or a portion of

the cost of retrofitting existing irrigation systems for reclaimed water.

ANALYSIS

Expenditures of public funds for the benefit of private individuals necessitates an analysis of the law governing impermissible gifts of public funds and extensions of the credit of the City. Each of the proposed financing plans involves an expenditure of public funds which may be considered to be a gift or extension of the City's credit. Although such expenditures generally are prohibited pursuant to San Diego Charter ("Charter") section 93 and California Constitution Article XVI, section 6, the proposed expenditures may be permissible under the "public purpose" exception. An analysis of the relevant law governing gifts of public funds and extensions of the City's credit follows.

Charter section 93 provides in relevant part:

The credit of the City shall not be given or loaned to or in aid of any individual, association or corporation; except that suitable provisions may be made for the aid and support of the poor.

Charter section 93's prohibition against giving or lending the City's credit has been construed to further bar a gift of public funds to any individual, association, or corporation.

Charter section 93 is derived from and is similar to Article XVI, Section 6 of the California Constitution which provides in relevant part:

The Legislature shall have no power to give or to lend, or to authorize the giving or lending, of the credit of the State, or of any county, city and county, city, township or other political corporation or subdivision of the State now existing, or that may be hereafter established, in aid of or to any person, association, or corporation, whether municipal or otherwise, or to pledge the credit thereof, in any manner whatever, for the payment of the liabilities of any individual, association, municipal or other corporation whatever; nor shall it have power to make any gift or authorize the making of any gift, of

any public money or thing of value to
any individual, municipal or other
corporation whatever. . . .

(Emphasis added.)

Although the constitutional prohibitions have been held to be inapplicable to charter cities (*Tevis v. City and County of San Francisco*, 43 Cal. 2d 190, 197 (1954); *Los Angeles Gas & Electric Corp. v. City of Los Angeles*, 188 Cal. 307 (1922)), the cases interpreting Article XVI, Section 6 are instructive.

Under the proposed financing plans, if the Department pays all or a portion of the cost to retrofit for the customer, then there is clearly a gift of public funds. The Department would be using public funds to benefit a private individual. Moreover, if the Department permits the reclaimed water customer to pay for the retrofit over a period of years via rates, discounted rates, or a loan, then the Department is extending the customer the credit of the City, and in effect utilizing property of the City for the benefit of a private individual. Such a gift of public funds and extension of credit is directly prohibited by Charter section 93.

The courts have recognized, however, an exception to the prohibitions of gifts of public funds and extensions of credit. The exception, known as the "public purpose" exception, is based upon a theory that if a public purpose is served through the use of public funds, no "gift" has been made even though a private individual may benefit from the loan or expenditure. *Board of Supervisors v. Dolan*, 45 Cal. App. 3d 237, 243 (1975); *California Housing Finance Agency v. Elliott*, 17 Cal. 3d 575 (1976); *San Bernardino County Flood Control Dist. v. Grabowski*, 205 Cal. App. 3d 885, 903 (1988). The determination of what constitutes a public purpose is primarily a matter left to legislative discretion; and the courts grant great deference to legislative bodies in reviewing the exercise of that discretion. *Schettler v. County of Santa Clara*, 74 Cal. App. 3d 990, 1005 (1977); *Atlantic Richfield Co. v. County of Los Angeles*, 129 Cal. App. 3d 287, 298 (1982).

In reviewing the exercise of a legislative body's discretion, the courts have examined the question of what is an appropriate municipal affair or public purpose.

A good test to apply to the question here is set forth in the following from *Bank v. Bell*, 62 Cal. App. 320, 330: "In defining a 'municipal affair' it has been said that 'the true test is that which requires that the work should be

essentially public and for the general good of all of the inhabitants of the city. It must not be undertaken merely for gain or for private objects. Gain or loss may incidentally follow, but the purpose must be primarily to satisfy the need, or contribute to the convenience, of the people of the city at large. Within that sphere of action, novelty should impose no veto."

Perez v. City of San Jose, 107 Cal. App. 2d 562, 566 (1951).

Applying these principles to the instant case, we believe that the proposed financing plans, while incidentally benefitting individuals, do serve a public purpose and therefore do not violate Charter section 93. As previously discussed, the City of San Diego is under an interim court order to construct a water reclamation program. Additionally, to obtain a waiver from secondary treatment standards, it must implement a water reclamation program. At present, those requirements are being addressed by the construction of the North City water reclamation plant.

In order to use the reclaimed water produced by the North City water reclamation plant, existing irrigation systems must be retrofitted. Given the estimated cost to complete a retrofit, there is not much incentive for an individual to sign on with the Department to purchase the reclaimed water. Providing a financial incentive to that individual to purchase the reclaimed water via the proposed financing plans therefore is in the best interests of the public at large. If there is no market for the reclaimed water, then the water will have to be put back into the sewer system and discharged into the ocean. This would be a waste of a valuable resource, as well as a waste of public funds. San Diego is an arid region which imports over ninety percent (90%) of its water. If the city is able to produce a new water source for the region, thereby increasing the availability of potable water, the general public is benefitted. The overall benefit to the public derives from the ability of the Department to sell the reclaimed water, and the financing plans provide the Department with the mechanism to accomplish that public purpose.

The financing plans therefore do not violate the prohibition against extension of the credit of the City or gifts of public funds. We would recommend, however, that with the exception of the first alternative financing plan in which the Department pays all or a portion of the retrofit cost without any

reimbursement by the reclaimed water customer, an agreement be drafted reflecting the terms and conditions under which the customer shall repay the Department for the retrofit and indicating the public purpose behind the agreement. Additionally, the financing plans should be brought before the City Council for a legislative finding of a public purpose through a resolution.

CONCLUSION

The proposed financing plans for retrofitting existing irrigation systems for reclaimed water are permissible pursuant to Charter section 93 under the public purpose exception if proper procedures are followed. The City Council must make a finding that the proposed financing plans serve a public purpose which benefits the general public. Additionally, if the Department does not pay for all or a portion of the retrofit, then we recommend that each water reclamation customer sign a contract with the City accepting the terms and conditions under which the customer will repay the Department for the retrofit.

JOHN W. WITT, City Attorney

By

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Deputy City Attorney

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