



April 11, 2022

VIA EMAIL

Chair Desmond,
LAFCO Commissioners, and
Executive Officer Simonds
San Diego County Local Agency Formation Commission
9335 Hazard Way, Suite 200
San Diego, CA 92123

Re: Letter from RMWD and FPU D to San Diego LAFCO Regarding Various CWA Detachment Issues

Chair Desmond, LAFCO Commissioners and LAFCO Executive Officer Simonds:

We submit this letter to the Commission on behalf of our respective clients, Rainbow Municipal Water District (“Rainbow”) and Fallbrook Public Utility District (“Fallbrook”), with the intention of providing the Commission with our clients’ perspective on three distinct issues related to their applications to LAFCO for detachment from the San Diego County Water Authority (“CWA”) and annexation into the Eastern Municipal Water District (“EMWD”), as follows:

1. The law must be the Commission’s guide with regard to its consideration of whether to impose a so called “exit fee” (or “departure fee” as described in Dr. Hanemann’s report) on Rainbow and Fallbrook as a condition of their separate detachment applications. The County Water Authority Act is clear that the only continuing obligation pertains to the continued taxation of property to pay for debt and other obligations secured by same. Rainbow and Fallbrook implore the Commission to follow the law (both statutory and case law) with regard to its imposition of terms and conditions.
2. CWA’s March 7, 2022 letter exemplifies CWA’s continued obfuscation of the facts by relying on selective quotations and the inclusion of extraneous topics of their own construction. Specifically, in its March 7, 2022 letter, CWA claims that LAFCO Staff made misleading “material errors and omissions” thereby materially misrepresenting the findings of Dr. Hanemann’s expert report (“Hanemann Report”). We believe that its letter goes beyond the pale, and we not only take exception to the tone of CWA’s letter, but also strongly disagree with the content of CWA’s letter, as LAFCO Staff’s summary is congruent with the conclusions of the Hanemann Report. We so conclude despite our clients’ disagreement with the Report’s conclusion on the “exit fee.”

3. Rainbow and Fallbrook want to assure the Commission that they will not needlessly submit responses to CWA’s prolific letter writing campaign simply for the sake of responding, as the Districts find responding to SDCWA’s self-identified irrelevant topics a poor use of public resources.

1. The Law Does Not Support an “Exit Fee” as Described in the Hanemann Report

A. The County Water Authority Act Already Requires a Continued Payment

As CWA itself has conceded, the Hanemann Report presented a factual analysis that was not legally based. Unfortunately, the factual analysis in the Report put forward a proposal for a proposed “exit fee” (or “departure fee” as described by Dr. Hanemann) that is not aligned with the law applicable to detachments from a county water authority, as required under the County Water Authority Act (“CWA Act”). Under the CWA Act, member agencies like Rainbow and Fallbrook wishing to be excluded from the boundaries of a county water district are not required to pay an “exit fee” of the type described in the Report. But this doesn’t mean that there is no payment required—to the contrary, the CWA Act requires that property taxes pledged to repay existing debt and other obligations assessed on properties within detaching districts continue to be assessed until the debt is discharged. Specifically, the CWA Act provides as follows:

. . . taxable property within the excluded area shall continue to be taxable by the county water authority for the purpose of paying the bonded and other indebtedness of the county water authority outstanding or contracted for at the time of the exclusion and until the bonded or other indebtedness has been satisfied.

(Water Code Appendix § 45-11(a)(2).)

Here the Fallbrook and Rainbow agree that the properties within the Districts’ boundaries must continue to be taxable by CWA to pay down CWA’s debt and other obligations secured by such revenue. The problem for CWA with this approach is that almost all of its debt is secured by rate revenue secured debt, so the amount to be recovered by CWA from taxable property continuing to be taxable within the Districts following detachment is small. But this should not impact application of statutory provisions applicable to a detachment.

B. Case Law Requires that LAFCO follow the Principal Act At Issue (here the CWA Act)

Case law further supports the Commission’s adherence to the specific terms of the CWA Act. Again, as conceded by CWA previously, the decision by the Court of Appeal in *Antelope Valley-East Kern Water Agency v. Local Agency Formation Com.* (1988) 204 Cal.App.3d 990, applies to the Districts’ detachment applications. In *Antelope Valley*, the Court held that a LAFCO imposed term and condition that was contrary to the principal act must be set aside. (*Antelope*

Valley-East Kern Water Agency v. Local Agency Formation Com. (1988) 204 Cal.App.3d 990, 992.) The court reasoned that the Legislature did not intend the Cortese-Knox Local Government Reorganization Act of 1985 (the predecessor to the current version of the law) to authorize LAFCO to override the Legislature’s specific provisions for territory excluded from the Antelope Valley-East Kern Water Agency (“AVEK”) regarding tax consequences. (*Id.*)

The factual circumstances are similar in *Antelope Valley* as they are here. And while the Court in *Antelope Valley* interpreted the provisions of a principal act other than the CWA Act—the provisions of the CWA Act and the principal act in *Antelope Valley* are nearly identical as you can read for yourself:

. . . the taxable property within such excluded area shall continue taxable by the Antelope Valley–East Kern Water Agency for the purpose of paying the bonded or other indebtedness of the Antelope Valley–East Kern Water Agency outstanding or contracted for at the time of such exclusion and until such bonded or other indebtedness shall have been satisfied, to the same extent that such property would be taxable for such purpose if such exclusion had not occurred.

(Water Code Appendix § 98-84.)

The Court’s decision included the following illustrative and we think interesting discussion:

A specific statute, section 84 of AVEK's principal act, declares in no uncertain terms the tax consequences of detachment of territory from AVEK: the taxable property shall continue taxable by AVEK for the purpose of paying the bonded indebtedness to the same extent it would have been taxable if exclusion had not occurred. A cardinal principle of statutory construction is that a special statute dealing expressly with a particular subject prevails over a general statute. (*Agricultural Labor Relations Bd. v. Superior Court* (1976) 16 Cal.3d 392, 420, 128 Cal.Rptr. 183, 546 P.2d 687.) Moreover, although appellant points out that the Cortese–Knox Act “provides the sole and exclusive authority and procedure for the initiation, conduct, and completion of changes of organization and reorganization for cities and districts” (Gov.Code, § 56100), the Act also recognizes that sometimes a local agency formation commission may be required to give effect to the specific provisions of an agency's principal act. Government Code section 56844,¹ subdivision (q) provides, “Any change of organization or

¹ Section 56844 was renumbered as Section 56886 (q) in 2000. The language remains the same.

reorganization may provide for, or be made subject to one or more of, the following terms and conditions.... (q) Any terms and conditions authorized or required by the principal act with respect to any change of organization.” (See also Gov. Code, § 56119.)

(*Antelope Valley*, 204 Cal.App.3d at 995.)

C. Crafting a Term and Condition for an Exit Fee on Some Other Basis, is Problematic as well.

Another important point for the Commission to keep in mind is the arbitrary basis on which Hanemann calculated his proposed “exit fee.” Imposing a term and condition based on the volume of water that the Districts had purchased in the past, but will not purchase if detachment occurs, runs not only afoul of statutory and constitutional provisions, but would also run contrary to CWA affirmative statements made to potential investors in the course of borrowing money. As set out in its bond report distributed to potential investors CWA states that member agencies are not responsible for any debt and are not obligated to pay for any set amounts of water. For example, just a few months ago, the CWA Board adopted Resolution 2022-02 authorizing the issuance of \$170M in debt. Included in the Official Statement for this financing are principles from CWA’s policy on member agency obligation for the debt, including the following statements:

NEITHER THE PAYMENT OF PRINCIPAL NOR INTEREST ON THE 2022A BONDS CONSTITUTES A DEBT, LIABILITY OR OBLIGATION OF THE WATER AUTHORITY OR ANY OF THE PUBLIC AGENCIES WHO ARE PARTIES TO THE AGREEMENT CREATING THE AGENCY.

(Official Statement Page 3, (capitalization in the original.)

Except as set forth in the next sentence, the Water Authority’s member agencies are not contractually or otherwise required to order and pay for any set amounts of water from the Water Authority.

(Official Statement Page A-6.) Notably the sentence which immediately follows the above, describes the unique obligations of Carlsbad and Vallecitos regarding their direct desalinated water deliveries).

D. Conclusion

In conclusion, the Districts’ urge the Commission to follow the law—here the statutory requirements—applicable to a detachment from a county water authority, like the Districts’

proposed detachments from CWA. If equity is what the Commission seeks, it should bear in mind that should the Districts successfully detach, they will leave on the table the following:

- Their proportionate share of CWA reserves which in total amounts to nearly \$400M of which approximately 6.179% (or nearly \$25M were contributed by Fallbrook and Rainbow ratepayers).
- The value of all CWA infrastructure and other assets for which the Districts contributed over the past 75+ years, which infrastructure and assets will continue to be enjoyed by the remaining CWA agencies for years to come. Over this period, Fallbrook and Rainbow have contributed a combined approximate 6.17% of all CWA revenues which equates to over \$211M in asset value left behind. (SDCWA Annual Comprehensive Financial Report Fiscal Year ending June 30, 2021, p. 28.)
- Approximately \$40M of infrastructure to be constructed to finally connect the Districts to the CWA Emergency Storage Project—a project that has been in the works for over 20 years, and for which the Districts have financially contributed for over 20 years.

We also want to emphasize that from a practical standpoint if the Commission does impose an “exit fee” such as the one described in the Hanemann Report, it would be at a cost of approximately \$58/month for FPUD ratepayers to offset the approximately \$1 per month impact on other SDCWA ratepayers.

2. LAFCO Staff’s Summary of the Hanemann Report

A summary, by nature, is merely a brief overview of the ultimate conclusions reached by the author of the underlying document, and it cannot, and should not, be expected to include every point and counterpoint raised by the author. It is insincere for CWA to complain that Staff’s summary was misleading merely because the overall conclusions of the Hanemann Report, as accurately summarized by LAFCO staff, did not tend to support CWA’s arguments against Fallbrook and Rainbows applications for detachment. It is clear that CWA is not interested in an objective summary of the Hanemann Report, and instead, in an attempt to create a narrative more favorable to CWA, seemingly prefers to cherry pick portions of the Report which, in conjunction with extraneous information not present or referenced in the report.

We believe that it is clear to anyone that read the Hanemann Report in full that LAFCO Staff accurately summarized the conclusions therein. For example, with regard to “Water Supply Reliability” Staff correctly stated that the Hanemann Report concludes that both CWA and EMWD have reliable wholesale supplies, even though he found that CWA’s water supplies are marginally more reliable. These were not mutually exclusive conclusions reached by Dr. Hanemann. Although the Hanemann Report includes a discussion of the differences in CWA’s and EMWD’s water supplies, including their relative price and availability, the Report ultimately concludes that FPUD and RMWD will not have a less reliable wholesale water supply by joining EMWD, just a

potentially more expensive supply during droughts. (Hanemann Report, p. 83-98.) Dr. Hanemann plainly stated as much:

Q. Is it likely that FPUD and/or RMWD will find themselves running out of water if they detach from SDCWA and join EMWD?

A. While I believe that FPUD and RMWD are taking something of a gamble on supply reliability if they switch from SDCWA to EMWD, the gamble ultimately is *not one of running out of water* but, rather, paying a higher price than they had anticipated to get by in a drought.”

(Hanemann Report, p. 98 (emphasis added).) The Hanemann Report includes additional support for this conclusion, providing that “[f]or surface water users in Southern California (unlike some groundwater users) the risk is not that the tap runs dry but, rather, that a temporary solution in a drought emergency turns out to be a rather expensive proposition.” (Hanemann Report, p. 98.) Furthermore, staff’s conclusion that Hanemann Report did not find the reliability differences between CWA and EMWD to be substantive relative to industry standards is reasonable, especially given the Report’s discussion of MWD’s efforts to secure future supply from the Delta Conveyance Project (Hanemann Report, p. 88-89.)

Similarly, with regard to “Water Rates,” LAFCO Staff was correct in stating that the Hanemann Report concludes that the cost-savings to Fallbrook and Rainbow, if they detach from CWA and annex into EMWD, will be \$2.9 million and \$4.8 million in CY 2022, respectively, and generate a combined net annual savings of \$7.7 million, representing net savings of 35% for FPUD and 21% for RMWD. Dr. Hanemann clearly states he was not presenting a multi-year analysis of the financial impacts of detachment on CWA, FPUD, and RMWD because he felt “that there is now too much uncertainty about future water supply, future water demand, and future rate schedules to justify making a projection of the annual financial impact over the coming decade” and therefore “restrict[ed] [his] analysis to an estimate of the financial impact in CY 2022.” (Hanemann Report, p. 65.) Dr. Hanemann unequivocally concluded that the estimated cost-savings to FPUD and RMWD in CY 2022, if they switch wholesale providers, would be \$2.9 million and \$4.8 million, respectively, with a total cost savings of \$7.7 million. (Hanemann Report, p. 12, 72.)

Last, with regard to LAFCO Staff’s summary of the Hanemann Report’s conclusion on the “Exit Fee” issue, while we disagree with the conclusions, and believe that the recommendations are not authorized by law, LAFCO’s Staff’s summary of the Report’s conclusion was accurate.

3. CWA’s Continuous Stream of Letters

Fallbrook and Rainbow have determined that responding to each and every of the numerous CWA letters, such as CWA General Counsel’s letter of February 16, 2022 to Adam Wilson, is



futile. The Districts' past exchanges of letters with CWA have failed to result in any resolution of the issues. These letters from CWA appear to be intended to continue the obfuscation of issues, very similar to the approach taken by CWA in Fallbrook's and Rainbow's previous attempts to discuss with CWA the issues around detachment for almost a year before filing the applications for detachment with LAFCO.

We want to communicate on the record, that CWA's communications continue to allege that the Districts have not conducted legal analysis on issues of concern to the Districts, such as the so called "exit fee" discussed in this letter above, ignoring not only the analysis contained in the Fallbrook and Rainbow applications to LAFCO themselves, but also as the numerous submittals detailing legal issues and analysis submitted to LAFCO since the applications were filed. Examples of such submittals can be found on the San Diego LAFCO webpage dedicated to the processing of the Fallbrook and Rainbow application, and include the following: The Nossaman LLP Letter to Hanemann dated 9/29/21: <https://www.sdlafco.org/home/showpublisheddocument/5922/637684127802770000>

Taken as a whole, the record of our individual and collective legal analyses of the relevant issues have been submitted so that LAFCO Counsel can make an informed determination.

We thank the Commission and LAFCO Staff for its time, and look forward to having our detachment proposals formally considered by the Commission in the near term.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Lloyd W. Pellman', written over a horizontal line.

Lloyd W. Pellman
Attorney for
Rainbow Municipal Water District

A handwritten signature in blue ink, appearing to read 'Paula de Sousa', written over a horizontal line.

Paula de Sousa
Attorney for
Fallbrook Public Utility District

cc: Holly O. Whatley, LAFCO Counsel [hwhatley@chwlaw.us]