

UKIAH VALLEY SANITATION DISTRICT

Change and Transparency Needed

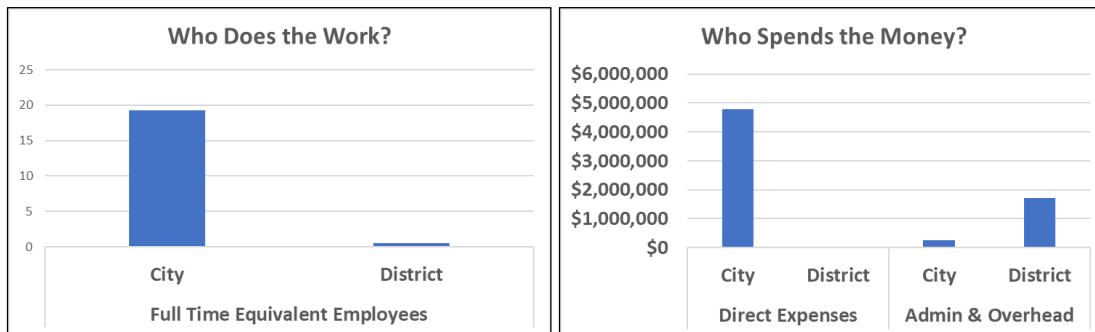
June 19, 2019

SUMMARY

Conflicting and incomplete newspaper reports, letters to the editor, and citizen concerns have led the Grand Jury (GJ) to review spending, debt and transparency issues between the Ukiah Valley Sanitation District (District) and the City of Ukiah (City). The lawsuit between the District and the City was settled in October 2018. Over \$16 million has allegedly changed hands with neither side admitting any wrongdoing. The lawsuit legal and administrative bills have approached \$9 million and continue to escalate. An estimated \$14 million could have been saved by the ratepayers if the existing bond had been refinanced at a lower rate of interest. The refinance could not occur because the District failed to produce State required audited financial statements for 2014-2018. Ultimately, the \$23 million (combined legal costs and interest savings) must be paid by the citizens of the City and the District via their monthly sewer bills. The City and District are already engaged in arbitration which involves the additional expense of attorneys for both sides.

Both City and District ratepayers are bearing the monetary cost of a dysfunctional relationship. The settlement that led to the new Operating Agreement (OA) is already being tested with a 4-1 vote by the District at the April 2019 meeting to initiate arbitration. The purpose of this report is to clarify the consequences of the lawsuit and settlement, and to urge all ratepayers be more involved with future decisions regarding their sanitation system.

At present, the single physical sanitation system including collection, treatment, maintenance, and administration is managed and operated by the City. The District's only responsibility has been to represent the ratepayers residing outside the 1954 City limits.



Charts show proposed labor allocation and budget expenditures for 2018-2019

The City and District are initiating a joint rate study to determine new sewer rates. The new rates will include the costs of the \$9 million combined legal and administrative fees and almost \$5 million in payments from the City to the District resulting from the lawsuit.

At the March and April 2019 District meetings, the City offered to negotiate a Memorandum of Understanding (MOU) or Joint Powers Agreement (JPA) with the District to restructure the relationship, reduce redundant costs, e.g. a new District Manager, and minimize the need for arbitration. The purpose of the MOU/JPA would be to operate the sewer services as a single system with District and City customers paying the same rates. The District Board would still serve the purpose of protecting the District ratepayers' interests.

Lack of transparency from the District with the public as well as the GJ has been an issue during the course of this investigation. Examples include:

- Long term litigation and attorney-client privilege has prevented transparency in regards to the District. For example: The attorney for the District advised District Board members not to sign the GJ standard confidentiality agreement which impeded the GJ's ability to conduct interviews.
- The District fails to meet the intent of the Brown Act for public meetings by not facilitating public input, agenda items lacking enough description to assist public comment, closed sessions held at the start of Board meetings instead of the end, and copies of documents handed out to Board members, however, not consistently given to the public.
- Denying the GJ's Public Records Act request for the Chair's prepared statement notes.

During the April 2019 District meeting, <https://uvsd.org/recordings.html>, the District Chair, after calling the meeting to order, read a nine minute non-agendized prepared statement advocating non-cooperation with the City's request to negotiate the MOU. The four other Board members had not been made aware of the content of this statement. This violates the intent of the Brown Act.

GLOSSARY

ESSU: Equivalent Sewer Service Units. One ESSU is the rate at which an average single family residence passes sewage into its sewer line. Expenses are shared between the City and the District based on the ratio of ESSUs between them.

JPA: Joint Powers Agreement is a contract between a city, a county, and/or a special district in which the city or county agrees to perform services, cooperate with, or lend its powers to, the special district.

MOU: Memorandum of Understanding is a formal business document used to outline an agreement made between two separate entities, groups or individuals. A MOU usually precedes a more detailed contract or agreement between the parties.

LAFCo: Local Agency Formation Commission is mandated by the State to, among other things, work with voters to create and consolidate special districts to fulfill essential services. The Ukiah Valley Sanitation District is a California special district.

Operating Agreement: The recently modified agreement between the City and District which defines their future relationship.

Overlap area: The District is responsible for the area surrounding the 1954 Ukiah City limits which is served by the City owned treatment plant. The overlap areas are within the current City limits but served by the District.

Participation Agreement: The original agreement between the City and District was first created in 1954 and modified four times since. In 2006 a Financing Agreement was added that specified the details for financing the upgraded and expanded sewage treatment plant. The new Operating Agreement serves as an amendment to the Participation Agreement.

Reserves: The funds maintained to pay for capital projects, make bond payments, and pay other bills as needed. The City and District maintain reserve funds.

Settlement: The October 1, 2018 agreement to dismiss the lawsuit filed by the District against the City.

BACKGROUND

In 1954, it was determined that the existing sewer treatment facility was inadequate to serve the growing Ukiah Valley population. The City built a new plant in 1956 which served both the District and City while the District provided the trunk line which is the collection line of the combined sewer system.

At its origin, the District's Board included two members from the Mendocino County BOS and one from the Ukiah City Council. The Participation Agreement (PA) between the City and District defined ownership and management responsibilities and specified that the City would be the paying and receiving agent for all District operations and maintenance. The PA has been modified four times, including provisions added in 2006, to finance the upgrade and expansion of the sewage treatment plant. In 2008, the District changed its board structure to consist of five resident directors elected by voters within the District.

METHODOLOGY

The GJ interviewed representatives from the District, the City and LAFCo. Documents from both entities and LAFCo were reviewed, including accessible past and recent budgets. The lawsuit claims, settlement, earlier PAs and amendments and the new Operating Agreement (OA) were studied. Financial audits and current arbitration documents are not yet available.

Newspaper articles, press releases and editorials from several county newspapers were also reviewed. The GJ members attended District Board meetings.

DISCUSSION

After the formation of the new Board in 2008, a number of financial, reporting, and procedural issues were raised with the City, some of which were resolved. However, agreement was not reached regarding the ESSU sharing of expenses to be divided between the City and District.

In 2012, the departure of the District's Manager, who was a licensed engineer and former City employee, led to the District's loss of fiscal capability, engineering, and historic knowledge of the combined sanitation system. The turnover of three District Managers from 2008-2017 further limited the District's reporting and accounting capabilities. In this same period from 2014-2018, the District did not provide State mandated reports and audits. The District has failed to demonstrate sound financial controls as shown by the \$130,000 severance pay to a District Manager who served for only six months. The current situation is complicated by the inability of the District to hire a District Manager and, in fact, the last two candidates accepted and then rejected their offer. The proposed salary range is \$130,000 to \$180,000 annually.

The GJ observed that District Board meetings (held at 151 Laws Ave, Ukiah on the second Wednesday of each month at 6pm) are not well attended by the ratepaying public.

The Lawsuit

On September 6, 2013, the District filed a claim against the City for approximately \$16 million. The claim was based primarily on an ESSU ratio which the District felt was financially advantageous to the City. The statute of limitations imposes a deadline on the ability to collect damages for claims. Some of the District's claims were far enough in the past that the District did not want to lose those claims. Therefore, the District asked the City to waive those deadlines. When the City failed to waive the deadlines, the District filed the lawsuit.

From 2013-2018, there were extended negotiations, including mediation, which failed to resolve the disputed issues. There were transfers of District reserve funds made in 2013, 2016 and 2017 requested by the District from District accounts held by the City. These District accounts were mandated in the original PA to be held by the City for the District because the City was the designated collecting and paying agent.

The District budget for administrative and legal expenses increased from \$504,850 in 2015-2016 to \$1,718,278 in 2018-2019 even though it has not taken on any new functions. The budget for District legal expenses increased from \$200,000 to \$1,055,711 during the same period.

Final Settlement

A final settlement between the City and the District was reached October 1, 2018 in which neither side admitted liability or wrongdoing. This settlement, along with the three earlier payments made by the City totaled more than \$16 million. At the October 10, 2018 board

meeting, the District claimed it received damages of \$16,416,296 from the City as a result of the lawsuit. Further GJ investigation revealed that \$11,431,986 of the \$16,416,296 were transfers from the District's own reserve funds held by the City, not damages. The City agreed to pay the balance of \$4,984,310 to end the lawsuit.

A review of the City's 2012 budget (prior to the lawsuit and available on the City of Ukiah website) indicates that the City did indeed hold balances owned by the District. The District funds were held in designated accounts, e.g. Rate Stabilization Fund and District Operating Fund, and had been earning interest on the District's behalf. In accordance with the 2018 settlement, these reserves have now been transferred to the District. The Bond Debt Service Fund is held by the bond trustee, a bank, now with directions agreed to by the City and District to be used on the District's behalf.

Reserves are required by the bonding agreement that financed the 2006 sewer treatment plant upgrade and expansion. If the District is not able to meet its future bond payments, due to a lack of sufficient reserves, the City would be liable for repaying the bond.

At the time of the lawsuit settlement, the District indicated that its legal and administrative expenses were nearly \$6.5 million, and the City estimated its lawsuit related expenses were over \$2 million.

The 2018-2019 District budget details \$1,055,711 for legal fees after the lawsuit settlement. The new OA gives the District the right to assume future management and operating responsibility for billing, system maintenance, and to build additional treatment plant(s) for its customers. This duplicates responsibilities that the City has exercised since 1954. According to the City's website, the current plant has capacity for the foreseeable future. Costs for the District to do this will be in addition to its responsibility to continue bond payments for the existing treatment facility and will require duplication of the City's staff and equipment already functioning on behalf of the District.

At the October 10, 2018 meeting, the District estimated that it could save more than \$1.5 million annually by assuming these future functions and from ESSU ratio recalculations triggered by the lawsuit settlement. The District has not provided sufficient detail to assess the accuracy of this estimate. The District's commitment to continue current treatment facility bond payments in addition to funding development of future sanitation infrastructure does not appear to have been taken into consideration.

Moving Ahead

In spite of the settlement between the City and the District there are still issues to be resolved:

- The City and the District are still unable to take advantage of lower bond interest rates to refinance the existing bond. This is due to the District's failure to conduct State mandated audited financial statements for 2014-2018 by the bond refinance deadline. The City estimates up to \$14,000,000 could have been saved for the ratepayers if the bonds had been refinanced at a lower interest rate.

- The City has applied to LAFCo requesting detachment of the overlap areas which are within the City limits but served by the District. This would reduce the District's number of customers by approximately half and would also reduce the District's percentage of expenses and income.
- The City and District are initiating a joint rate study to determine new sewer rates. Specifics cannot be determined until the study is complete and the City Council and District act. New rates must account for the costs of the \$9 million combined legal and administrative fees and almost \$5 million of payments from the City to the District resulting from the lawsuit.
- In addition to rate increases caused by the lawsuit and settlement, if the District chooses to take responsibility for billing, maintenance and construction of a new treatment plant, District rates would increase even more.
- In the post settlement discussions between the City and District to resolve ESSU and budget issues, the District continues to be represented by outside legal counsel in the absence of capable District staff. Because the District is represented by legal counsel at considerable cost, the City is compelled to also have legal counsel present, increasing the City's costs.
- In the October 10, 2018 settlement, the City is required to reimburse the District for a portion of their administrative costs. The City is contesting the amount determined by the District and the District has initiated arbitration to resolve the issue.

At the March 13, 2019 District meeting the City requested a meeting to negotiate a MOU for the City to manage the combined district as a single entity. A single entity would provide economies of scale and reduce costs to all ratepayers.

FINDINGS

- F1.** The lawsuit settlement between the City and District left unresolved issues resulting in current arbitration, and continued duplication of services and costs.
- F2.** There is only one sewage collection and treatment system which serves both the City and District.
- F3.** The City and District being jointly responsible for the single sanitation system has led to significant needless expense.
- F4.** Due to limited staffing and high turnover, the District has not demonstrated the capability to responsibly manage its business and financial affairs. Failure to provide audited financial reports for five years (2014-2018) further demonstrates this lack of capability.
- F5.** In the absence of staffing continuity with technical and financial expertise, the District has used expensive attorneys and consultants to conduct day-to-day business and negotiations with the City.

- F6.** The District claims the funds paid to them by the City are for damages. This is misleading. Of the \$16,415,296 paid, \$11,431,986 were from existing District reserves held by the City on the District's behalf.
- F7.** To avoid further legal expense, the City agreed to pay the District \$4,984,310 over five years. This amount is substantially less than the legal costs of the lawsuit to the District. The difference will be paid by the District's ratepayers.
- F8.** The City's settlement and legal expenses will be borne by the City's ratepayers.
- F9.** The City no longer holds any of the District's reserves.
- F10.** The District's claim that it can save over \$1.5 million per year by assuming responsibility for the billing, maintenance and sewage treatment for its ratepayers is not supported by any documentation.
- F11.** Future changes allowed in the settlement could trigger redundant expenses to be borne by all ratepayers. These include detachment of the overlap areas by the City and the District's assumption of their billing, maintenance, and sewage treatment.
- F12.** The MOU/JPA proposed by the City is intended to provide a cost effective solution to the ongoing disputes between the City and the District by operating as a single system with the same rate structure applying to all customers.
- F13.** The District has violated the intent of the Brown Act which has reduced transparency for District ratepayers.
- F14.** The \$23 million combined legal costs and lost opportunities to refinance the bond will be borne by the City and District ratepayers.

RECOMMENDATIONS

The Grand Jury recommends that:

- R1.** the City and District work together to find a way to manage the overall sewer system as a single entity equitably and efficiently for all ratepayers,
- R2.** the District enter into negotiations with the City regarding the proposed MOU/JPA,
- R3.** the District provide specific details to ratepayers for its claims that it can save over \$1.5 million per year by assuming billing, maintenance and sewage treatment responsibilities with a detailed feasibility and cost analysis,

R4. the District Board must act in accordance with the Brown Act which promotes transparency and public participation.

REQUIRED RESPONSES

Pursuant to Penal Code §933 and 933.05, responses are *required* from the following individuals:
From the following governing bodies:

- The City of Ukiah (F1-F3, F7-F9, F11, F14 and R1)
- The Ukiah Valley Sanitation District (F1-F7, F10-F14 and R1-R4)

The governing bodies indicated above should be aware that the comment or response of the governing body must be conducted subject to notice, agenda and open meeting requirements of the Brown Act.

SOURCES

Link to videos of District Meetings:

<https://www.uvsd.org/recordings.html>

Link to videos of Ukiah City Council Meetings:

<http://www.cityofukiah.com/meetings/>

Link to the Ralph M. Brown Act:

https://california.public.law/codes/ca_gov't_code_section_54952

Reports issued by the Mendocino County Grand Jury do not identify individuals interviewed. Penal Code §929 requires that reports of the grand jury not contain the name of any person or facts leading to the identity of any person who provides information to the civil grand jury.
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