



June 21, 2012

The Honorable Thomas J. Borris  
Presiding Judge of the Superior Court  
700 Civic Center Drive West  
Santa Ana, CA 92701

**SUBJECT: EOCWD RESPONSE TO 2010-2011 GRAND JURY REPORT:  
"LET THERE BE LIGHT" DRAGGING SPECIAL DISTRICTS  
FROM THE SHADOWS**

DIRECTORS

Richard E. Barrett  
Richard B. Bell  
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General Manager

Dear Judge Borris:

The Grand Jury serves an important function in our county – they represent the citizens by investigating, evaluating and reporting on the operations of local government. While we have not always agreed with the findings of the Grand Juries, we respect that their third party review is a healthy check and balance for us, and has spurred us to more and better transparency about our operations.

But even more, we admire and honor the citizens that devote a year of their life and spend countless hours immersing themselves into the minutia of local government – reading innumerable documents, researching historical and computer records, attending trainings and briefings - so that they can perform their duties. It is no easy task to understand our acronyms, the engineering and science behind our water and wastewater systems, and the myriad ways we fund them. Because of this rigorous course of study, the reports produced were generally balanced and accurate.

It is because of this high esteem that we were surprised and dismayed to receive a report that, did not reflect the depth and breadth of study that previous Grand Juries had undertaken, but rather, contained substantive inaccuracies and unsupported opinion, included selective comments from outdated reports and even an editorial from a San Luis Obispo County newspaper – yet, they *never met with us*, and with the exception of one survey that requested general information, they *never obtained any detailed information from us*.

As a small special district, we understand that there are those who feel that size represents the quality or usefulness or value of a particular governmental entity – bigger is better. As a district that has been around for a long time (50 years) - but never in the headlines - we understand that there are those who believe we have outlived our usefulness and/or are hidden from our constituency. This despite the fact that we provide high quality, competitively priced water, that we send them bills every two months that include newsletters describing our activities, or that we receive phone calls every day with questions about their bills, water service or rates; or that they elect our Board. We recognize that there are those who don't believe that we should receive property tax funding and they think our property tax money should go to a school district or the state – anybody but a water district – which could be accomplished if we weren't here any longer.

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What puzzles us is why the Grand Jury chose to only investigate and report on those opinions and not any that might represent the other side? Why was the information that LAFCO provided about the Municipal Services Reviews they conduct every five years – which amount to a performance audit – excluded from the report? Why we were asked to come in and review the report, and when we provided extensive comments and corrections – none were included in the final version? Why one special district was afforded the opportunity to meet with representatives of the grand jury before the report was released and allowed to provide further information, but the rest weren't?

For this response, we've selected a quote from the same Kimia Mizany and April Manatt publication quoted by the Grand Jury, *What's so Special About Special Districts*:

“Celebrated as the best example of democracy, cursed as the worst form of fragmented government, and generally misunderstood even by the experts, special districts are California's unique contribution to local government. But what *is* so special about special districts anyway? The answer: **focused service**.

**Focused** because special districts only serve in specifically defined areas, unlike counties and cities that provide services throughout their boundaries. Special districts are also **focused** because most of them provide only a single service, allowing them to concentrate on one activity. **Service** because special districts deliver public programs and public facilities that their constituents want. Cities and counties must provide a wide variety of services, some of them mandated by the federal and state governments. Special districts provide the public services that the public wants.”

### **Response to Findings**

The Grand Jury has requested that the District to respond to Findings/Conclusions F-1, F-2, F-5, F-6, F-7, F-8, F-9, F-10, F-14 and F-15 and Recommendations R-1, R-4, R-5, R-6, R-7, R-8 and R-9. In accordance with Penal Code Sections 933 and 933.05, the following are the District's responses.

**F1.** Most Orange County special districts with or without the assistance of LAFCO, have been incapable or unwilling to consolidate, absorb or eliminate these outmoded and/or redundant agencies. LAFCO typically addresses larger issues such as merging of cities and elimination of “islands” within the county. The special districts themselves have not worked seriously toward their consolidation or demise. In this regard, the enterprise special districts and the non-enterprise special districts require independent evaluation and handling.

**Response: We disagree. There have been numerous consolidations of special districts in Orange County, but other organizations will speak to this.**

**With regards to EOCWD, in 1985, the County of Orange requested that we absorb their Water Works District No. 8 into our district, and we obliged – despite the fact that we received it in extremely poor condition and with no reserve funds to repair**

**it. We've been trying to play "catch-up" ever since; this is the reason we levied our Capital Replacement Fee.**

**Since 1994, our District twice reviewed consolidation with Serrano Water District, and twice reviewed privatizing with the Southern California Water Company (currently Golden State Water Company). Also, exploratory discussions were held with Irvine Ranch Water District many years ago to consolidate with them and they declined.**

**As recently as 2009/2010, in another attempt at consolidation, and in coordination with Supervisor Campbell's office and LAFCO; EOCWD formally issued Requests for Proposals (RFPs) to six potential merger/consolidation candidates (City of Orange, City of Tustin, Irvine Ranch Water District, Golden State Water District, Serrano Water District and the Municipal Water District of Orange County). We spent one year working with these agencies, providing them detailed information on the state of our system and our finances.**

**On the bid opening date of February 1, 2010, all of these agencies declined to make an offer to consolidate. We believe that having reviewed our management structure, our operating costs and our still heavy capital replacement burden, these agencies realized that none of them would be able to operate the system less expensively than we are doing - which meant that they would have to raise their new customer's rates, or else their current customers would be subsidizing the new customers – a situation that wouldn't be fair to their current customers.**

**F2. Special districts have made very little progress in complying with the recommendations made by various governmental agencies. To ensure recommendations are followed, more coordination and cooperation is needed from the city and county agencies.**

**Response: We disagree with respect to EOCWD. As we've noted previously, we worked with Supervisor Campbell's office and LAFCO on our last consolidation effort.**

**Without having an in-depth knowledge of water industry operations and with all of the variables that can come into play, one cannot conclude that a single solution or approach can be applied to any given agency.**

**F5. The sixteen enterprise districts typically started as local agricultural irrigation providers and sanitation providers for local communities. These special districts have transitioned into providers of potable water and sewerage disposal for the cities that blossomed around them after 1950. These districts grew until their boundaries met a neighboring special district that was also growing. Some of these local smaller providers have already been absorbed by larger districts under one management.**

**Response: We partially disagree. We don't know why or how many of these districts started, or how many have been absorbed by larger districts, but EOCWD was never formed for agriculture irrigation; it was formed to supply imported water to the**

**east county area because there was insufficient groundwater to supply the area – which included portions of the growing cities of Orange and Tustin. These cities were already formed and functioning - but they did not extend water service to the unincorporated areas of the county (Orange Park Acres, Lemon Heights, Cowan Heights, Panorama Heights and North Tustin). We agree that in 1985, EOCWD cooperated with the County of Orange and absorbed Water Works District No. 8 into our district.**

F6. The sixteen enterprise special districts of Orange County founded between 1919 and 1964 have grown with the urbanization of the county. Thirteen of these special districts rely upon taxes collected by the county while three rely on fees and other sources for their revenue. This suggests that all of these enterprise special districts could wean themselves from tax subsidies and rely on fees for their revenue. Severance from the tax subsidies would enable financial transparency and let the customers see the true cost of the services provided.

**Response: We disagree. The property taxes we receive form the firm foundation of our short and long range financial plans. These funds are fundamental to the ability to operate and maintain this water system at a competitive price for the benefit of our ratepayers.**

The Grand Jury's statement that special districts could "wean themselves from tax subsidies," implies that the property taxes we receive are not critical to the operation and maintenance of this district – and that there is something better and more readily available to take their place. They are critical, and there is no place else to go to get this money than from the people that are already paying it – our ratepayers.

Property taxes comprise one-fifth of our revenue – an estimated \$950,000 out of a proposed \$5,525,000 FY 2012/13 budget. If we lost this revenue, we would need to increase our Retail customer's bills by approximately \$29.00 per month. For our customers that use very little water, this increase would almost double their monthly water cost.

Further, much as it would for a household to lose one-fifth of its income, the loss of these funds would wreck havoc with the financial planning that – along with the frugal nature of our operation – has allowed us to take care of our obligations. Water districts are capital intensive operations – we set aside funds for emergency repairs (if one of our 24" water lines breaks under a major road such as Newport Avenue or Jamboree, the cost of repair could easily approach \$500,000 to \$700,000), for the planned replacement of pipelines, water tanks and pump stations. Just two years ago it cost us \$1,200,000 to paint the inside and outside of just one of our reservoirs – and because of the economy, we felt fortunate to receive a price that was almost \$400,000 less than we estimated it would have two years earlier. In 2011, we replaced 2,400 feet (less than ½ mile) of old 1940s/50s steel pipe at a cost of over \$700,000 (inclusive of engineering) – we still have about 26,600 feet or 5 miles of this pipe in our system. Taking away these funds would mean that we would either defer or forgo this work.

**Our cost for water - which is our single largest annual expense and over 40% of our budget, has risen over 100% since 2006. Our Retail Zone water rate has risen 40% over this same period – the loss of these property taxes would add another 63% increase on top of this.**

**Taking away this source of revenue means that a portion of the property taxes our customers are paying to operate, maintain, repair and reconstruct their water system will no longer be going towards something that not only maintains their property value – but that through the provision of fire flow – protects life and property. They would pay more and not get anything more than they are receiving now – and this would be a further disincentive to consolidation with another agency.**

F7. The unrestricted reserves of the special districts are available to the governing boards to spend as they please. Local citizens are not openly informed of this wealth when agencies ask for fee increases, special assessments, or bond measures. Most of the special districts do not appear to have specific criteria for amassing these reserves nor do they have published long-range plans for their constructive use.

**Response: We disagree. As shown in the copies attached to this response, the EOCWD Board adopted reserve fund policies in 1979, 1985 and updated them in 2001. These funds are annually identified in our 5-Year Capital Improvement Program budget (also attached), and can only be spent with the specific approval of the EOCWD Board. Our CIP is part of our budget and is posted on our website. We are also required to submit annual financial reports to the State Controller's Office and a copy of our annual budget to the County of Orange.**

F8. The twenty-seven special districts in Orange County have amassed unrestricted reserves of over \$866,000,000. That is enough money to fund all of these special districts for more than year without taxes, fees, interest, or other sources of revenue. The boards of directors have the sole discretion to spend these unrestricted reserves.

**Response: We disagree. By law, the only restricted reserve funds an agency can have are those that are limited by legal or contractual requirements – this does not mean that these funds are undesignated. As we noted in F7, our Capital Improvement Plan shows the allocation of reserve funds for planned repairs and replacements in our system and for security and back-up power enhancements. These lists don't include emergencies that can quickly ruin reserves. For example, even a relatively mild earthquake could significantly damage our wells; so instead of getting 68% of our water at a cost of \$300/Acre-Foot (AF), we would be required to import it at a cost of \$800/AF – a new well costs about \$2 million, so we would have the expense of the well, plus the cost of the imported water for a year until we could get the well back on-line, an additional \$520,000 expense.**

F10. The enterprise special districts could save millions of dollars in administration costs by consolidation into regional special districts. Five or six such enterprise special

districts within Orange County could save at least \$500,000 per year for each special district absorbed.

**Response: We disagree. The report provides no information upon which they based that statement, so we don't believe that we can constructively comment on it.**

**We believe that with respect to EOCWD, we have demonstrated that contrary to generally accepted belief, small special districts can be efficient and effective in delivering services to their customers. One need only look to the myriad of small businesses that thrive in America to realize that while large agencies certainly enjoy economies of scale, they often blunt these advantages by becoming bureaucratic, lethargic and non-responsive to their customers. It is flawed logic to assume that just because another agency can deliver water services, that they will do it better or for a lower price than the existing agency. If this were the case, Orange County – and indeed the state – would only have 5 or 6 large cities or counties.**

F14. The true cost of water and sanitary sewers in the enterprise special districts is hidden when both taxes and fees fund these districts. Only when the monthly service bills to the customers include all the costs for these services without the tax subsidy will the public understand the true cost of these services and achieve financial transparency.

**Response: We disagree. Adam Smith, the Scottish Economist wrote in *The Wealth of Nations* that, "The real price of everything, what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it."**

**A portion of the property tax that our customers pay to the County two times per year is returned to them in the form of a transfer payment to their water district. Therefore, their toil and trouble of acquiring water is reduced by \$30.00 each month that they've already paid. If they were then required to pay an additional \$30.00 and their taxes were reduced by \$30.00, we assume that there would not be much outcry as this would be revenue neutral to them. But nowhere in the Grand Jury Report is that suggested. Instead, the implication is that they would still pay the \$30.00 they have been paying (which would now go to some other government agency), plus an additional \$30.00 – without getting them any closer to the "real price of water." The price didn't change, just the source of the revenue.**

**We think customers are probably more interested in why all water districts don't receive a portion of their ratepayers' property taxes, than they are in the true cost of water.**

F15. Only one of the special districts, The South Coast Water District, has had recent performance audits. The lack of performance audits for the remaining special districts leaves the potential for inefficiencies, poor practices, outmoded operations, etc. hidden from the governing boards and the communities they serve. The lack of published performance audits has contributed to the public's ignorance of these districts.

**Response: We partially disagree. We welcome the concept of performance audits in general as we believe we run an efficient, no-frills operation that gets the job of safe, reliable water done.**

However, LAFCO conducts Municipal Service Reviews, which evaluate our efficiency and effectiveness and updates them every 5 years. Currently, we pay over \$15,000 per year to fund this and other LAFCO work. Because of this, we disagree with the recommendation as it would, in our opinion, be duplicative and costly without yielding any more or better information.

#### **Responses to Recommendations R1, R4, R5, R6, R7, R8 and R9**

R1. All special districts (except the Vector Control District and the County Cemetery District) should be eliminated from the county tax rolls and should rely solely on fees or the services of surrounding governments. (See F2, F3, F4, F5, & F6.)

**Response: The District will not take any action to implement this recommendation because it is not warranted and it is not reasonable for all of the reasons that were previously stated under the "Findings" section.**

Taking away the portion of the 1% property tax that our district receives without giving the property owners equivalent relief on their property taxes would not only impose an incredible hardship on our ratepayers, but it is arguably an illegal tax increase. While it is true that, like Redevelopment Agencies, the state can take away our right to exist, under the provisions of Proposition 13, it can't create a new tax without a vote of the affected people. Effectively, shifting our property tax revenue away and requiring a successor agency to absorb the lost revenue would be doing just that.

R4. Water and sewer districts should be consolidated into no more than six regional districts. Consideration should be given to including the city water agencies in the consolidation. LAFCO should meet with the water and sewer districts before October 31, 2012 to develop plans and schedules for consolidation. (See F5, F6 & F9.)

**Response: The recommendation will not be implemented because the Grand Jury has failed to present any factual evidence that it warranted and there is any reasonable basis for the number of regional districts cited.**

R5. Water and sewer districts should be removed from the tax rolls and operate solely on fees and other revenues for their services. Consideration should be given to forming non-profit agencies with ownership shared by the constituents. These districts should meet with county officials before October 31, 2012 to prepare plans and schedules to remove themselves from the county tax rolls. (See F2, F5, & F6.)

**Response: The District will not take any action to implement this recommendation because it is not warranted and it is not reasonable for all of the reasons that were previously stated under the "Findings" section, R1 and R4.**

**R6.** Special districts should adopt "board of director's practices" for all their reserves, restricted and unrestricted. All reserves should be classified in their 2013-2014 budgets according to GASB Standard No. 54. LAFCO should work with the special districts to prepare standard criteria for accumulating reserves according to the new classifications by December 15, 2012. These standards should be used in preparing the 2013-2014 budgets. (See F7 & F9.)

**Response:** This recommendation requires input from our Auditor and analysis and discussion with our Board ; both will occur within the next six months.

We have been advised that GASB 54 applies to General Fund entities (Counties, Cities, and School Districts) and dependent special districts - not independent (enterprise) entities such as EOCWD. Ironically, this statement was adopted by the Governmental Accounting Standards Board and applied to cities, counties and school districts for the very reason that it is not applicable to special districts: the way fund balance (reserve) information was being reported by cities and counties was vague and unclear, and allowed cities and counties to use water and sewer reserve funds to fund non-enterprise facilities (like parks and roads). Special District reserves can only be used to fund improvements, rehabilitation or replacement of facilities of the special district – nothing else.

There is merit to reiterating in our audited financial statements the information on reserve funding that is detailed in our CIP.

**R7.** Excessive unrestricted reserves should be used to reduce existing debts. Future revenues should be reduced to avoid the accumulation of unallocated revenue that does not meet the adopted new standards. (See F7 & F8.)

**Response:** This recommendation will not be implemented because it is not warranted – EOCWD currently has no debt. Because of credit tightening, we have been advised that have healthy reserves will result in a lower interest rate for long-term debt. If a certain portion of reserves is used as credit enhancement and/or to fund a portion of our debt service reserve fund, as well as to reduce the amount of revenue we would need to collect to provide the "coverage ratio," we understand that this is a primary indicator for debt-issuers – including the State when making loans or grants – that the entity is financially sound and able to repay the debt.

**R8.** Each special district should have an independent performance audit at least every three years. The executive summary of the performance audit should be distributed to all the taxpayers of each special district. Each of the special districts that has not had a performance audit within the last five years should contract with an independent outside consultant to conduct such an audit during 2012. These audits should be repeated at least every three years. (See F15.)

**Response:** The recommendation will not be implemented; please see our response to F15).



**R9.** Each special district should contribute 1% of its unrestricted reserve fund to LAFCO to help finance preparing and directing the consolidation, absorption, or elimination, and the setting of standards for reserves for the special districts. These funds should be included in LAFCO's future programs and budgets until the consolidation, absorption or elimination of each special district is achieved. With these additional funds, LAFCO should begin meeting with each special district before the 2014 fiscal year is budgeted for consolidation, absorption and/or elimination of these districts. (See F1, F2, F3, F4, F5, & F6.)

**Response: The District will not take any action to implement this recommendation because it is not warranted and it is not supported by any factual information. Please see all of the reasons that were previously stated under the "Findings" section.**

Please contact me or our General Manager, Lisa Ohlund at 714-538-5815 should you have any questions or concerns.

Respectfully Submitted,



William VanderWerff,  
President East Orange County Water District

Copies to: Orange County Grand Jury  
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