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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SIX

CITY OF OXNARD et al.,
Plaintiffs and Appellants,

v.

AARON STARR,
Defendant and Respondent.

2d Civ. No. B295252
(Super. Ct. No. 56-2016-
00479696)
(Ventura County)

CITY OF OXNARD et al.,
Plaintiffs and Respondents,

v.

AARON STARR,
Defendant and Appellant.

2d Civ. No. B297294
(Super. Ct. No. 56-2016-
00479696)
(Ventura County)

The city enacted an ordinance raising its wastewater utility rates. The city's voters passed Measure M, an initiative that

returned the rates to where they were prior to the ordinance. The city sued to invalidate Measure M. The trial court issued a preliminary injunction but ultimately found Measure M to be valid. We reverse. The uncontradicted evidence shows Measure M violates the Revenue Bond Law of 1941. (Gov. Code, § 54300 et seq.)¹ The reversal renders moot a consolidated appeal of the trial court's refusal to order the utility to return to ratepayers the amount collected in excess of the Measure M rates while Measure M was enjoined.

FACTS

The City of Oxnard (City) operates a wastewater utility. The utility collects, treats, recycles, and discharges up to 19 million gallons of sewage each day, serving a population in excess of 230,000.

The City has four outstanding series of bonds secured by wastewater utility rates. The bonds require the City to maintain the wastewater system in good working order and to pay all maintenance and operating costs as they become due. Each bond also contains a covenant that requires the City to fix utility rates sufficient to yield revenue at least equal to the sum of the amount of the debt service for each fiscal year, plus a reserve equal to 25 percent of the debt service.

In 2015, the City hired Carollo Engineers (Carollo) to conduct a study recommending new utility rates. The study found that the current rates were insufficient and that the City would fall short of its reserve commitment to bond holders by more than \$5 million. The study recommended a significant increase in rates.

¹ All statutory references are to the Government Code.

Ordinance No. 2901

In January 2016, the City adopted Ordinance No. 2901. Following Carollo's recommendation, the ordinance increased the utility's rates by 35 percent, starting March 1, 2016, with additional increases of 10 percent in 2017, and 8 percent in 2018, 2019, and 2020.

Measure M

Measure M repealed Ordinance No. 2901 and returned the rate structure to that existing prior to its adoption. The voters passed Measure M on November 8, 2016.

Injunction

Shortly after Measure M passed, Standard & Poor's issued a credit watch stating that unless a court stayed Measure M's implementation, it would downgrade the City's BBB credit rating. The notice stated a downgrade could have two adverse consequences. First, a letter of credit provided by Union Bank was set to expire and would not be renewed. The City would immediately owe \$16.75 million. Second, an interest rate swap with the Royal Bank of Canada would expire, immediately costing the City \$3.7 million.

To avoid these consequences, the City moved for a temporary restraining order and preliminary injunction to prevent Measure M from going into effect pending trial on the merits.

Aaron Starr filed an opposition to the City's motion. He did not dispute the facts on which the City based its request for an injunction. Nor did he dispute that the utility needed more money than Measure M would provide. Instead, he filed an affidavit in which he stated he had been meeting with City staff. Starr declared, "[D]uring the meeting, the participants were able

to strip out much of the unnecessary expenditures and reach a reasonable first year rate increase of 20%, with annual inflation adjustments of 3% thereafter.”

The trial court issued a temporary restraining order and subsequently a preliminary injunction.

New Rates

With Measure M in abeyance, the City reconsidered rates. It did not impose the 10 percent rate increase authorized by Ordinance No. 2901 for January 2017. Instead, the City undertook a new rate study and established a Utility Ratepayers Advisory Panel (URAP). Starr was appointed to the URAP.

The City gave the URAP five options to consider. Based on an updated report by Carollo, the URAP voted four-to-two for a version of one of the options. Starr was one of the two no votes. Starr presented a sixth option of his own he called Scenario 6. That option recommended rates that exceed those allowed under Measure M.

Carollo’s updated report recommended a 5.25 percent rate increase in each fiscal year 2017/2018 through 2021/2022. The City adopted that recommendation, effective July 1, 2017, as Ordinance No. 2917.

CITY’S EVIDENCE

(a) Minimum Operating Expenses

In December 2016, shortly after Measure M passed, the City calculated the monthly average of operating and maintenance costs to be \$2.07 million per month, excluding depreciation and debt service, just to keep the utility functioning. Debt service on the utility’s bonds would add \$750,000 per month, for a total cost of \$2.82 million per month. But the rates

under Measure M would bring in only \$2.23 million per month, leaving a deficit of almost \$600,000 per month.

Starr claimed the City's operating costs were overstated. He argued that based on Carollo's data, the operating costs should be around \$1.74 million per month. But when debt service is added, that still leaves a deficit of over \$265,000 per month.

Finally, Starr argued the best source for operation and maintenance costs was the City's Comprehensive Annual Financial Report (CAFR) for 2016-2017. Starr claimed that based on the report, the utility's operating expenses were \$1.53 million per month. That figure leaves a deficit of approximately \$50,000 per month when bond interest is added. As Starr's counsel conceded during closing argument, "[U]nder that situation, the deficit that the parties, I suppose, agree on, shrinks to just \$50,000."

(b) Capital Improvements

The above operating expenses do not include depreciation or capital improvements.

The wastewater treatment plant was built in the 1950's and last updated in the 1970's. The wastewater utility division manager testified that 68 to 70 of the utility's manholes are in disrepair and need replacing. The manholes are necessary to maintain the wastewater system in compliance with its regulatory permit.

Critical components of the wastewater treatment plant regularly fail. The plant's Vietnam War era backup generator that the City purchased for one dollar has repeatedly failed, causing sewage spills into the ocean. The clarifier tanks are heavily corroded; a walkway to a tank is on the verge of collapse;

50 percent of the nozzle heads on a sprayer arm are plugged from corrosion; and the roof of a digester is riddled with holes and has plants growing on it. Forty percent of the utility's assets are in poor or very poor condition.

The wastewater plant's control system failed 92 times in one year. An equipment failure caused 219,000 gallons of primary effluent to spill into the ocean. The Regional Water Quality Control Board issued a notice that the utility is in violation of its regulatory permit.

STARR'S EVIDENCE

Starr calculates the amount the City collected under Ordinance No. 2901, above what would have been allowed under Measure M, to be \$5 million. Starr claims the wastewater utility could have recovered the \$5 million shortfall without raising rates. He claims there are three ways the City could have recovered the difference.

(a) Charging Recycled Water Costs to the Water Utility

Most of the City's wastewater is treated and discharged into the ocean. A portion of the wastewater, however, receives additional treatment and enters into the City's recycled water program. The recycled water program is known as Advanced Wastewater Purification Facility (AWPF). Starr testified the City told him the purification system was going to cost \$235 million and the City would not be able to sell water for 10 years. The City expected to sell approximately \$2 million a year.

The City's former public works director, David Rydberg, was asked whether the additional cost of treatment should be billed to the wastewater or the water utility. He replied, "Depends what the purpose is. But if the purpose would be for

treating water, you know, not for the wastewater permit, then it would be charged to the water enterprise.”

Rydberg sent an e-mail to the City’s Ordinance No. 2901 rate modeler suggesting that the rates include a \$55 million contribution from the water utility to the wastewater utility to pay for those costs. When asked if the contribution happened, Rydberg replied, “I don’t remember. You know, this was the time frame when we were going through many, many different scenarios, so I don’t recall the final scenario. I don’t believe that was in the final scenario though. I think it’s kind of related to the other e-mail. Just different scenarios we were going through trying to come up with kind of a, you know, most economical solution to meet the requirements of the utility.”

(b) Depreciation

The wastewater rates fund both a capital improvement plan and asset replacement by tracking depreciation. In addition, the City sets aside reserves for operating and maintenance expenses. The reserves include depreciation. In fiscal year 2016/2017, the City charged \$7.8 million to depreciation and amortization.

(c) Infrastructure Use Fee

The City charged the wastewater utility \$2.05 million in fiscal year 2016/2017 for an “infrastructure use fee” (IUF). The fee is to cover the City’s cost for street maintenance, facilities use, and public safety (police and fire). The fee covers what the utility would pay in taxes if it were a private enterprise.

Debt Coverage Ratio

The City’s wastewater bonds require that wastewater fees be sufficient to cover 100 percent of the debt service, plus enough to have a 25 percent reserve fund. Starr claims on appeal the

evidence shows that, as allowed by the bonds when depreciation is eliminated, the revenue-to-debt service ratio under Measure M would be 1.48. When both depreciation and IUF charges are eliminated, the ratio would be 1.69.

STATEMENT OF DECISION

The trial court stated that all presumptions favor the validity of initiative measures, and such measures must be upheld unless their unconstitutionality clearly, positively, and unmistakably appears.

The trial court found that much of the wastewater plant was built in the 1950's and the last significant upgrades were done in the 1970's. The system needs upgrades and suffers from occasional failures. Prior to 2015, the wastewater rates were last set in 2012.

The rates set by the City in 2016 by Ordinance No. 2901 were "evidence based" and reflected "prudent practices." Nevertheless, the trial court found: "Here, at the time the citizens of Oxnard passed Measure M, their wastewater system was functioning. It may not have been functioning as well or efficiently as a 'best practices' system, but it was still operational. The Court cannot say that the citizens of Oxnard acted unreasonably in concluding that, at that point in time, and presumably with other pressing issues to address, that they were willing to accept their existing wastewater systems and defer upgrades and improvements to a later date. The court further finds that the revenue generated by Measure M would be sufficient for Oxnard's wastewater system to function at the level the people of Oxnard had chosen to accept."

The trial court further stated: "In respect to the issue that Measure M impairs Oxnard's ability to meet its contractual and

bond obligations, the Court finds those arguments to be speculative and premature. See *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208.”

The trial court found Measure M to be valid.

POST-JUDGMENT MOTION

Starr made a post-judgment motion to amend the judgment to require the refund in excess fees collected by the City while Measure M was stayed. Starr estimated the amount at \$5 million. The trial court denied the motion.

Both the City and Starr appeal.

DISCUSSION

City's Appeal

I

Burden of Proof

The City contends the trial court applied the wrong burden of proof.

The trial court determined that it must uphold Measure M unless the City can show that the initiative is “clearly, positively, and unmistakably” invalid. (Citing *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 814.) The City argues that standard is close to beyond a reasonable doubt. It claims the correct burden of proof is the general civil burden of a preponderance of the evidence.

We agree with the City that a statute passed by initiative is entitled to no greater deference than a statute passed by the Legislature. But it is entitled to no less. A statute passed by the Legislature as well as by initiative is presumed valid unless its invalidity “clearly, positively, and unmistakably appears.” (See *In re Ricky H.* (1970) 2 Cal.3d 513, 519.)

The courts have no expertise in operating a wastewater facility or any other utility. The rates such as a utility must charge to ensure its lawful and proper operation are left to the sound discretion of the local legislature or the voters by initiative. The courts have no power to interfere with the exercise of such legislative discretion unless it clearly, positively, and unmistakably appears to be improperly applied. The courts are definitely not rate-making bodies.

In any event, the question of burden of proof here is academic. As we explain below, Measure M fails under any burden of proof.

II

Regulations

The rates the wastewater utility must charge are governed by the Revenue Bond Law of 1941. (§ 54300 et seq.)

Section 54515 mandates that the wastewater utility's revenues "shall be at least sufficient to pay": "(a) The interest on and principal of the bonds as they become due and payable. [¶] (b) All payments required for compliance with the resolution authorizing the issuance of the bonds or any other contract with the bondholders, including the creation of sinking and reserve funds. [¶] (c) All payments to meet any other obligations of the local agency which are charges, liens, or encumbrances upon, or payable from, the revenues of the enterprise. [¶] (d) All current expenses of maintenance and operation of the enterprise"

Section 54513 requires the utility to operate in an "efficient and economical manner." Section 54516 requires the utility to "operate, maintain and preserve the enterprise in good repair and working order."

Section 54515, subdivision (b) requires revenue sufficient to comply with “any other contract with the bondholders.” The contract with bondholders contains provisions similar to those in the Government Code. The bonds require utility rates sufficient to pay the amount of yearly debt service, plus enough to maintain a reserve equal to 25 percent of the debt service, in addition to maintenance and operation costs. In addition, the bonds require the City to maintain the wastewater system in good working order.

The funds to comply with such requirements must come from the utility’s revenues and not from the “proceeds of taxation.” (§ 54478.) Thus, the City’s general fund is not available to make up any deficit.

In its statement of decision, the trial court concluded the arguments on whether Measure M impaired the City’s contractual and bond obligations are speculative and premature. Thus, the trial court made no findings on that issue. The court cited *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization*, *supra*, 22 Cal.3d 208 in support of its conclusion. *Amador Valley* involved a constitutional challenge to the Jarvis-Gann initiative, commonly known as Proposition 13. The case involved no specific amount of revenue and no specific bonds. Here the question is whether the specific amount of revenue generated under Measure M is sufficient to meet the obligations under a specific set of bonds. The question is anything but speculative and premature.

Ordinarily we would remand the matter to the trial court to make findings. But here the uncontradicted evidence shows that only one reasonable conclusion is possible. Measure M violates the Revenue Bond Law of 1941. The rates charged under

Measure M are insufficient (1) to pay operation and maintenance costs plus bond debt service; (2) to operate the utility in an economical manner; and (3) to keep the utility in good repair and working order. Any one of those deficiencies is sufficient to invalidate Measure M. Measure M suffers from all three.

*(1) Operation and Maintenance Costs
Plus Bond Debt Service*

Section 54515 requires that the utility have revenue sufficient to pay operation and maintenance costs plus bond debt service. The consensus of expert opinion is that Measure M would not produce sufficient revenue. Two reports by Carollo stated that rates higher than allowed under Measure M were necessary to keep the wastewater system functioning. Standard and Poor's said Measure M would lower the City's bond rating if it went into effect. Starr did not introduce expert opinion to counter that evidence.

Starr had two opportunities prior to trial to show that Measure M rates were adequate. The first was in his opposition to the preliminary injunction. The second was the result of his participation in the URAP when he recommended Scenario 6. In both instances, he recommended rates higher than those allowed under Measure M.

The City introduced evidence that minimal operation and maintenance costs plus bond debt service produced a deficit. The best Starr could do is reduce the deficit to \$50,000 per month. In closing argument, Starr's counsel stated, "[T]he deficit, that the parties, I suppose, agree on, shrinks to just \$50,000."

Starr argues the wastewater utility can save money in a number of ways. He claims that the utility accounts for depreciation multiple times. But he makes no attempt to show

that the aggregate amount of depreciation is excessive. Starr also claims the City's IUF charges to the wastewater utility are unlawful. He says such charges are being challenged in a different case, but cites no authority holding them to be unlawful.

Most importantly, both depreciation and IUF charges were excluded in calculating what Starr's counsel conceded would produce a \$50,000 per month deficit under Measure M.

Starr also claims that the wastewater's utility's cost for the AWPf program should be borne by the water utility. He cites an e-mail from the City's former public works director to the Ordinance No. 2901 rate modeler suggesting a \$55 million contribution from the water utility. In fact, none of the AWPf program costs were attributed to the wastewater utility in structuring its rates. Instead, AWPf costs were attributed to the water utility rates.

Finally, Starr expends much effort in an attempt to convince us on appeal that Measure M rates would have produced an adequate debt coverage ratio. What he fails to do is show how that assertion correlates with his counsel's admission that the parties agree Measure M rates would produce a \$50,000 per month deficit or with the calculations that produced the admission. In any event, assuming that Measure M rates would produce an adequate debt coverage ratio, that is not the only requirement for setting rates.

(2) Operating in an Economical Manner

Section 54513 requires that the wastewater utility "operate . . . in an . . . economical manner." Standard and Poor's stated that if Measure M goes into effect, it will lower the City's BBB bond rating. That would immediately cost the City over \$20 million, exceeding by far the \$5 million Starr claims the

wastewater rate payers would have saved had Measure M gone into effect. Immediate costs aside, lowering the City's bond rating will increase the City's cost of borrowing in the future. Measure M would not have allowed the City to operate the wastewater utility in an economical manner.

(3) Good Repair and Working Order

Section 54516 requires the utility to operate, maintain, and preserve the enterprise in good repair and working order. The bonds contain similar language.

The uncontradicted evidence is that the wastewater treatment facilities are not in good repair and working order. They were last updated in the 1970's. Forty percent of the utility's assets are in poor or very poor condition. The trial court found that the wastewater facilities are in need of upgrades and suffered from "occasional failures." The uncontradicted evidence is that the wastewater utility's control system failed 92 times in a single year. A recent equipment failure caused 219,000 gallons of primary effluent to spill into the ocean. The Regional Water Quality Control Board issued a notice that the utility is in violation of its regulatory permit.

Starr does not argue, no less attempt to show, that the rates charged under Measure M are sufficient to pay for the repairs and improvements necessary to place the wastewater system in good repair and working order. The trial court found that the revenue generated by Measure M would be sufficient for Oxnard's wastewater system to function at the level the people of Oxnard had chosen to accept. But that is not the standard. The wastewater system pumps wastewater into the ocean. Its failure affects the health and safety of everyone. Common decency and

the law require that it be placed and kept in good repair and working order. Measure M did not allow that.

The judgment validating Measure M is reversed. The order denying Starr's request that the City be ordered to return excess rate charges to ratepayers is affirmed. Costs are awarded to the City.

NOT TO BE PUBLISHED.

GILBERT, P. J.

We concur:

PERREN, J.

TANGEMAN, J.

Rocky J. Baio, Judge

Superior Court County of Ventura

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