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TO: Atwin King, Chairman
FROM: Thomas F. Johnson, Attorney

RE: Annexation/Merging with Redwood Valley

You have asked for a no-frills analysis of the advantages and disadvantages of annexation of or merger with Redwood Valley.

I. GENERAL INFORMATION AND ANALYSIS

Redwood Valley is now organized as a County Water District pursuant to Water Code §30,000 et seq. MCRRFC&WCID is a water conservation and improvement district set up pursuant to Act 4830 of the Uncodified Water Acts and regulated by that act and the provisions of the Water Conservation District Act set out at §74000 of the California Water Code.

1. DEBT

WC §31012 provides that if a County water District's "water system is acquired" by another public agency, then the funds derived from the operation of that system must be accounted for separately and used exclusively for the purpose of maintenance, operation betterments, and bond debt service on the acquired system. Those funds may not be used for any other purpose until all the debt of the former system has been paid in full or a majority of the electorate of the acquired district votes otherwise.

I spoke to Keith Tieman and he advises that Redwood Valley owes \$7,313,000 to the Bureau of Reclamation. There was a proposal a few years ago to buy out the loan from the Bureau for forty percent of face value and there is legislation pending to revive this proposal. If that legislation passes, Redwood Valley will buy out the loan for approximately \$3,000,000. If that proposal fails, there is another proposal to commence repayments of the original amount with annual payments of \$250,000 per year and ending with \$350,000 per year (30 year amortization). That was the original payment schedule but apparently there must be some change in the schedule to account for accrued interest which has been run up on the unpaid balance and Keith didn't know what exactly would be done with that. He said that Redwood is earning

sufficient revenue to repay \$350,000 per year. It also is going to incur approximately \$50,000 in new debt on its line extension now under construction.

1A) Affect of Merger

Obviously the debt repayment is of great concern if the Redwood Valley County Water District is to be merged into the MCRRFC under the provision of WC §31012. The funds generated from the operation of the Redwood Valley District must be used to maintain that system and pay its debts and cannot be used for any other purpose until the debt is paid or the people of Redwood Valley vote otherwise.

1B) Affect of Annexation

County water districts may exist within improvement and conservation districts. In fact, within the MCRRFC&WCID there are already two county water districts, one public utility district, and numerous other districts. Where the territory of a county water district is included in an improvement district but the two districts are not merged, the CWD continues to operate exactly as it had before the annexation. Under such a scenario, MCRRFC&WCID's boundaries would be enlarged but we would not "take over" or the operation of the RVCWD nor "acquire" its water system and the MCRRFC&WCID would not become responsible for RVCWD's debts.

2. INCOME AND EXPENSES

Any analysis of the advantages and disadvantages of merger must review the cash flow, account balances, debts, et cetera. I have ordered this information from the auditor's office and when it arrives I will forward it to you.

3. LIABILITIES

The liabilities associated with operation of a water system are fairly obvious: negligent employees, products liability for delivery of tainted water, et cetera. These liabilities are, for the most part, insurable. All water delivery operations face similar liabilities and in my opinion, while you must be conscious of, and protect the District from, such liabilities, they are not reason to avoid merger or annexation.

I am not aware of any specific existing liabilities or lawsuits or potential liabilities or lawsuits; but, if the districts were to merge, obviously this issue must be examined carefully. In the event of annexation of the territory, even if Redwood Valley were to be subject to substantial liabilities and lawsuits they would not affect the MCRRFC&WCID.

4. TAX RATE

If the tax shift from special districts to the schools goes into

effect, it may affect the incomes of both districts. However, with respect to merger or annexation the effect will be the same.

5. WATER RIGHTS AND CONTRACT RIGHTS

Redwood has a "winter water right", the MCRRFC&WCID has an 8,000 AF water right and a contract with Sonoma County to purchase 13,000 AF.

Merger: If the districts merge, Redwood would probably be entitled to a proportionate share of the water under this contract. Redwood's water right is restricted to Redwood Valley as its place of use would have to be changed to include MCRRFC&WCID. The state board would not be required to do so but probably would without limitation. The 8,000 AF right already includes Redwood Valley in its place of use subject to limitations required by the State Board and it will probably require those limitations to stay in place.

Annexation: Redwood's right would probably continue to benefit only Redwood. The 8,000 AF right would likely be handled the same as in a merger situation. The contract right would likely be handled as in a merger situation.

6. BONDS

MCRRFC&WCID has no bonds. Any new bonds issued after merger or annexation would apply to the added territory. Bonds, if any, in annexation remain Redwood's responsibility. In a merger, Redwood's bonds would become our obligation but Redwood's income would be used first to retire its bonds.

II. CONCLUSION

The primary question to answer is: if the two Districts joined, would they do so by merger or annexation?

A. MERGER

A1) MCRRFC&WCID will become responsible for Redwood's debt.

A2) Redwood's income could only be used for paying Redwood's cost of operation, maintenance, and debt and bond service until the debt and bond service were paid for or Redwood's voters voted otherwise.

A3) I have not done an income and expense analysis of Redwood's system. This should be done to determine if Redwood is able to meet its current and long-term obligations and maintenance and operation expenses.

A4) In a merger situation, the MCRRFC&WCID would become responsible for Redwood's liabilities and bonded indebted-

ness.

A5) The tax rates would be unaffected except by the effect of pending state legislation and then the effect will be the same whether the Districts merge or are annexed. The District's tax rate could be extended to Redwood Valley citizens if it were made a condition of merger (or annexation). [This would probably require a 2/3 vote of Redwood's citizens but I would not recommend either annexation or merger unless Redwood's citizens paid the same tax rate as MCRRFC&WCID's citizens.]

A6) The water contract and water rights of the respective district will be modifiable as noted above without much significant different whether the merger or annexation route is followed.

A7) Bonds: See #6 above.

B. ANNEXATION

B1) MCRRFC&WCID will not be responsible for Redwood's debts or bonds or liabilities.

B2) Redwood's income and expenses will remain Redwood's to do with as it sees fit.

B3) Tax rates would be unaffected as noted above. The comments about the tax shift legislation and extending our tax rate to Redwood Valley, noted above, are equally applicable in annexation.

B4) Bonds: See #6 above.

TFJ/plw