HOFMANN
LAND DEVELOPMENT
COMPANY

November 7, 2012

Rick Howard
Board of Directors
Town of Discovery Bay
1800 Willow Lake Road
Discovery Bay, CA 94514

Ref Agenda item G-1

Gentlemen,

This is to protest and object to the adoption and imposition of Capacity Charge Fees as Outlined in the above noted Agenda Item, Public Hearing, Notice and Report.

The report and documentation provides no nexus between the amount of fee charged for the "First 284 EDU's" and "Next 337 EDU's. The reference to a contractual agreement to pay this amount of fee is inaccurate. Additionally this new report fails to incorporate the amount of funds the Town intends to collect under this Committed Capacity element of the fee and calculate a commensurate reduction in the amount of the other components of the fee. This modification results in the collection of additional funds beyond those calculated under the prior analysis. The Fee study also uses inaccurate or incomplete information to arrive at the amount of remaining capacity in EDU's available to "Hofmann". Additional comments regarding the Fee is contained in the attached October 3, 2012 letter from Sheppard Mullin previously transmitted to you.

Sincerely,
Hofmann Land Development Company

David T. Lennon

OFFICE: 3000 OAK ROAD• SUITE 360 • WALNUT CREEK, CA 94597 • PHONE 925/478-2020 • FAX 925/977-1689
MAIL: P.O. BOX 907 • CONCORD, CA 94522

SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
ATTORNEYS AT LAW

Four Embarcadero Center | 17th Floor | San Francisco, CA 94111-4109
415-434-9100 *office* | 415-434-3947 *fax* | *www.sheppardmullin.com*

Writer's Direct Line: 415-774-2996
dlanferman@sheppardmullin.com

Our File Number: 32TP-170950

October 3, 2012

Via Electronic Mail

Rick Howard
General Manager
TOWN OF DISCOVERY BAY C.S.D.
1800 Willow Lake Road
Discovery Bay, CA 94514
[rhoward@todb.ca.gov]

Re: **Discovery Bay – Board Agenda: October 3, 2012**
Proposed New Water and Wastewater Fees; Standby Charges
Comments and Objections

Dear Mr. Howard:

We appreciate this opportunity to submit comments and objections, on behalf of our client the Hofmann Land Development Co., regarding the proposed new "Water and Wastewater Capacity Fee" being considered by the Town of Discovery Bay Community Services District.

In addition to points raised by Mr. David Lennon of Hofmann Land in his on-going series of communications with the District regarding the proposed new fee, this letter will further outline our comments on the "final draft technical memorandum" (9/18/12) provided by Bartle Wells (the "TM"), regarding proposed changes in the District's capacity charges, as well as our objections to the District's imposition of "standby charges" ($400/unit) on parcels owned by our client.

A. Preliminary Comments on "Capacity Charges"

Government Code Section 66013 defines "capacity charges" and provides the express statutory limitations on water and wastewater "capacity charges" and "connection fees" as follows: "[F]ees for water connections or sewer connections, or … capacity charges … shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed."

Although the same rule applies to both, the statute distinguishes "capacity charges" from "connection fees." The District's proposal involves "capacity charges" and this letter will comment in that context. "Capacity charge" is defined in § 66013(b)(3) as "a charge for facilities in existence at the time a charge is imposed or charges for new facilities to be constructed in the future that are of benefit to the person or property being charged." Thus, "capacity charges" must be limited to the reasonable cost of providing facilities which are demonstrably "of benefit" to the person or property on whom the charge is to be imposed.[1]

California law puts the burden on the community service district considering the imposition of facilities fees or capacity charges to factually justify the amount of the proposed fees. This burden includes, "at a minimum, (1) evidence of the estimated reasonable cost of the services or facilities actually planned to be provided by the agency with the proceeds of the fees, and (2) the district's basis for determining the amount of the fee allocated to the plaintiff, i.e., the manner in which [the District] apportioned the contemplated construction costs among the new users." *Beaumont Investors v. Beaumont-Cherry Valley Water District, supra,* 165 Cal.App.3d 227, 234.

The public agency seeking to establish or impose public facilities fees bears the burden of producing evidence in the public record to demonstrate the propriety and amount of the proposed fees before they are enacted. *Bixel Associates v City of Los Angeles* (1989) 216 Cal.App.3d 1208 (fire hydrant connection fees held invalid due to insufficient evidence to justify allocation of costs to new development); *Oildale Mutual Water Co. v. North of the River Municipal Water Dist.* (1989) 215 Cal.App.3d 1628 (water service fee held invalid where the district failed to demonstrate that its fee did not exceed the reasonable costs of service).

Bearing in mind these general legal principles, the following summarizes our comments on and objections to the proposed new capacity fees described in the TM:

B. Methodology

(1) Proposed use of two (2) fee calculation approaches: The TM reports (p. 2) that it recommends that the District consider calculating the proposed new capacity fee on the basis of both "a buy-in portion and an expansion portion." We have some concerns conceptually regarding the proposal to base the new capacity charge calculations on these distinct components, since they involve differing – and inconsistent – assumptions about the

---

1 This definition has been interpreted as meaning that a "capacity charge" is limited to a charge for facilities, meaning "capital improvements" (something built or installed, or "to be constructed") and could not be used for services. (*Scurich v. Pajaro Valley Water Dist.* (Cal.App. 2004) 2004 WL 1191948 [portion of district's groundwater augmentation charge devoted to services was not a "capacity charge" under §66013].)

District's existing capacity and facilities. In addition, it appears that this approach would entail a change in the methodology previously used by the District to justify its capacity charges.

(2) Critical Importance of Identifying Available Existing Capacity and Needs Future Facilities to Serve New Users: In our experience, the two different approaches to calculating capacity charges tend to be used in different situations:

(a) the "Buy In" (or "Equity") approach is typically used where the utility provider has existing facilities which have sufficient 'excess' capacity that is available to accommodate and serve new development, and it may thus be appropriate to have the new users "buy in" to the existing facilities that are available to serve them and which provide benefit to the new users;

(b) the "Expansion" (or "Future Facilities") approach is more commonly encountered where the utility provider has little or no capacity available in its existing facilities or systems to serve new users, and thus represents the allocated costs of creating/constructing new and additional capacity made necessary by the new users.

Since these two scenarios involve conflicting assumptions regarding the availability of existing capacity (although not necessarily mutually-exclusive assumptions), it is not common for a utility provider to be eligible to use both approaches simultaneously.

Therefore, if it is proposed to use both of these methods for the new capacity charges, it is critical that the District establish that it currently does have "existing capacity" (beyond existing and committed demands) that will be of benefit to new users being asked to "buy in," and to identify and quantify how much existing capacity in the various system components may be available for the benefit of new users. Conversely, as to the "Expansion" or Future Facilities" component of the fee calculation, it is critical to identify in the evidentiary record how many units of new development can be served by the additional capacity to be added by constructing the future facilities that purport to justify the new fees.

(3) Excluding Discovery Bay West (DBW) from "Buy-In" Charges: In particular, as to the proposed "buy in" component of the new capacity fee, it is important to recognize that our client, Hofmann Land Development, has already "bought in" and provided water and wastewater facilities that were intended to provide capacity to serve its ultimate development and build out of additional homes in Discovery Bay West ("DBW"). The TM acknowledges the agreements whereby the District has committed to reserve and provide capacity for the DBW development based on its prior contributions. It is therefore inappropriate for the TM to assume that Hofmann can be legally required or expected to pay a redundant "buy in" charge for access to the existing infrastructure facilities previously provided by Hofmann for the DBW project. The calculations of the "buy in" component should therefore be revised to exclude the possibility of DBW properties being expected to again pay for such facilities.

(4) **The "Buy In" Calculation:** The limitations on using the buy-in (or 'equity') approach to infrastructure capacity charges have been well-recognized in the literature as well as in case law. (See, e.g., Principles of Water Rates, Fees and Charges ("Manual M-1") published by the American Water Works Ass'n., 5th Edition ["AWWA Manual"], at p. 199:[2]

> *The goal of the equity method is to achieve an equity position between new and existing customers of the system. The method assumes that existing customers have provided equity in the existing system and that built-up equity should accrue to benefit existing customers. Under the equity method, the base level of the SDC is established at the current level of system equity related to the capacity used to serve an existing equivalent residential customer. This approach is most appropriate where current system facilities adequately serve existing and future customers, where no new significant system investment is anticipated, and where existing facilities are not scheduled for replacement in the near future.*

It is not clear that the District satisfies these criteria as described by the AWWA for invoking the "buy in" methodology. To the contrary, it appears that the existence and extent of "existing capacity" is uncertain, that the existing facilities include identified deficiencies, and that significant new facilities are anticipated, and the existing facilities are scheduled for repair, upgrading, and restoration.

Even if this approach were applicable in the District, it also appears that the TM may be in error in its application of the buy-in methodology in this calculation: First, it erroneously assumes that all of the Town's existing facilities may provide "capacity" to serve new users, or may provide "value" to new users – for which they may be required to pay. (TM, Table 2.) However, as explained above, a utility provider may only justify a "buy-in" fee to a limited extent, i.e., to the extent the existing facilities have surplus capacity that may be used by, and benefit, new users. The approach in the TM erroneously assumes that all of the facilities have the same amount of capacity (whatever it may be) available to serve new users.

2 The AWWA Manual discusses water "capacity charges" under the label of "system development charges" ("SDCs") [Text quoted from the AWWA Manual is *italicized.*]

Second, it appears that the TM has simply divided the purported "value" of the existing facilities by the (undefined) "build-out capacity" to come up with a "value/user" figure which is then included as a proposed uniform "buy-in" component of the new fee. This approach erroneously ignores the fact that different users or types of users have made differing contributions to the existing facilities. Many of the "existing users" have made little or no contribution to the costs of constructing or providing the existing facilities, or at least have contributed far less than has Hofmann for its DBW properties. It would be inequitable, therefore, for the TM to over-simplify and credit all users with the same "equity" in the existing facilities in calculating the "buy in" component of the proposed new fee.

Third, the approach used in the TM erroneously fails to take into account that Hofmann has already paid for its share of the existing facilities deemed necessary to provide capacity to serve the build-out of the DBW project. Having already "bought in" to these facilities, the DBW properties cannot be charged a duplicative "buy in" component in the new fees for the same facilities. The "buy in" charge must be recalculated to recognize that Hofmann's remaining EDUs for DBW will not be paying to again buy in to the existing facilities (with the possible exception of new water treatment or supply facilities or additional wastewater treatment facilities.)

As noted above, the "buy-in" approach to infrastructure fees is premised on the assumption that the existing community has already built, and paid for, facilities which have excess capacity available to be used by, and "sold to," new development. This scenario does not frequently occur in the rapidly-developing communities of California, and our research has not identified any published California case in which such a "buy-in" approach to capacity charges has been approved. In any event, the District cannot lawfully "sell" any capacity in the existing facilities to DWB properties because DBW properties has already paid for or provided that capacity. Particularly egregious are proposed new charges for wastewater collection buy-in. Hofmann built a wastewater collection system which has capacity to serve all DWB properties, and which actually circumnavigates the balance of the Town of Discovery Bay sewage collection system and directly discharges to the wastewater treatment plant.

Even in those states where the use of a "buy-in" approach has been recognized the courts have required that such buy-in charges must be "fair and equitable" and must be "uniform and nondiscriminatory." Courts in those states have invalidated buy-in charges which failed to meet these standards. See, e.g., *State ex rel Waterbury Dev. Co. v. Witten* (Ohio 1978) 377 N.E.2d 505; *Deerfield Estates v. Township of East Brunswick* (N.J. 1972) 286 A.2d 498; *Kreifels v. South Panorama Sanitary Dist.* (Iowa 1991) 474 N.W.2d 567 (invalidated $1500 sewer capacity fee imposed on new homes to fund system wide improvements as a discriminatory 'buy-in' charge).[3]

(a) **Need to Identify "Available Existing Capacity:"** Assuming the District has existing capacity of benefit to new users justifying use of a "buy in" component to the new fee, that existing capacity must be identified in terms of how many additional users can be served by the particular facilities.

(b) **Need to Correct the "Valuation" of Existing Facilities:** The TM purports to have used a "replacement cost new, less depreciation" methodology in order to estimate a "value" for the existing facilities. "New replacement cost" is not an appropriate basis for calculating a buy-in to existing facilities. (See, e.g., *Boe v. City of Seattle* (Wn. 1965) 401 P.2d 648, in which the Court held a sewer capacity/connection fee was unreasonable and invalid where it was based on the present day cost of replacement of facilities constructed more than 20 years earlier.)

Moreover, the methodology as described in the TM (p. 3) is not consistent, and erroneously inflates the value of the assets by "escalating" the historic cost of the assets to their purported "present worth" by use of an index of construction costs. Present "costs" of construction do not equal the present "worth" of facilities. Even adjusting the present worth by an uncertain factor for "depreciation" fails to account for the TM's erroneous use of new replacement costs or duplicative escalation of historic costs of installation.

(c) **Depreciation:** The "buy-in" approach must adjust the "value" of existing facilities for which the fee is being charged by reasonable allowances for depreciation, to avoid charging new users for facilities that are no longer optimally functional, or that fail to meet new public health or environmental standards, or that are otherwise deficient. As stated in the AWWA Manual (p. 200):

---

3 In *Kreifels*, the Iowa Supreme Court noted that "differentiating between existing structures and subsequently built structures may be discriminatory." The Court observed: "We see no valid reason why longtime owners in the area should not share an equitable, rather than a nominal, cost in the construction of the new facility. ... That they spent large sums in the past in what has proven to be, or has become, an inadequate scheme for sewage disposal is no doubt regrettable. But it is not fair to recoup those past investments by way of disproportionate assessments against the plaintiffs." (474 N.W.2d at 570.)

> *System equity. A key component in developing an equity method SDC is determining system equity. The major components include the valuation of system assets, accumulated depreciation, system liabilities, sources of equity, and system capacity. Whether using original or reproduction costs, asset values are often expressed as net of depreciation to reflect the valuation of the system available to new customers.*

California law is also clear that the effects of "depreciation" must be factored in to the calculation of water facilities fees. See, *Bixel v. Los Angeles, supra* (fire hydrants were 95 years old and overdue for replacement.)

The allowance for depreciation of existing facilities in calculating a "buy in" value should avoid arbitrary use of mere generalized "depreciation" and should consider actual or field depreciation, to reduce the risk that the resultant buy in charge would require new growth to pay for inoperable or deficient components.[4] "Straight-line" depreciation may fail to accurately identify existing deficiencies in the existing system (functional or economic obsolescence).

C. The "Expansion" or "Facilities Fees" Calculation:

The projected costs of the significant proposed new facilities should be carefully allocated between needs attributable to upgrading the level of service, water quality, or meeting regulatory standards or needs of the existing water users on the one hand, and the distinct needs for additional capacity to serve new development, based on identified quantities of new capacity to be added to the system. The evidence reflecting the basis for this allocation should be included in the final documentation prior to Board consideration.

---

4 "Depreciation" in this context is generally deemed to include loss in value resulting from three elements, each of which should be reflected in the deduction from cost. *Physical deterioration* is loss in value resulting from wear and tear and the normal aging process, including action of the natural elements. *Functional obsolescence* is loss in value resulting from functional inadequacies within the property, including those caused by improvements in technology. *Economic obsolescence* is loss in value resulting from economic factors outside the property, such as decreased demand, governmental restrictions, and social changes. (Deductions from cost reflecting functional and economic obsolescence are necessary under proper appraisal theory, and required by California regulations of property tax valuations. See, e.g., 18 C.C.R. § 6(e).)

Fees on new development or new connections <u>cannot</u> include any costs which are attributable to the costs of repairing, replacing, or otherwise curing existing deficiencies. (*Bixel Associates v City of Los Angeles, supra,* 216 Cal.App.3d at 1218-9; Gov't Code § 66001(g), amended in 2006 to expressly incorporate this limitation on the calculation of fees.)

Also, California Government Code §65913.8 generally <u>prohibits</u> the inclusion of any costs for "operations or maintenance" of public facilities in a development fee (with the sole exception of small, project-specific, facilities serving 19 or fewer lots).

We appreciate that the District and its consultants have been conscious of the need to make fair and accurate allocations between the costs of facilities attributable to new users vs. facilities costs necessary for other reasons (TM, p. 4). However, the bases for these allocations are not always clearly explained or justified in the TM in a transparent or non-technical manner that can be readily understood or validated by the lay public. (E.g., Tables 3 and 4.)

Allocation of New "Expansion" Facility Costs:

Tables 3 and 4 in the TM list many individual "*Capital Improvement Projects*" and there may be reasonable questions as to the bases for the TM's proposed allocations of those costs between "existing & committed connections" and "future connections" to the Discovery Bay West properties. Among them:

(1) Table 3 – Water Capital Improvement Cost Items:

There are several items listed here for the "replacement" of various water distribution lines which should not be included in the "future facilities" component of any fees to be imposed on the remaining DBW parcels. As previously explained and acknowledged by the District, Hofmann has previously provided the facilities and water distribution lines deemed adequate to provide capacity to serve the needs of the Discovery Bay West project area. At most, Hofmann may be charged fees for such new water treatment and supply improvements as may be shown to be necessary to serve its development as a result in errors or oversights in estimating those needs in the existing infrastructure agreements.

(2) Table 4 – Wastewater Capital Improvement Cost Items:

As above, Hofmann has previously provided in full for the wastewater collection and transmission facilities sufficient to serve the anticipated needs of the Hofmann DBW development, and therefore DBW properties should not be charged fees for "future facilities" of that nature. It appears that some of the items on Table 4 include costs for such transmission pumps, and facilities, which should not again be paid for by DBW properties. At most, the fees on DBW properties may include costs for additional wastewater treatment facilities if shown to be necessary by more demand generated by the Hofmann property than anticipated in the existing agreements.

D. Erroneous Omission of "Credits" For Account Balances:

The TM does not appear to include or credit the District's accumulated "capacity charges" (roughly $2.346 million in the cumulative "capacity fee accounts" as reported in the Year End Report for 2009-2010) as credits against the capital costs of the planned new facilities on the list. Those previously-collected fees, imposed for the same purposes as the proposed new fees, should be applied so as to reduce the amount of revenue to be raised by new fees to fund the construction of the various infrastructure projects that supposedly justify the new fees.

E. Unlawful "Standby Charges:"

The District apparently intends to impose unjustified "standby charges" ($400/year/unit) on mapped lots with sewer and water laterals. We object that the imposition of such standby charges on any of the Hofmann lots is unlawful and inconsistent with the applicable provisions of the Uniform Standby Charge Procedure Act (Gov't Code §§54894 et seq.)

Here, the District is levying these charges on more than 300 parcels owned by Hofmann which have previously been mapped and to which water and sewer laterals have been installed. However, the District cannot lawfully levy standby charges on any parcels unless water or sewer service is made available to those parcels. A community services district may only levy standby charges against parcels of property "to which water, sewer, or water and sewer services are made available." (Gov't Code §54984.2.)

As confirmed in the TM, it appears that the District takes the position that it has no capacity, or no responsibility, to actually make water or sewer service available to some of Hofmann's parcels to the extent they exceed the District's tally of the remaining reserved and "committed capacity" for the DBW properties – i.e., no more than 284 EDUs of water service or 621 EDU's of sewer service. Such standby charges are therefore unjustified and unlawful as to any of the Hofmann parcels not included in this tally.

Moreover, even as to such Hofmann parcels that the District may agree to make water and sewer service available, the standby charges are unlawful since they essentially require

Hofmann to make duplicate payments for water distribution and wastewater collection and treatment facilities that Hofmann has previously provided and/or which will be included in the "buy in" component of the proposed new fee (triplicate payment). Imposition of "standby charges" on <u>any</u> of the Hofmann parcels is therefore redundant and illegal.

Conclusion:

We again note our appreciation for your ongoing communications with us and with our client regarding the proposed new fees and the infrastructure needs/plans for the District. We trust that you, the District's consultants, and the Board will take these comments and objections into consideration before acting on the proposed new fees to assure compliance with controlling legal and accounting principles as well as to promote acceptance or support from the development community.

Again, my clients and I appreciate the opportunity to review and comment on the proposed changes. Please contact me to discuss any questions or concerns. Thank you.

Very truly yours,

David P. Lanferman

for SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

SMRH:406825367.2

cc: David Lennon, Hofmann Land Development Co.