ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

"PRELIMINARY REPORT ON CONFLICTS OF INTEREST IN THE PROCESSING AND APPROVAL OF THE REGIONAL DESALINATION PROJECT CONTRACTS, AND THE IMPACT OF ANY CONFLICT ON THE VALIDITY OF THE CONTRACTS"

Submitted to the Board of Directors of
Marina Coast Water District

By:
RICHARDS, WATSON & GERSHON
James L. Markman
B. Tilden Kim
Shiri Klima

1 Civic Center Circle, PO Box 1059
Brea, California 92822-1059
(714) 990-0901
(714) 990-6230 – facsimile
jmarkman@rwglaw.com

RICHARDS | WATSON | GERSHON
ATTORNEYS AT LAW – A PROFESSIONAL CORPORATION
1 CIVIC CENTER CIRCLE, PO BOX 1059, BREA, CALIFORNIA 92822-1059
TELEPHONE 714.990.0901 FACSIMILE 714.990.6230

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

Preliminary Report on Conflicts of Interest in the Processing and Approval of the Regional Desalination Project Contracts, and the Impact of Any Conflict on the Validity of the Contracts.

A. Statement of Objectives and Process Employed

We have been requested to review documents and interview persons pertinent to the subject described above. Our goals were (1) to determine whether there is any indication that any public official of Marina Coast Water District ("Marina Coast" hereinafter) engaged in any activity constituting a legal conflict of interest in working on the Regional Desalination Project ("Regional Project" hereafter); and (2) to determine whether the contracts entered in order to implement the Regional Project could be invalidated due to a violation of conflict of interest law by any involved public official and, particularly, by Mr. Stephen Collins.

Accordingly, in order to prepare and submit this Report, we have reviewed the Settlement Agreement approved by the California Public Utilities Commission in proceeding A.04-09-019, the agreements referenced in the Settlement Agreement governing the implementation of the Regional Project, other related agreements and documents provided, including an Outfall Agreement, statements for services rendered on the Regional Project submitted to Marina Coast by RMC Water and Environment ("RMC" hereinafter), statements for services rendered on the Regional Project to RMC and then through to Marina Coast submitted by Mr. Stephen Collins, numerous newspaper articles on the subject published by the Monterey Herald and an 11 page document distributed by the Monterey County Board of Supervisors, dated June 21, 2011, entitled "Summary of Preliminary Findings Regarding Director Stephen Collins' Business Relationship with RMC Water and Environment and Marina Coast Water District" prepared by Remcho, Johansen & Purcell, LLP (hereinafter referred to as "the Remcho Report"). We also interviewed Mr. Jim Heitzman, General Manager of Marina Coast, Mr. Lloyd Lowrey, District Counsel for Marina Coast, Mr. Mark Fogelman, Special Counsel to Marina Coast, Mr. Lyndel Melton, principal of RMC and Mr. Stephen Collins, former member of the Board of Directors of Monterey County Water Resources Agency ("County Water Agency" hereinafter). Please note that no statements were taken in any formal manner. The statements were not made under oath in depositions and are not in the form of declarations under penalty of perjury. Nor could we speak with all of the persons referred to in this Report who might contradict statements contained

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

herein. That is the core reason why this Report must be considered preliminary. However, each statement made to us did not contradict any other statement made to us in any substantial manner. All statements were made to me and B. Tilden Kim, a shareholder with Richards, Watson & Gershon, simultaneously, to insure the accuracy of the contents of this Report.

B. Statement of Facts

Following are identifying facts related to persons mentioned in this portion of this Report:

Mr. Stephen Collins was a member of the Board of Directors of the County Water Agency and a provider of professional services under contract to RMC in order to implement the Regional Project.

Mr. Curtis V. Weeks is General Manager of the County Water Agency.

Mr. Lyndel Melton is a principal of RMC.

Mr. Jim Heitzman is General Manager of Marina Coast.

Mr. Lloyd Lowrey is a partner in the law firm Noland Hamerly Etienne & Hoss and serves as District Counsel to Marina Coast.

Mr. Mark Fogelman is a partner in the law firm Friedman Dumas & Springwater LLP and serves as Special Counsel to Marina Coast.

Ms. Kelly Cadiente is Director of Administrative Services for Marina Coast.

Mr. Don Evans is a Principal of Evans Group International LLC and a special project implementation consultant for Marina Coast.

Mr. Dan Carroll is a partner with the law firm Downey Brand LLP and is outside counsel to the County Water Agency.

Mr. Kevin O'Brien is a partner with the law firm Downey Brand LLP and is outside counsel to the County Water Agency.

Mr. Robert MacLean is the President of California-American Water Company ("Cal-Am" hereinafter).

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

Mr. Irv Grant is a Deputy County Counsel for the County of Monterey and serves as counsel for the County Water Agency.

Mr. Charles McKee is County Counsel for the County of Monterey and is counsel for the Monterey County Board of Supervisors and the County Water Agency.

Mr. Louis R. Calcagno is a Monterey County Supervisor.

Mr. Dave Potter is a Monterey County Supervisor.

Mr. Simon Salinas is a Monterey County Supervisor.

The Regional Project was approved by the California Public Utilities Commission ("CPUC" hereinafter) in its Decision 10-12-016 dated December 2, 2010, and formally issued December 3, 2010. That decision approved multiple contracts as to which Marina Coast, the County Water Agency and Cal-Am were parties. The contracts provide for the construction and operation of wells to extract brackish water by the County Water Agency, conveyance of that brackish water to a desalination plant owned, constructed and operated by Marina Coast, and conveyance of a substantial majority of the product water from the plant to Cal-Am to replace Carmel River water now diverted and distributed by Cal-Am which is subject to a State Water Resources Control Board cease and desist order. The referenced implementing agreements, including a Settlement Agreement and a Water Purchase Agreement, were conditionally approved by Marina Coast and Cal-Am subject to CPUC approval during April, 2010 (Marina Coast's Board of Directors approved the agreements by adopting its Resolution 2010-20 on April 5, 2010). The County Water Agency, by action of the Board of Supervisors, approved those agreements by Resolution 10-091 on April 6, 2010, subject to CPUC approval and reserving the discretion to reconsider approval of the agreements subsequent to CPUC approval. Notably, on April 5, 2010, the Board of Directors of the County Water Agency had adopted a motion recommending that approval with Mr. Collins voting "yes." The final approval of the project and project agreements by the Board of Supervisors upon reconsideration after CPUC approval occurred on January 11, 2011.

The Remcho Report suggests that the activities of Mr. Collins on the Regional Project leave doubt as to the validity of the Regional Project agreements approved by the County Water Agency. Facts previously disclosed and stated below show that while Mr. Collins served as a member of the Board of Directors of the County Water Agency, he simultaneously was a paid consultant seeking implementation of the Regional Project and was involved in the CPUC process. The Remcho Report includes no details on how Mr. Collins became a paid consultant, but states that Mr. Heitzman asked Mr. Melton at RMC to hire him, incorrectly implying that it

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

was Mr. Heitzman's notion and desire to do so. Accordingly, the area to be first explored in the factual portion of this Report is how RMC came to contract for Mr. Collins' services.

Mr. Collins was on the County Water Agency's Board of Directors for 16 years as of 2010. He worked on many water projects in Monterey County. He thought it fair to acknowledge that in 2009 through 2011 he was considered one of the County's leading water experts. He also considered himself to be thought to be a person who could work with agricultural interests to implement the Regional Project. During early January, 2010, Mr. Collins received a telephone call from Supervisor Calcagno during which Mr. Collins was told that he needed to work on "closing the deal" on the Regional Project because Mr. Weeks could not get the job done. At about the same date, Mr. Collins was called on the telephone by Supervisor Potter who urged Mr. Collins to work on the Regional Project which he felt was needed to prevent his district from "becoming a desert."

The next relevant phone call to Mr. Collins came shortly thereafter, still in early January, from Mr. Weeks who invited Mr. Collins to a meeting at the County Water Agency's offices. The meeting included Mr. Heitzman, Mr. Weeks and Mr. Collins. At the meeting, Mr. Weeks stated that Mr. Collins should be hired to work on the Regional Project, that he would be helpful in dealing with the Ag Land Trust and others within "the lettuce curtain" and that he could provide oversight on the project. Mr. Weeks suggested that RMC should contract with Mr. Collins, that the cost would be included in RMC statements to Marina Coast, the lead entity advocating the implementation of the Regional Project and the one employing RMC to provide its assistance.

Mr. Heitzman then stated that he was concerned with a conflict of interest problem if Mr. Collins remained on the Board of Directors and was paid for the services suggested. Mr. Collins said he shared that concern and would resign from the Board of Directors the following Monday. Mr. Weeks asked Mr. Collins not to do so until Mr. Weeks could talk to the Supervisors.

The following Monday, Mr. Weeks spoke to Mr. Collins and stated the following:

1. The Board Members do not want Mr. Collins to resign from the Board of Directors as Mr. Collins was crucial to that Board's ability to function;

2. It would not be a conflict of interest for Mr. Collins to do the private paid work so long as he did not bill for time spent in his capacity as a board member of the County Water Agency; and

3. Mr. Weeks' conclusions were backed up by the County Counsel's office.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

Mr. Collins then met with Mr. Melton to negotiate a contract. Previously, Mr. Heitzman had told Mr. Melton that Mr. Weeks had told Mr. Heitzman that "they had to bring Mr. Collins on board." Mr. Heitzman confirms that Mr. Weeks told him that they had to bring Mr. Collins on board.

At their meeting, Mr. Melton and Mr. Collins constructed a general consulting agreement with an initial total billing limit of $25,000.00. During the conversations on the contract, Mr. Melton asked whether Mr. Collins felt there might be a conflict of interest in doing the work. According to Mr. Melton, Mr. Collins responded that he had a County Counsel's opinion to the effect that he could do so. He also indicated that he was willing to resign from the Board of Directors and, in fact, wanted to resign, but Supervisors would not let him do so. This statement was made numerous times to Mr. Melton during 2010 while Mr. Collins worked on the project. Mr. Melton asked to see a copy of the County Counsel's opinion. Mr. Collins responded that he did not have a copy with him but that he could produce one. To date of this Report, no such copy has been produced for Mr. Melton.

Mr. Melton specifically recalled a January 13, 2010 dinner with Mr. Collins and Mr. Don Evans in San Francisco. During that dinner, Mr. Collins said that in doing this work he was taking direction given by Supervisors Calcagno and Potter and that Supervisor Calcagno was the "main handler." Mr. Collins said that those Supervisors felt that Mr. Weeks could not "close the deal" while Mr. Collins could do so.

On numerous occasions up until August, 2010, Mr. Heitzman asked Mr. Collins and Mr. Weeks for a copy of the County Counsel opinion approving Mr. Collins' dual roles. No such letter ever was produced. During a conversation with Mr. Weeks during the summer of 2010, Mr. Weeks said that the opinion letter in question actually had been provided by the law firm of Downey Brand LLP.

During August, 2010, after consulting with Kelly Cadiente of MCWD, Mr. Heitzman caused Marina Coast to cease paying RMC for work billed by Mr. Collins, and to take a credit against the amounts due RMC for payments previously paid for Mr. Collins' work. Mr. Heitzman stated that when he took this action, he informed Mr. Weeks and Mr. Melton that Mr. Collins had neither quit the County Water Agency Board of Directors as promised nor provided the promised written legal opinion demonstrating that his work for RMC raised no conflict of interest. Mr. Heitzman told Mr. Melton he was taking this action and then informed Robert MacLean at Cal-Am that he was doing so, so that Cal-Am would know that reimbursement from Cal-Am would not be sought for Mr. Collins' work.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

Mr. Melton then talked to Mr. Weeks upon learning that RMC would have to absorb the cost of Mr. Collins' services. Mr. Melton felt that Mr. Weeks simply blew him off, stating "that's too bad."

During the course of providing services to RMC on the Regional Project, Mr. Collins recalls the following specific circumstances which indicate to him that many County officials were aware of his dual roles and condoned Mr. Collins' activities on the Regional Project:

First, during January, 2010, Mr. Collins attended a session of the Board of Supervisors, or its executive committee with Supervisors Calcagno, Potter and Salinas present. Mr. Collins stated that during that meeting, he was told that he had to "close the deal" and act as a subconsultant to RMC in reference to its contract with Marina Coast.

Second, during January, 2010, Mr. Collins was at a meeting in San Francisco at Cal-Am's offices with Mr. Carroll and Mr. Grant. Mr. Collins stated that Mr. Heitzman was concerned that Mr. Collins could have a conflict of interest in his dual functions on the project and that Mr. Lowrey had raised that concern several times to Mr. Heitzman. Mr. Carroll responded that Mr. Collins had no conflicts problem so long as he did not bill for attendance at County Water Agency Board of Directors meetings.

Third, during an automobile trip from Monterey to San Francisco together with Mr. Weeks and Mr. Grant, Mr. Collins was told by Mr. Grant that "he was fine" and that Mr. Grant was aware of a Downey Brand "1090 opinion" stating that Mr. Collins' activities were "okay." Mr. Collins had never seen that opinion as of June 27, 2011.

Fourth, during May or June, 2010, at a meeting at the CPUC offices in San Francisco, Mr. Collins again offered to resign from the Board of Directors of the County Water Agency and Mr. Carroll again assured him that he did not need to do so. Mr. Collins believes that Mr. O'Brien, Mr. Grant, Mr. Weeks and Mr. Fogelman were at that meeting.

While he had voted as a member of the County Water Agency Board of Directors to recommend approval of the Regional Project contracts on April 5, 2010, Mr. Collins recused himself months later from voting to recommend a Regional Project contract.

From January, 2010 through November, 2010, Mr. Collins provided services to RMC and the proponents of the Regional Project for which he was paid a total sum of approximately $160,000. The Remcho Report catalogs the type of work performed by Mr. Collins.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

On December 2, 2010, the CPUC approved the Regional Project and related agreements, in a decision that was formally issued December 3, 2010. Mr. Collins' work for RMC on the Regional Project terminated on December 2, 2010, and Mr. Collins had provided his final invoice to RMC in late November, 2010.

In a potentially related matter, Mr. Collins and Mr. Weeks formed a business entity named Collinsweeks Consulting, L.L.C. on January 4, 2010. During a meeting with Mr. Heitzman in early 2010, Mr. Weeks told Mr. Heitzman that he and Mr. Collins were forming a private company which would seek to manage the Regional Project. Mr. Weeks asked Mr. Heitzman if he would like to join. That never occurred.

Similarly, during the last week of October, 2010, Mr. Collins and Mr. Weeks asked Mr. Melton to join them for a meeting at the Wild Thyme Deli in Marina. At the meeting, Mr. Collins and Mr. Weeks said they had formed their company to contract with the County Water Agency to manage and run the County Water Agency's part of the Regional Project. They also told Mr. Melton that Mr. McKee, the County Counsel, had been asked to see how that arrangement could be structured.

Again, the potential relevance, or lack thereof, of the proposed activities of Collinsweeks Consulting, L.L.C. cannot be ascertained based on inquiries which have occurred to date.

C. LEGAL ANALYSIS AND OPINIONS

1. Conduct of Public Officials of Marina Coast.

We have discovered no facts whatsoever which indicate that either Mr. Heitzman or any other official or employee of Marina Coast had a financial interest as defined by applicable conflict of interest statutes and cases in the Regional Project or any of its implementing contracts. Accordingly, we know of no basis upon which any person could assert or allege that either Mr. Heitzman or any other Marina Coast official or employee was or is in violation of statutory conflicts of interest provisions such as Government Code Sections 1090 or 87100 or any body of common law prohibiting conflicts of interest.

2. Conduct of Mr. Collins.

Based on the facts stated above, and notwithstanding Mr. Collins' repeated efforts to steer himself away from a conflict of interest violation, our view is, due to those facts, a court could

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

well conclude that Mr. Collins violated the prohibition stated in Government Code Section 1090.[1]

Government Section 1090 provides in relevant part:

> "Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. . . ."

The prohibition contained in Section 1090 is intended to preclude a public official from using his or her official position as a government officer or employee to obtain business or financial advantage. The purpose of the prohibition is to remove the possibility of any personal influence that might bear on an official's decision-making activities with respect to contracts entered into by the governmental entity.

The prohibition contained in Section 1090 involves three principal components: (1) the person subject to the prohibition must be regarded as an officer or employee of one of the types of governmental entities listed; (2) the public officer or employee must be financially interested in the contract; and (3) the contract must be made by either (i) the public official in his or her official capacity; or (ii) the body or board of which the official is a member.

Over the years, the courts have broadly interpreted the key provisions of Section 1090. For example, the California Supreme Court has ruled that the term "financially interested" includes any direct interest, such as that involved when a public official enters directly into a contract with the body of which he is a member (*Thompson v. Call*, 38 Cal.3d 633 (1985)). The California Court of Appeal has interpreted "financially interested" as including indirect financial interests in a contract where, for example, a public official would gain something financially by the making of the contract (*Fraser-Yamor Agency, Inc. v. County of Del Norte*, 68 Cal.App.3d 201 (1977)). Additionally, the California Court of Appeal has construed the term "made" as encompassing such elements in the making of a contract as preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans or specifications and solicitation for bids (*Milbrae Association for Residential Survival v. City of Milbrae*, 262 Cal.App.2d 222, 237 (1968); *City Council of the City of San Diego v. McKinley*, 80 Cal.App.3d 204 (1978)).

---

[1] We will not discuss the application of cases dealing with common law conflicts of interest or provisions of the Political Reform Act of 1974 (Government Code Section 81000, *et seq.*) further in this report because a violation of those laws could not impact the implementation of the Regional Project.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

More specifically, it is clear that a member of an advisory body may violate Government Code Section 1090 if his or her actions in an official capacity would promote a personal financial interest. (*City Council of the City of San Diego v. McKinley,* 80 Cal.App.3d 204 (1978); *Shaefer v. Berinstein*, 140 Cal.App. 2d 278 (1956)).

We believe that when Mr. Collins voted as a member of the Board of Directors of the County Water Agency on April 5, 2010, to recommend that the Board of Supervisors approve the Regional Project and its implementing agreements, he violated Government Code Section 1090. On that date, Mr. Collins had acted for months and still was acting in his private capacity to provide personal services, the goal of which was to implement the Regional Project. A positive vote by the Board of Supervisors would cause the contracts to move forward through a CPUC process, a process in which Mr. Collins would be involved and would thereby generate personal income.

We have no reason to believe that Mr. Collins was not motivated to vote to recommend approval of the Regional Project because of his belief that public policy required him to do so. However, neither his basis for motivation nor his stated inability to receive legal guidance provides him protection against a Government Code Section 1090 transgression. Following are the pertinent legal principles on intent and the role of legal advice relevant to this matter:

a. "The official must know that there is a reasonable likelihood that the contract may result in a personal financial benefit to him… This does not require that the official know that his act is criminal." *People v. Honig*, 48 Cal.App.4th, 289, 338 (1996); *see also People v. Chacon*, 40 Cal.4th 558 (2007).

b. "It is not a defense that the official acted in good faith, sincerely believed the contract was in the public best interest or acted under advice of counsel." (*D'Amato v. Superior Court,* 167 Cal.App.4th 861, 869, *citing People v. Chacon,* 40 Cal.4th 558 (2007)).

Government Code Sections 1091 and 1091.5 respectively lists circumstances in which an apparent conflict of interest would be considered a remote interest (as to which an abstention by the impacted public official would obviate a conflict claim) or no interest at all. We have reviewed the list of circumstances and can find none which would apply to the facts at hand.

We have not engaged in a comprehensive inquiry into Mr. Collins' other activities in his capacity as a member of the Board of Directors of the County Water Agency during the period when he worked for RMC. We understand Marina Coast's interest to be specifically focused on the impact of any Government Code Section 1090 violation on the continued viability of the Regional Project and its implementing contracts, as approved by the CPUC. Since we have

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

identified what we believe could be held to be a Government Code Section 1090 violation, we will next discuss the potential impacts of that violation.

3. Penalties which could result due to a Government Code Section 1090 Violation.

The subject potential penalties are as follows:

a. The contract will be deemed void, if its validity is challenged timely in a court proceeding (Government Code Section 1092); and

b. The violating public official may be subject to civil and criminal penalties and may be forever banned from holding public office (Government Code Section 1097).

The following final section of this Report explains the bases for our belief that the validity of the Regional Project contracts may not now be asserted due to the discussed Section 1090 violation or on any other basis.

4. The Regional Project contracts are not now subject to an assertion of invalidity based on the discussed Government Code Section 1090 violation or on any other basis.

a. Final approval of the Regional Project and its implementing contracts occurred after Mr. Collins' financial conflict had ceased.

One reason why a court could well deny a request to invalidate the subject contracts is that Mr. Collins terminated his work on the Regional Project for RMC on or before December 2, 2010. A review of the relevant actions of the Board of Supervisors indicates that the County Water Agency, acting through the Board of Supervisors, did not finally approve the Regional Project and the contracts until January 11, 2011.

On April 6, 2010, the Board of Supervisors adopted its Resolution No. 10-091. At first blush, the Resolution appears to finally approve the Regional Project, subject only to CPUC approval. The Resolution specifically instructs its staff to execute the Settlement Agreement and the Water Purchase Agreement. However, the third to last Recital (statement of intent) contained in Resolution No. 10-091 states as follows:

> "WHEREAS, if the CPUC approves the settlement proposal, MCWRA intends to reaffirm its conditional approval following reconsideration and review of the Final EIR and re-adoption of findings and mitigation measures ('second conditional project approval')."

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

In accordance with above quoted Recital, on January 11, 2011, the Board of Supervisors adopted a motion which took actions related to the Final Environmental Impact Report certified by the CPUC and then specifically "approve the regional desalination project consistent with MCWRA's conditional project approval as set forth in Resolution No. 10-091...." Assuming that the January 11, 2011 action was meaningful, rather than an idle act, and that, therefore, the actions contained in Resolution No. 10-091 which Mr. Collins voted to recommend, were preliminary indications of support, the County Water Agency's contractual approval occurred at a time when Mr. Collins had no conflict.

We have found no statute or case which provides guidance on the question of whether a former Section 1090 violation would be a basis for invalidity of a contract. Stated as a question, "Does a contract remain valid if at the time of its approval, a member of an advisory board previously had a financial interest in the contract and violated Section 1090, but no longer has that interest when the contract is approved?" Certainly, it cannot reasonably be asserted that the Regional Project and its implementing contracts could never be approved once a Section 1090 violation occurred. If suit were brought to invalidate the subject contracts, the circumstances discussed in this section of this Report would be asserted as a defense.

b. Any suit brought to invalidate the Regional Project contracts would be time barred by applicable 60 day statutes of limitation.[2]

We are aware of the fact that in 2007 the Legislature enacted Government Code Section 1092(b) thereby resolving longstanding confusion about the statute of limitations normally applicable to the assertion of a Government Code Section 1090 violation. Prior to the enactment of that legislation, depending on the subject matter of a contract at issue, a court would be required to determine the nature of the right sued upon to decide which basic statute of limitations applied. *Marin Health Care District v. Sutter Help,* 103 Cal.App.4th 861 (2002) is an example of a case in which a conflict of interest was asserted to attack a contract. There, the court had to choose between a one year statute of limitations applicable to forfeitures or a four year statute of limitations provided in Code of Civil Procedure Section 343. Now, Section 1092(b) provides a basic four year statute of limitations to a lawsuit which attempts to invalidate a public entity contract based on a Government Code Section 1090 violation. While it is now clear which of many potential statutes of limitation may apply to most governmental contracts when a Section 1090 violation is asserted, it also remains clear that a much shorter statute of limitations, a 60 day statute of limitations, applies when the subject governmental contract or contracts must

[2] This Report does not include a discussion of provisions of the Public Utility Code, including Public Utility Code Sections 1709, 1731, 1756 and 1759 which also may apply a time bar to any attempt to invalidate the subject contracts since the District retains other special counsel to advise on those matters.

receive immediate protection to remove a legal cloud over a public agency's financial transactions with third party partners. That 60 day statute of limitations is contained within the validating proceedings established in Title 10, Chapter 9, Sections 860, *et seq.* of the Code of Civil Procedure. Specifically, Code of Civil Procedure 863 requires that any party seeking to assert the invalidity of a matter specified in Code of Civil Procedure Section 864, including certain contracts, must do so by filing an in rem action concerning the matter within 60 days of the public entity's approval of it. Such actions are referred to as reverse validation actions. (*McLeod v. Vista Unified School District*, 158 Cal.App.4th 1156 (2008)). Other statutes and case law prescribe the types of contracts which are protected by the 60 day statute of limitations. Government Code Section 53511(b) pertinently provides that "A Local agency that issues bonds, notes, or other obligations the proceeds of which are to be used to purchase, or to make loans evidenced or secured by, the bonds, warrants, contracts, obligations, or evidences of indebtedness of other local agencies, may bring a single action in the superior court of the county in which that local agency is located to determine the validity of the bonds, warrants, contracts, obligations, or evidences of indebtedness of the other local agencies, pursuant to Chapter 9 (commencing with Section 860) of Title 10 of Part of the Code of Civil Procedure."

This code provision has been amplified by cases which apply the Validating Act statute of limitations to contracts involving financing and financial obligations as distinguished from ordinary contracts such as a contract for professional services (*Phillips v. Seely* 43 Cal.App.3d 104, 112 (1975) or the purchase of a computer (*Smith v. Mt. Diablo Unified School District* 56 Cal.App.3d 412, 420-21 (1976)). A case explaining the public policies supporting the application of the subject 60 day statute of limitations is *Friedland v. City of Long Beach*, 62 Cal. App. 4th 835, 838 (1998). There, the trial court sustained a demurrer without leave to amend to plaintiffs' complaint because they did not take part in or bring a timely challenge to a city's validation action, and the appellate court affirmed. The challenge was to bond financing for the "Aquarium of the Pacific" ("Aquarium"), an aquarium facility being built by a nonprofit public benefit corporation and financed through the issuance of $130,000,000 worth of revenue bonds. (*Id.*) Since the bond market was not familiar with aquariums as revenue-generating projects and the Aquarium had no track record to provide security that would allow the underwriters to obtain a marketable rating for the bonds, supplemental security for the repayment of the bonds was needed. (*Id.*) The bond financing thus required the cooperation and participation of the nonprofit public benefit corporation, the city, the board of harbor commissioners, and the redevelopment agency, and the city and redevelopment agency filed and obtained a judgment pursuant to Government Code section 860 *et seq. (Id.)* That judgment validated conclusively against all other persons (1) a lease between the city and the nonprofit, (2) a pledge by the redevelopment agency of certain transient occupancy taxes as security for payment of debt service on bonds issued by the Aquarium as provided for in an Owner Participation Agreement,

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

(3) a pledge by City of the City's Tidelands Operating Funds as additional security for payment of debt service on bonds issued by the Aquarium, as provided for in a City Pledge Agreement, and (4) an agreement by Board to subordinate and defer its rights to receive payments of transient occupancy taxes from the redevelopment agency under a Fourth Amendment to Third Cooperation Agreement. (*Id.* at 839.) The court explained the policy behind validating acts:

A validation action implements important policy considerations. "[A] central theme in the validating procedures is speedy determination of the validity of the public agency's action." (*Millbrae School Dist. v. Superior Court* (1989) 209 Cal.App.3d 1494, 1497) "The text of section 870 and cases which have interpreted the validation statutes have placed great importance on the need for a single dispositive final judgment." (*Committee for Responsible Planning v. City of Indian Wells* (1990) 225 Cal.App.3d 191, 197–198) The validating statutes should be construed so as to uphold their purpose, *i.e.*, "the acting agency's need to settle promptly all questions about the validity of its action." (*Millbrae School Dist. v. Superior Court, supra*, 209 Cal.App.3d at p. 1499)

"[I]n its most common and practical application, the validating proceeding is used to secure a judicial determination that proceedings by a local government entity, such as the issuance of municipal bonds and the resolution or ordinance authorizing the bonds, are valid, legal, and binding. Assurance as to the legality of the proceedings surrounding the issuance of municipal bonds is essential before underwriters will purchase bonds for resale to the public." (Sen. Rules Com. Re: SB 479.)

A key objective of a validation action is to limit the extent to which delay due to litigation may impair a public agency's ability to operate financially. (*Graydon v. Pasadena Redevelopment Agency* (1980) 104 Cal.App.3d 631, 644–645) A validation action fulfills a second important objective, which is to facilitate a public agency's financial transactions with third parties by quickly affirming their legality. "The fact that litigation may be pending or forthcoming drastically affects the marketability of public bonds[.] ... [T]he possibility of future litigation is very likely to have a chilling effect upon potential third party lenders, thus resulting in higher interest rates or even the total denial of credit," which may impair a public agency's ability to fulfill its responsibilities. (*Walters v. County of Plumas* (1976) 61 Cal.App.3d 460, 468)

(*Id.* at 842-43.) Regarding why these agreements were proper subjects of the validation action, the court explained:

> "The Fourth Amendment to Third Cooperation Agreement and Resolution HD–1775 were integral components of financing for the Aquarium. They constituted pledges of funds from various sources to insure repayment of AOP bonds in the

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

> event that Aquarium revenues could not repay that debt. Thus they were proper subjects of the validation action."

(*Id.* at 845.) Plaintiffs argued that they may raise constitutional challenges to a public agency's act at any time. *Id.* at 846. The court explained that even a constitutional right is subject to a reasonable statute of limitations, and it held, "as to matters which have been or which could have been adjudicated in a validation action, such matters—including Constitutional challenges—must be raised within the statutory limitations period in section 860 *et seq.* or they are waived." (*Id.* at 846-47.) The conclusion states:

> "This case shows why validation statutes exist. Defendant public agencies timely sought judicial review of the legal validity of the financing resolutions they had enacted. The public agencies followed statutory procedures and obtained a judgment, which was not appealed. Then Friedland's complaint appeared, alleging matters casting a legal cloud over the financing resolutions, thereby reducing the marketability of financial instruments created pursuant to those resolutions and impairing the ability of the public agencies to act. The Legislature enacted the validation statutes to address this very problem. This appeal provides no basis for departing from the scheme set forth by the Legislature and complied with by defendant public agencies."

(*Id.* at 851.)

Another instructive case is *Graydon v. Pasadena Redevelopment Agency*, 104 Cal. App. 3d 631, 634-35 (1980). In *Graydon*, plaintiff filed a petition for mandamus against a redevelopment agency alleging that the contract for the construction of a publicly owned garage under a proposed private retail center was awarded without competitive bidding, that the contract was favorable to the contractor and unfavorable to the taxpaying public, and that payment pursuant to the contract was unauthorized and a misuse of public funds. To finance the public cost of the retail shopping center development for acquisition of land, demolition of buildings, relocation of residents and businesses, and construction of required parking facilities comprised of a subterranean garage beneath the shopping center and two above ground parking structures, the agency sold tax allocation bonds in the principal amount of approximately $58 million. Id. at 634. On November 2, 1977, at a public meeting at which appellant was present, the agency's governing body awarded and authorized execution of a negotiated contract for construction of the subterranean garage for the project for a maximum price not to exceed $11,939,466, and in December, the agency sold and awarded $26,000,000 tax allocation bonds to finance the construction of the public parking facilities. Id. at 634, 638. Plaintiff sought a writ directing the agency to advertise for competitive bids before awarding a contract for the construction of the

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

garage, for a declaration that the contract between the agency and the contractor was illegal, and to prohibit the agency from disbursing funds in accordance with the contract. (*Id.* at 635.) The trial court entered a judgment denying the writ, and the Court of Appeal affirmed, holding in relevant part that the agency's ability to operate would be substantially impaired absent a prompt validating procedure as to the contract, that the procedures in Code of Civil Procedure section 860 et seq. were therefore applicable, and, because plaintiff did not bring an action challenging the validity of the contract within sixty days after it was awarded and authorized, the action was barred by the sixty-day limitations period. (*Id.* at 637, 648.) Regarding the sixty-day limit due to the validation action, the court stated:

> "The trial court in the case at bench considered the evidence of respondents' statutory purpose, the manner in which it had been and is obliged to carry out its purpose and the manner in which that purpose must be, and is, being financed, found that the questioned contract is such that respondents' ability to operate would be substantially impaired absent a prompt validating procedure as to such contract, and accordingly, held that chapter 9 of title 10 of part 2 of the Code of Civil Procedure (commencing with § 860) applies, and that this action is barred by the 60-day limitations of sections 860 and 863.
>
> "We agree. The negotiated contract for the construction of the subterranean garage is an integral part of the whole method of financing the public costs associated with the retail center. The financing is by bonds issued by the Agency to be paid from tax increments allocated to the Agency. The record indicates that if completion of the retail center was delayed beyond March 1, 1980, because of delay in commencement of construction, a loss of tax increment revenue of $1,556,000 would result for the 1981-1982 fiscal year. There was evidence that if the contract were competitively bid, a delay of approximately 14 months would have resulted. It is uncontroverted that a considerable delay would have resulted. The ability of the Agency to pay its bonds, dependent in large part upon the flow of tax increment monies resulting from the completion of the retail center, was thus directly linked to the award of the questioned contract.
>
> "A considerable delay, and certainly one of 14 months, would impair the ability of the Agency to pay the bonds and to operate and carry out the redevelopment plan. The contract is inextricably bound to the Agency's financial obligations. On December 15, 1977 (approximately six weeks after awarding this contract), the official statement with respect to the bonds in the amount of $26 million sold and awarded on December 15, 1977, stated that the contract had been authorized and awarded on November 2, 1977, based upon the opinion of the Agency's general

> counsel that the bidding requirements were not applicable to the contract for the construction of the subterranean garage. These bonds were intimately and inextricably bound up with the award of this contract. Delay in the completion of the retail center because of the delay which would inevitably have resulted if the contract had been competitively bid and would have had a direct bearing on the financial ability of Agency to meet its financial obligations and statutory purpose.
>
> "These conclusions compel the result we reach here. The lack of a prompt validating procedure would impair this public agency's ability to operate and carry out its statutory purpose. We hold that chapter 9 of title 10 of part 2 of the Code of Civil Procedure (commencing with § 860) applies and that this action, which was not commenced until January 26, 1978, more than 60 days after the contract came into existence on November 2, 1977, is barred by the 60-day limitation provisions of sections 860 and 863."

(*Id.* at 645-46.)

The fact that the Validating Act 60 day statute of limitations is applicable to the public entities involved in the Regional Project is made clear by two specific statutes in addition to Government Code Section 53511(b). First, Water Code Section 30066, a provision contained within the County Water District Act (Water Code Sections 30000, *et seq.*) specifically makes the Validating Act applicable to contracts entered into by a county water district. Marina Coast is a county water district and, as a contracting party to the Regional Project contracts, is entitled to the protection of those contracts afforded by Code of Civil Procedure Section 863 if the contracts are recognized as the type which need to be protected by the 60 day statute of limitations, that is, financing agreements in which a legal cloud needs to be lifted quickly to allow insured reliance by other parties and financial institutions.

In addition, Water Code Appendix Section 52-39, a provision contained in the County Water Agency's Governing Act, states that:

> "Any judicial action or proceeding to attack, review, set aside, void, annul, or challenge the validity or legality of the formation of a zone, ***any contract entered into by the agency or a zone***, any bond or evidence of indebtedness of the agency or a zone, or any assessment, rate, or charge of the agency or a zone shall be commenced within 60 days of the effective date thereof.
>
> "The action or proceeding shall be brought pursuant to Chapter 9 (commencing with Section 860) of Title 10 of Part 2 of the Code of Civil Procedure.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

> "The agency may bring an action pursuant to that Chapter 9 to determine the validity of any of the matters referred to in this section." [Emphasis added.]

This very specific provision could well be held by a court to require any action brought to invalidate any contract entered into by the County Water Agency to be filed within 60 days of the approval of such a contract. At a minimum, it very specifically shows that a financing agreement entered into by the County Water Agency is protected by the 60 day statute of limitations.

We cannot imagine that any party familiar with the Regional Project would assert that the Settlement Agreement, the Water Purchase Agreement and ancillary agreements would not be considered financing agreements protected by the 60 day statute of limitations in accordance with the *Friedland* and *Graydon* cases discussed above. Should doubt remain on that point, following are indisputable findings made by the CPUC included in its Decision 10-12-016 (Dec. 3, 2010), approving the regional Project agreements, which should be considered dispositive:

"4. According to the FEIR, as of 1995, Cal-Am served approximately 105,000 customers in its Monterey District, supplying them with approximately 17,000 afy. Of this amount, approximately 14,106 afy was supplied from the Carmel River system and 2,700 afy was supplied from the Seaside Basin. Today, there are approximately 39,000 metered connections in the Monterey District.

5. In 1995, the SWRCB issued its Order No. WR 95-10, which concluded that although Cal-Am had been diverting 14,106 afy from the Carmel River, it has a legal right to only 3,376 afy from the Carmel River system, including surface water and water pumped from the Carmel Valley wells.

6. The SWRCB ordered Cal-Am to replace what SWRCB determined to be unlawful diversions of 10,730 afy from the Carmel River with other sources and through other actions, such as conservation to offset 20 percent of demand.

7. In 2006, the Monterey County Superior Court issued a final decision regarding adjudication of water rights of various parties who use groundwater from the Seaside Basin. (*California American Water v. City of Seaside, et al.*, Case No. 66343). The court's decision established physical limitations to various users' water allocations to reduce the drawdown of the aquifer and prevent additional seawater intrusion and set up a Watermaster to administer and enforce the Court's decision.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

8. Cal-Am is currently allocated 3,504 afy from the Coastal subarea of the Seaside Basin and 345 afy from the Laguna Seca subareas. These allocations will be reduced over time until they eventually reach 1,474 afy from the overall Seaside Basin. Prior to the Seaside Basin adjudication, Cal-Am's allocation for the Coastal subarea was 4,000 afy.

9. In 2006, the MPWMD issued a technical memorandum, updating the demand in Cal-Am's service territory. In sum, the replacement water supply required to meet total updated demand is 12,500 afy.

...

65. We find that the Regional Project is the most feasible alternative that provides a viable solution to the water constraints on the Monterey Peninsula, given the adverse social and economic consequences associated with taking no action or delayed action, in the timeframe imposed by the State Water Resource Control Board's Cease and Desist Order, meets the restrictions on ownership of a desalination plant in Monterey County, and satisfies the prohibitions on exporting water from Salinas Basin, and certain technological factors.

...

72. The Settlement Agreement states that the Regional Project provides the most expeditious , feasible and cost-effective alternative to address the water supply constraints on the Monterey Peninsula.

73. The Settling Parties maintain that time is of the essence, both because of the pending Cease and Desist Order and because there are financing opportunities that may be lost if the Regional Project is delayed.

74. The Monterey County Water Resources Agency will construct, own, operate, and maintain the brackish source water wells that will provide the feedwater for the desalination facility, as well as the conveyance pipeline to the desalination facility.

75. The Marina Coast Water District will construct, own, operate, and maintain the desalination plant and transport the desalinated water to a delivery point within its service territory. At that point, the Marina Coast Water District will receive a portion of the water and Cal-Am will receive a portion of the water.

76. Cal-Am will construct, own, maintain, and operate there large diameter conveyance pipelines, two distribution storage reservoirs, and aquifer storage and recovery

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

facilities; all of these facilities will provide the infrastructure to serve its customers with the desalination water (also known as product water).

77. The brine from the desalination plant would be discharged through the outfall owned and operated by the Monterey Regional Water Pollution Control Agency.

78. The Marina Coast Water District has exercised an option which it held, and acquired 224 acres of land on the Armstrong Ranch north of Marina, adjacent to the regional wastewater treatment plant operated by the Monterey Regional Water Pollution Control Agency and the regional landfill operated by the Monterey Regional Waste Management District shown in the FEIR as the proposed location for the desalination plant for the Regional Project.

79. Because the source water cannot be exported from the Salinas Valley, this factor becomes a critical component to the Regional Project.

...

81. The Settlement Agreement includes two implementing agreements: a Water Purchase Agreement and an Outfall Agreement. The Water Purchase Agreement provides extensive detail as to each parties' rights and responsibilities, and addresses the design, construction, and permitting of the components of the proposed Regional Project.

82. The Water Purchase Agreement has an initial term of 34 years, and, in accordance with its terms, 6 automatic renewal terms of 10 years each.

83. The Water Purchase Agreement requires the construction of test wells, the data from which will be analyzed by the Monterey County Water Resources Agency to ensure compliance with the Agency Act.

84. The Marina Coast Water District and Monterey County Water Resources Agency will endeavor to secure cost-effective financing for the Regional facilities, including low-cost SRF loans, as well as grants, where available, which, if obtained, will lower the cost of the Regional Project. Cal-am will provide shortfall financing for the project, if necessary.

...

95. In order to ensure coordination, the parties plan to jointly select and hire a project manager to manage the permit, design, engineering, and construction process, and to ensure that the proper coordination takes place.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

...

97. The Settling Parties request that the Commission approve a capital cost cap of $297.47 million (escalated to mid-2012 $) that excludes interest during construction and any debt service coverage required to obtain financing for the Regional Project.

...

104. Because of the public financing opportunities, we find that the Public Agencies bring benefits to the Regional Project that would not be achieved by Cal-Am ownership of either the Moss Landing Project or the North Marina Project; in addition, litigation related to private ownership of the desalination plant and compliance with the Agency Act could ensure with either the Moss Landing Project or the North Marina Project.

...

113. The Settling Parties acknowledge that a financing package is not finalized and explain that they are evaluating several options for obtaining a financing package with will reduce the costs of indebtedness, including accessing State Revolving Fund financing and federal grants.

...

132. The low-cost financing opportunities that the Public Agencies may be able to access are at the core of the benefits of the Regional Project.

133. Based on the Unified Financing Model the parties jointly developed, Exhibit 113 considers the impact of a single issuance of private activity bonds, issuance of tranches of private activity bonds, and the interaction of such bonds with SRF loans and federal grants."

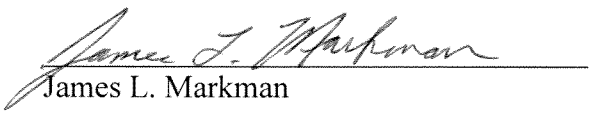
The Regional Project contracts require complex financing and cooperation among two public entities and a public utility, all under time constraints to avoid a water shortage catastrophe. It is difficult to imagine agreements more in need of rapid removal of legal clouds so that the parties may safely discharge their contractual responsibilities.

The applicable 60 day statute of limitations ran from April 5 and 6, 2010 or from January 11, 2011. In either case, the statute of limitations expired months ago. Accordingly, it is our view that a suit asserting the invalidity of the Regional Project contracts would be held to be time barred.

ATTORNEY–CLIENT PRIVILEGE
CONFIDENTIAL

Respectfully submitted,

RICHARDS, WATSON & GERSHON
JAMES L. MARKMAN
B. TILDEN KIM
SHIRI KLIMA

By: 
James L. Markman