

NORTH OF THE RIVER MUNICIPAL WATER DISTRICT AND OILDALE MUTUAL WATER COMPANY

PREFACE:

The 2012-2013 Kern County Grand Jury (Grand Jury) North of the River Ad-Hoc Committee (Committee) investigated the proposed merger between North of the River Municipal Water District (NOR), a Special District, and Oildale Mutual Water Company (OMWC), a private water company, pursuant to California Penal Code §925. Both NOR and OMWC are non-profit organizations. The extent of the investigation was limited as the Grand Jury does not have authority to investigate a private company.

PURPOSE OF INQUIRY:

The Grand Jury report is in response to multiple complaints received and public concern.

PROCESS:

Grand Jury Members obtained information regarding the proposed merger between the two companies by:

- Interviews
- Internet research
- Newspaper articles
- Documentation obtained through subpoena

BACKGROUND:

NOR

The North of the River Municipal Water District was formed in 1969 to provide wholesale delivery of State Water Project water to supply the community of Oildale. The NOR, being a governmental entity, used low interest water bonds to install an infrastructure that includes two 4.5 million gallon reservoirs, two 1.9 million gallon reservoirs and two 1.2 million gallon reservoirs at various elevations in the NOR. The NOR also has many miles of pipelines and other facilities including turnouts, pressure reducing stations and relief valves.

Until the 1980's the NOR provided wholesale water to OMWC alone. In the early 1980's Highland Park Public Utility District (HP) requested NOR be responsible for the retail customers and HP facility. The consolidation of NOR and HP was completed in 1982.

The increasing demand for water in the community and Bakersfield resulted in a joint agreement in 2005 between NOR, East Niles Community Services District, California

Water Service and the City of Bakersfield with the Kern County Water Agency (KCWA) to double the size of the Henry C. Garnett Water Purification Plant. The expansion also doubled the transmission pipeline capacity to NOR reservoirs. The electrical power supply was increased partly by the construction of a one million megawatt solar electrical generation facility resulting in lower costs to customers.

The agreement in 2005 provided improvements and a commitment of the NOR to purchase an additional 6,500 acre-feet of treated water per year from the KCWA, bringing the NOR supply total to 15,000 acre-feet per year. The delivery schedule began in 2012 with 10,600 acre-feet of treated water and will increase yearly until the 15,000 acre-feet supply is met.

Revenue to operate NOR is met with user fees to retail customers, property tax revenue, hook-up fees and the wholesale contract with OMWC.

OMWC

Oildale Mutual Water Company was founded in 1919. The current service area encompasses approximately 10 square miles north of the City of Bakersfield in Kern County area. The OMWC has more than 8,000 retail customers. Each customer is a “stockholder” in the company.

FACTS:

- A. The OMWC owns and operates several groundwater wells. The OMWC purchases all potable water from NOR. The wells are presently used as an emergency back up supply and for peak service times.
- B. The OMWC website states “*Although NORMWD (NOR) serves over 1,800 retail customers, its primary mission is to buy treated water from the Kern County Water Agency and resell it to others.*”
- C. Two “innovations” in place since 2009 mentioned in OMWC’s website:
 - Dual water service for newly developed business parks providing separate water delivery for domestic and non-potable service.
 - A remote meter reading system requires replacement of existing meters. The remote meters are installed on new accounts and replacements as time allows.
- D. In 2007 NOR obtained a three million dollar grant to upgrade the infrastructure of the District.
- E. The NOR has a grant to exchange water meters in the District.

FINDINGS:

- F1. The NOR is financially sound with reserves in the bank.
- F2. The OMWC has shown losses of \$1.5 million in the past three years.
- F3. Reportedly the OMWC has a deteriorating infrastructure whereas NOR's infrastructure is sound.
- F4. The friction between the two entities started soon after NOR took over the retail customers in Highland Park. **Because HP was a Special District, the OMWC could not "take over" the customers.**
- F5. The NOR's primary customer revenue is OMWC (approximately 80%). The remaining customers are Highland Park retail customers.
- F6. The OMWC expressed concern in 1981 about the separation of accounting between wholesale and retail operations for NOR. In 1983 OMWC sued NOR. The lawsuit lasted 10 years and resulted in an agreement.
- F7. The 1993 agreement constituted OMWC paying direct costs for water plus a share of the Districts costs. **The OMWC account is credited with a portion of the property taxes collected by NOR.**
- F8. In the 2005 agreement, NOR (and OMWC) increased the amount of water purchased from KCWA at a higher rate. The result was an increase in costs to NOR.
- F9. In 2008 OMWC hired an accountant to audit the billing from NOR. The accountant discovered bookkeeping errors. The former General Manager (GM) of NOR worked with the GM from OMWC to correct the audit findings.
- F10. In 2011 the former GM of NOR retired. The OMWC approached NOR to discuss increasing the funding credits from NOR.
- F11. It was reported to the Grand Jury some OMWC Directors do not pay "hook-up" fees for homes built in Oildale. Hook-up fees on the OMWC website for single homes are \$3,000 and \$1,750 for multiple residences.
- F12. In 2011 three of the five Directors from NOR were accused in *The Bakersfield Californian* newspaper of improper conduct (misuse of funds such as unnecessary trips out of the country), although the trips were authorized by the Board of Directors of NOR. The three Directors were voted out of office in 2012.

F13. The OMWC supported (in the amount of \$45,000) three candidates for the NOR Board of Directors. The three candidates were elected in November 2012. The new NOR Directors represent a quorum on the NOR Board.

F14. The Meter Exchange Program in NOR was “put on hold” by the new NOR Board in early 2013. The action of the Board prevented the expenditure of the grant money in NOR reserves.

F15. If the three new NOR Directors were to approve an agreement, based on receipt of campaign contributions by OMWC, the possibility of a Government Code §1090 violation could exist.

F16. The GM of OMWC is the son of one of the new NOR Directors.

COMMENTS:

Before the 2012 election the NOR was a well run and established company. The NOR now has a quorum of three new Directors whose campaigns were financed by the OMWC. Much of the OMWC infrastructure is in disrepair and upgrades are needed. The OMWC has had revenue losses in the last three years of \$1.5 million dollars as shown in past tax records thus OMWC will likely have another year of negative revenue in 2012-2013.

A Community Service District formed by the merging of the retail and wholesale business of the two entities may better serve the community. The infrastructure in the OMWC area could then be upgraded to the standards already in place at NOR.

RECOMMENDATIONS:

R1. The Grand Jury suggests NOR and OMWC have forensic audits performed.

R2. The NOR and OMWC should be consolidated to form a new Community Services District, including a new set of by-laws, to better serve the needs of the communities of Oildale and Highland Park.

R3. To alleviate loss of employment from the previous entities, staffing for the new Community Services District should be combined whenever possible.

NOTES:

The North of the River Municipal Water District should post a copy of this report where it will be available for public review.

Persons wishing to receive an email notification of newly released reports may sign up at www.co.kern.ca.us/grandjury, and click on: Sign up for early releases.

Present and past Kern County Grand Jury Final Reports and Responses can be accessed on the Kern County Grand Jury website: www.co.kern.ca.us/grandjury.

RESPONSE REQUIRED WITHIN 90 DAYS TO:

**PRESIDING JUDGE
KERN COUNTY SUPERIOR COURT
1415 TRUXTUN AVENUE, 2ND FLOOR
BAKERSFIELD, CA 93301**

**cc: FOREMAN
KERN COUNTY GRAND JURY
1415 TRUXTUN AVENUE, SUITE 600
BAKERSFIELD, CA 93301**



North of the River Municipal Water District

4000 Rio Del Norte Street • Bakersfield, CA 93308 • Office (661) 393-5411 • FAX (661) 399-8911

COPY

August 22, 2013

Honorable Colette Humphrey, Presiding Judge
Kern County Superior Court
1415 Truxtun Avenue, 2nd Floor
Bakersfield, CA 93301

**RE: Response to Grand Jury Report of June 17, 2013—North of the River
Municipal Water District and Oildale Mutual Water Company**

Dear Judge Humphrey:

INTRODUCTION

This response is as directed by the above referenced Report. It was reviewed by and approved by the Board of Directors of the North of the River Municipal Water District (NOR) at its meeting of August 21, 2013. We will address each of the Findings and Recommendations of the Report, although in a few instances, as indicated, we have no specific information regarding the Findings and refer to Oildale Mutual Water Company's (OMWC) response for that item. We have attached a copy of OMWC's response of August 15, 2013, (Attachment A, hereto) for convenient reference and to insure that their views are received by the Grand Jury and part of the record; however, NOR does not endorse, adopt or approve all or any part of their response.

JURISDICTION

As an initial matter, we must note that although we wish to cooperate with the Grand Jury as it carries on its work, we are compelled to point out in this instance the prior Grand Jury appears to have exceeded its authority and jurisdiction in preparing the Report pursuant to Penal Code section 925.

Penal Code section 925 empowers the Grand Jury to examine the accounts and records of all county officers; section 929 extends this examination to county officers acting ex officio as officers of certain other districts.¹ The Supreme Court of California stated, "Although [the grand jury's] powers are broad, they are carefully defined and limited by statute, and the grand jury has no inherent investigatory powers beyond those granted by the Legislature."² Moreover, the

¹ (*Board of Trustees of Calaveras Unified School Dist. v. Leach* (1968) 258 Cal.App.2d 281, 286-87.)

² (*McClatchy Newspapers v. Superior Court* (1988) 44 Cal.3d 1162, 1172; citing *Board of Trustees v. Leach* (1968) 258 Cal.App.2d 281, 285; *People v. Superior Court* (1973 Grand Jury) (1975) 13 Cal.3d 430, 437.)

application of Penal Code sections 925-929 is limited to county officials.³ NOR is neither administered by the county, nor via county officers acting ex officio. Thus, the current Report was prepared and completed beyond the authority and jurisdiction of the prior Grand Jury and should not be accepted for filing.

In retrospect, the prior Grand Jury may have been empowered to conduct a review of NOR as a "special-purpose assessing or taxing district" pursuant Penal Code section 933.5, but any such review would be limited solely to NOR's "operational procedures." The terms of section 933.5 do include the review of the method or system "of performing the duties of such district..."⁴ The investigative authority of a Grand Jury with respect to special districts must be focused on procedural considerations. (*Ibid.*) Procedural considerations must be carefully distinguished from *substantive concerns*. (*Ibid.*) Thus, the parameter of operational procedure **does not extend to an inquiry as to the merit, wisdom, or expediency of substantive policy determinations which may fall within the jurisdiction and discretion of a particular district.** (*Ibid.*)

The prior Grand Jury's investigation and report regarding NOR and the proposed "merger", even if conducted under section 933.5, in large part would appear to have exceeded its statutory authorization. To the extent the Report's analysis of the proposed "merger" relates to substantive concerns and policies it is outside the Grand Jury's review. Substantive policy determinations are to be made by the elected Board of Directors of NOR.

BACKGROUND AND FINDINGS

We have no comments concerning the first two pages of the Report (preceding the Findings), and find the information generally correct, but for clarification note:

- (a) Under the "NOR Background" second paragraph: *NOR provided wholesale water to both OMWC and Highland Park Public Utility District as far back as 1975 per a Water Service Agreement dated December 16, 1975.*
- (b) Under the "Facts," paragraph E: *NOR has been notified it is eligible for a grant of \$398,570 and a loan (20 years at 0% interest) of \$99,642 to install meters at all the remaining retail connections in NOR's service area that are on flat rates without meters.*

For the Findings and Recommendations portions of the Report, following we restate the Grand Jury's Finding or Recommendation and our Response.

³ (*Board of Trustees v. Leach, supra*, at 286 -87.)

⁴ (78 Ops.Cal.Atty.Gen. 290 (1995); citing 64 Ops.Cal.Atty.Gen. 900 (1981).)

F1. The NOR is financially sound with reserves in the bank.

Accurate; no response.

F2. The OMWC has shown losses of \$1.5 million in the past three years.

We have no specific information; please refer to OMWC's response.

F3. Reportedly the OMWC has a deteriorating infrastructure whereas NOR's infrastructure is sound.

We have no specific information concerning OMWC's infrastructure; please refer to OMWC's response.

F4. The friction between the two entities started soon after NOR took over the retail customers in Highland Park. **Because HP was a Special District, the OMWC could not "take over" the customers.**

NOR records show that a reorganization study was agreed upon by both Highland Park Public Utility District and NOR. The feasibility studies "Indicate the best interests, convenience and public welfare would better served by such reorganization.." Both governing bodies agreed to the reorganization and Highland Park Public Utility District was dissolved. (see NOR's Resolution No. 80-18, Attachment B, hereto). We have no information indicating OMWC could not have "taken over" the Highland Park customers and they become shareholders of OMWC.

F5. The NOR's primary customer revenue is OMWC (approximately 80%). The remaining customers are Highland Park customers.

By way of clarification, NOR receives about \$2 million per year in retail water sales. The majority of the retail water service area is the old Highland Park area but there are other areas that NOR serves. "Revenue" derived from OMWC for wholesale services is based on a contract between NOR and OMWC, and is approximately \$3.4 million per year (including cost of water, operating expenses and capital repayment for facilities). The NOR's largest "customer" in providing water is OMWC.

F6. The OMWC expressed concern in 1981 about the separation of accounting between wholesale and retail operations for NOR. In 1983 OMWC sued NOR. The lawsuit lasted for 10 years and resulted in an agreement.

This finding is essentially correct—the litigation actually lasted 11 years.

F7. The 1993 agreement constituted OMWC paying direct costs for water plus a share of the Districts costs. **The OMWC account is credited with a portion of the property taxes collected by NOR.**

By way of clarification, we note that such credits benefiting OMWC thereby benefit OMWC's shareholders/customers, who are also residents and constituents of the NOR, who also pay taxes. Such property taxes in essence help support the importation of supplemental water supplies to all residents and landowners in the North of the River area.

F8. In the 2005 agreement, NOR (and OMWC) increased the amount of water purchased from KCWA at a higher rate. The result was an increase in costs to NOR.

By way of clarification, NOR entered into an agreement with KCWA in regard to an expansion of the water treatment plant and committing to additional water entitlement. That Agreement committed NOR to increased costs for the additional water and capital facilities cost. The 2005 Agreement between NOR and OMWC committed both entities to pay for the additional water entitlement and capital facilities costs.

F9. In 2008 OMWC hired an accountant to audit the billing from NOR. The accountant discovered bookkeeping errors. The former General Manager (GM) of NOR worked with the GM from OMWC to correct the audit findings.

The CPA hired by OMWC to review past billings of NOR to OMWC lead to various discussions of discrepancies as asserted by OMWC. The general managers from the respective entities discussed and attempted to resolve the matter and both board of directors were also discussing the alleged discrepancies. Resolution did not take place.

F10. **In 2011 the former GM of NOR retired. The OMWC approached NOR to discuss increasing the funding credits from NOR.**

The former general manager for NOR retired in October of 2010. We do not understand the statement "The OMWC approached NOR to discuss increasing the funding credits from NOR," and would appreciate an explanation for what that statement means.

F11. It was reported to the Grand Jury some OMWC Directors do not pay "hook-up" fees for homes build in Oildale. Hook-up fees on the OMWC website for single homes are \$3,000 and \$1,750 for multiple residences.

We have no specific information; please refer to OMWC's response.

F12. In 2011, three of the five Directors from NOR were accused in *The Bakersfield Californian* newspaper of improper conduct (misuse of funds such as unnecessary trips out of the country), although the trips were authorized by the Board of Directors of NOR. The three Directors were voted out of office in 2012.

By way of clarification, there were three NOR seats up for election in November 2012. Two incumbents elected to re-run, one did not. At a meeting in 2001 and a meeting in 2008, those Directors present voted to authorize a trip to be taken by the General Manager.

F13. The OMWC supported (in the amount of \$45,000) three candidates for the NOR Board of Directors. The three candidates were elected in November 2012. The new NOR Directors represent a quorum on the NOR Board.

Form 460 filed by "Concerned Citizens for Tyack, Etcheverry and Meier for NOR Municipal Water District Board 2012" with the County Elections Department, dated January 14, 2013, indicates a total of \$15,535 (vs \$45,000) was contributed by OMWC on behalf of those three candidates. The balance of the finding is correct.

F14. The Meter Exchange Program in NOR was "put on hold" by the new NOR Board in early 2013. The action of the Board prevented the expenditure of the grant money in NOR reserves.

NOR has three years to complete the grant and loan in question authorized by the State of California. A majority of the NOR Board voted to table the purchase of the meters under this program at that time, desiring to wait pending the outcome of the investigations of possibly integration the NOR retail with OMWC (referenced below) and to secure additional information concerning the meters. There is the possibility of the purchase of the meters in the future and the grant and loan being completed within the three year window. The desire of the Board remains to utilize the authorized grant and loan and secure the best performing meters at the least cost.

F15. If the three new NOR Directors were to approve an agreement, based on receipt of campaign contributions by OMWC, the possibility of a Government Code § 1090 violation could exist.

In light of the Grand Jury's caution, NOR and OMWC retained Joe Hughes of Klein, DeNatale and Goldner to perform an independent review of the matter. Based on review of various documents, numerous interviews and review of the applicable law, they concluded that the receipt by the three NOR Directors of campaign contributions by OMWC would not cause there to be a violation of Government Code Section 1090 if a contract was entered into between NOR and OMWC to integrate their operations, as proposed. (See copy of their opinion, Attachment C, hereto)

F16. The GM of OMWC is the son of one of the new NOR Directors.

The son of one of the new District Directors is the field superintendent for the Company, not the GM of the Company.

RECOMMENDATIONS:

R1. The Grand Jury suggests NOR and OMWC have forensic audits performed.

In conjunction with other investigations as to the feasibility of integrating NOR's retail function into OMWC and OMWC wholesale facilities into NOR, a "neutral" CPA is conducting various analysis, including a review of audits of both entities.

R2. The NOR and OMWC should be consolidated to form a new Community Services District, including a new set of by-laws, to better serve the needs of the communities of Oildale and Highland Park.

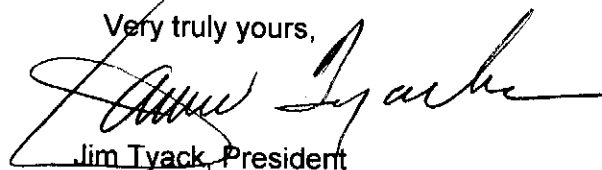
At its July 17, 2013, meeting the NOR Board considered this recommendation. Based on the fact that NOR's ad hoc committee working with OMWC on the potential integration of functions referenced above has already determined it initially appeared the integration of functions alternative it is pursuing is preferably and would be less time consuming than forming a CSD, the NOR Board voted not to pursue further investigating forming a CSD at this time. However, depending on the outcome of the ongoing investigations concerning possible integration of functions, the Board may in the future investigate the CSD alternative further.

R3. To alleviate loss of employment from the previous entities, staffing for the new Community Services District should be combined whenever possible.

Also as part of the investigation of integration of functions referenced above, human resources special counsel has been retained to advise both entities on how best to address these and other HR issues, if there was such an integration.

Please contact our General Counsel if you have any questions regarding this response.

Very truly yours,



Jim Tyack, President

cc: **Foreman, Kern County Grand Jury**,
District Board of Directors
Oildale Mutual Water Company
Ernest A. Conant of Young Wooldridge, LLP, District Counsel

ATTACHMENT - A



**Oildale
Mutual
Water
Company**

FILED AUG 20 2013
N.O.R.M.W.D.

INCORPORATED OCTOBER 30, 1919

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BAKERSFIELD, CA 93388

August 15, 2013

PRESIDING JUDGE
KERN COUNTY SUPERIOR COURT
1415 Truxtun Avenue, 2nd Floor
Bakersfield, California 93301

Re: **Response to Grand Jury Report (released June 17, 2013)
Oildale Mutual Water Company/NOR Municipal Water District**

Dear Judge:

We take this opportunity to respond to that portion of the Grand Jury Report (released June 17, 2013) referring to NORTH OF THE RIVER WATER DISTRICT and OILDALE MUTUAL WATER COMPANY. Our response is as follows:

1. Jurisdiction:

It is stated that a committee of the Grand Jury chose to investigate a proposed "merger"¹ between North of the River Municipal Water District (NOR or District) and Oildale Mutual Water Company (OMWC or Company). Authority cited for the investigation is Penal Code § 925. That statute provides, in pertinent part:

The grand jury shall investigate and report on the operations, accounts, and records of the officers, departments, or functions of the county including those operations, accounts, and records of any special legislative district or other district in the county created pursuant to state law for which the officers of the county are serving in their ex officio capacity as officers of the districts.

¹ The proposal being considered by OMWC and NOR is not a "merger"; rather, it is more in the nature of a reorganization. The term "merger" implies that the two entities would become one, i.e., only one would survive the process. In fact, the proposal under discussion is that NOR retail operations and facilities be transferred to OMWC to avoid or reduce duplication of services and equipment, increase efficiency, and save substantial amounts of money for the customers of both OMWC and NOR. NOR will continue to exist and will continue to operate as a wholesale provider of water and water service to OMWC.

OMWC is, of course, a private entity not subject to the jurisdiction of the Grand Jury.² As to NOR, it is not a district for which the officers of the county are serving in their ex officio capacity as officers of the district. Accordingly, Penal Code § 925 does not apply to either entity and the subject investigation is in excess of the jurisdiction of the Grand Jury.

It is recognized that the Grand Jury may investigate certain activities of a special district, such as NOR, pursuant to Penal Code § 933.5. However, an investigation under this section is limited in purpose and scope. [See, e.g., *Board of Trustees v. Leach* (1968) 258 Cal.App.2d 281, 287-288]. For example, although § 933.5 allows the Grand Jury to examine the "method or system of performing the duties" of a district such as NOR, the California Attorney General has held that this authority extends only to "operational procedure" as distinguished from "substantive concerns." [64 Ops.Cal.Atty.Gen. 900 (1981): "...the parameter of operational procedure does not extend to an inquiry as to the merit, wisdom, or expediency of substantive policy determinations which may fall within the jurisdiction and discretion of a particular district"]. A subsequent Attorney General Opinion sheds more light on the difference between "operational procedures" and "substantive concerns". In 78 Ops.Cal.Atty.Gen. 290 (1995) dealing with school districts, the California Attorney General explained that such policy matters as the selection of school sites or the purchase and improvement of school property would constitute substantive concerns falling exclusively within the discretion of the school board. The opinion goes on to say that the same is true of school district reorganizations, which could include such matters as the transfer of territory of one district to another. Similar to a school district reorganization, the proposed "merger" is a substantive concern which falls exclusively within the discretion of the NOR board and, therefore, outside the jurisdiction of the Grand Jury.

Frankly, we are at a loss to explain how or why the Grand Jury was allowed to wander so far afield. Applicable here is the language of Harold W. Kennedy and James W. Briggs in *Historical and Legal Aspects of the California Grand Jury System* (43 Cal.L.Rev. 251, 267): "The California grand jury is endowed with broad powers as an inquisitorial and judicial body but it is enjoined to exercise those powers with mature discretion. It is not to engage in 'fishing expeditions,' ... nor is it to attempt to act as a supervising administrative agency controlling the discretionary activities of public officers." [*Samish v. Superior Court* (1938) 28 Cal.App.2d, 685, 688].

2. Procedure:

It is stated that the Grand Jury Members obtained information about the alleged merger through (i) interviews, (ii) internet research, (iii) newspaper articles, and (iv) documentation

² The Grand Jury acknowledges that it has no jurisdiction over OMWC stating: "The extent of the investigation was limited as the Grand Jury does not have authority to investigate a private company."

obtained through subpoena. It is important to note that no interviews were requested of any member of the board or staff of OMWC. Neither was any subpoena served upon, or other request for "documentation" sought from, any representative of OMWC. In addition, there are three newly elected members of the NOR board who play a prominent role in the Grand Jury report, none of whom were contacted by the Grand Jury. While the Grand Jury has refused to disclose the names of those persons actually interviewed, it is apparent that the list will include only those persons who are adamantly opposed to the reorganization under discussion between OMWC and NOR. In effect, the Grand Jury Report presents one side of the story without any adequate investigation of the facts and/or opportunity to respond. As will be seen, this cavalier approach has led to the publication of several findings which are erroneous, incomplete or misleading, and others which are outright falsehoods. The result is a Report that is, at best, negligent and irresponsible and, at worst, intentional and malicious.

3. **Disputed Findings:**

We will not attempt to correct every error in the Grand Jury Report, but focus on the following as the most flagrant examples:

F1. The NOR is financially sound with reserves in the bank.

The implication of F1 is that NOR is financially sound *because* it has reserves in the bank. What this finding fails to consider is the fact that (i) OMWC has contributed the vast majority of the funds making up NOR's reserves and (ii) there is a dispute between OMWC and NOR over whether those funds have been appropriately used by NOR in the past. Although OMWC claims are "on hold" pending the outcome of reorganization efforts, such claims are very much alive and, if pursued, could seriously affect the financial condition of NOR.

F2. The OMWC has shown losses of \$1.5 million in the past three years.

The implication of F1 and F2, taken together, is that NOR is financially sound and OMWC is not. A further implication is that NOR is well managed and OMWC is not. A final implication is that a "merger" between the two would be to the financial advantage of OMWC customers and the financial disadvantage of NOR retail customers. Such is not the case. F2 is inaccurate and misleading.

Attached hereto as Exhibit "A" is a spreadsheet showing the actual cash position of OMWC from fiscal 2005 through fiscal 2012 and the projected cash position through fiscal 2013. It can readily be seen that the cash reserves of the Company have ranged from a low of \$4.28 million (2011) to a high of \$6.28 million (2009). What is not reflected in the Grand Jury Report are the following facts:

a. The OMWC books and records are audited annually by an independent, licensed CPA. The annual audit is presented to and reviewed by the Board of Directors each year. The Company is not required by law to perform such an audit but does so, on its own initiative, as a sound business practice. All figures shown in Exhibit A are taken from the Company's annual independent audits.

b. The so-called "losses" do not occur in the past three years – they fall within the period of fiscal 2009 through fiscal 2011.

c. The so-called "losses" do not amount to \$1.5 million. From a "cash flow" perspective, the "losses" for the years in question total \$1,150,775.³

d. The so-called "losses" do not result from mismanagement of the Company. The full story is this: (i) the treatment plant expansion was authorized in 2005; (ii) OMWC knew that debt service for these capital improvements would require a significant outlay starting in 2009 (see Exhibit A: note the increase in "Bond Payments" for 2009 and following); (iii) rather than raising rates a huge amount in a single year, OMWC embarked on a program of gradual rate increases (i.e., every two years) to meet this obligation; (iv) knowing that the gradual rate increase would not cover the entire debt service requirement by 2009, OMWC determined to use a portion of its reserves to help meet the bond payments until such time as the new rate revenues would be sufficient for that purpose; thus, (v) the so-called "losses" are nothing more than planned utilization of reserves for rate stabilization. The Company is not now, nor has it ever been, in dire financial condition. As shown on Exhibit A, by the end of fiscal 2013 it is expected that the Company will have absorbed the massive increase in its debt service and will have fully restored its reserves to the highest levels in the past 9 years.

e. The Company is so well managed and operated that, notwithstanding the several biennial rate increases described above, water service rates charged by the Company to its customers today remain lower – virtually across the board and for every class of service – than those currently charged by NOR to its retail customers.

F3. Reportedly the OMWC has a deteriorating infrastructure whereas NOR's infrastructure is sound.

Again, without the benefit of any meaningful investigation whatsoever, and without the courtesy of even discussing the "reported" accusation with the management, staff or consultants of OMWC, the Grand Jury adopts, publishes and apparently sanctions inaccurate and misleading information. Again, the obvious implication is that OMWC is mismanaged and a merger of NOR retail with OMWC will be to the advantage of the latter and the disadvantage of

³ For Income tax purposes the reported "loss" is greater due to inclusion of depreciation which is a non-cash expense.

the former. Why? Because NOR retail customers will someday be forced to help pay for replacement of OMWC's "deteriorating infrastructure." The facts are quite different.

OMWC has been in existence and operating since 1919. It has provided safe, reliable and inexpensive water service for nearly 100 years without significant disruptions in service. It has successfully transitioned from a dwindling groundwater supply to a more reliable, imported supply. It has participated in financing substantial improvements for the storage, transmission, treatment and distribution of that water supply to approximately 8,000 customers, while maintaining water rates significantly lower than other retail purveyors, including NOR. And, it has done all of this seamlessly – without fanfare and accolade – just ordinary people getting the job done. Along with all of these tasks so well performed, OMWC has not failed to maintain, and replace when necessary, its infrastructure.

OMWC owns, operates and services over 80 miles of water mains. These facilities are constantly monitored for performance issues and service interruptions. Pipeline breaks are infrequent and promptly repaired, usually within hours of the occurrence. When significant deterioration is detected in a given pipeline, it is replaced. In 1978 the Company initiated a major main replacement program. Maintenance records from the past twenty years were reviewed and unreliable water lines were identified and scheduled for replacement. Since that date the Company has replaced approximately 10 miles of pipeline at a cost, in today's dollars, of approximately \$2,500,000. As of today, the Company has replaced 100% of its original redwood mains and approximately 90% of the later-installed cast iron mains. Those few cast iron mains still in service are, for whatever reason, continuing to perform without fault. It should be noted as well that, Company's approach – replacement of lines when and as needed – allowed most of this work to be accomplished by Company personnel at a significantly reduced cost. The infrastructure of OMWC is just as sound as the infrastructure of NOR's retail operation.

F4. The friction between the two entities started soon after NOR took over the retail customers in Highland Park. Because HP was a Special District, the OMWC could not "take over" the customers. [Emphasis in the original].

It is incorrect to state that OMWC could not "take over" the customers of HP. OMWC is not aware of any legal impediment preventing a merger, consolidation or other form of integration between itself and HP.

F6. The OMWC expressed concern in 1981 about the separation of accounting between wholesale and retail operations for NOR. In 1983 OMWC sued NOR. The lawsuit lasted 10 years and resulted in an agreement.

Finding F6 is woefully incomplete. It is true that, at the time NOR merged with HPPUD, great concern was expressed by Oildale that NOR would be unsuccessful in separating its wholesale activities from its retail activities, all to the detriment of Oildale. Following the merger, many disputes arose between Oildale and NOR over NOR's accounting and billing practices, culminating in litigation commenced in 1983. There followed 11 years of litigation involving two trials and one appeal. What the Grand Jury fails to mention is that the litigation between OMWC and NOR resulted in a JUDGMENT essentially agreeing with the Company. Key elements of the Court's final decision include the following:

- "NOR costs" billed to Oildale from 1981 to 1991 did not represent costs reasonably borne in providing wholesale water service to Oildale.
- Oildale had not paid any part of NOR's operation and maintenance charges for approximately 10 years and at trial NOR was demanding payment of past due bills totaling \$4,133,527.43. Of this amount, the Court only allowed it to recover \$568,518.74, or about 13.75% of what had been billed to OMWC.
- NOR sought to recover interest on the unpaid bills (interest on over \$4.0 million for over 10 years) as part of its damages. The Court denied the request saying: "It is not at all surprising that Oildale refused to pay NOR any money until the court determined an amount owing. This is true based on the conflicts in the evidence, NOR's odd accounting practices, and the difficulty in reaching any determination of damages."
- The Court specifically found that, in order to operate and maintain the wholesale facilities, it would take no more than 856 man hours per year. The Court noted that "[t]his is consistent with NOR's own engineer, Ernest Kartinen's, original estimate in 1975 that it would only take one part-time person to operate and maintain these facilities."

In essence, OMWC's claims were vindicated. OMWC knew then, as it knows now, that NOR operations are much more expensive than they need to be. The Court agreed.

Following the JUDGMENT, NOR made changes in its staff (hiring a new manager). Although it threatened to continue the litigation with additional appeals, NOR was properly chastened, the threats were hollow, and it sued for peace. Subsequent discussions resulted in the 1993 Settlement Agreement followed by a "First Amended Water Service Agreement". Key elements of these documents include the following:

- It was recognized that OMWC is better suited to provide retail water service in the NOR service area but that it would take time to transfer existing retail service from NOR to OMWC.
- As to future retail customers: they would be served by OMWC. To accomplish this, the 1993 Agreement fixed and determined a limited retail service area for NOR. All lands outside the designated retail service area of NOR are served, if at all, by Oildale.

- As to existing retail customers of NOR: the parties agreed to use their best efforts in cooperation with one another to meet regularly, at the manager, committee and board level, to discuss and hopefully reach agreement on, among other things, whether to transfer all retail operations to OMWC.

Following up on the 1993 directive to transfer all retail operations to OMWC, NOR and OMWC moved the entire southeast quadrant of Chevron's North Meadows Development from the NOR retail service area to the Company's retail service area by a simple letter agreement executed in 1994. Again, in 1996, NOR and OMWC moved the Airport Industrial Park from the NOR retail service area to the Company's retail service area using a simple agreement entitled "Agreement re Service Area Adjustment 96-1" (which, among other things, included provisions transferring all water facilities and property interests in the subject area from NOR to OMWC). Current discussions regarding the transfer of NOR retail operations to OMWC do not constitute a radical change in attitude or philosophy, but are merely intended to complete the process started in 1993.

F7. The 1993 Agreement contemplated OMWC paying direct costs for water plus a share of the District's costs. The OMWC account is credited with a portion of the property taxes collected by NOR. [Emphasis in the original].

As to the first sentence: it should be noted that, under the 1993 Agreement, OMWC agreed to pay a percentage share of NOR's employee costs. This was a poor decision on OMWC's part. It was believed at the time that NOR's employee costs would be kept to a minimum and that OMWC's share thereof would approximate 80% of the 856 man hours per year which the Court felt was sufficient to operate and maintain the facilities serving OMWC. Over time this has not proven to be the case. Today, NOR employs 3 full time employees for administrative functions and 3 full time employees for field operations at an annual cost in fiscal year 2012 of \$829,189. OMWC pays approximately 40% of these employee expenses or \$331,715 for one year. Although the operation and maintenance of wholesale facilities have not appreciably changed since 1993, OMWC is currently being charged over 5,000 man hours per year for these services. OMWC is convinced that it can perform these same services with its own personnel at substantially less cost. The proposed reorganization currently under consideration will accomplish this goal.

As to the second sentence: OMWC is not certain why the Grand Jury felt it necessary to include and/or emphasize the statement that OMWC is "credited" with a portion of property taxes collected by NOR. If there is a point to be made, it escapes us. The fact is that NOR receives a portion of county-collected property taxes. These taxes are paid by all landowners within the boundaries of NOR (approximately 80% of which are OMWC customers). These tax revenues are expected to be used for the benefit of those landowners. NOR provides that benefit by using the tax revenues to offset its wholesale operating costs. This offset benefits

both NOR retail and OMWC (and their respective customers) by reducing the amount of wholesale operating costs each would otherwise be required to pay.

F9. In 2008 OMWC hired an accountant to audit the billing from NOR. The accountant discovered bookkeeping errors. The former General Manager (GM) of NOR worked with the GM from OMWC to correct the audit findings.

The former GM of NOR did not work with the GM of OMWC to correct the "audit findings"; they worked together to correct the "bookkeeping errors" which were disclosed by the audit findings and which had resulted in overcharges to OMWC of approximately \$250,000 between fiscal 2004 and fiscal 2008. It is important to note that no credit has been issued to OMWC for these (and/or subsequent) overcharges although the "bookkeeping errors" were acknowledged by the former GM some years ago. Ultimately, in order to avoid the accrual of a statute of limitations defense, OMWC was forced to file suit against NOR for reimbursement of the overcharges. That lawsuit was filed in November 2011. Currently these claims (and others), totaling well over \$1.0 million, have been suspended via a tolling agreement pending the outcome of current discussions. It is believed that an appropriate reorganization, one that permanently eliminates the financial friction between the two entities, will eliminate the necessity of resurrecting these currently dormant claims.

F10. In 2011 the former GM of NOR retired. The OMWC approached NOR to discuss increasing the funding credits from NOR.

The former GM of NOR actually retired in 2010, not 2011. At the time OMWC became aware of the intended retirement of the former GM of NOR, OMWC approached NOR to discuss a reorganization, not an increase in funding credits from NOR.

In April 2010, when OMWC's GM (Doug Nunneley) became aware of the possible retirement of NOR's then GM (Bill Miller), the former wrote to the latter saying:

You had mentioned something about studying the possibility of streamlining our two operations or something like that. Not knowing that you were thinking of retiring I didn't want to encroach on your turf. After thinking about it for a while maybe this is the time to take a look at the advantages. It could simplify the financial auditing and our contract changes for sure.

Mr. Miller responded that he did not want to deal with the subject and suggested that Mr. Nunneley take it up with the next manager. Mr. Nunneley replied saying: "I do think we need to get together to see what would make good sense for our area." Mr. Nunneley expressed the view that, since both entities are going to lose several key people soon, this could be the only chance for a major change without affecting existing personnel.

Although Mr. Miller did not wish to pursue the subject of streamlining operations, the Board of Directors of OMWC did. Accordingly, on May 14, 2010, a letter was sent from OMWC to NOR – Board to Board – pointing out that the 1993 Agreement (and subsequent amendments) require each entity to seek ways to minimize costs to their respective customers, which should include the possibility of reorganizing for greater efficiency. OMWC urged action saying:

We understand that the District's General Manager is retiring at the end of this year. Such retirement, along with personnel changes anticipated in the Company, provides all of us a unique opportunity to explore the benefits and savings that may be available if certain functions and operations of our respective entities are combined. For example, this may be an advantageous time to transfer all retail operations within the District to the Company. We believe such action could be accomplished without job loss and/or significant detriment to existing District and/or Company employees and, properly structured to avoid duplication, could result in a cost savings of as much as \$500,000 per year. Of course, we need to discuss these options with you before any commitment is made with respect to Mr. Miller's replacement. [Emphasis in original].

Unfortunately, this message was not well received. In subsequent correspondence NOR accused Oildale of trying to engineer a "back-door, takeover attempt" and OMWC was thereafter largely unsuccessful in getting the NOR board to even consider a reorganization proposal.

F11. It was reported to the Grand Jury some OMWC Directors do not pay "hook-up" fees for homes built in Oildale. Hook-up fees on the OMWC website for single homes are \$3,000 and \$1,750 for multiple residences.

This may be the single, most disturbing Finding in the entire Grand Jury Report. It was bad enough that the Grand Jury wrongly accused the staff and directors of OMWC of mismanagement based on anonymous and unattributed "reports"; now it goes so far as to accuse them of what amounts to criminal misconduct (*e.g.*, theft, fraud, embezzlement, or the like). The finding is totally, absolutely and completely false.

OMWC believes that the "reported" accusation is tantamount to libel⁴ or slander⁵. The Grand Jury conveniently attempts to shield itself from liability by attributing the accusation to

⁴ Libel is a false and unprivileged publication by writing, printing, picture, effigy, or other fixed representation to the eye, which exposes any person to hatred, contempt, ridicule, or obloquy, or which causes him to be shunned or avoided, or which has a tendency to injure him in his occupation. [California Civil Code §45; emphasis added].

some unnamed third party. Upon receipt of the Grand Jury Report, OMWC representatives immediately contacted the Grand Jury and demanded that the source of the accusation be named. The Grand Jury representatives declined to identify the source but claimed that the information had been obtained through "interviews". Assuming that this information was provided to the Grand Jury under oath, the person providing the same may be guilty of perjury.⁶ Accordingly, OMWC demands that the Grand Jury either identify the source of the accusation (so that the person or persons may be named in a civil suit for libel and/or slander), or cause the District Attorney's office to investigate the source for possible charges of perjury, or both. In addition, OMWC demands that the Grand Jury immediately issue a full retraction of the untrue accusations.⁷

In support of this demand, we provide the following information: OMWC is governed by a five member board of directors. The current directors are Bill Purkiser, Lonny Boller, Fred Hupp, Don Wattenbarger and Hugh Pearson.

- Bill Purkiser is the newest member of the OMWC board of directors, having served since 2002. Mr. Purkiser is a Navy veteran and also served 27 years with the Kern County Fire Department, rising to the level of Captain. Mr. Purkiser has been fully retired for the last 8 years. The only real property Mr. Purkiser owns in the Company's service area is his home. He has lived in that home since 1967, and was residing in that home at the time he became a director of OMWC. In the 11 years that he has been on the board of OMWC, Mr. Purkiser has never requested nor received relief from any hook-up or other fees normally charged by the Company.
- Lonny Boller joined the OMWC board of directors in 1998. Mr. Boller has been an Oildale resident for 68 of his 70 years. Mr. Boller owned and operated a successful oil well service contracting business for 25 years and has been retired since 1992. The only real property Mr. Boller owns in the Company's service area is his home. He has lived in that home since 1974, and was residing in that home at the time he became a director of OMWC. In the 15 years that he has been on the board of OMWC, Mr. Boller has never requested nor received relief from any hook-up or other fees normally charged by the Company.

⁵ Slander is a false and unprivileged publication, orally uttered, and also communications by radio or any mechanical or other means which: (1) charges any person with a crime....; (3) tends directly to injure him in respect to his office, profession, trade or business....; or (5) which, by natural consequence, causes actual damage. [California Civil Code §46; emphasis added].

⁶ We understand that individuals normally testify before the Grand Jury under oath and assume that such practice was followed in this instance. If that practice was not followed, and these heinous accusations were repeated without the support of sworn testimony, we would be incredulous.

⁷ In an editorial published in the *Bakersfield Californian* on July 14, 2013, Lois Henry suggests that the newly constituted Grand Jury needs to revoke the subject report and either redo it properly or can it entirely. Since the Grand Jury lacks jurisdiction in the first instance, a "redo" is not proper. Canning the report is certainly warranted, but such action must be accompanied by a full retraction of F11.

- Fred Hupp has served on the OMWC board since 1968. He has been an Oildale resident for 63 years. Mr. Hupp is a retired public accountant and former insurance sales representative. The only real property Mr. Hupp owns in the Company's service area is his home. He has lived in that home since 1951, and was residing in that home at the time he became a director of OMWC. In the 45 years that he has been on the board of OMWC, Mr. Hupp has never requested nor received relief from any hook-up or other fees normally charged by the Company.
- Don Wattenbarger joined the OMWC board in 1969. Although Mr. Wattenbarger has been active in the building industry since he was a teenager, he has not built in the Oildale service area for approximately 40 years. The only real property Mr. Wattenbarger currently owns in the Oildale service area are commercial properties. In the 44 years that he has been on the board of OMWC, Mr. Wattenbarger has never requested nor received relief from any hook-up or other fees normally charged by the Company.
- Hugh Pearson has served on the OMWC board for approximately 25 years and also served on the NOR board for 8 years. Mr. Pearson was a home builder for approximately 20 years but retired from that business in 1999. Mr. Pearson built many homes in both NOR retail and the Company's service area. The only real property Mr. Pearson currently owns in the Oildale service area is commercial properties. In the 25 years that he has been on the board of OMWC, Mr. Pearson has never requested nor received relief from any hook-up or other fees normally charged by the Company.

The information provided above was and is readily available to the Grand Jury – a simple phone call would have sufficed. Why would the Grand Jury intentionally choose not to avail itself of this information? We can only infer that the Grand Jury was not the least bit interested in the truth or falsity of the accusation; it was only interested in using the same to harass and embarrass the staff and directors of OMWC.

The directors of OMWC have served the Company for a combined period of 140 years. They are devoted, conscientious and capable individuals. They tenaciously guard the interests of the Company and its stockholders. But they are also members of the Oildale community and only seek what is best for the entire area. These individuals serve selflessly. They do not ask or expect a pat on the back; neither do they expect or deserve a slap in the face.

F12. In 2011 three of the five Directors of NOR were accused in The Bakersfield Californian newspaper of improper conduct (misuse of funds such as unnecessary trips out of the country), although the trips were authorized by the

Board of Directors of NOR. The three Directors were voted out of office in 2012.

As to the first sentence: OMWC has been unable to locate a 2011 article published in *The Bakersfield Californian* which accuses three of the five Directors of NOR of "improper conduct". OMWC has found an article published June 17, 2012 which mentions that three of five NOR directors are up for re-election. The article does not name the directors and does not accuse them of "improper conduct". On the subject of travel, the article includes the following:

The district spent more than \$31,000 on travel for employees and board members in 2008. They spent that much again in 2010. Most years the amount hovered around \$15,000 a year. In the last two years the district has cut back on travel, relatively speaking. But if I paid property taxes in Oildale, which is one of the district's main funding sources, I'd still question the nearly \$10,000 spent on employee and board member travel this past year. **I can't think of any justification for a district with six (6!) employees to spend that kind of taxpayer money on travel every year.**

We find nothing in this statement that accuses any NOR director of "improper conduct"; we find much in this statement that demonstrates the propensity of all incumbent NOR directors toward unnecessary, unwarranted, and excessive spending. It is for this very reason that OMWC felt the need to support opposition candidates.

As to the second sentence: it is not accurate to state that "the three directors" were voted out of office in 2012. In actuality, only two of the incumbents ran for re-election and both were defeated. A third incumbent did not choose to run and that seat was contested by two new candidates.

F13. The OMWC supported (in the amount of \$45,000) three candidates for the NOR Board of Directors. The three candidates were elected in November 2012. The new NOR Directors represent a quorum on the NOR Board.

OMWC did support three candidates for election to the NOR Board of Directors. As disclosed by campaign statement filings, the amount contributed by OMWC in support of said candidates was \$15,535, rather than the alleged \$45,000. Although OMWC was the largest contributor, it was not the only contributor.

The fact that OMWC felt the need to replace incumbent directors was well known and widely publicized.⁸ For example, OMWC published an article in its July 2012 newsletter entitled

⁸ OMWC was up-front with the voters at all times. Unlike OMWC, supporters of other candidates (including the two incumbent directors running for re-election) attempted to hide their contributions behind an LA-based political action

"Why Oildale Mutual will support New Candidates for election to the NOR Municipal Water District Board of Directors". This article includes the following explanation:

As most of our customers know, your Board of Directors has been fighting a culture of rampant over-spending, over-charging and under-reporting by our water wholesaler, North of the River Municipal Water District.

NORMWD, a taxpayer financed public agency, primarily exists to buy treated water from the Kern County Water Agency and resell it to others, like Oildale Mutual Water Company. Those efforts come with charges that are supposed to be directly related to the costs of providing water for our customers. However, unlike Oildale Mutual, North of the River Municipal Water District does not operate in a cost-conscious, fiscally responsible manner. They spend extravagantly and simply pass the cost on to our customers.

When confronted with these questionable practices, NORMWD initially agreed to make some adjustments to past billings. However, the District has since changed its position and refused to acknowledge and/or negotiate any over-charges to Oildale Mutual. This forced our company to pursue litigation in order to protect our customers' rights.

Ultimately we believe the problem lies with the elected members of the North of the River Municipal Water District Board of Directors. These individuals have utterly failed to run a fiscally responsible public agency accountable to the taxpayers. Unfortunately, they are more interested in defending their past practices than they are in correcting them.

Based on the foregoing, the OMWC article concludes:

...we hope that you will join our board in supporting individuals who will show leadership, integrity and accountability to the taxpaying public.

The public responded by electing the Company's preferred candidates by overwhelming margins (approximately 2-to-1).

F15. If the three new NOR Directors were to approve an agreement, based on receipt of campaign contributions by OMWC, the possibility of a Government Code §1090 violation could exist.

Precision does not appear to be the watchword of the Grand Jury Report. First of all, the Finding states that the new NOR Directors could violate §1090 if they approve "an agreement" (i.e., any agreement of any kind). We assume that the Grand Jury did not intend to go so far and, instead, is referring to an agreement involving the transfer of NOR retail operations and facilities to OMWC. In the second place, the possible §1090 conflict is said to exist based on "receipt of campaign contributions by OMWC". We assume what is meant is receipt of campaign contributions by the candidates from OMWC. In the third place, the Finding only suggests the "possibility" of a violation that "could" exist. Not very helpful or definitive.

California Government Code § 1090 provides in pertinent part as follows:

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. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity.

OMWC is not aware of any basis for applying § 1090 in the instant circumstances. OMWC is not aware of any financial interest, different from the public generally, which any one or more of the new directors might have in the proposed reorganization. Neither did OMWC obtain a promise or commitment from any one or more of the candidates to vote a certain way on any issue coming before the NOR board in exchange for the Company's support. All the Company sought in supporting the newly elected directors, and all that the Company expects from them, is a fresh, unbiased look at issues involving the two entities, including the reorganization proposal.

Notwithstanding the foregoing, in a meeting of the NOR Board of Directors, a member of the public raised the specter of § 1090 in light of the campaign contributions. In response to that concern, OMWC and NOR jointly commissioned the independent law firm of Klein-DeNatale-Goldner to examine the issue (along with other issues). Admittedly, the Klein law firm did not conduct an investigation of all the facts. However, based on a review of the law and what information was readily available, they concluded that § 1090 would not apply. Now that the Grand Jury has weighed in on the issue, albeit without conviction, OMWC and NOR have asked the Klein law firm to conduct a thorough investigation of the facts and provide a more definitive opinion on the subject. This investigation was conducted during preparation of this response and a report was issued which concludes that there is absolutely no evidence of any kind to support the existence of a § 1090 violation. The report further concludes that the newly elected board members are free to consider and/or implement the proposed reorganization without fear of violating that section. We trust that this issue may now be put to rest once and for all.

F16. The GM of OMWC is the son of one of the new NOR Directors.

The GM of OMWC is Doug Nunneley. Mr. Nunneley's only father (he has no step-father) died approximately 5 years ago and, therefore, is not currently serving on the Board of Directors of NOR.⁹

4. Disputed Comments:

Immediately following the Findings, the Grand Jury inserts various "Comments". We address the more egregious as follows:

1. "Before the 2012 election the NOR was a well run and established company." We see no evidence to support this bare conclusion.

2. "Much of the OMWC infrastructure is in disrepair and upgrades are needed." We see no evidence to support this bare conclusion. The facts are to the contrary as shown in the response to F3 above.

3. "The OMWC has had revenue losses in the last three years of \$1.5 million dollars as shown in past tax records thus OMWC will likely have another year of negative revenue in 2012-2013." This statement is false as shown in response to F2 above. Further, the recently completed independent audit for fiscal year 2012-2013 does not reflect "another year of negative revenue" – what it does reflect is net positive revenue for said fiscal year of \$984, 939 (including depreciation which is a non-cash expense) or \$1,150,092 (excluding depreciation).

4. "A Community Services District formed by the merging of the retail and wholesale business of the two entities may better serve the community." See response to recommendations, *infra*.

5. "The infrastructure in the OMWC area could then be upgraded to the standards already in place at NOR." Upgrades are not necessary as shown in the response to F3 above. In addition, the suggestion that the formation of a Community Services District will somehow aid in the upgrade process is nonsensical. Finally, if the goal is to protect NOR retail customers from having to contribute to such upgrade, dragging all parties into a Community Services District and then performing the upgrade is counter-productive.

5. Response to Recommendations:

⁹ One of the newly elected directors of NOR, Dennis Meier, has an adult son who is an employee of OMWC (albeit not the GM). Such fact does not create a prohibited conflict and we see no reason why it would be considered relevant to the Grand Jury Report.

Since the Grand Jury lacks jurisdiction to issue its Report in the first instance, no response is required with respect to any of its recommendations. However, assuming for the moment that the Grand Jury did have jurisdiction to review the proposed reorganization, OMWC understands that it would be the duty of NOR to respond with particularity to each of the recommendations contained in the Grand Jury Report. [California Penal Code § 933(c)]. In this regard, California Penal Code § 933.05 states that, as to each grand jury finding, the responding entity shall state whether it agrees with the finding in whole or in part and the reasons therefor. In addition, the responding entity shall report one of the following actions as to each recommendation: (i) the recommendation has been implemented, with a summary regarding the implemented action; (ii) the recommendation has not yet been implemented, but will be implemented in the future, with a timeframe for implementation; (iii) the recommendation requires further analysis, with an explanation and the scope and parameters of such further analysis and a timeframe for the matter to be prepared for discussion by the governing body of the public agency, which timeframe shall not exceed six months from the date of publication of the grand jury report; or (iv) the recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor. In accordance with this directive, again assuming jurisdiction over the subject matter, OMWC proposes the following response to each recommendation:

R1. The Grand Jury suggests NOR and OMWC have forensic audits performed.

The Grand Jury has no jurisdiction over OMWC and cannot require anything of it, including a forensic audit. On the other hand, in the absence of a successful reorganization, the Company would welcome a forensic audit of NOR.

Notwithstanding the foregoing, it should be noted that annual audits of both OMWC and NOR are performed in the ordinary course of business. And, in connection with the reorganization effort, it was recognized early on that the financial condition of each entity (especially OMWC) would need to be examined.¹⁰ Accordingly, NOR and OMWC have already authorized the retention of the accounting firm, Brown Armstrong, to conduct such review. The assignment given to Brown Armstrong is the following:

The first phase will be a determination of the financial impact of the proposed integration on the Company and the District. Specifically, [Brown Armstrong] will provide a presentation of the financial statements of the Company and the District immediately prior to implementation of the proposed integration, the financial adjustments to those financial statements pursuant to

¹⁰ As early as December 7, 2012, in a meeting between OMWC and NOR, chaired by Kern Citizens for Sustainable Government as mediator, there was discussion that the financial condition of each entity should be examined by an independent auditor.

the proposed integration, and the financial statements immediately following the implementation of the proposed integration....

The second phase will be a projection of the balance sheet, statement of income, and summaries of significant assumptions and accounting policies of the Company and the District covering a five year period commencing with the effective date as the proposed integration. This projection might commonly be referred to as a cost-benefit analysis....

The parties have authorized up to \$50,000 for this work and expect the work to be completed (both Phase 1 and Phase 2) within the next few weeks. Quite honestly, OMWC does not know what constitutes a "forensic audit". However, with respect to the financial condition of each entity, it is believed that the assignment given to Brown Armstrong should suffice. In essence, this recommendation has already been implemented.

R2. *The NOR and OMWC should be consolidated to form a new Community Services District, including a new set of by-laws, to better serve the needs of the communities of Oildale and Highland Park.*

The Grand Jury has no jurisdiction over OMWC and cannot require it to assist in the formation of a new CSD and/or merge with such entity once formed. Besides, this suggestion has already been considered by OMWC and rejected.

The suggestion to form a new Community Services District (CSD) in lieu of pursuing a reorganization was first proposed by the current GM of NOR (David Aranda) in an undated memo a copy of which is attached hereto as Exhibit "B". The concept is entitled "DAVIDS IDEA"; calls for the creation of a new CSD with broad powers; calls for the new district to absorb not only OMWC and NOR but also North of the River Sanitation District and North Bakersfield Recreation and Parks District; and calls for the addition of new powers such as code enforcement, solid waste management, graffiti removal and public safety (i.e., police and fire protection). The memo unrealistically projects formation of the CSD by 2015 and full transition (i.e., mergers and consolidations) by 2016; etc. This memo was considered in meetings between OMWC and NOR representatives which were mediated by Kern Citizens for Sustainable Government. During the course of these meetings it became readily apparent to all (with the possible exception of the author), that formation of a new CSD did nothing to address the issues dividing OMWC and NOR and actually created more problems than it could ever hope to resolve. The proposal was rejected then, and it must be rejected now.¹¹

¹¹ We understand that, at its regular board meeting held July 17, 2013, the NOR board voted unanimously to reject this recommendation and to include such rejection in its response to the Grand Jury report.

In the parlance of California Penal Code § 933.05: OMWC suggests that recommendation R2 not be implemented because it is neither warranted nor reasonable. We support this conclusion with the following facts:

- Creation of a new CSD as described will require the cooperation of several entities including the North of the River Sanitation District and North Bakersfield Recreation and Parks District. OMWC is informed and believes that such cooperation will not be forthcoming.
- Merger of OMWC into the CSD cannot be accomplished without the consent of a majority of the shareholders of the Company. OMWC is informed and believes that such consent will be impossible to obtain.
- It is important to retain OMWC as the entity providing retail water service in the Oildale area. The Company is a private entity and, as such, is not burdened by government regulations which increase operating costs (i.e., prevailing wages, bidding requirements, Proposition 218, CEQA, etc.). As is generally true when comparing public sector performance to private sector performance, OMWC can and does operate more efficiently and at less expense than NOR. In the final analysis, the CSD is just another public agency, no different from NOR, and there is no reason to believe that it can operate as efficiently as OMWC.
- It is important to retain NOR for the performance of its duties and functions as a wholesale water service provider to the area. As a public agency NOR provides access to tax revenue, public financing, LAIF investment opportunities, County Treasury investment opportunities, and the like. Further, it can exercise the power of eminent domain without the necessity of outside approval. Lastly, public entities seem to carry more weight in the water community when it comes to inter-agency activities, such as transfers, exchanges, etc. If NOR is retained as a viable entity, formation of the CSD is superfluous.
- The purpose of the proposed integration of operations is to eliminate friction between NOR and OMWC by putting all retail operations in OMWC and all wholesale operations in NOR. Transferring all operations (wholesale and retail) to a new CSD perpetuates rather than eliminates the internal strife between the two retail service areas.
- Substantial savings are available to NOR retail customers and OMWC customers through the proposed reorganization. These savings have been estimated at anywhere from \$500,000 per year (NOR estimate) to \$1,000,000 per year (OMWC estimate). The reorganization can be accomplished at very little cost, in a matter of days (or weeks at the most), and the savings will begin to accrue immediately upon completion. By way of

contrast, formation of a CSD will be very expensive, will take years to accomplish (if it is accomplished at all), and millions of dollars in potential savings will be lost in the interim.

- The water service needs of the communities of Oildale and Highland Park will not be better served by the formation of a CSD; they will be better served by implementation of the reorganization proposal currently under consideration without further delay.

R3. To alleviate loss of employment from the previous entities, staffing for the new Community Services District should be combined whenever possible.

Since OMWC does not support the implementation of R2, neither will it support the implementation of R3. However, it should be recognized that the Company has every intention of minimizing loss of employment resulting from the proposed reorganization. It will be recalled that the Company first broached the subject of the reorganization at a time when it was thought that loss of employment could be minimized. As noted in the Company's letter to NOR of May 14, 2010 the proposed retirement of Mr. Miller, along with other changes in Company personnel, provided a "unique opportunity" to combine operations "...without job loss and/or significant detriment to existing District and/or Company employees." Unfortunately, that may no longer be the case.

Be that as it may, OMWC and NOR do not intend to ignore employment issues that may result from the proposed reorganization. In fact, both entities have jointly authorized the retention of the BeldenBlaine Law Group to examine the potential human resource (HR) consequences of the proposal.

It should also be noted that at least 2 of the 6 NOR employees will be amply protected whatever we do. On or about March 21, 2012 the current GM (David Aranda) and the current office manager (Linda Cook) were given written employment contracts extending through December 31, 2016. Under the terms of these contracts, if the employee is terminated other than for cause prior to December 31, 2016, the employee will continue to receive full salary and benefits for an additional eighteen (18) months.

6. Conclusion:

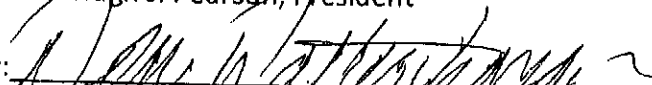
Needless to say, OMWC is extremely disappointed with the one-sided, poorly researched, inaccurate and totally biased report issued by the Grand Jury on a matter over which it has no jurisdiction in the first instance. We are particularly upset that no attempt was made to investigate or verify, at the source, the malicious and slanderous accusations hurled at OMWC by nameless detractors. It is obvious to us that one or more persons, antagonistic to the proposed reorganization being discussed among OMWC and NOR, hijacked the Grand Jury process in order to advance their own personal, political agenda. In our opinion this is a clear

abuse of authority which severely damages the credibility of the Grand Jury.¹² We request and expect the Kern County Superior Court to take appropriate, corrective action.

Very truly yours,

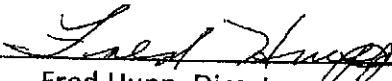
OILDALE MUTUAL WATER COMPANY

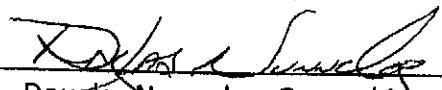
By: 
Hugh J. Pearson, President

By: 
Don Wattenbarger, Director

By: 
Lonny Boller, Director

By: 
Bill Purkiser, Director

By: 
Fred Hupp, Director

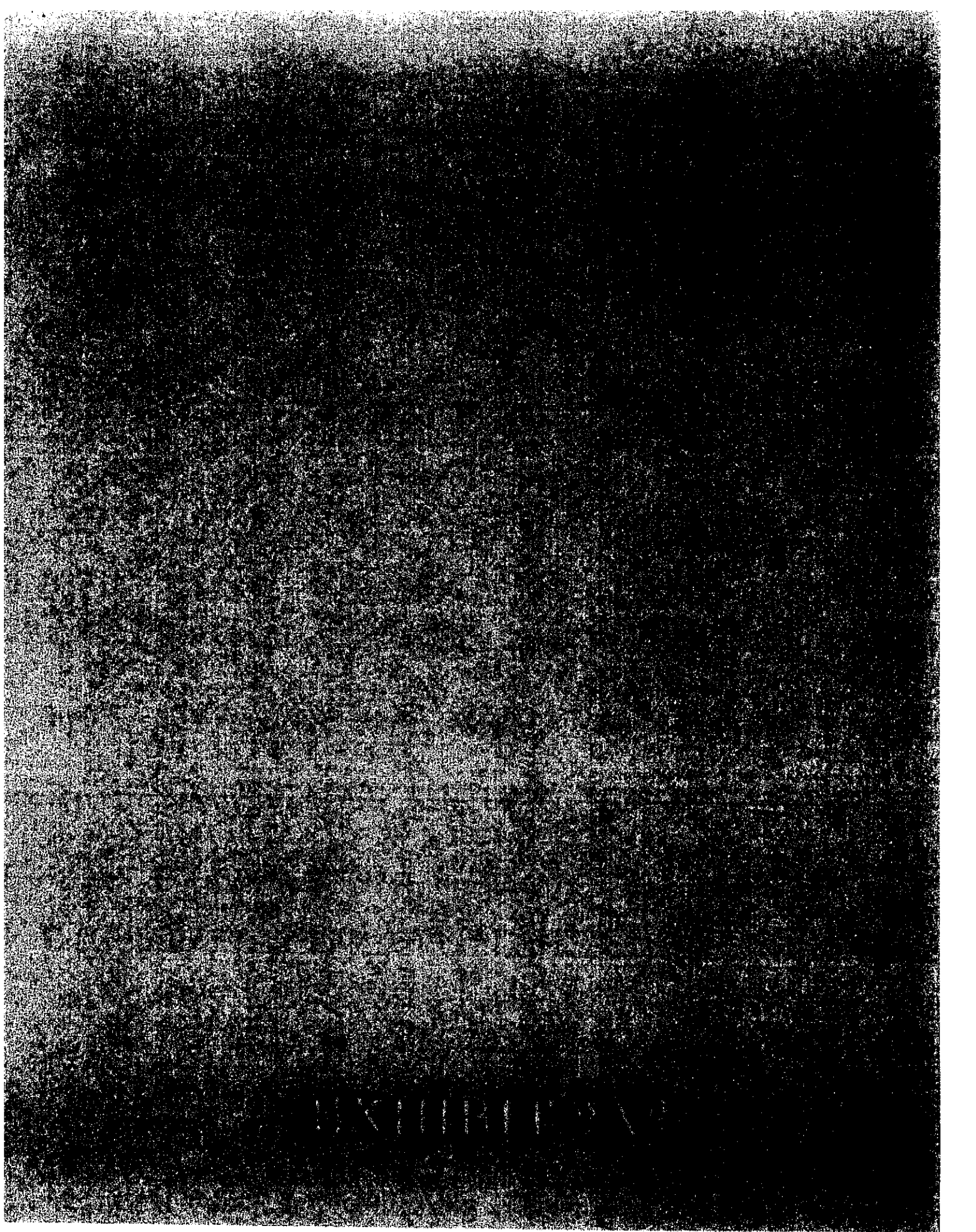
By: 
Douglas Nunneley, General Manager

cc: FOREMAN, KERN COUNTY GRAND JURY
1415 Truxtun Avenue, Suite 600
Bakersfield, California 93301

McMURTREY, HARTSOCK & WORTH
2001 22nd Street, Suite 100
Bakersfield, California 93301

Board of Directors
NORTH OF THE RIVER MUNICIPAL WATER DISTRICT
4000 Rio Del Norte Street
Bakersfield, California 93308

¹² California Penal Code § 939.9 states in part: "A grand jury shall make no report, declaration, or recommendation on any matter except on the basis of its own investigation of the matter made by such grand jury". Here It is apparent that the Grand Jury failed to carry out its duty.

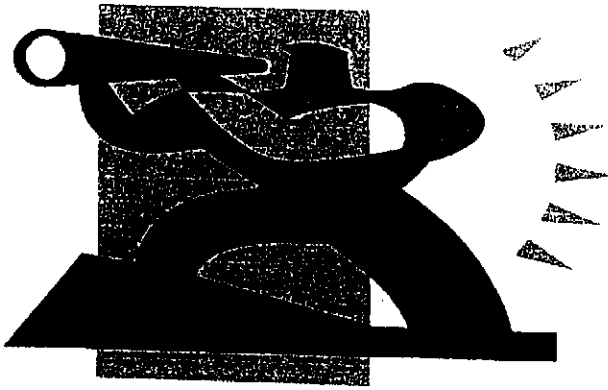


OILDALE MUTUAL WATER COMPANY CASH FLOW

	FISCAL YEARS ENDING										Estimated 6/30 2013	TOTALS
	6/30 2005	6/30 2006	6/30 2007	6/30 2008	6/30 2009	6/30 2010	6/30 2011	6/30 2012				
CASH RESERVES	\$4,880,985	\$5,971,321	\$6,179,512	\$6,206,498	\$5,289,388	\$4,701,384	\$4,282,328	\$5,207,256			\$6,200,000	
TOTAL REVENUES	\$3,223,639	\$3,463,664	\$3,758,960	\$4,190,304	\$4,616,647	\$4,838,042	\$4,675,818	\$5,383,313			\$6,800,000	
KCWA COSTS	\$1,203,075	\$1,086,545	\$1,288,642	\$1,177,843	\$1,270,264	\$1,352,195	\$1,335,979	\$1,583,263			\$1,650,000	
BOND PAYMENTS ACTUAL	\$0	\$0	\$184,797	\$48,827	\$1,806,919	\$1,617,016	\$1,612,426	\$892,732			\$1,567,239	
\$ PMT. NOR O&M TUNNEL & PUMPS	\$416,788	\$478,756	\$398,225	\$256,963	\$232,727	\$270,000	\$870,826	\$588,338			per budget \$630,000	
CASH FLOW	\$611,079	\$869,882	\$347,509	\$434,671	(\$334,670)	(\$197,428)	(\$618,677)	\$523,811			\$950,000	\$2,586,177
			Cash Flow 2005-2008			Cash Flow 2009-2011		Cash Flow 2012-2013			\$1,473,811	
			\$2,263,141			(\$1,150,775)						
NET INCOME ANALYSIS												
DEPRECIATION	\$178,961	\$188,912	\$209,472	\$208,353	\$225,495	\$225,123	\$200,060	\$186,192			\$185,000	
NET INCOME	\$432,118	\$680,970	\$138,037	\$226,318	(\$560,165)	(\$422,551)	(\$818,737)	\$337,619			\$765,000	\$778,609
			Net Income 2005-2008			Net Income 2009-2011		Net Income 2012-2013			\$1,102,619	
			\$1,477,443			(\$1,801,453)						

* = rate increase in January of fiscal year

EXHIBIT



VISION FOR THE FUTURE OF OILDALE

INITIAL THOUGHTS:

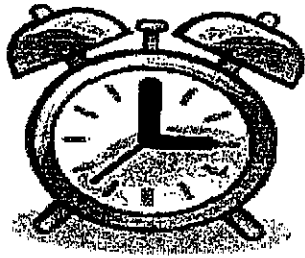
- LEADERS AND VISION..... "BOARDS THAT MAKE A DIFFERENCE"
 1. LOOK OUTSIDE THE BOX FOR THE GOOD OF THE PEOPLE FIFTY YEARS FROM NOW.
 2. OBTAIN OUTSIDE CONSULTANT WITH DIFFERENT IDEAS
- DAVIDS IDEA:

"OILDALE COMMUNITY SERVICES DISTRICT"



- NEW BOUNDARY
- NEW GOVERNING BODY
- ONE ENTITY SERVING OILDALE
- ABILITY TO PROVIDE VARIOUS SERVICES AT EFFICIENT AND EFFECTIVE COSTS, I.E. MERGE SANITATION SERVICES, PARK SERVICES, ADD CODE ENFORCEMENT, SOLID WASTE, GRAFFETTI REMOVAL AND PUBLIC SAFETY.

- REDUCE CAPITAL NEEDS/PURCHASES
- NEW PENSION PLAN
- NEW HEALTH PLAN
- RETAIN TAX MONEY
- MORE OPTIONS TO OBTAIN GRANT MONEY.
- INITIAL SAVINGS OF \$500,000 TO \$600,000 ANNUALLY IN OPERATIONAL COSTS
- FUTURE SAVINGS OF ADDITIONAL \$200,000 PER YEAR



TIMING

ESTABLISH THE CSD IN.....

2015 WITH IT BEING FULLY TRANSITIONED BY 2016.

WHY?

1. THIS WILL ALLOW THE TIME NEEDED TO FORM THE CSD AND THE GOVERNING BODY.
2. ALLOW NATURAL PROCESS OF EMPLOYEE REDUCTION VIA RETIREMENT AND RESIGNATION
3. MINIMIZE LAWSUITES
4. ALLOW CAPITAL PROJECTS TO BE COMPLETED
5. FOR FISCAL YEARS 2014 AND 2015 NO NEW HIRES AND COST RECOVERY IS STOPPED.

JANUARY, 2013 JULY, 2013 JANUARY, 2014 JULY, 2014 JANUARY, 2015 JULY, 2015 JANUARY, 2016

FORMATION OF A CSD

TRANSITION NOR & OMWC TO CSD

Minimum \$500,000 per year annual reduction operating costs and retention of all property taxes

GRANT METERING PROJECT

TANK 900 COATING

TANK 750 COATING

FREEZE NEW HIRING ->

FREEZE COSTS RECOVERY ->

REALIZE RETIREES REDUCING LABOR

NETITS C.S.D. - NEW GOVERNIN
RESTRUCTURE PAY BENEFITS - FUTURE CONSOLIDATION & POWERS BENEFIT OILDALE

ATTACHMENT - B

1 HIGHLAND PARK PUBLIC UTILITY DISTRICT into the NORTH OF THE RIVER MUNICIPAL
2 WATER DISTRICT, and

3 WHEREAS, the feasibility studies indicate the best interests, con-
4 venience and public welfare would be better served by such reorganization, and

5 WHEREAS, the boundaries of the HIGHLAND PARK PUBLIC UTILITY DISTRICT
6 lie within the boundaries of the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT,
7 and

8 WHEREAS, Government Code Section 56261.1 provides;

9 " If the legislative bodies by unanimous vote of all the
10 members thereof, of two or more districts adopt
11 substantially similar resolutions of applications making
12 proposals either for the consolidation of all such districts
13 or for the reorganization of all or part of such district
into a single district the Commission may authorize the
Board of Supervisors to order the consolidation or reorgani-
zation (1) without notice and hearing by the Board of
Supervisors, (2) without election or (3) both."

14 and

15 WHEREAS, Government Code Section 56470, together with Water Code
16 Section 71599 provides for the terms and conditions which may be authorized
17 for the reorganization. A copy of the proposed Terms and Conditions are
18 attached hereto as Exhibit "C" and made a part hereof by reference, and

19 WHEREAS, both districts have the powers to acquire or dispose of
20 property, and

21 WHEREAS, growth within the area is progressing which requires the
22 installation and distribution of additional retail water facilities, and

23 WHEREAS, the proposed reorganization should be known as "Reorgani-
24 zation No. 1." the legal description of which, together with a map or plat
25 thereof is attached hereto, marked Exhibit "A" & "B" and made a part hereof by
26 reference.

27 NOW, THEREFORE, it is determined, ordered and resolved as follows:

28 SECTION 1. The foregoing recitals are true and correct.

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SECTION 2. That proceedings be initiated in accordance with District Reorganization Act of 1965 for the reorganization and consolidation of the HIGHLAND PARK PUBLIC UTILITY DISTRICT with the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT.

SECTION 3. That the President and Secretary of the Board be authorized and instructed to file or cause to be filed with the Local Agency Formation Commission any and all applications, documents and papers required to implement the procedures required by the District Reorganization Act of 1965 and other applicable laws and statutes.

SECTION 4. That said proposed reorganization be known as REORGANIZATION NO. 1.

ADOPTED, SIGNED AND APPROVED this 26th day of November, 1980.

ATTEST:

Ralph L. Gifford
Secretary, Board of Directors

Ann Cross
President, Board of Directors

I, RALPH L. GIFFORD, Secretary of the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT, Bakersfield, Kern County, California, do hereby certify that the foregoing resolution was duly adopted at a regular meeting of the Board of Directors of the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT held on the 26th day of November, 1980 by the following vote, to wit:

AYES: Directors Cross, Massey, Scoles & Smith
NOES: Directors None
ABSENT: Directors None

Ralph L. Gifford
Secretary - Board of Directors

"e"
EXHIBIT "A"

TERMS AND CONDITIONS OF THE REORGANIZATION OF THE
NORTH OF THE RIVER MUNICIPAL WATER DISTRICT AND THE
HIGHLAND PARK PUBLIC UTILITY DISTRICT INTO A SINGLE
DISTRICT

(Government Code Section 56470)

1. All funds derived from the operation or the sale of assets of the HIGHLAND PARK PUBLIC UTILITY DISTRICT water system and facilities shall be separately accounted for and used exclusively for the purposes of expenses of maintenance, operation and betterments within the Improvement District hereinafter referred to. No funds, including any sales of assets, derived from the operation of the HIGHLAND PARK PUBLIC UTILITY DISTRICT system and facilities shall be used for any other such purpose until all debt, if any, of the HIGHLAND PARK PUBLIC UTILITY DISTRICT has been paid in full.

2. NORTH OF THE RIVER MUNICIPAL WATER DISTRICT shall succeed to and own all personal and real property, including property rights-of-way, and any other assets of the HIGHLAND PARK PUBLIC UTILITY DISTRICT. NORTH OF THE RIVER MUNICIPAL WATER DISTRICT shall succeed to all liabilities and obligations, contingent or otherwise, of the HIGHLAND PARK PUBLIC UTILITY DISTRICT, including those existing at the time the reorganization is effective.

3. All present employees of the HIGHLAND PARK PUBLIC UTILITY DISTRICT shall be retained as employees of the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT. Continuation of said employment shall be contingent upon the merits of the individual employee. Retirement rights are currently with a private plan and will be retained or terminated for a more favorable plan or inclusion in the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT's deferred compensation plan, with the concurrence of the employees of the HIGHLAND PARK PUBLIC UTILITY DISTRICT. Seniority rights and other employee benefits and rights shall be preserved insofar as is reasonably possible. HIGHLAND PARK

1 PUBLIC UTILITY DISTRICT shall compensate the employees for any loss of
2 accrued sick-time. In all other respects, the employees shall be integrated
3 into the NORTH OF THE RIVER MUNICIPAL WATER DISTRICT employment with like
4 rights, benefits and policies as other NORTH OF THE RIVER MUNICIPAL WATER
5 DISTRICT employees.

6
7 4. Concurrently with the filing of the Application for Reorganiza-
8 tion with the Local Agency Formation Commission, NORTH OF THE RIVER MUNICIPAL
9 WATER DISTRICT shall institute proceeding to form an Improvement District, to
10 be known as NORTH OF THE RIVER MUNICIPAL WATER DISTRICT IMPROVEMENT DISTRICT
11 A, pursuant to California Water Code Sections 72000 et seq. The boundaries
12 of the Improvement District shall be the same as the existing boundaries of
13 the HIGHLAND PARK PUBLIC UTILITY DISTRICT.

14 5. HIGHLAND PARK PUBLIC UTILITY DISTRICT shall assign, transfer
15 and set over to the Improvement District all its right, title and interest in
16 and to its tax base, tax increments, augmentation funds and any other benefits
17 accruing to HIGHLAND PARK PUBLIC UTILITY DISTRICT.

18 6. The boundaries of the Improvement District and all reports
19 required by County and State governmental agencies shall be filed with such
20 agencies.

21 7. The Board of Directors of NORTH OF THE RIVER MUNICIPAL WATER
22 DISTRICT shall be the governing board of the Improvement District.

23 8. Upon completion of reorganization HIGHLAND PARK PUBLIC
24 UTILITY DISTRICT shall be extinguished, dissolved and cease to exist, and
25 exercise no corporate powers except to wind up its affairs.

26 9. The reorganization shall be complete from the date of
27 execution of the certificate of completion of proceedings.

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We, the undersigned members of the Board of Directors of the
HIGHLAND PARK PUBLIC UTILITY DISTRICT and the NORTH OF THE RIVER MUNICIPAL
WATER DISTRICT do hereby mutually approve and adopt the foregoing terms and
conditions for reorganization of the NORTH OF THE RIVER MUNICIPAL WATER
DISTRICT and the HIGHLAND PARK PUBLIC UTILITY DISTRICT into a single District.

HIGHLAND PARK PUBLIC UTILITY DISTRICT

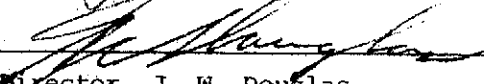
NORTH OF THE RIVER MUNICIPAL WATER
DISTRICT



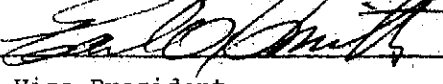
Director, K. Z. Leimbach




President



Director, J. W. Douglas



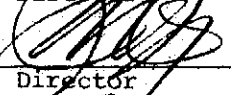
Vice President



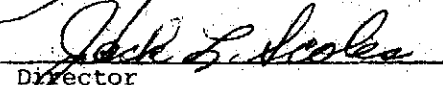
Director, Pete E. Lee



Director



Director



Director

ATTACHMENT - C

MEMORANDUM

TO: Oildale Mutual Water Company
North of the River Municipal Water District

FROM: Joseph D. Hughes

DATE: August 22, 2013

RE: Government Code Section 1090: Results of Investigation

CLIENT/MATTER: 20563-001

Issue and Background Facts

Oildale Mutual Water Company (“Oildale Mutual”) and North of the River Municipal Water District (“North of the River”) are investigating consolidation of their operations. Under the consolidation as proposed by Oildale Mutual, North of the River’s board of directors could enter into contracts pursuant to which the retail functions of North of the River would be integrated into Oildale Mutual, and Oildale Mutual would receive retail assets and customers from North of the River, and North of the River would remain as the wholesaler for the area (the “proposed consolidation”).

Three of North of the River’s board members were elected in 2012. They are Dennis Meier, Ray Etcheverry, and Jim Tyack (the “New Board Members”). Each of the New Board Members received monetary support from Oildale Mutual. Oildale Mutual’s public relations consultant, who writes its monthly newsletters, was hired and paid by Oildale Mutual to advise the New Board Members’ campaigns.

The Kern County Grand Jury recently issued a preliminary report regarding the proposed consolidation. In the report, the Grand Jury states:

F15: If the three new NOR Directors were to approve an agreement, based on receipt of campaign contributions by OMWC, the possibility of a Government Code §1090 violation could exist.

California Government Code section 1090 ("Section 1090") provides: "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."

Klein DeNatale was asked to investigate the underlying facts to determine if there is a potential Section 1090 violation prohibiting Oildale Mutual and North of the River from consolidating their operations. This memorandum (a) outlines the legal and factual investigation conducted by Klein DeNatale, (b) summarizes the facts discovered, and (c) concludes that there is no evidence of a potential violation of Section 1090.

I. Klein DeNatale conducted a legal and factual investigation.

Klein DeNatale conducted its investigation in four main stages. First, it researched Section 1090 and relevant case-law. Second, it developed interview outlines designed to disclose any relevant Section 1090 violations. Third, it interviewed people who might have knowledge of a Section 1090 violation. These included current and former North of the River board members and employees, and Oildale Mutual employees. Fourth, it collected and reviewed extensive written materials related to the 2012 North of the River election.

- A. An overview of Section 1090 and case law interpreting that statute demonstrates that if any board member has a financial interest in the transaction, Section 1090 bars the transaction.**

Section 1090 is designed to prohibit self-dealing or personal gain at public expense. *HUB City Solid Waste Services, Inc. v. City of Compton* (2010) 186 Cal.App.4th 1114, 1126, 1128. It prohibits public agency board members from being “financially interested” in any contract made by the public agency. The term “financially interested” is not defined in Section 1090. Prohibited financial interests under Section 1090 are not limited to express agreements giving the public official a financial interest in the contract, and need not be proven by direct evidence, but include implied agreements and can be proven by circumstantial evidence. *People v. Hoenig*, 48 Cal.App.4th 289, 315 (Ct.App. 3 Dist. 1996). The term “contract” in Section 1090 is interpreted broadly and includes negotiations, discussions, and planning preliminary to making a contract. *Chapman v. Superior Court*, 130 Cal.App.4th 261, 274 (Ct.App. 4 Dist. 2005).

If the New Board Members are financially interested in the proposed consolidation, North of the River cannot enter into the transaction, even if the New Board Members abstain from voting. *Chapman, supra* at 274 (Section 1090 is a bar to the entire board; abstention of the affected member does not bar liability).

Two recent cases examined Section 1090 as it applies to campaign contributions.

- 1. *City of Compton* demonstrates that financial self-dealing, not legitimate political activity, is prohibited by section 1090.**

In *HUB City Solid Waste Services, Inc. v. City of Compton*, 186 Cal.App.4th 1114, (2010) the city of Compton awarded a 15-year trash collection franchise to HUB, a

corporation whose owner was (a) the city's trash collection consultant, and (b) the man who recommended franchising the city's trash collection. *Id.* at 1120.

Compton later terminated the franchise and argued the agreement was void under section 1090 because HUB's owner bribed members of the Compton city council with large campaign contributions and other favors to obtain the franchise. The jury agreed with Compton. *Id.* at 1122.

On appeal, the court found there was sufficient evidence showing HUB's principal had bribed the city council members for their votes in favor of the franchise agreement with HUB. *Id.* at 1129. From the revenue generated by the franchise agreement, HUB made large campaign contributions to each of the members who voted in favor of the contract. *Ibid.* It also gave jobs to several council members' relatives. *Id.* at 1130. Also, HUB's owner had bribed government officials on at least three other occasions. *Id.* at 1121-22.

Compton stands for the proposition that campaign contributions can, at times, be illegal financial interests, representing bribes for voting in favor of contracts. *Id.* at 1128. But it also emphasizes that Section 1090 prohibits *self-dealing*, not legitimate political activity. Legitimate political activity includes giving campaign contributions "to officials who favor a particular position or who support the donee..." *Ibid.*

The *Compton* court explained that Section 1090 prohibits situations where (a) there is an understanding that a payment is made in anticipation of political favor and (b) the political act was made on account of the payment. *Id.* at 1128.

2. *City of Compton* relied heavily on *BreakZone Billiards*, where the court concluded campaign contributions did not violate Section 1090.

The *Compton* court relied heavily on *BreakZone Billiards v. City of Torrance*, 81 Cal.App.4th 1205 (Ct. App. 2 Dist. 2000). In the *BreakZone* case, various city council

members had received campaign contributions—ranging from \$100 to \$5,500—from a developer about 17 months before a vote that affected the developer. *Id.* at 1231. The court held that none of the members had a prohibited financial interest under section 1090. It wrote:

The purpose of this section is to prohibit self-dealing, not representation of the interests of others...BreakZone contends that the recipients of political contributions voted the interest of the developer who had a history of contributing to their political campaigns. That allegation, whether true or not, is not forbidden by either Government Code section 1090 or section 87103...

Id. at 1230.

The court continued: “[To be illegal, i]t is not sufficient that a city council member desires to advocate the position of a campaign supporter; there must be some financial or pecuniary benefit to the governmental official which could sway his or her judgment.” *Id.* at 1231.

3. Section 1090 does not prohibit campaign contributions, unless there has been a quid pro quo sufficient to create a financial interest on the part of the government official.

Compton and *BreakZone* can be reconciled. In *BreakZone*, the city council members received contributions from a donor, and later voted on something affecting that donor. The court held that was permissible and was not a violation of Section 1090. In *Compton*, the evidence showed that the city council members—when they voted to award the contract to HUB—knew that they would get a piece of the revenue from the contract. Ultimately, that “piece” came as campaign contributions and other benefits paid using the contract they had voted on. When they voted for the contract, they knew they were putting money in their own pockets. That was self-dealing and violated Section 1090.

B. Klein DeNatale designed interview outlines to uncover evidence of Section 1090 violations.

After researching Section 1090, Klein DeNatale drafted interview outlines covering the types of prohibited actions raised by the cases examining Section 1090. Klein DeNatale ultimately developed two sets of interview outlines. One outline was used in interviews with the New Board Members and Oildale Mutual employees, each of whom would presumably have direct knowledge of a Section 1090 violation. The second outline was for other North of the River board members and other persons who would not have direct knowledge of Section 1090 violations.

Each interview was conducted using the outlines to ensure that key areas that could point to a Section 1090 violation were covered with each interviewee. These areas included:

- The motivations causing each New Board Member to run for the North of the River board in 2012.
- The types of campaigning by each New Board Member in the 2012 election (i.e. speaking engagements, door knocking, mailers, telephone calls, or signage.)
- The types and amount of support received by the New Board Members from Oildale Mutual in the 2012 election.
- Whether any of the New Board Members discussed consolidation with Oildale Mutual before they were elected to the North of the River board.
- The New Board Members' communications with Oildale Mutual prior to the election, including discussions that took place in Oildale Mutual's board of directors' closed sessions.
- Whether the New Board Members made express promises to Oildale Mutual in exchange for its support of their campaigns.
- Whether the New Board Members had an implied agreement with Oildale Mutual to vote for consolidation in exchange for its support of their campaigns.

- Whether there were any written documents reflecting the New Board Members' communications with Oildale Mutual before the election.
- Whether the New Board Members received any money or gifts from Oildale Mutual after the election.
- Whether the New Board Members or their family members received jobs or consulting work from Oildale Mutual after the election.

C. Klein DeNatale interviewed nine people regarding potential Section 1090 violations.

This table contains the names of the persons interviewed, the date of the interview, and that person's role in relation to the proposed consolidation:

Interviewee	Date	Relation to transaction
David Aranda	6-27-13	North of the River General Manager
Jim Tyack	7-11-13	North of the River "New Board Member" -elected 2012
Ray Etcheverry	7-12-13	North of the River "New Board Member" -elected 2012
Dennis Meier	7-19-13	North of the River "New Board Member" -elected 2012
Becky McClure	7-19-13	Former North of the River board member: lost 2012 election
Steve Esselman	7-23-13	Current North of the River board member
Stuart Townsend	7-24-13	Former North of the River board member: did not run in 2012 election
Doug Nunneley	7-29-13	Oildale Mutual General Manager
Jack Scoles	7-31-13	Former North of the River board member

Current North of the River board member Cal Wesson was contacted to schedule an interview. He responded that he did not feel that he had any information to provide. No interview was therefore conducted.

The interviews were conducted informally. They were not recorded. Klein DeNatale interviewers Joe Hughes and Kaleb Judy took notes during the interviews. Relevant statements made during the interviews are summarized below.

D. Klein DeNatale also reviewed various documents for evidence of Section 1090 violations.

Klein DeNatale reviewed the following documents and categories of documents as part of its investigation. Unless noted otherwise, the documents were collected by or obtained from David Aranda:

- California Form 460 "Recipient Committee Campaign Statement" for *Concerned Citizens for Tyack, Etcheverry, & Meier for NOR Municipal Water District Board 2012*. This disclosure statement was obtained from the Kern County Elections Commission.
- February 7, 2013, memo from Oildale Mutual Ad Hoc Committee to Kern Citizens for Sustainable Government.
- Oildale Mutual newsletters dated September 2011, November 2011, January 2012, March 2012, July 2012, (reprinting June 17, 2012, Lois Henry *Bakersfield Californian* column) October 2012, February 2013, and June 2013.
- Printout of Oildale Mutual website (<http://www.oildalewater.com/news/default/html>) "News and Issues" dated December 6, 2012.
- October 31, 2012 Oildale Mutual service bill to Mickle Johnson containing the statement: "Vote Ray Etcheverry for NOR Municipal Water Board!"
- Photograph appearing to show Oildale Mutual service truck pulling trailer with "Tyack, Meier, Etcheverry" campaign sign (undated, unknown photographer).
- December 6, 2012, letter from Oildale Mutual to its customers.

- Printout of KGET 17 story "Tensions boil over NOR Water Board election" (<http://www.kget.com/local/storyTensions-boil-over...>) accessed 10/23/2012.
- *Bakersfield Californian* "Another View" article by Doug Nunneley, dated November 1, 2012.
- National Tax Limitation Committee newsletter dated November 6, 2012, endorsing Ray Etcheverry.
- Budget Watchdogs mailer (undated) endorsing Ray Etcheverry.
- "Vote for Dennis Meier" mailer paid for by *Concerned Citizens for Tyack, Etcheverry, & Meier for NOR Municipal Water District Board 2012*.
- June 27, 2012, letter from Oildale Mutual to North of the River.
- Printout of <http://www.reformnorwater.com> dated 9/18/2012.
- August 16, 2012, letter from Oildale Mutual to NORMWC.

Additionally, Klein DeNatale reviewed several transcripts of depositions taken in recent litigation between Oildale Mutual and North of the River. In connection with that litigation several Oildale Mutual board members were questioned regarding whether Oildale Mutual "recruited" the New Board Members. Hugh Pearson agreed with North of the River's attorney that Oildale Mutual had "recruited" the New Board Members. Pearson Dep. 134:5-135:12. Fred Hupp testified that the New Board Members were not recruited, but that their campaigns were being supported financially. Hupp Dep. 95:2-16. Bill Purkiser testified that, although he had known Mr. Tyack and Mr. Etcheverry for years, they were not recruited by Oildale Mutual's board. Purkiser Dep. 103:11-106:15.

II. No evidence was found that Oildale Mutual's support of the New Board Members created a Section 1090 violation.

Section 1090 is designed to prevent legislative self-dealing. It is not designed to prevent a public official from supporting an entity who contributed to his

or her campaign. Based upon the above reference interviews, information cited and our independent research, following are our conclusions:

- The investigation revealed no evidence that the money Oildale Mutual contributed to the New Board Members' campaigns came from the proposed transaction between Oildale Mutual and North of the River.
- The investigation revealed no evidence of any express promise by any New Board Member to vote for any proposed consolidation if Oildale Mutual contributed to his campaign.
- The investigation revealed no evidence of an implied agreement by any New Board Member to vote for any proposed consolidation if Oildale Mutual contributed to his campaign.
- Each New Board Member expressed that he ran for the North of the River board in 2012 out of dissatisfaction with North of the River's perceived lavish spending and waste. Two of the New Board Members ran against an incumbent for that particular board seat in the 2012 election. Director Tyack ran against another non-incumbent.
- None of the New Board Members discussed with Oildale Mutual the idea of consolidating North of the River's retail operations with Oildale Mutual's before they were elected to the North of the River Board.
- The New Board Members' communications with Oildale Mutual prior to the election, including discussions that took place in Oildale Mutual's board of directors' closed sessions, were limited to campaign strategy discussions, and did not include post-election strategizing.
- The investigation revealed no evidence of any written documents reflecting the New Board Members' communications with Oildale Mutual before the election.
- The investigation revealed no evidence that the New Board Members received any money or gifts from Oildale Mutual after the election.
- The investigation revealed no evidence that the New Board Members or their family members received jobs or consulting work from Oildale Mutual after the election. However, Dennis Meier's son was employed by Oildale Mutual before the election, and continues to be employed there as a field worker. According to Mr. Meier, his son had not received any unusual promotions, raises, or benefits after the election, and did not

anticipate receiving any if the proposed consolidation were carried out. This is consistent with the financial projections provided by Oildale Mutual, which project salaries remaining flat after the proposed consolidation.

III. There is no evidence that a section 1090 violation occurred.

If Oildale Mutual's campaign support of the New Board Members was a Section 1090 violation, that violation would prohibit North of the River's entire board from making any contract with Oildale Mutual. Carrying that logic further, if a public employee union contributed to a single state legislator, that would prohibit the entire state legislature from making any contract with that public employee union. The courts in *Compton* and *BreakZone* expressly held that this was not the purpose of Section 1090. Unless the board member (or his family member) would get money from the contract he or she is voting on, or there is evidence of a "quid pro quo" arising from Oildale Mutual's campaign contributions, Section 1090 is not violated. Klein DeNatale found no evidence that any of the New Board Members would get money from the proposed consolidation of North of the River's and Oildale Mutual's operations, nor that there was some "quid pro quo." Accordingly, there is no evidence of a Section 1090 violation.

Although it has not been raised, several of the New Board Members own shares of stock in Oildale Mutual, which could be a separate financial interest. However, the potential financial interest the New Board Members each have by virtue of his stock ownership in Oildale Mutual is a statutorily defined "interest not constituting an interest." Here, as long as the ownership interest of particular board member in Oildale Mutual is reflected on the official records of North of the River, the members will not be barred from voting regarding the consolidation. Govt. Code § 1091.5(a)(7).

North of the River's board and Oildale Mutual's board can continue to explore consolidating their operations.