

MEMORANDUM

TO: Board of Directors

FROM: District Manager

DATE: March 20, 2006

SUBJECT: Application to the Santa Cruz Local Agency Formation Commission for Amendment of the San Lorenzo Valley Water District Sphere of Influence and for a Change in Organization to Annex the Territory Associated with California-American Water Company, Felton District into the San Lorenzo Valley Water District

RECOMMENDATION:

It is recommended that the Board of Directors review this memorandum and all associated attachments thereto, and approve the attached resolution which authorizes application to the Santa Cruz Local Agency Formation Commission for amendment of the San Lorenzo Valley Water District Sphere of Influence and for a change in organization to annex the territory associated with California-American Water Company, Felton Water System into the San Lorenzo Valley Water District.

BACKGROUND:

On December 19, 2002 your Board approved Resolution No. 17 (02-03), Resolution of Application to the Santa Cruz Local Agency Formation Commission (LAFCO) for a Sphere of Influence Amendment. This resolution was adopted in response to requests from the Felton community that the District initiate actions to enable the potential public acquisition of the California-American Water Service Company (Cal-Am) Felton Water System. The District subsequently applied to LAFCO for a change of organization to include within the San Lorenzo Valley District Sphere of Influence the area of the Cal-Am Felton Water System that currently receives water service from Cal-Am. On September 3, 2003 LAFCO approved said application for an amendment of the District's Sphere of Influence (LAFCO No. 890).

In April 2005, the County of Santa Cruz established a Community Facilities District in the Felton area for the expressed purpose of incurring bonded indebtedness for the potential public acquisition of the Felton Water System. In March 2005, the County of Santa Cruz and the District approved a Joint Facilities Agreement relative to the Felton Community Facilities District. The Joint Facilities Agreement addressed the responsibilities of both parties and, should the potential public acquisition be realized, certain terms and conditions for operation of the Felton Water System. The Joint Facilities Agreement provided that SLVWD would be solely responsible for all activities

relative to the potential public acquisition of the Cal-Am Felton Water System. In July 2005, Santa Cruz County conducted a special tax election in the Felton community to approve and authorize the issuance of up to \$11,000,000 in bonds for the potential public acquisition of the Cal-Am Felton Water System. The special tax measure was approved by 74.8% of the registered voters voting in the special election. The special tax measure provided Santa Cruz County with the authority to levy a special tax on Felton property to pay back the bonds. The District now has available funds and authority to use said funds for the potential public acquisition of the Cal-Am Felton Water System.

OVERVIEW:

For your Board's review and consideration is a resolution requesting that LAFCO proceed to review and approve an application to further amend the District's Sphere of Influence, and to authorize the annexation of territory associated with the Cal-Am Felton Water System into the District. The purpose of this application to LAFCO is to enable the District's potential public acquisition of the Cal-Am Felton Water System facilities and properties associated therewith.

The District is proceeding with activities associated with the potential public acquisition of the Felton Water System. Should the potential public acquisition of the Cal-Am Felton Water System be realized, the District intends to provide public water service, including collection, treatment, distribution, billing, and customer service to the area being proposed for annexation. Currently the Cal-Am Felton Water System has approximately 1,315 service connections. The District plans to provide water service that is substantially similar to the water service currently provided by Cal-Am. The District would utilize the same water sources, treatment, and distribution systems. The only difference would be that the District would own, operate, maintain and manage the Felton Water System, rather than Cal-Am. District staff has determined that the Felton Water System would be operated, maintained and managed as a separate "stand alone" water system. Should the District's potential public acquisition be realized, the Felton Water System would become the District's third independent and separate water system.

The District currently operates two (2) separate "stand alone" water systems. These two (2) water systems are commonly known as the Northern System and the Southern System. The two systems combined serve an area of about 58 square miles, including the unincorporated towns of Boulder Creek, Brookdale, Ben Lomond, Zayante, and a portion of the city of Scotts Valley.

The Northern System supplies water service to the unincorporated area of San Lorenzo Valley north of Felton, including Zayante. Since 1986, total service connections in the Northern System have increased from approximately 4,840 to 5,245, an average growth rate of approximately 0.5% per year. Water supply for the SLVWD's Northern System is generated from both surface water and ground water sources. Since 1984, total water production from all supply sources in the Northern System has ranged from 1,335 to 1,661 acre-feet per year (AFY). Average annual production is 1,435 AFY. Historically the District has obtained 35% to 82% of the Northern System's total water production from surface sources. The range in surface water production is directly related to

variances in annual precipitation and other climatic conditions. The Northern System is supplied by four surface tributaries of the San Lorenzo River: Foreman Creek, Peavine Creek, Clear Creek, and Harmon Creek. In addition, SLVWD has a contractual right to purchase approximately 300 AFY of the total supply of Loch Lomond from the City of Santa Cruz.

The Northern System's four ground water sources are located in the Quail Hollow Wellfield and the Olympia Wellfield. The Quail Hollow Wellfield draws from a subunit of the Santa Margarita Sandstone Aquifer. The Olympia Wellfield draws from the underlying Lompico Sandstone Aquifer. The estimated safe yield for the Northern System ground water sources ranges from 1,400 to 2,400 AFY. The District engages in conjunctive use of surface and groundwater in the Northern System. Conjunctive use involves the coordinated and planned operation of both surface water and groundwater resources to meet water requirements in a manner that conserves and protects water resources.

The District's Southern System provides water service to approximately 550 service connections in the northwesterly portion of the City of Scotts Valley and the surrounding unincorporated area along Lockwood Lane and Hidden Glen Drive. Water supply for the Southern System comes solely from groundwater wells, which draw from the Pasatiempo sub-unit of the Lompico Sandstone Aquifer. This aquifer, which SLVWD shares with other water districts and private users, is being overdrafted by an estimated 170 acre-feet per year. SLVWD is taking action to reduce its pumping. The service area in the Southern System is virtually built out, so the SLVWD does not expect a significant increase in demand.

The District has an application pending before LAFCO (LAFCO No. 901) for a proposed amendment to its Sphere of Influence and annexation into the District relative to the Manana Woods Mutual Water Company. Manana Woods is a private mutual water system which provides water service to approximately 117 single-family homes in the general vicinity of La Cuesta Drive and Miraflores Road, Scotts Valley. The District will acquire title to the Manana Woods Mutual Water Company groundwater wells and associated treatment plant. Manana Woods will be connected to the District's Southern Distribution System.

The Northern System and Southern System are separate "stand alone" systems. The District has plans to connect the Northern and Southern Systems via a proposed intertie pipeline that would run along E. Zayante Road and Graham Hill Road. The proposed intertie would allow the District, in normal and wet years, to use surface water sources from the Northern System to supply the Southern System, reducing the amount it pumps from the Lompico aquifer. The proposed intertie pipeline would also allow for potential future utilization in the Southern System of the District's contractual rights to purchase approximately 300 AFY of the total supply of Loch Lomond from the City of Santa Cruz. The Northern System has sufficient water resources to reduce groundwater demand in the Southern System.

Special District Counsel Jeffery M. Oderman, Rutan & Tucker, LLP has prepared a memorandum dated March 10, 2006 regarding the applicability of the California Environmental Quality Act (CEQA) to the proposed Sphere of Influence amendment and annexation of the territory associated with Cal-Am Felton Water System into the District. See Attachment 1. Based upon the facts presented in said memorandum, Mr. Oderman has concluded that the proposed sphere of influence amendment and annexation is not a CEQA “project” and, therefore no environmental review of the proposed actions are required under CEQA. Mr. Oderman’s memorandum sets forth the reasons for this determination and provides a summary of key facts. The attached resolution provides a determination that the actions to be undertaken are not a “project” subject to CEQA and are exempt for CEQA and, accordingly, the District Manger is authorized and directed to file a Notice of Exemption in the office of the Santa County Clerk.

It is recommended that the Board of Directors review this memorandum and all associated attachments thereto, and approve the attached resolution which authorizes Application to the Santa Cruz Local Agency Formation Commission for amendment of the San Lorenzo Valley Water District Sphere of Influence and for a change in organization to annex the territory associated with California-American Water Company, Felton Water System into the San Lorenzo Valley Water District.

James A. Mueller
District Manager

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SAN LORENZO VALLEY WATER DISTRICT

RESOLUTION NO. 32 (05-06)

SUBJECT: RESOLUTION OF APPLICATION TO THE SANTA CRUZ LOCAL AGENCY FORMATION COMMISSION PURSUANT TO CALIFORNIA GOVERNMENT CODE SECTIONS 56425 ET SEQ. AND 56800 ET SEQ. FOR AMENDMENT OF THE SAN LORENZO VALLEY WATER DISTRICT SPHERE OF INFLUENCE AND FOR A CHANGE OF ORGANIZATION TO ANNEX THE TERRITORY ASSOCIATED WITH THE CALIFORNIA-AMERICAN WATER COMPANY FELTON WATER SYSTEM INTO THE DISTRICT'S BOUNDARIES

WHEREAS, residents in the unincorporated Felton community of Santa Cruz County who are currently served by the California-American Water Company ("Cal-Am") have approached the San Lorenzo Valley Water District (the "District") and requested that the District undertake the necessary proceedings to annex into the District's boundaries all the properties located within the Felton Unit of the California-American Water Company and all the Felton Watershed properties of California-American Water Company associated therewith (hereinafter referred to as the "Felton Service Area"); and

WHEREAS, residents in the unincorporated Felton Community have requested that the District acquire and manage the Cal-Am Felton Service Area properties and facilities; and

WHEREAS, the District has determined that such actions will provide a benefit to the residents and customers within the Felton Service Area through lower water rates, provision of local governmental control, and improved accountability; and

WHEREAS, that portion of the Felton Service Area that is depicted and described in Exhibit "A" to this resolution and that is hereinafter referred to as the "Sphere of Influence Area" is not currently located within the District's Sphere of Influence; and

WHEREAS, that portion of the Felton Service Area that is depicted and described in Exhibit "B" to this resolution has been located within the District's Sphere of Influence for many years; and

WHEREAS, on September 3, 2003, the Board of Directors of the Santa Cruz Local Agency Formation Commission ("LAFCO") unanimously adopted its Resolution No. 890 approving a municipal service review and adding to the District's Sphere of Influence the approximately 1,150-acre remaining portion of the Felton Service Area that is depicted and described in Exhibit "C" to this resolution; and

WHEREAS, the District's staff has prepared and the Board of Directors has reviewed a plan for the District's provision of services within the Felton Service Area; and

WHEREAS, both the District and Cal-Am have adequate system-wide water supplies, treatment, and storage to meet the current and proposed needs of their respective customers; and

WHEREAS, the District does not plan or intend to implement any changes to the facilities and operations of Cal-Am and the District agrees with the 2003 LAFCO determination (in its "Proposed Felton Amendment to San Lorenzo Valley Water District Sphere of Influence and Service Review of Water Services in the San Lorenzo Valley") that "[t]he principal water infrastructure need in Felton and the rest of San Lorenzo Valley is replacement of aging mains, booster pumps, and storage tanks," which both the District and Cal-Am are funding at "a reasonable pace" and independent of any proposed transfer of ownership or operational authority; and

WHEREAS, the District expressly disclaims any plan or intention to export water generated from within the Felton Service Area to serve District customers or needs outside the Felton Service Area, which action would in any event require an amendment to the existing Cal-Am permit (No. 20123) issued to Cal-Am by the State Water Resources Control Board, Division of Water Rights, which restricts the "place of use" of the water extracted by Cal-Am from Bull Creek, Bull Spring, Bennett Creek, and Fall Creek to the Felton Service Area; and

WHEREAS, the District has no control or authority over land use and development within the District's boundaries, water supply is not a constraint on new development within the existing District boundaries or within the Felton Service Area, properties within both the existing District boundaries and the Felton Service Area are nearly "built out" and there is little additional growth potential, and there is no reason to believe that the District's annexation of the Felton Service Area will affect land use or be "growth inducing" in any respect; and

WHEREAS, the Board of Directors has reviewed and considered a March 10, 2006, memorandum from special legal counsel Rutan & Tucker LLP concluding that, based upon the relevant facts, annexation by the District of the Felton Service Area is not a "project" within the meaning of the California Environmental Quality Act (Public Resources Code § 21000 *et seq.*, "CEQA") and, accordingly, that no further environmental review or documentation is required with respect thereto; and

WHEREAS, the Board of Directors has determined that the public interest would be served by extending the District's boundaries to include the Felton Service Area;

NOW, THEREFORE, BE IT RESOLVED by the Board of Directors of the San Lorenzo Valley Water District as follows:

1. That with respect to the Sphere of Influence Area this resolution is made pursuant to Chapter 4 of Part 2 of Division 3 of Title 5 of the California Government Code, commencing with § 56425, and with respect to the entire Felton Service Area this resolution is made pursuant to Part 3 of Division 3 of Title 5 of the California Government Code, commencing with § 56650.

2. That the nature of this proposal with respect to the Sphere of Influence Area is to request that LAFCO initiate proceedings to add the Sphere of Influence Area to the District's sphere of influence and the nature of this proposal with respect to the entire Felton Service Area is to request that LAFCO initiate proceedings to approve annexation of such area to the San Lorenzo Valley Water District boundaries.

3. That the boundaries of the Sphere of Influence Area and the Felton Service Area are as described above and shown on the maps and generally depicted in Exhibits "A," "B," and "C" attached hereto and made a part hereof.

4. That the District elects to act as the "lead agency" for purposes of processing these applications to LAFCO and with respect to the Sphere of Influence Amendment and change of organization (annexation) pursuant to CEQA.

5. That there are no proposed terms or conditions of annexation.

6. That the reasons for the proposed Sphere of Influence Amendment and annexation are that (i) the District can provide service to the residents and customers located within the Felton Service Area at a lower cost and at lower rates without sacrificing the service or water rates provided to and paid for by the District's existing customers and (ii) the District has a locally elected Board of Directors and will provide more responsive and accountable governance to residents and customers within the Felton Service Area.

7. That the citizens and residents within the Felton Service Area are in support of the annexation, as manifested by their request that the District initiate the necessary proceedings to extend its boundaries and provide service to the Felton community and by virtue of the overwhelming approval by voters in the Felton Service Area for the formation of a community facilities district and levy of a special tax on properties within the Felton Service Area to finance the District's acquisition of the Cal-Am utility.

8. That the District's Board of Directors requests that LAFCO initiate the necessary proceedings pursuant to Government Code § 56425 et seq. to consider and approve an amendment of the District's Sphere of Influence to include the Sphere of Influence Area and that LAFCO further initiate the necessary proceedings pursuant to Government Code § 56650 et seq. to consider and approve the annexation of the Felton Service Area to the District's boundaries.

9. That upon LAFCO's approval of the Sphere of Influence Amendment the District's annexation proposal will be entirely consistent with the District's sphere of influence and with the sphere of influence of all other affected cities and special districts.

10. That the plan for the provision of services that is required by Government Code §§ 56653 and 56654(c) is attached to this Resolution as Exhibit "D" and incorporated herein by this reference and is hereby approved.

11. That the Board determines that the actions to be undertaken in accordance with this resolution are not a "project" subject to CEQA and are exempt from CEQA and, accordingly, the District Manager is authorized and directed to file a Notice of Exemption in the

County Clerk's office memorializing the District's determination that the annexation is not a "project" for purposes of CEQA and is exempt from formal CEQA review.

12. That the District Manager and special legal counsel are authorized and directed to take all actions consistent with this resolution to apply for and process the annexation request with LAFCO.

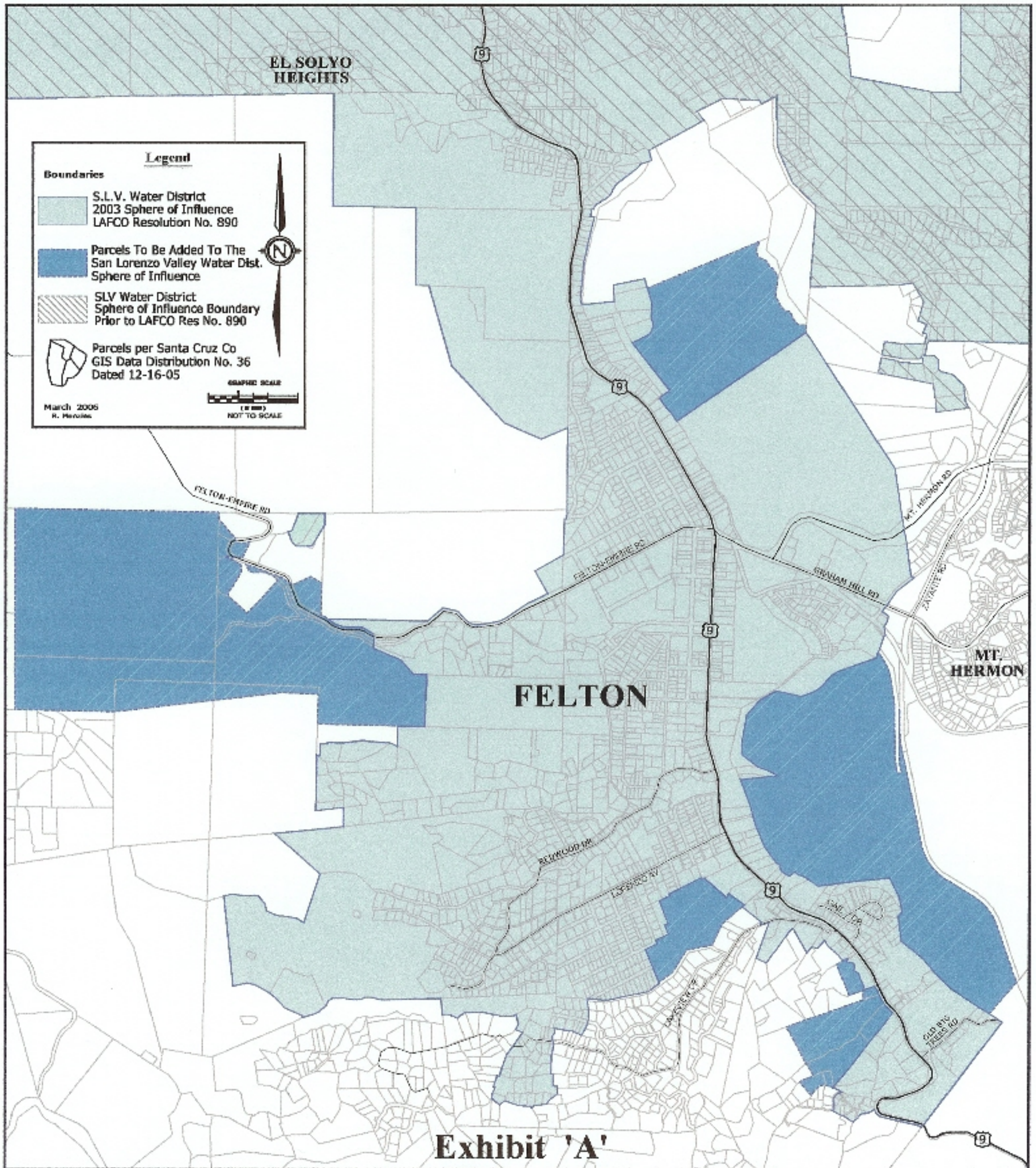
PASSED AND ADOPTED by the Board of Directors of the San Lorenzo Valley Water District, County of Santa Cruz, State of California, on the 23rd day of March, 2006, by the following vote of the members thereof:

AYES:
NOES:
ABSENT:

District Secretary
San Lorenzo Valley Water District



Sphere of Influence Amendment Map





El Solyo Heights Area

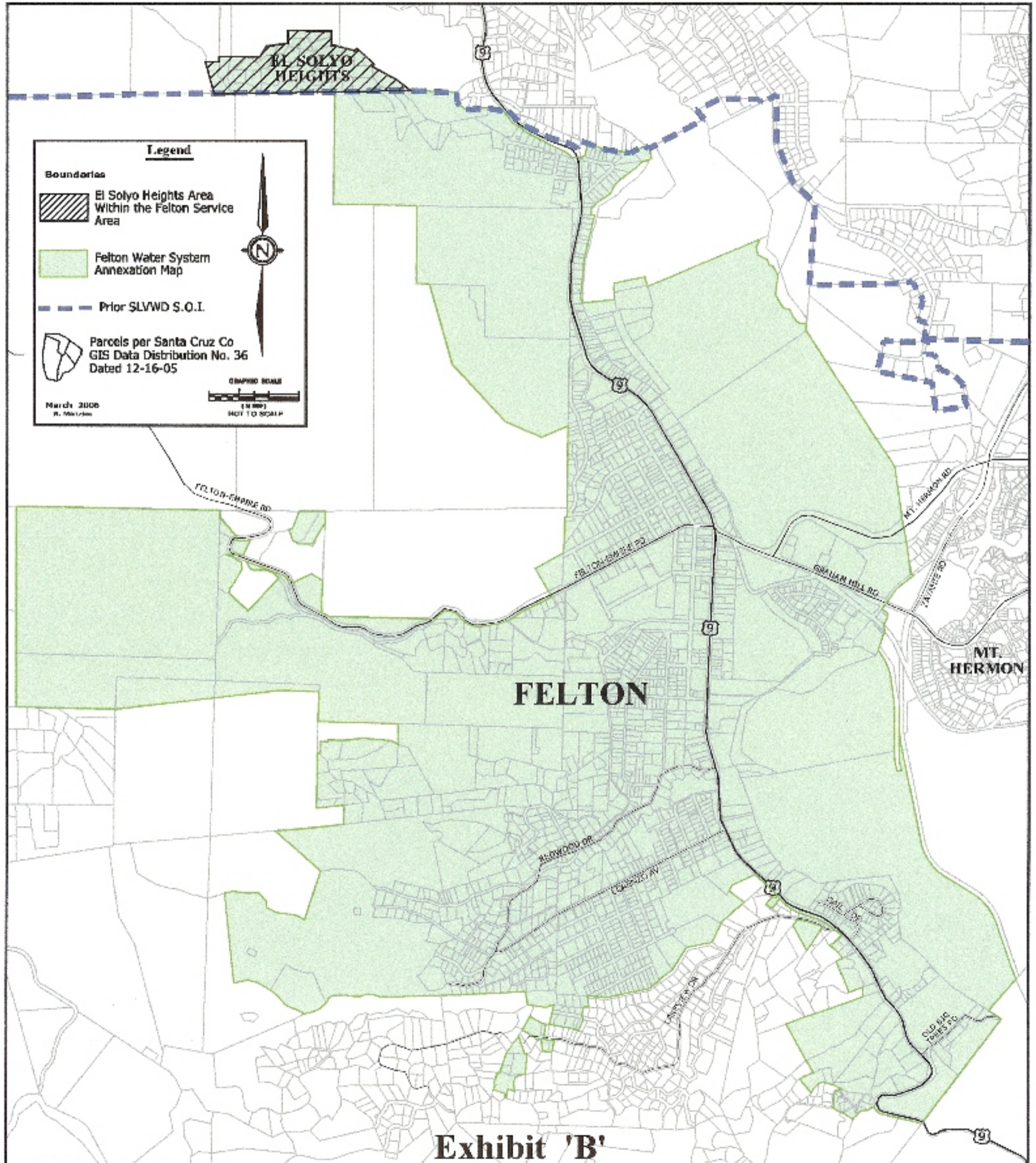


Exhibit 'B'



Felton Water System Annexation Map

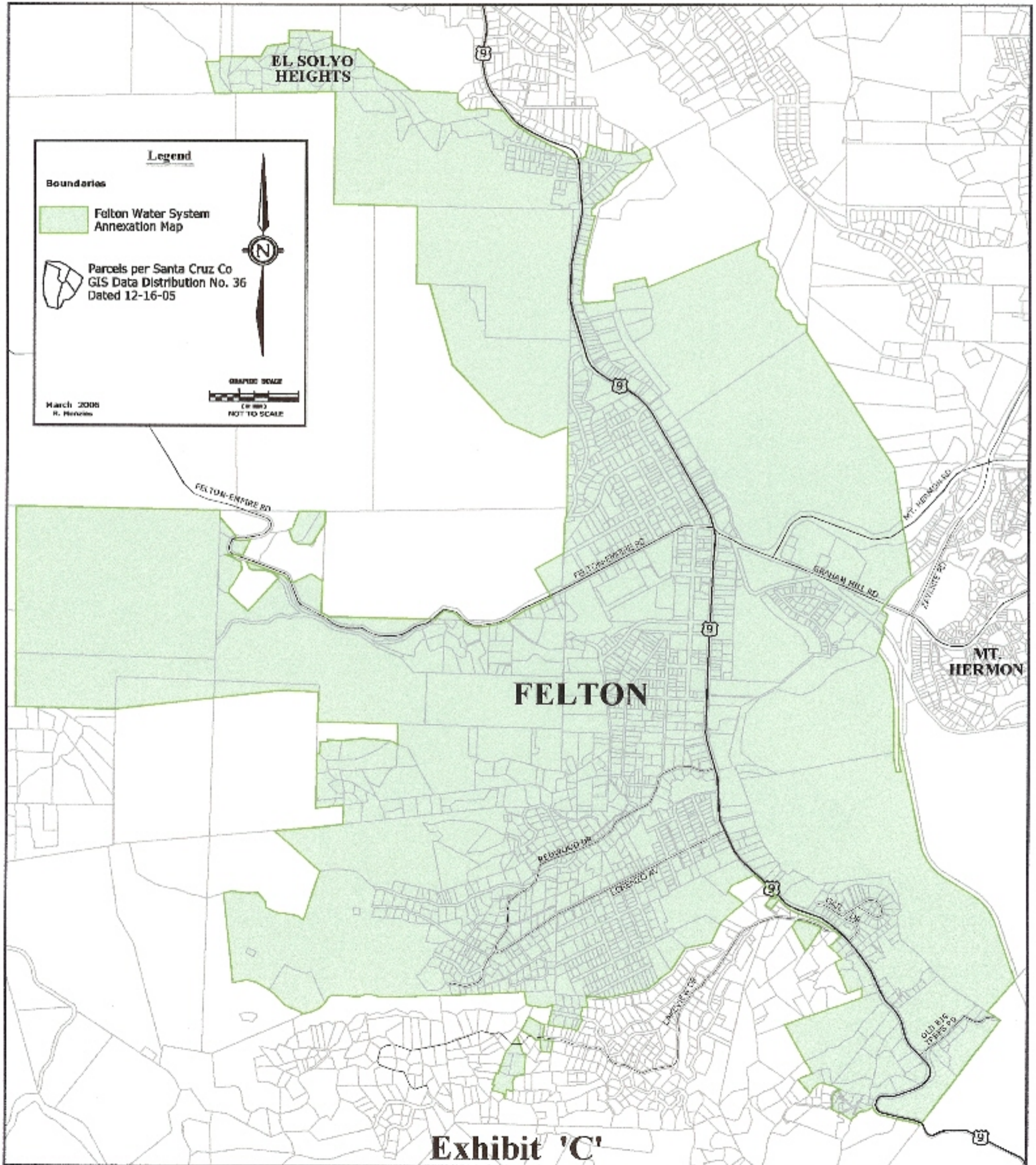


EXHIBIT “D”

San Lorenzo Valley Water District Felton Water System Change of Organization Plan for Providing Services

BACKGROUND

San Lorenzo Valley Water District (SLVWD) was formed in 1941 pursuant to Chapter 592, Statutes of 1913, since codified into Section 30,000 et seq. of the California Water Code. On December 19, 2002, the Board of Directors of SLVWD approved Resolution No. 17 (02-03), Resolution of Application to the Santa Cruz Local Agency Formation Commission (LAFCO) for a Sphere of Influence Amendment. This resolution was made in response to requests from the Felton customers of California-American Water Service Company (Cal-Am) that SLVWD initiate actions to enable the potential public acquisition of the Cal-Am Felton Water System. SLVWD subsequently applied to LAFCO in 2003 for a change of organization to include within its Sphere of Influence the area of Felton that currently receives water service from Cal-Am. On September 3, 2003 LAFCO approved the application (LAFCO No. 890).

The current application for a change of organization has also been initiated by SLVWD. SLVWD is requesting that LAFCO proceed to review and approve this application to further amend the SLVWD Sphere of Influence, and to authorize the annexation of territory associated with the Cal-Am Felton Water System into SLVWD. The purpose of this application to LAFCO is to enable the potential public acquisition of the Cal-Am Felton Water System facilities and properties associated therewith. SLVWD intends to provide substantially similar water service and watershed protection for source water supply, to that which is currently being provided by Cal-Am.

PLAN FOR PROVIDING SERVICES

In accordance with California Government Code Section 56653, the Board of Directors of SLVWD hereby submits, along with its “Resolution of Application to the Santa Cruz Local Agency Formation Commission pursuant to California Government Code Sections 56425 et seq. and 56800 et seq. for Amendment of the San Lorenzo Valley Water District Sphere of Influence and for a Change of Organization to Annex the Territory Associated with the California-American Water Company Felton Water System into the District's Boundaries,” the following Plan for Providing Services within the affected territory:

(1) An enumeration and description of the services to be extended to the affected territory.

SLVWD proposes to extend public water service, including collection, treatment, distribution, billing, and customer service to the area being proposed for annexation. SLVWD plans to provide water service that is substantially similar to the water service

currently provided by Cal-Am. SLVWD would utilize the same water sources, treatment, and distribution systems. The only difference would be that SLVWD would own, operate, maintain and manage the Felton Water System, rather than Cal-Am. SLVWD does not plan to extend any other services to the affected territory.

2) The level and range of those services.

In terms of level of service, both Cal-Am and SLVWD are obligated to their respective existing customers for the provision of adequate water supply, and water quality that meets all state and federal standards for public health protection. Both have treatment plants and water supply sources to serve their respective existing customers. Should this change of organization be approved, and the potential public acquisition of the Cal-Am Felton Water System is realized, the Felton Water System would become the third independent and separate water system to be owned, operated, maintained and managed by SLVWD.

The Cal-Am Felton Water System has approximately 1,315 service connections. The number of connections has remained essentially unchanged since 1987. SLVWD has approximately 5,800 service connections. The potential public acquisition of the Cal-Am Felton Water System would increase SLVWD total service connections to 7,115. This represents an increase in service connections of approximately 22.7%. SLVWD possesses the necessary technical, managerial and financial capacity to determine and implement the type and level of operations, maintenance, water testing, and regulatory oversight necessary to ensure that safe drinking water is provided to the public. SLVWD operates pursuant to a domestic water supply permit issued by the State of California, Department of Health Services in accordance with California Health and Safety Code Section 116525. SLVWD has competent trained personnel, with valid certifications and applicable grade requirements, necessary for operation and maintenance of the Felton Water System water treatment and distribution systems pursuant to State of California, Department of Health Services regulations (Title 17, California Code of Regulations).

SLVWD would, at a minimum, provide the range of service currently provided by Cal-Am to its customers. The Cal-Am Felton Water System service area comprises approximately 2 square miles (1270 acres), and includes:

- Central business district along Highway 9 south of Felton-Empire Road
- Central residential areas north, south, and west of the central business district
- San Lorenzo Valley High Schools and adjacent elementary and middle schools
- El Solyo Heights residential area north of the schools
- Felton Fair Shopping Center
- Felton Covered Bridge County Park
- Felton Grove residential area east of the San Lorenzo River
- Residential areas along Highway 9 south of town as far as Glengarry Road

(3) An indication of when those services can feasibly be extended to the affected territory.

Public water services to the affected territory can be extended by SLVWD whenever SLVWD becomes the legal owner of the Felton Water System. Since SLVWD plans to operate and utilize the Felton Water System as a separate water system, extension of water services by SLVWD would not involve infrastructural or other physical changes. By acquiring a turnkey system, SLVWD plans to extend water service in a manner that appears seamless to its customers. The date for change of ownership is unknown, as it depends on future potential public acquisition activities relative to this matter.

(4) An indication of any improvement or upgrading of structures, roads, sewer or water facilities, or other conditions the local agency would impose or require within the affected territory if the change of organization or reorganization is completed.

The principal water infrastructure need in Felton and the entire San Lorenzo Valley is replacement of aging mains, booster pumps, and storage tanks. Both SLVWD and Cal-Am have adopted capital improvement programs. SLVWD anticipates a continuing need to fund future capital improvements at a reasonable pace. Future capital improvements may include, but not be limited to the replacement of aging water mainlines, booster pump stations and other distribution and treatment facilities.

Should this change of organization be approved, and the potential public acquisition of the Felton Water System is realized, improvements in other conditions, such as increased public participation and local accountability would result from the change in ownership from a private investor-owned utility to a local government agency. For example, SLVWD has a locally elected Board of Directors, while the officers of Cal-Am report to corporate management. SLVWD conducts business locally in open public meetings, while Cal-Am's business is conducted privately, often at distant locations.

(5) Information with respect to how those services will be financed.

SLVWD has the necessary financial resources needed to comply with drinking water requirements; both short and long term. SLVWD is funded through water service fees, service charges and property tax revenue. In 2000, SLVWD sold 1,340 acres of its property for \$10.9 million, invested the proceeds from the sale, and receives additional revenue from its investment earnings.

SLVWD has adequate income and assets to sustain its capital improvements program, which in the last three years funded improvements, replacements, and a new administrative building. SLVWD is controlling costs by utilizing a SCADA system to monitor for off-peak pumping at reduced energy costs, implementation of a conservation program, and maximizing the use of surface water sources, which are less energy intensive than groundwater sources.

In April 2005, the County of Santa Cruz established a Community Facilities District in the Felton area for the expressed purpose of incurring bonded indebtedness for the potential public acquisition of the Felton Water System. In March 2005, the County of Santa Cruz and SLVWD approved a Joint Facilities Agreement relative to the Felton

Community Facilities District. The Joint Facilities Agreement addressed the responsibilities of both parties and, should the potential public acquisition be realized, certain terms and conditions for operation of the Felton Water System. The Joint Facilities Agreement provided that SLVWD would be solely responsible for all activities relative to the potential public acquisition of the Cal-Am Felton Water System. In July 2005, Santa Cruz County conducted a special tax election in the Felton community to approve and authorize the issuance of up to \$11,000,000 in bonds for the potential public acquisition of the Cal-Am Felton Water System. The special tax measure was approved by 74.8% of the registered voters voting in the special election. The special tax measure provided Santa Cruz County with the authority to levy a special tax on Felton property to pay back the bonds. SLVWD now has available funds and authority to use said funds for the potential public acquisition of the Cal-Am Felton Water System. Should LAFCO approve this Sphere of Influence amendment and change of organization to annex the territory of the Felton Water System into SLVWD and, the potential public acquisition be realized, SLVWD will be solely responsible for all associated operational, maintenance and management activities for the Felton Water System.

In April 2004, the SLVWD Board of Directors adopted Resolution No. 32 (03-04) which states that should SLVWD acquire the Felton Water System, the District's current water rate schedule would be applied within the Cal-Am Felton Water System. Under public SLVWD management water service rates for customers of the Felton Water System would be substantial less than current Cal-Am rates. A typical customer in the Felton Water System would pay approximately 70% less for the same quantity of water under public SLVWD management.

Cal-Am is currently billing its Felton Water System customers a separate surcharge authorized by the California Public Utilities Commission (CPUC) for debt service payments relative to a \$4,408,503 loan that Cal-Am borrowed under the Safe Drinking Water Bond Act for construction of a water treatment plant. Provisions of the Joint Facilities Agreement state that SLVWD would not impose said surcharge on customers in the Felton Water System. This represents an additional savings for customers in the Felton Water System under public SLVWD management.

For Test Year 2004 SLVWD estimated a projected annual expense of \$563,000/year for operation and maintenance activities solely related to the Felton Water System. With the addition of the annual debt service payments associated with the treatment plant loan (\$186,700/year), total annual operating costs, less capital improvements, is estimated at approximately \$750,000/year for the Felton Water System. Total annual revenue from metered water service from the Felton Water System under public SLVWD management is estimated at \$705,000/year. These estimated projections, representing a "worst-case" scenario, results in an estimated annual shortfall of \$45,000/year. However, annual expense savings are anticipated under SLVWD management of the Felton Water System due to synergies associated with the potential for a reduction in payroll, administration, customer service and/or finance related expenses.

SLVWD emphasizes that, even under this “worst-case” scenario, the District would be required to raise rates by an average of \$0.53 per month to its customers. Quite possibly, other cost savings resulting from public acquisition would offset this potential rate increase. For at least three reasons, it is quite possible that future consumer rates under SLVWD management would be less than future rates if Cal-Am operated the Felton Water System. First, the current water rates of Cal-Am are significantly higher than the rates of SLVWD. Second, Cal-Am has file Application No. A.05-02-013 pending before the CPUC, to increase its rates for water service in Felton by 105% in year 2006. Third, operating costs under SLVWD management could be less due to the District not paying federal, state or local taxes; or due to operation efficiencies from the operation of two similar adjacent water systems in the San Lorenzo Valley.

CERTIFICATION

I hereby certify that the statements furnished above present the data and information required to the best of my ability, and that the facts, statements and information presented herein are true and correct to the best of my knowledge and belief.

Prepared and Approved by:

James A. Mueller
District Manager

MEMORANDUM

Attachment 1

TO: Board of Directors of the San Lorenzo Valley Water District
FROM: Jeffrey M. Oderman, Rutan & Tucker, LLP
DATE: March 10, 2006
RE: Applicability of California Environmental Quality Act to SLVWD's Proposed Amendment of its Sphere of Influence and Annexation of the Felton Unit of the California-American Water Company Service Area

I. BACKGROUND:

At its March 23, 2006, meeting, the Board of Directors of the San Lorenzo Valley Water District ("SLVWD") will be considering adoption of a Resolution of Application to the Santa Cruz County Local Agency Formation Commission ("LAFCO") requesting LAFCO to initiate the necessary proceedings to further amend the District's sphere of influence and to authorize the annexation to the District of all of the properties located within the Felton Unit of the California-American Water Company service area and all the Felton watershed properties of California-American Water Company associated therewith (collectively, the "Felton Service Area"). This Memorandum is intended to address the applicability of the California Environmental Quality Act (California Public Resources Code § 21000 *et seq.*, hereinafter "CEQA") to these proceedings.

II. ISSUE:

Is SLVWD's proposed amendment of its sphere of influence and annexation of the Felton Service Area a "project" subject to the provisions of CEQA?

III. CONCLUSION:

Based upon the facts applicable to this matter, the proposed sphere of influence amendment and annexation is *not* a CEQA "project" and, accordingly, no environmental review of these actions is required under CEQA.

IV. STATEMENT OF FACTS:

Our conclusion that SLVWD's proposed amendment to its sphere of influence and annexation of the Felton Service Area is not a CEQA project is based upon our review of the history of SLVWD actions with respect to this activity, SLVWD's identified purposes in proceeding with the sphere amendment and annexation, prior LAFCO actions relating to this subject (including primarily the 2003 proceedings which resulted in LAFCO's addition of the

vast majority of the Felton Service Area to SLVWD's sphere of influence), relevant information regarding the facilities and operations of the California-American Water Company ("Cal-Am"), and communications generated from various sources over the past few years regarding environmental issues that might arise out of the sphere of influence amendment, the annexation, and the eventual transfer of ownership and operational authority from Cal-Am to SLVWD (including without limitation correspondence from Cal-Am itself). While limitations of space preclude an exhaustive presentation in this Memorandum of all of the past history and facts, a summary of some of the key facts upon which we have based our conclusion is set forth below:

A. SLVWD Service Area.

The San Lorenzo Valley Water District encompasses approximately 30,000 acres in the unincorporated areas of Boulder Creek, Brookdale, Ben Lomond, Zayante, and a portion of the City of Scotts Valley. SLVWD currently has approximately 5,800 connections and serves a population of approximately 17,900. (See July 2003 LAFCO document entitled "Proposed Felton Amendment to San Lorenzo Valley Water District Sphere of Influence and Service Review of Water Services in the San Lorenzo Valley" [hereinafter the "Sphere of Influence and Service Review"] at pp. 1-13 and 23.) The number of SLVWD customers increased at a rate of approximately 0.22% per year between 1995 and 2002 (the last year for which statistics were available based upon the records provided to our office). (*Id.*, p. 15.) LAFCO additionally noted that there is "little growth potential" in the SLVWD service area. (*Id.*, p. 23.)

B. Felton Service Area.

The proposed Felton Service Area currently managed by Cal-Am comprises the approximately 1,150 acres that were the subject of the 2003 LAFCO proceedings on the major sphere of influence amendment, plus certain watershed property owned by Cal-Am (sometimes referred to in this Memorandum as the "Sphere of Influence Area"), plus a small area that has been located within the District's sphere of influence for many years but historically has been served by Cal-Am. The Cal-Am service area contains an estimated population of 3,350. (*Id.*, pp. 23-25.) Cal-Am currently has 1,315 service connections, a number that has been "essentially unchanged" since at least 1980. (*Id.*, pp. 20-21.) Just as it did with respect to SLVWD's existing service area, LAFCO noted that the Felton Service Area has "little growth potential." LAFCO staff estimated that the build-out potential of the vacant and under-utilized parcels in Felton would generate water demand equivalent to 100 single-family dwellings, and stated that "[t]he community is not likely to approach . . . build out anytime soon." (*Id.*, pp. 23, 25.)

C. Adequacy of SLVWD and Cal-Am Water Supplies and Facilities to Meet Current and Proposed Demands.

SLVWD's proposed amendment of its sphere to include the Sphere of Influence Area and its proposed annexation of the Felton Service Area and takeover of the water delivery system currently operated by Cal-Am are not being justified based upon any need by SLVWD to obtain additional water supplies or any intention to modify any of SLVWD's or Cal-Am's water treatment, storage, or delivery systems. As noted by LAFCO, both SLVWD and Cal-Am have adequate system-wide water supplies, treatment, and storage to meet the current and proposed needs of their respective customers. (*Id.*, pp. 13-14 and 31-33.) SLVWD has had a capacity problem in its southern unit (the Pasatiempo Pines neighborhood of Scotts Valley) where the aquifer shared by SLVWD with other users in Scotts Valley is being over drafted, but SLVWD has been proceeding with other capital projects and programs to resolve this issue independent of any resort to water supplies in the Felton Service Area. (*Id.*, pp. 31-37; see also pp. 2-3 of the September 3, 2003, letter from SLVWD District Manager James Mueller to LAFCO regarding the then-pending Felton sphere of influence amendment.)

As noted by LAFCO, "[t]he principal water infrastructure need in Felton and the rest of San Lorenzo Valley is replacement of aging mains, booster pumps, and storage tanks," which both SLVWD and Cal-Am are funding at "a reasonable pace" and independent of the proposed annexation and any transfer of ownership or operational authority. (Sphere of Influence and Service Review, pp. 34-37.)

D. SLVWD Would Not Have the Authority to Export Water Out Of the Felton Service Area In Any Event.

In addition to the fact that SLVWD has expressly disclaimed any intention of exporting water generated from within the Felton Service Area to meet alleged water "deficits" elsewhere within SLVWD's boundaries (see, e.g., September 3, 2003, Mueller letter to LAFCO cited above), it should be emphasized that SLVWD would not have the legal right to do so in any event. All but a tiny fraction of Cal-Am's water rights are derived from a permit (No. 20123) issued by the State Water Resources Control Board, Division of Water Rights, which restricts the "place of use" of the water extracted by Cal-Am from Bull Creek, Bull Spring, Bennett Creek, and Fall Creek to the Felton Service Area. (See Exhibit "A" hereto.) SLVWD has no authority to unilaterally implement any change to this "place of use" restriction and, prior to doing so, would have to apply for and obtain a new or amended permit from the State (which permitting process, in turn, would be subject to applicable CEQA requirements).

E. The Felton Community, SLVWD, and LAFCO Have All Consistently Justified SLVWD's Proposed Annexation of the Felton Service Area on the Basis of Lowering Water Rates and Providing Local Governmental Control of and Improved Accountability to the Felton Customers/Rate Payers, Not on the Basis of Any Changes to Cal-Am's Facilities or Operations that Would Result in Direct or Indirect Impacts to the Physical Environment.

After annexation, SLVWD has no plan to institute any capital projects or any changes to the manner in which Cal-Am manages its property and operates its facilities that would result in any direct or indirect physical changes in the environment.

The process leading to this minor additional sphere of influence amendment and proposed annexation was initiated by Cal-Am customers in Felton who approached the County and SLVWD in 2002-2003 with complaints regarding Cal-Am's high water rates and the lack of any local governmental control or accountability. (See, e.g., LAFCO's Sphere of Influence and Service Review, p. 1; see also, September 3, 2003, Mueller letter to LAFCO, p. 1.) When SLVWD applied to LAFCO shortly afterwards to expand SLVWD's sphere of influence to include the bulk of the Felton Service Area, SLVWD similarly cited as its sole justifications that "water service provided by SLVWD would allow control of water service via a [responsive locally elected] governmental agency and reduced water rates." (See SLVWD's March 6, 2003, application to LAFCO, pp. 1-2, ¶ 6.) SLVWD noted that its application "will have no anticipated impacts on present and/or future Santa Cruz County general plan land use designations or zoning designations," that "the present water resource capacity of the Cal-Am Felton District is sufficient to provide water service in the area," that SLVWD would simply "acquire said existing facilities and operation thereof would be self-sufficient and sustainable," and that SLVWD's acquisition "will not induce growth." (*Id.*) With respect to the watershed property owned by Cal-Am in particular, the District has had an official policy in place since November 1985 that prohibits the logging of District-owned watershed properties and the District has an excellent record of preserving such properties with no environmental changes or impacts.

LAFCO staff prepared an Environmental Initial Study for SLVWD's sphere of influence application in June 2003 and subjected the application to environmental review in no fewer than 86 separate categories, concluding in each instance that SLVWD's application would result in "no impact" on the environment. (A copy of this initial study is set forth in Appendix B to the Sphere of Influence and Service Review.) After receiving a handful of written communications questioning LAFCO's analysis, including 3 letters submitted by or on behalf of Cal-Am, LAFCO's counsel followed up by preparing a 21-page single spaced memorandum reaffirming the validity of the LAFCO staff finding of "no impact." (See August 27, 2003, memorandum from LAFCO counsel David Kendig to LAFCO Commissioners.) LAFCO's "bottom line" conclusion, supported by the uncontradicted evidence in its records, was that the "project could

not have a significant effect on the environment” (LAFCO Resolution No. 890, adopted September 3, 2003, ¶ 6) given that SLVWD was not proposing any operational changes and instead asserted its intention to operate in a substantially similar manner to the manner in which Cal-Am has operated its system. (See, generally, LAFCO’s Environmental Initial Study [State Clearing House No. 200304218] and the Negative Declaration included as Appendix B to the Sphere Influence and Service Review.)

To SLVWD's knowledge, nothing has changed in this regard since LAFCO approved the Sphere of Influence Amendment for the bulk of the Felton Service Area in September 2003. In short, the SLVWD and Cal-Am operations historically have existed side-by-side and SLVWD has no plan to change the status quo from the standpoint of capital facilities and programs, operations, or in any other respect that could directly or indirectly result in any change to the physical environment. Needless to say, SLVWD will continue to address capital facility needs and operational requirements for the existing SLVWD service area and the Felton Service Area as needs arise, but based upon the information currently available to SLVWD there is no reason to believe that any actions to be taken with respect to capital facilities or the ownership and operation of the SLVWD and Cal-Am properties and facilities will differ based upon whether SLVWD and Cal-Am continue to own and operate separate water systems or SLVWD owns and operates both systems.

V. LEGAL ANALYSIS: THE ADDITIONAL SPHERE OF INFLUENCE AMENDMENT AND THE ANNEXATION OF THE FELTON SERVICE AREA INTO SLVWD’S BOUNDARIES ARE NOT A PROJECT SUBJECT TO CEQA BECAUSE THESE ACTIONS HAVE NO POTENTIAL TO RESULT IN A PHYSICAL CHANGE IN THE ENVIRONMENT.

A. Introduction.

Only activities considered to be “projects” are subject to CEQA. (See Public Resources Code §§ 21065, 21080, 21160, and 21151, and 14 Cal. Code Regs. § 15002(d).) Accordingly, a determination that an activity is not a “project” as that term is defined in CEQA means that the activity is not subject to or is exempt from CEQA. (*Id.* at § 15060(c).)

Under CEQA, the term “project” applies to the “whole of an action.” (14 Cal. Code Regs. § 15378(a).) CEQA requires that environmental considerations not be concealed by “chopping up a project into bite-sized pieces” and separately focusing on isolated parts of a larger planned action. (See *Bozung v. LAFCO* (1975) 13 Cal.3d 263, 283; *City of Sacramento v. State Water Resources Control Bd.* (1992) 2 Cal.App.4th 960; *McQueen v. Board of Directors* (1988) 202 Cal.App.3d 1136, 1144; *Lexington Hills Ass’n v. State* (1988) 200 Cal.App.3d 415; and *City of Carmel-by-the-Sea v. Board of Supervisors* (1986) 183 Cal.App.3d 229, 241.) The entire activity which is being approved may be subject to several discretionary governmental

approvals. The environmental review accompanying the first discretionary approval must evaluate the impacts of the ultimate physical change in the environment that is contemplated. The term “project” does not refer to each separate governmental approval that may be required for the activity to occur. (14 Cal. Code Regs. § 15378(c).)

Accordingly, even though SLVWD has not formally committed itself to acquiring Cal-Am’s Felton utility by negotiated purchase or condemnation,¹ for purposes of determining whether SLVWD’s proposed addition of the Sphere of Influence Area to SLVWD’s sphere and its annexation of the Felton Service Area individually or collectively are a CEQA “project” we acknowledge that SLVWD and LAFCO *are* required to consider *at this time* the environmental impacts (if any) of the sphere amendment, the annexation, the subsequent potential acquisition by SLVWD of Cal-Am’s water utility, and any proposed changes that SLVWD may be planning to institute to Cal-Am’s properties, facilities, and operations assuming the acquisition does in fact occur.

There are two elements to the test used under CEQA for determining whether a CEQA “project” is implicated. First, the activity in question must be one that is directly undertaken by a public agency, an activity supported in whole or in part by a public agency, or an activity involving the issuance by a public agency of some form of entitlement or permit. Second, the activity must be one that may cause a direct, or reasonably foreseeable indirect, physical environmental change. (Pub. Res. Code § 21065; 14 Cal Code Regs. § 15378.)

There is no question that both SLVWD and LAFCO are public agencies and the addition of the Sphere of Influence Area to SLVWD’s sphere and the annexation of the Felton Service Area into SLVWD’s boundaries will be supported by and directly undertaken by both SLVWD and LAFCO. It is also undisputed that the sphere amendment and annexation are preliminary steps that are intended to facilitate the eventual acquisition by SLVWD of the Cal-Am water facility and operations—by negotiated purchase or condemnation—which is or will be an activity to be supported by and directly undertaken by SLVWD. Therefore, the first element of the test for determining whether the proposed sphere amendment and annexation are a CEQA “project” is satisfied.

The basis for the conclusion in this Memorandum that the proposed sphere amendment and annexation are not a CEQA “project” is based upon the second element of the above-referenced test. Based upon the specific facts applicable to SLVWD’s proposed addition of the Sphere of Influence Area to SLVWD’s sphere and its annexation of the Felton Service Area, our

¹ As of the date this Memorandum is being prepared, SLVWD has not made a formal offer of compensation to Cal-Am and has not conducted a condemnation hearing or adopted a so-called “resolution of necessity” that would be a pre-requisite to the filing of an eminent domain action. (See, generally, Government Code § 7267.2 and Code of Civil Procedure §§ 1245.220-1245.240.)

conclusion is that these activities will *not* cause any direct or reasonably foreseeable physical change in the environment.

B. Other CEQA Decisions Involving Local Governmental Agency Boundary Changes Support the Conclusion that the Addition of the Sphere of Influence Area to SLVWD's Sphere of Influence and SLVWD's Annexation of the Felton Service Area Are Not a CEQA "Project."

There are several closely analogous judicial decisions involving whether particular LAFCO decisions involving local governmental agency boundary changes constitute "projects" under CEQA. Close review of these decisions demonstrates that the answer to the question requires careful review of the particular facts in each case. (*Bozung v. LAFCO, supra*; *People ex rel Younger v. Local Agency Formation Commission* (1978) 81 Cal.App.3d 464; *City of Redding v. Shasta County Local Agency Formation Commission* (1989) 209 Cal.App.3d 1169, 1173-1177; *City of Agoura Hills v. Local Agency Formation Commission* (1988) 198 Cal.App.3d 480, 493-496; and *Simi Valley Recreation and Park District v. Local Agency Formation Commission* (1975) 51 Cal.App.3d 648, 662-666.)

Thus, for example, in *Bozung*, the court held that the proposed annexation of a 677-acre ranch into the City of Camarillo was a CEQA "project" and that an environmental impact report had to be prepared to consider the impacts of that project. The dispositive fact compelling this result was that the annexation was the first step in an overall plan to ultimately permit subdivision and development of land that historically had been in agricultural use. "Vital to our disposition of this case is that [the] application stated that the land was presently used for agriculture and would be used 'for residential, commercial and recreational uses,' and that such development was 'anticipated...in the near future.'" (13 Cal.3d at 269-270; see also *Fullerton Joint Union High Sch. Dist. v. State Board of Education* (1982) 32 Cal.3d 779, 794.)

As stated in Remy, *Guide to California Environmental Quality Act* (CEB 1999), § IV(A)(2), p. 67:

In holding that the proposed annexation constituted a project, the [*Bozung*] court emphasized that the annexation was an essential part of a development plan by which a property owner intended to urbanize agricultural property. 'Planning was completed, preliminary conferences with city agencies had progressed "sufficiently" and development in the near future was anticipated.' Thus it was apparent that the annexation would 'culminate in physical changes to the environment.' The court stressed that its holding was not intended to imply that 'any...approval of any annexation to any city may have a significant effect on the environment.'

(Accord, *Kaufman & Broad-South Bay Inc. v. Morgan Hill Unified School District* (1992) 9 Cal.App. 4th 464, 472 and *Simi Valley, supra*, 51 Cal.App.3d at 665-666.)

On the other hand, the court came to a contrary conclusion in *Simi Valley* based upon the fact that the LAFCO boundary change at issue in that case was not a preliminary step in a series of actions intended to lead to physical changes in the environment. That case involved a LAFCO approved detachment of 10,000 acres of undeveloped land from a park district. No CEQA documents were prepared. While there was a general allegation that other properties in the area were beginning to develop, the court noted that no development plans had been proposed for the property in question and that “the detachment in this case did not make any change whatever in the uses to which the land might be put.” (51 Cal.App.3d at 665.) Accordingly, the court held that the LAFCO-approved boundary change was not a CEQA “project” and no environmental documents needed to be prepared. As stated by the court (*id.* at 663):

CEQA was not intended to make and cannot reasonably be construed to make a project of every activity of a public agency, regardless of the nature and objective of such activity. Such a construction would invoke the expansive and time-consuming procedures required to complete at least a negative declaration in respect of virtually every action of a public agency.

Similarly, in *City of Agoura Hills, supra*, the court held that a LAFCO decision to approve a city’s sphere of influence virtually coterminous with the city’s existing municipal boundaries was not a “project” because the action did not relate to any planned or reasonably foreseeable potential effects on the physical environment. (198 Cal.App.3d at 493-496; see also 14 Cal Code Regs § 15378(b)(5).) The court held that a LAFCO decision to adopt a sphere of influence is not necessarily a first step toward development and will not necessarily result in a change in the physical environment. A mere change in political boundary lines is not in and of itself a change in the physical environment.

SLVWD’s proposed addition of the Sphere of Influence Area to SLVWD’s sphere and its annexation of the Felton Service Area is analogous to the situation addressed by the courts in *Simi Valley* and *City of Agoura Hills* and is distinguishable from the facts in *Bozung*. In this case, the proposed sphere amendment and annexation are not a precursor to capital projects or development or any change in Cal-Am’s or SLVWD’s operation of their respective properties or facilities that will culminate in a physical change in the environment. Accordingly, the SLVWD sphere amendment and annexation are not a “project” and no further CEQA environmental review is required.

C. **The Mere Speculation That at a Future Date SLVWD May Institute Changes With Respect to Cal-Am Properties, Facilities, or Operations Is Not Sufficient to Convert the Proposed Sphere Amendment and Annexation into a “Project” that Must Be Evaluated Under CEQA.**

While CEQA requires a public agency to consider the reasonably foreseeable environmental consequences of its discretionary actions, including reasonably probable future changes to the scope or nature of those actions (see, e.g., *Laurel Heights Improvement Association v. Regents of the University of California* (1988) 47 Cal.3d 376, 395-396), CEQA requires that a public agency’s decision be based upon *evidence* and does not permit a public agency to base its decision on argument, speculation, or unsubstantiated opinion. (See, e.g., Public Resources Code §§ 21080(e) and 21082.2(c) and 14 Cal. Code Regs. §§ 15064(f)(5) and 15384.) Accordingly, SLVWD and LAFCO are not required to acknowledge the sphere amendment and annexation are a CEQA “project” based upon unsubstantiated allegations that SLVWD might in the future attempt to export water out of the Felton Service Area (which it has no intention of doing and would be prohibited from doing consistent with the existing State water permit held by Cal-Am) or that SLVWD might otherwise institute changes with respect to capital facilities, properties, or operations to effectuate some other direct or indirect change to the physical environment.

Thus, for example, the court in *Silverian v. Las Gallinas Valley Sanitary District* (1997) 54 Cal.App.4th 980 determined that a sanitary district acquiring acreage surrounding a treatment facility for buffer zone purposes (i.e., no physical change) was not required to consider the potential for the buffer zone property to eventually be used for an expansion of the treatment facility. The court stated (at p. 992):

[i]f [the district] plans a different project or an expanded treatment facility in the future, that project would be a substantially different project than the one considered here and it would have to receive separate approval and a separate determination whether an EIR would be required. The only project being considered is acquiring the adjacent property, and using it as an odor buffer zone.

Similarly, in *El Dorado County Taxpayers for Quality Growth v. County of El Dorado* (2004) 122 Cal.App.4th 1591, the court upheld a negative declaration for a reclamation plan that did not discuss environmental impacts of a possible future expansion of a mining operation onto adjacent federal land. The court stated that possible later additions to or expansion of a project need not be considered if no commitment has been made to the future addition/expansion and that addition/expansion is not reasonably foreseeable. The future mining expansion was not a foreseeable consequence of project approval in *El Dorado* because a decision to proceed with that activity would depend upon various environmental, social and political factors that had not yet been addressed. In these circumstances, the court ruled, no purpose would be served in

requiring the county to engage in speculation about the environmental consequences of uncertain future development. (*Id.* at 1600.)

As stated by one commentator:

If the agency's action is a necessary step that starts in motion a chain of events that will foreseeably result in impacts to the physical environment, the activity must be treated as a project subject to CEQA. The key distinction is between a “governmental approval which constitutes an essential step culminating in an action which may effect the environment” and an approval “which portends no particular action affecting the environment.

(Kotska & Zischke, *Practice Under the California Environmental Quality Act* (CEB 2005), section 4.20 at p. 170-171, emph. added [citing various cases, including *Fullerton Joint Union High Sch. Dist. v. State Bd. of Educ.* (1982) 32 Cal 3d 779, 796, and *Heninger v. Board of Supervisors* (1986) 186 Cal App 3d 601.) If, however, the proposed action in question does nothing more than enable the public agency to take later action that will affect the environment but does not commit the agency to that future action it is not a project subject to CEQA. (*Kaufman & Broad-South Bay, Inc., supra.*) Here, while SLVWD's ultimate acquisition of Cal-Am's properties and facilities makes certain future actions by SLVWD theoretically possible, it does not commit SLVWD to any such actions and therefore does not necessitate CEQA review (at this time).

An example of the application of this principle arose in *Kaufman, supra*. In that case, a developer unsuccessfully challenged a school district's formation of a community facilities district (CFD) under the Mello-Roos Community Facilities Act, arguing that the district's action constituted a “project” requiring CEQA compliance. The school district argued that the “mere act of securing financing for anticipated but uncertain future projects” would not have a significant effect on the environment. Additionally the school district reasoned,

[t]hat while the formation of [a CFD] may contribute to its ability to ultimately construct new schools, it in no way commits [the school district] to any particular course of action in that regard or influences the ultimate decision which [would] affect the environment – whether, where and when to build new schools. (*Id.*, at 471.)

The Court of Appeal agreed. As discussed in Remy, *supra*, Section IV(A)(2) at p. 66:

[The *Kaufman* court] rejected the developer's argument that the formation of a CFD was an “implementation step” in a comprehensive process that would ultimately result in physical changes to the environment. The court reasoned that

there was *no causal link* between the action (formation of a CFD) and the alleged environmental impact (the construction of new schools), in that the formation of a CFD would not create a need for new schools; *nor* would the construction of new schools be *entirely dependent* on the formation of a CFD. [Emphasis added.]

The developer argued that the potential for future activities required environmental review at the time of CFD formation, notwithstanding the lack of any certain plan by the school district for development. The court disagreed, stating that the CEQA procedure permitting phased review “does not obviate the need for the initial project to be sufficiently advanced to begin environmental review.” (*Id.*)

In summary, if at some future date SLVWD devises a plan to change the manner in which Cal-Am’s water utility is owned and operated such that there is a potential for a direct or indirect physical change in the environment, that plan will be subject to CEQA review (if otherwise required) at that time. The mere speculative possibility that such a future plan may be devised at some point in time, however, is not sufficient to make SLVWD’s proposed sphere amendment and its proposed annexation of the Felton Service Area a CEQA project at *this* time.

D. Our “No Project” Conclusion is Bolstered by Certain Statutory and Categorical Exemptions from CEQA.

Even assuming for the sake of argument that SLVWD’s proposed sphere amendment and its proposed annexation of the Felton Service Area and acquisition of the Cal-Am water utility could somehow be viewed as a CEQA “project,” SLVWD and LAFCO nevertheless would still be required to determine whether these actions are exempt from CEQA review either by statute or pursuant to a “categorical exemption” adopted by the Resources Agency. (Public Resources Code §§ 21080(b) and 21080.01-21080.33 and 14 Cal. Code Regs. §§ 15061(b)(2), 15260-15285, 15300-15332, and 15354.) In this regard, at least one statutory exemption and at least 3 categorical exemptions would appear to apply to our facts.

Even assuming that SLVWD had a current plan to physically integrate the Cal-Am water distribution system into the distribution system currently operated by SLVWD, our understanding is that the most logical connection would occur by means of a pipeline located within an existing public street right-of-way that would extend some 700 feet in length. In this regard, by statute CEQA “does not apply to any project of less than one mile in length within a public street or highway or any other public right-of-way for the installation of a new pipeline or the maintenance, repair, restoration, reconditioning, relocation, replacement, removal, or demolition of an existing pipeline.” (Public Resources Code § 21080.21.)

In addition, the so-called “Class 1” categorical exemption set forth in 14 Cal. Code Regs. § 15301 exempts from CEQA review “the operation, repair, maintenance, permitting, leasing,

licensing, or minor alteration of existing public or private structures, facilities, mechanical equipment, or topographical features, involving negligible or no expansion of use beyond that existing at the time of the lead agency's determination," including specifically "[e]xisting facilities of both investor and publicly-owned utilities used to provide electric power, natural gas, sewerage, or other public utility services." The annexation of the Felton Service Area into SLVWD's boundaries and eventual acquisition by SLVWD of Cal-Am's water utility operation is not an activity that triggers the need for or increases the likelihood of ongoing maintenance and repair of Cal-Am's (or SLVWD's) facilities—those activities would continue to occur if the sphere amendment and annexation were abandoned and the two utilities continued to operate on their own. Even if there were some nexus between the transfer of authority from Cal-Am to SLVWD and the maintenance, repair, and upgrading of utility facilities currently owned by one or both entities, however, that sort of ongoing activity would be exempt from CEQA review as a Class 1 exemption.

The "Class 20" categorical exemption set forth in 14 Cal. Code Regs. § 15320 also applies. That regulation exempts from CEQA review "changes in the organization or reorganization of local governmental agencies where the changes do not change the geographical area in which previously existing powers are exercised." (Compare § 15319, which exempts from CEQA review "annexations to a city or special district of areas containing existing public or private structures developed to the density allowed by the current zoning or pre-zoning of either the gaining or losing governmental agency whichever is more restrictive. . . ." Given that the Felton Service Area is the equivalent of some 100 single-family units short of full "build out," we have not directly relied on this exemption.) Under the Cortese-Knox Local Government Reorganization Act of 1985 that governs SLVWD's proposed annexation, the annexation is considered a "change of organization." (See Government Code § 56021(c).) The annexation will not change the geographical area in which previously existing powers are being exercised—it will be nothing more than a step in the direction of changing the identity of the entity exercising those powers—formerly Cal-Am and ultimately SLVWD.

Finally, with respect to the SLVWD's potential acquisition of the Cal-Am watershed property in particular, the "Class 25" categorical exemption (14 Cal. Code Regs. § 15325) exempts from CEQA review the transfer of ownership of land "to preserve the existing natural conditions."

While the statutory and categorical exemptions assume that a CEQA "project" exists in the first place, the applicability of these exemptions to various aspects of SLVWD's overall proposal supports our conclusion that no CEQA analysis of the impacts of the proposed sphere amendment and annexation is required, albeit based upon a slightly different legal rationale.

E. The Fact that LAFCO Prepared An Initial Study and Negative Declaration for the 2003 Sphere of Influence Amendment Is Not Inconsistent With a Determination that the Currently Proposed Additional Sphere Amendment and Annexation Are Not a CEQA “Project.”

As noted in Section IV.E above, LAFCO prepared an Environmental Initial Study and a Negative Declaration for the Sphere Influence Amendment that LAFCO approved in September 2003. On the surface, LAFCO’s action might be viewed as being somehow inconsistent with our conclusion that SLVWD’s proposed addition of the Sphere of Influence Area to SLVWD’s sphere and its annexation of the Felton Service Area are not a CEQA “project” at all.

If one carefully reviews the prior Environmental Initial Study and Negative Declaration, however, their basic conclusion is wholly consistent with our position. The LAFCO staff certainly did not know all of the particulars of SLVWD’s annexation and service plans prior to the time that the Sphere of Influence and Service Review and Environmental Initial Study were prepared. Those documents addressed all of the pertinent facts and arguments and validated the basic point that a transfer of jurisdiction from Cal-Am to SLVWD will not result in a physical change in the environment that must be (further) reviewed under CEQA.

VI. CONCLUSION.

“The purpose of CEQA is not to generate paper, but to compel government at all levels to make decisions with environmental consequence in mind.” (14 Cal. Code Regs. § 15003(g), citing *Bozung v. LAFCO, supra.*) Consistent with these objectives, public agencies are encouraged to “reduce delay and paperwork” when addressing CEQA compliance issues. (*Id.*, § 15006.) Based upon the fact that SLVWD’s proposed addition of the Sphere of Influence Area to SLVWD’s sphere and its proposed annexation of the Felton Service Area will not result in any direct or indirect physical changes in the environment, the proper course of action is to determine that these actions do not constitute a CEQA “project.” Appropriate recitals and findings consistent with the conclusion set forth in this Memorandum have been included in the draft Resolution of Application that is being presented to the Board for your consideration at your March 23, 2006, meeting.

Board of Directors of the San Lorenzo Valley
Water District
March 10, 2006
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Attachment 1

EXHIBIT A

STATE WATER RESOURCES CONTROL BOARD
DIVISION OF WATER RIGHTS

PERMIT FOR DIVERSION AND USE OF WATER

PERMIT 20123Application 24652 of Citizens Utilities Company of CaliforniaP. O. Box 15468, Sacramento, California 95813Filed on July 26, 1974, has been approved by the State Water Resources Control Board SUBJECT TO VESTED RIGHTS and to the limitations and conditions of this Permit.

Permittee is hereby authorized to divert and use water as follows:

1. Source:

Tributary to:

(1) Bull CreekSan Lorenzo River(2) Bull SpringBull Creek(3) Bennett CreekFall Creek(4) Fall CreekSan Lorenzo River

2. Location of point of diversion:

(1) North 84°00' East 2,607 feet
from W_{1/2} corner of Section 2148-acre subdivisions
of public land survey
or collection thereof

Section

Town-
ship

Range

Zone
and
MeridianSE $\frac{1}{4}$ of NW $\frac{1}{4}$

21

10S

2W

MD

(2) South 1,700 feet and East 100 feet
from NW corner of Section 21SW $\frac{1}{4}$ of NW $\frac{1}{4}$

21

10S

2W

MD

(3) South 576 feet and East 41 feet
from NW corner of Section 21NW $\frac{1}{4}$ of NW $\frac{1}{4}$

21

10S

2W

MD

(4) North 45°05' East 78 feet from
fractional corner between Sections
16 and 21 on west boundary of
Zayante RanchoSE $\frac{1}{4}$ of SE $\frac{1}{4}$

16*

10S

2W

MD

15-45

County of

Santa Cruz

*Projected

3. Purpose of use:

4. Place of use:

Section

Town-
ship

Range

Zone
and
Meridian

Acres

MunicipalService area of Citizens
Utilities Company of
California, being within
projected and fractional
Sections 16 and 21, and
projected Sections 15,
22, 23, 26, 27 and 28 as
shown on map filed with
the State Water Resources
Control Board.

10S

2W

MD

The place of use is shown on map filed with the State Water Resources Control Board.

5. The water appropriated shall be limited to the quantity which can be beneficially used and shall not exceed 1.7 cubic feet per second to be diverted from January 1 to December 31 of each year. The maximum amount diverted under this permit, together with that diverted under licensed Applications 5297, 5299, 8843, 8844 and 8845 shall not exceed 1,059 acre-feet per annum. (0000005)
6. The amount authorized for appropriation may be reduced in the license if investigation warrants. (0000006)
7. Complete application of the water to the authorized use shall be made by December 31, 2000. (0000009)
8. Progress reports shall be submitted promptly by permittee when requested by the State Water Resources Control Board until license is issued. (0000010)
9. Permittee shall allow representatives of the State Water Resources Control Board and other parties as may be authorized from time to time by said Board, reasonable access to project works to determine compliance with the terms of this permit. (0000011)
10. Pursuant to California Water Code Sections 100 and 275, and the common law public trust doctrine, all rights and privileges under this permit and under any license issued pursuant thereto, including method of diversion, method of use, and quantity of water diverted, are subject to the continuing authority of the State Water Resources Control Board in accordance with law and in the interest of the public welfare to protect public trust uses and to prevent waste, unreasonable use, unreasonable method of use or unreasonable method of diversion of said water.
- The continuing authority of the Board may be exercised by imposing specific requirements over and above those contained in this permit with a view to eliminating waste of water and to meeting the reasonable water requirements of permittee without unreasonable draft on the source. Permittee may be required to implement a water conservation plan, features of which may include but not necessarily be limited to: (1) reusing or reclaiming the water allocated; (2) using water reclaimed by another entity instead of all or part of the water allocated; (3) restricting diversions so as to eliminate agricultural tailwater or to reduce return flow; (4) suppressing evaporation losses from water surfaces; (5) controlling phreatophytic growth; and (6) installing, maintaining, and operating efficient water measuring devices to assure compliance with the quantity limitations of this permit and to determine accurately water use as against reasonable water requirements for the authorized project. No action will be taken pursuant to this paragraph unless the Board determines, after notice to affected parties and opportunity for hearing, that such specific requirements are physically and financially feasible and are appropriate to the particular situation.
- The continuing authority of the Board also may be exercised by imposing further limitations on the diversion and use of water by the permittee in order to protect public trust uses. No action will be taken pursuant to this paragraph unless the Board determines, after notice to affected parties and opportunity for hearing, that such action is consistent with California Constitution Article X, Section 2; is consistent with the public interest and is necessary to preserve or restore the uses protected by the public trust. (0000012)
11. The quantity of water diverted under this permit and under any license issued pursuant thereto is subject to modification by the State Water Resources Control Board if, after notice to the permittee and an opportunity for hearing, the Board finds that such modification is necessary to meet water quality objectives in water quality control plans which have been or hereafter may be established or modified pursuant to Division 7 of the Water Code. No action will be taken pursuant to this paragraph unless the Board finds that (1) Adequate waste discharge requirements have been prescribed and are in effect with respect to all waste discharges which have any substantial effect upon water quality in the area involved, and (2) the water quality objectives cannot be achieved solely through the control of waste discharges. (0000013)

12. For the protection of fish and wildlife, diversion under this permit shall be subject to the following bypass flows at the Fall Creek diversion:

(a) April 1 through October 31, 1.0 cubic foot per second and (b) November 1 through March 31, 1.5 cubic feet per second. The natural streamflow shall be bypassed whenever it is less than the required bypass flow. However, during a dry year, the bypass requirement shall be reduced to 0.75 cubic foot per second November 1 through March 31 and 0.5 cubic foot per second April 1 through October 31. A dry year is one in which cumulative monthly runoff in the San Lorenzo River at the U. S. Geological Survey gage at Big Trees is less than the amounts shown in the following schedule.

November 1 for the month of October	500 acre-feet	
December 1 for October and November	1,500 acre-feet	
January 1 for October through December	5,000 acre-feet	
February 1 for October through January	12,500 acre-feet	
March 1 for October through February	26,500 acre-feet	(0140400)

13. Permittee may divert water under this permit only when flow in the San Lorenzo River below the Felton Diversion Weir exceeds the following amounts:

- a. September -- 10 cubic feet per second;
- b. October -- 25 cubic feet per second;
- c. November 1 through May 31 -- 20 cubic feet per second. (0350400)

14. No water shall be diverted under this permit until permittee has installed a device on Fall Creek, satisfactory to the Chief, Division of Water Rights, of the State Water Resources Control Board, which is capable of measuring the flows required by the conditions of this permit. Said measuring device shall be properly maintained. (0350400)

15. Permittee shall maintain a record of the stream and bypass flows on Fall Creek and make such records available to the State Water Resources Control Board upon reasonable request. (0090400)

16. In accordance with Sections 1601 and 6100 of the Fish and Game Code, no water shall be diverted under this permit until the Department of Fish and Game has determined that measures necessary to protect fishlife have been incorporated into the diversion facilities. The construction, operation, and maintenance costs of any required facility are the responsibility of the permittee. (0350500)

17. Permittee shall install and maintain a fish screen at any point of diversion past which salmon or steelhead are expected to migrate as determined by the Department of Fish and Game and as required by Section 6100 of the Fish and Game Code. (0360500)

18. Permittee shall establish only those raw water service connections that have been authorized by any required local permits and which demonstrate compliance with the Central Coast Regional Water Quality Control Plan, as may be amended from time to time. (0450300)

19. Permittee shall consult with the Division of Water Rights and develop and implement a water conservation plan or actions. The proposed plan or actions shall be presented to the State Water Resources Control Board for approval within one year from the date of this permit or such further time as may, for good cause shown, be allowed by the Board. A progress report on the development of a water conservation program may be required by the Board at any time within this period.

All cost-effective measures identified in the water conservation program shall be implemented in accordance with the schedule for implementation found therein. (0410700)

20. Total diversion of water under this permit and licensed Applications 5297, 5299, 8843, 8844 and 8845 have a daily maximum of 1.87 cubic feet per second is prohibited until the permittee demonstrates, and the Chief, Division of Water Rights concurs in writing that the permittee can provide a dependable supply of water to its users during the months of July through November. (0350800)

This permit is issued and permittee takes it subject to the following provisions of the Water Code:

Section 1320. A permit shall be effective for such time as the water actually appropriated under it is used for a useful and beneficial purpose in conformity with this division (of the Water Code), but no longer.

Section 1321. Every permit shall include the specification of conditions thereto which in substance shall include all of the provisions of this article and the statement that any appropriation of water to whom a permit is issued takes it subject to the conditions therein expressed.

Section 1322. Every permittee, if he accepts a permit, does so under the conditions precedent that he value whatsoever in respect of the actual amount paid to the State therefor shall at any time be assigned to or claimed for any permit granted or issued under the provisions of this division (of the Water Code), or for any rights granted or acquired under the provisions of this division (of the Water Code), in respect to the regulation by any competent public authority of the services or the price of the services to be rendered by any permittee or by the holder of any rights granted or acquired under the provisions of this division (of the Water Code) or in respect to any valuation for purposes of sale to or purchase, whether through condemnation proceedings or otherwise, by the State or any city, city and county, municipal water district, irrigation district, lighting district, or any political subdivisions of the State, of the right and property of any permittee, as the possessor of any rights granted, issued, or acquired under the provisions of this division (of the Water Code).

Date:

AUGUST 03 1997

STATE WATER RESOURCES CONTROL BOARD

Raymond Walsh