



TUOLUMNE UTILITIES DISTRICT

Board of Directors

Barbara Balen
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August 9, 2022

Assistant Presiding Judge of the Superior Court
County of Tuolumne
Department 2 – Second Floor
12855 Justice Center Drive
Sonora, CA 95370

Re: Tuolumne Utilities District Report: Water is Life
2020-2022 Grand Jury Report

Dear Judge Krieg,

On May 9, 2022 TUD received a copy of the Grand Jury report saying the report would be made public on May 12 and to respond to the Findings and Recommendations within 90 days.

Attached are TUD's responses that correspond to each of the 3 Parts: 1) Finance, Management, and Operations; 2) Personnel and Leadership Changes and; 3) Water Rights and Future Development.

I found the TUD Grand Jury Report to be helpful and insightful and the 2020-22 members very professional. While the Report looked into TUD's plans and operations, it also called attention to the need for *broader goals that integrate TUD within the community and the watershed*. This is reflected in the Grand Jury's title for TUD's report: **Water is Life**.

TUD's response strives to match the level of thoughtfulness the Grand Jury used in guiding its inquiry into the workings of TUD. We recognize the need for improvements and appreciate the Grand Jury's suggestions. It was clear that the Grand Jury understood the complexity of issues over TUD's 30-year history, and we respect it being able to present those issues in a helpful manner.

Last, on behalf of the TUD board and the agency, I would like to thank the members of the Grand Jury and its Foreperson, Alicia Bergman for their professionalism and due diligence. Tuolumne County is fortunate to have this caliber of citizen on its Grand Jury.

Sincerely,

Barbara J. Balen, TUD Board President

Part 1. Finance, Management, and Operations

Findings

F1.1: Considering its inherited and aging infrastructure, TUD's existing rate structure is not adequate to fund its capital improvement needs unless significant grant funding materializes. While the agency is doing a good job in maintaining affordable rates, living within its means, and seeking external funding, it relies heavily on sources beyond its CIP. This creates a risk of further deferring important capital improvements.

District Response

Unfortunately, the total needs far exceed the ability to maintain affordable rates, so we are continuing to seek grant funding everywhere possible. The district plans on conducting a cost of services study as soon as appropriate which will likely develop rate change recommendations.

While it is true that TUD relies on outside resources like grants and loans, we are fortunate that these programs are available for water systems within disadvantaged communities. Although the emphasis is on being self-reliant, we also see the strength in responding to grant opportunities that require community-based solutions in partnership with local tribes and private partners. These grants achieve much community benefit that supplement operations and maintenance type projects.

F1.2: TUD's budget is not providing adequate contingency reserve funding, as illustrated by the discrepancy between the estimated \$100,000 in damage from the December 2021 storm event compared to the \$19,486 set aside in the Fiscal Year 2022 budget for the water contingency fund. The ability of TUD customers to survive and thrive requires the agency to have a robust capacity to budget and to plan for the unforeseen without relying on emergency declarations, grants, or assistance from other agencies in the short response term.

District Response

Pursuant to its Reserve Policy, the District maintains an Operating Fund Reserve and a Contingency Emergency Fund Reserve for both the Water Fund and the Sewer Fund at prescribed targeted levels. The amount identified in the Fiscal Year 2022 budget referenced in the finding was the single-year budgeted amount to add to the water contingency fund to maintain the targeted levels based on the budgeted operation and maintenance for the Fiscal Year 2022. Total balances in the Operating Fund Reserve and Contingency Emergency Fund Reserve as of June 30, 2021, were \$3,340,505 and \$256,917 respectively for the Water Fund.

TUD recognizes that the environmental stressors on small water agencies in rural communities are serious and potentially devastating.

For this reason, TUD has initiated a plan to identify fire water access points where county roads intercept the gravity ditch system, increased its emergency inventory of materials, is entering into mutual aid agreements with water agencies in Calaveras County to share materials and personnel, enhanced its cybersecurity, researched fire protection measures to defend TUD facilities in remote areas and participated in vegetation management programs.

F1.3: TUD has a clear and appropriate new connections process and has not impeded county development through denial of new connections.

District Response

The district agrees with this finding.

Recommendations

R1.1: TUD should continue to seek grant funding for its capital improvement needs. Recognizing the recent passage of the Infrastructure Investment and Jobs Act, the next several years could be a watershed opportunity for funding upgrades to aging infrastructure in the utilities sector. TUD should ensure it is prepared to meet oncoming changes by:

- staying abreast of grant qualification thresholds (i.e., proportional rate percent of MHI);
- dedicating the best people and pool resources to prepare successful grant applications; and
- ensuring it has adequate resources for matching/contributing grant and loan funding requirements.

District Response

The district agrees to work toward these goals.

R1.2: Because the timing and availability of grant funding are beyond TUD's control, the TUD Board of Directors should also consider undertaking a new rate study by January 2023 that addresses CIP funding, specifically:

- the funding of infrastructure consolidation projects already in the CIP;
- ensuring revenue supports not just the marginal cost of supplying water but CIP and inflation; and
- identifying additional savings opportunities that could be applied to infrastructure modernization and improvement.

District Response

The district agrees with this finding.

R1.3: The TUD Board of Directors should consider undertaking a new rate study by January 2023 that re-evaluates the adequacy of TUD's contingency reserve funding. This should include an analysis of the sufficiency of the two percent contingency target reserve and how reserve fund levels are tracked and reported.

District Response

The district recognizes the need for a new rate study, and we will re-evaluate the adequacy of TUD's contingency reserve funding at that time. We would like this to be timed with the PG&E negotiations for assets and water rights acquisitions; however, this may not be possible.

In particular, TUD will re-evaluate the district's adopted Reserve Policy which states the following:

3.4 The following funds and reserve targets are established with this Reserves Policy:

3.4.1 Operating Fund Reserve

- a) Purpose - the purpose of the Operating Fund Reserve is to provide working capital to meet cash flow needs during normal operations and to support the operation, maintenance and administration of the district. The reserve is intended to reduce impacts from unforeseen events such as increased costs, severe drought, heavy rainfall, replacement of rolling stock, litigation, and legislative actions. This reserve ensures that operations can continue should there be significant events that impact cash flows.*
- b) Target Reserve-the target reserve for this fund is established as a range between a minimum of 90 days (3 months) of annual operation and maintenance ("O&M") expense and a maximum of 270 days (9 months) of O&M. Reserves over 270 days will be transferred to the Capital Improvement Projects Fund Reserve at the end of a fiscal year.*

3.4.2 Contingency/Emergency Fund Reserve

- a) Purpose-the purpose of the contingency/emergency fund reserve is essentially to protect the district against the financial impacts from unanticipated catastrophes or emergencies. It provides funding for emergency repairs or failure of essential equipment that needs to be immediately replaced. Typically, the level of contingency/emergency funds that is deemed sufficient is an amount equal to the required cash flow until such time that adequate emergency financing can be secured from conventional resources.*
- b) Target Reserve - the target reserve for this fund is two percent (2%) of annual O&M.*

The Reserves Policy was last evaluated and adopted on June 9, 2020 and is updated as needed. The cash reserve balances are to be maintained in separate funds within the accounting system in a manner that maintains accurate tracking of transactions and transparency to the district's ratepayers. The district follows standardized methods of financial reporting such as Governmental Accounting Standards Board (GASB) No. 34 and/or No. 54.

Part 2. Personnel and Leadership Changes

Findings

F2.1a: The frequent termination and turnover of TUD general managers over the last decade has carried both tangible and intangible costs, including costs associated with the payment of severance pay and benefits, impacts to employee morale, and a reduction in productivity associated with changes in leadership priorities.

District Response

TUD agrees with the assessment that there are both tangible and intangible costs associated with general manager turnover. Each board weighs these costs usually at the time a GM contract is up. Termination at the end of the contract term is often the most cost-effective way to end the relationship, but in certain situations it may not be, or it may not be desirable. On two occasions over the past 30 years, the TUD board terminated a GM before their contract was up. The reasons for this were varied but believed to be in the best interest of TUD at that time.

It is the district's goal to hire and retain high performing staff, including at the general manager level. The Board and the current general manager executed a five-year employment agreement in October 2021 and are committed to continuity of operations and the benefits that leadership longevity can have for its customers.

F2.1b: Adoption of a board-approved policy that establishes the process for the selection, termination, evaluation, and compensation of the general manager would assist the TUD Board of Directors in pre-empting the higher than ideal turnover in this key position and the tangible and intangible costs described in F2.1a.

District Response

TUD agrees with this finding. While termination and compensation are spelled out in the GM contract (General Manager Employment Agreement), a board-approved stand-alone policy to guide the process would be helpful.

F2.2: TUD department managers and other agency employees may be uniquely suited to assist the TUD board in assessing qualifications of general manager applicants and evaluating the performance of the general manager or other senior TUD employees, but there is no TUD board- approved policy encouraging the involvement of subordinate employees in hiring and performance review appraisals of the general manager or other senior TUD staff.

District Response

The TUD board agrees with this finding.

F2.3: The competitiveness of TUD employee compensation is an important consideration in the district's ability to recruit and retain the quality personnel upon which it is so dependent.

District Response

The district agrees that competitive employee compensation is an important consideration in its ability to recruit and retain quality personnel – TUD's most valuable asset. Since 2017, the district has conducted four comprehensive total compensation studies to fully understand how its compensation and benefits compare within its comparison market and provided equity adjustments to positions' salary whose total compensation fell below 3% above the average total compensation for comparison agencies in multiple years. The district typically conducts total compensation studies preceding new contract negotiations with the Laborers' Union.

Recommendations

R.2.1: Prior to the next performance review/compensation cycle, the TUD Board should adopt a policy that establishes the process for hiring and firing, evaluating the performance of, and adjusting the compensation of the general manager.

District Response

These criteria are established in the current general manager's contract and were reached through negotiation between the Board and the general manager, which is very typical for general managers.

R.2.2: The TUD board should consider including a role for TUD department managers and other agency employees (e.g., via a "360-degree" review process) in any policy adopted pursuant to R2.1. Similarly, TUD should consider involving subordinate employees in the hiring process and performance review appraisals for other members of the TUD staff such as department managers.

District Response

The TUD board agrees to involve TUD managers, staff and employees in the process of hiring, evaluating the performance of, and adjusting the compensation of the general manager as appropriate. This could be a professionally facilitated workshop to insure fairness and neutrality.

R2.3: Particularly in light of recent trends in the labor market, TUD should, withing the next year, consider:

- **Commissioning an updated evaluation of employee salary structures and benefit packages;**
and
- **Adopting a policy for the regular evaluation of manager and other employee salary structures that:**

- **Uses salary survey allowing for comparison and other comparable agencies in the region that provide water and wastewater services and are comparable in size to TUD; and**
- **Requires a new salary survey, at minimum, every five years and posts the survey on TUD's website, along with compensation information for TUD board members and employees.**

District Response

The district plans to conduct another total compensation study preceding its next contract negotiations with the Laborers' Union, which has been the district's practice. All wages, hours and working conditions are negotiated with the Laborers' Union.

Since 2017, the district has conducted four comprehensive total compensation studies to fully understand how its compensation and benefits compare within its comparison market and provided equity adjustments to positions' salary whose total compensation fell below 3% above the average total compensation for comparison agencies in multiple years.

The district's salary schedule (i.e., compensation) and benefits summary for all TUD employees are available on the TUD website.

3. Water Rights and Future Development

Findings

F3.1: There has been a lack of transparency about the status, progress, potential conclusion, and possible effects of the proposed acquisition of PG&E property and water rights on TUD and the ratepayers. Potential effects of this lack of transparency include public confusion and ultimately a risk to public support for the proposal.

District Response

Approximately five years ago, PG&E approached TUD about acquiring the Phoenix System and associated water rights on the South Fork Stanislaus River. Since that time TUD has completed many of the "due diligence" tasks necessary to communicate with the public about the costs, benefits, and risks associated with acquiring or not acquiring the PG&E assets. Some of the initial work involved executing non-disclosure agreements, a term sheet, and recruiting and retaining several consultants to assist in evaluating the technical and financial aspects of the transaction. As was the case in previous PG&E hydroelectric project divestments across California, many details cannot be released and are appropriately part of a legally binding non-disclosure agreement between PG&E and TUD as the two parties negotiate towards an agreement.

Throughout the process TUD has shared what information it could with the public; however as mentioned, much of the information is protected under the legally binding non-disclosure agreement. Further, TUD worked hard to accommodate PG&E and its desire to have review and approval authority over public documents and press releases. TUD worked patiently and cooperatively with PG&E to provide valuable information to both utilities' customers.

TUD is a strong advocate of transparency and practices transparency throughout the organization. Recognizing the importance of the PG&E acquisition, TUD hired a communications firm to assist in developing a comprehensive communications plan incorporating stakeholder interview, videos, print and radio advertisements, and informational materials. TUD has been transparent from the beginning; however, we are also very sensitive to managing expectations of the public in respect to the transaction with PG&E, a private company, while the negotiations were on-going, and terms had not been finalized. Until an agreement is executed between the two parties, TUD is unable to be fully transparent.

TUD has held several public meetings with the community, including joint meetings with the County and the City during which TUD shared the information it had available. While this was occurring, TUD staff and its consultants completed an extensive line by line analysis of the operations and maintenance costs of assuming ownership of the Phoenix System. This exercise and due diligence took significant time and many requests for information from PG&E to reach an appropriate level of certainty on costs so that TUD could calculate the additional revenue necessary to fund the expected O&M costs. TUD hired Raftelis to develop the financing plan and to calculate the impact to customers in the form of rate increases. The rate study and proposed rate increase details were recently released to the public.

It would have been premature and potentially damaging to the public trust for TUD to share draft revenue needs and draft rate increases with the public until thoroughly vetted and its third-party financial consultant (Raftelis) completed the financing plan. The information was first daylighted to the TUD Board on May 9, 2022. On May 10th, the information was shared with the Tuolumne County and City of Sonora at a joint board meeting in the Tuolumne County Board of Supervisors chambers. Press releases to local media outlets were circulated and public outreach was coordinated. TUD also scheduled future meetings and open houses to give the public a voice in the process. The TUD Board authorized mailing a Proposition 218 Notice to all of its customers outlining the justification and rationale for a rate increase. The notices were mailed on June 1, 2022.

Unfortunately, on June 2nd, one day after TUD mailed its Proposition 218 rate notice, TUD General Manager Don Perkins was informed that PG&E was suspending negotiations until at least the end of 2023. The challenge for TUD moving forward will be to continue being transparent by keeping the public engaged and informed during the next 18 months, when little to no new information will likely be available to share. TUD is committed to upholding its commitment to the public and will share any new disclosable information as it becomes available.

In addition, since the GJ report came out, TUD has taken the opportunity to fill a staff vacancy with a community relations specialist dedicated to providing timely information.

F3.2: The PLPRP has been only partially implemented and has not addressed important opportunities for recreation or environmental benefits.

District Response

When adopted by the TUD Board in 2012, the Phoenix Lake Preservation and Restoration Plan was only a plan with no identified funding for implementation. TUD staff worked diligently for several years to secure funding to implement the entire project, but ultimately and despite significant effort, staff secured limited funds to complete the most important aspects of the plan as they related to improve

water quality and increase water storage. It was and still is extraordinarily difficult to locate adequate funding for a project of this magnitude as the grant process is competitive, has strict timelines, and the funds are limited. While an entity may be able to secure funding from one source, one must use those funds within a limited time or risk losing those funds. If the funding is inadequate, funding from other sources must be obtained before losing the first grant funds. Very few grant applications result in funding to implement an entire project. In the case of the PLPRP, the original project cost was estimated at \$12 Million in 2012 (and \$15.7 Million today) and TUD was only able to secure \$6,380,083 in funding of which the district's local cost share requirement was \$1,249,708. The district completed as much of the project it could with the funding available.

Funding has yet to be secured to implement the remaining vision of the plan, including some the recreational concepts outlined in the plan. Before any recreational improvement project can be implemented there are many costly details that need to be worked out, including CEQA compliance, alignment and width of access roads and trails for ingress and egress, right-of-way and property acquisitions, issues related to indemnification of TUD and other property owners, public outreach about the neighborhood's support (or lack thereof) for developing public access, parking, lighting, garbage collection, noise, public safety, landowner objections, agency negotiations, permit acquisition, environmental and regulatory requirements, habitat mitigation requirements, and who would be responsible for the ongoing operations and maintenance expenses, to name a few. The PLPRP identified three locations for public access to the lake, and the TUD Board intends to prioritize which locations are preferred so that staff have clear direction on how to proceed on this recreational benefit. As noted in this year's Grand Jury Report, TUD is already falling short of establishing a system where revenue is equal to expenses, including capital improvements and replacements. If additional funds are diverted away from the already underfunded services (water and sewer) for important public benefits, then the shortfall between revenue and expenses will increase. Unless TUD secures additional sources of revenue or a multimillion-dollar grant, it cannot afford to implement the remaining portions of the PLPRP.

The TUD Board's original objective was to have a "triple bottom line approach" meaning projects must consider the environmental and social benefits in addition to economic benefits. The initial study by Horizon Water and Environment consultants laid the groundwork for this objective, however while some projects were completed with partial funding, others identified in the plan were not pursued for lack of funding. The Board recognizes the need for integrated resource management, and it may be possible to address this by approaching projects with a broad disciplinary team that can enhance many benefits at the same time.

F3.3: TUD has an important opportunity to protect, preserve, and enhance the environment, and to enrich recreational opportunities in the county that are not adequately addressed in their strategic plan, its staffing, and funding.

District Response

The TUD board agrees that it has an important opportunity to protect, preserve, and enhance the environment, and it has taken advantage of this opportunity where possible. These values have translated into healthy communities and improved quality of life for those rural mountain counties who

have adopted them. Many small districts have four revenue streams: water, sewer, recreation and hydropower. TUD currently has two: water and sewer. If the revenue streams increase in number or scope, then more opportunities can be realized. TUD seeks to use an inter-disciplinary approach to carry out and seek funding for these opportunities in a meaningful way.

Recommendations

R3.1: TUD should designate a “point person” to answer public inquiries regarding the PG&E acquisition. Without further delay, TUD should disclose to the public all non-confidential information regarding the current state of discussions regarding the PG&E acquisition.

District Response

With the PG&E negotiations in mind, TUD has already taken steps to address this Recommendation by filling the community outreach position with an external affairs specialist. This person will be dedicated to working with the GM and TUD’s communications consultant to ensure timely distribution of important public information.

We understand the public desires more information about the acquisition and share their frustration in TUD’s limitations to share information; unfortunately, at this juncture, there is very little left to share with the public until negotiations resume and TUD and PG&E can execute an agreement.

R3.2: TUD should provide a clear explanation of the benefits to the TUD ratepayer associated with the direct costs of the proposed acquisition, as well as ancillary costs such as the hiring of a professional negotiator and a public relations firm.

District Response

The transactional costs associated with the acquisition are contained in the District’s Audited Financial Statements and Operating Budget under the categories of legal expenses and consultants, both of which have been presented to the TUD Board in open session. Some of the details related to the legal expenses are protected under attorney-client privilege. This level of confidentiality protects the district from other downstream entities which may perceive this as an opportunity to attempt to acquire these PG&E assets for their own purposes. Additionally, disclosing some of TUD’s internal figures could compromise our position at the bargaining table with PG&E. The sheer magnitude of a water rights and hydropower plant transfer that is governed by a Federal Energy Regulatory Commission (FERC) License is too complex to handle with TUD staff alone, which is why the TUD Board enlisted consultants with specific expertise in these types of transactions. The TUD Board identifies this opportunity as the district’s top, number one priority that TUD cannot afford to lose. Being proactive and assembling a team of top-notch experts was the best plan for success in this once-in-a-lifetime opportunity for the benefit of the community as a whole.

R3.3: By June 2023, TUD should actively develop a plan and pursue funding for full implementation of the PLPRP.

District Response

The TUD board hopes to develop a plan and pursue funding for full implementation of the PLPRP.

TUD has limited resources, however. Should the decision be made to pursue the balance of the project, additional funding must be located, otherwise full implementation of the PLPRP would be at the expense of other capital projects. Without knowing which other critically needed infrastructure improvements would need to be deferred in order to promote the PLPRP, it is difficult to assess the impacts of this recommendation on its ratepayers.

If established as a priority, and funding is allocated or obtained, then staff could complete preliminary design, conduct CEQA, write grants, and/or hire grant writers. Unfortunately, even if designed, the project simply isn't within TUD's financial means without grant funds for implementation. TUD staff will continue to canvass state and federal programs to identify funding opportunities for the project; however, full implementation of the project will cost at least \$10 million, and most grants have a cap of \$2 million to \$5 million, which means that multiple grants must be secured in order to finish the project.

R3.4: The TUD board should amend its strategic plan to include stronger environmental and recreational goals and objectives by June 2023.

District Response

The TUD board agrees to consider amending its strategic plan to strengthen its environmental and recreational goals at an upcoming strategic planning session.

At this point, the district has not identified a revenue source to fund recreational improvements. Unless grants are obtained, the funding for recreation would come directly from water and wastewater ratepayers.