



RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES

DATE: NOVEMBER 9, 2020

ITEM NO: 10

SUBJECT: AGREEMENT FOR OPERATION OF GAGE CANAL FACILITIES BETWEEN THE CITY AND THE GAGE CANAL COMPANY

ISSUE:

Receive and file this report on the Agreement for Operation of Gage Canal Facilities between the City of Riverside and the Gage Canal Company.

RECOMMENDATION:

That the Board of Public Utilities receive and file this report on the Agreement for Operation of Gage Canal Facilities between the City of Riverside and the Gage Canal Company.

BACKGROUND:

City Acquisition of the Gage Canal Assets / 1965 Judgment in Eminent Domain

The Gage Canal Company (Company) was established in 1890 as a private, non-profit California corporation. The purpose of the Company was to bring artesian and pumped well waters, originating in the Bunker Hill basin area of San Bernardino, into Riverside for the purposes of irrigation. Later, additional wells were drilled in the Riverside North and Riverside South basins to increase their water supply. Shareholders in the Company had a right to a certain amount of gravity-fed water from the canal delivered on certain days of the month. In 1959, the City of San Bernardino and San Bernardino Valley Municipal Water sought to condemn the Gage Canal Company in order to reduce the amount of water being exported out of the Bunker Hill groundwater basin. At the behest of some of the Gage shareholders, the City of Riverside (City) exercised its power of eminent domain by filing a lawsuit to acquire all assets of the Company in 1959 to secure water rights for the beneficial use of the residents of the City.

The condemnation was delayed, in part, by legal action brought in 1962 by certain Company shareholders. The plaintiffs in the case of *Erwin, et al, vs Gage Canal Company* (Attachment 7) were shareholders who argued that the water rights were appurtenant to the land, were not owned by the Company and the Company could not negotiate a settlement with the City for acquisition of those rights. The court disagreed, holding that Company shares only represent a delivery right to Gage Canal water, and that the water rights were owned by the Gage Canal Company. In 1963, the *Erwin* case was resolved in favor of the Company and the City's condemnation lawsuit continued forward.

On June 9, 1965, the City and the Company entered into a stipulated judgment (Stipulation for Judgement in Eminent Domain and Final Order of Condemnation, Case No. 70785), under which the City acquired the majority of the Company's assets. One of the conditions of the stipulated judgment was the City agreed to continue irrigation water delivery to the shareholders and to employ the Company for the operation of the canal. In effect, the City purchased all the water rights, facilities, and property of the Gage Canal Company, less three operating properties the Company retained. The purchase price was \$547,277 which would be the equivalent of approximately \$4 million in 2020 dollars.

The three (3) properties not condemned to the City were the Company's headworks office and residences in San Bernardino at 1271 Tippecanoe Avenue; the Company's main administrative office located at 7452 Dufferin Avenue in Riverside; and the property with residences located adjacent to the Mockingbird Canyon dam and reservoir at 1850 Jackson Street in Riverside.

As part of the 1965 judgment, the City agreed to have the Company continue to operate its newly acquired assets. The *Agreement for Operation of Gage Canal Facilities* (Operating Agreement) was a specific condition and part of the stipulated judgment approved by the court. The Operating Agreement has afforded the City with 55 years of successful operation and coordination with the Company.

Components of the Operating Agreement

The original Operating Agreement (Attachment 2) had 23 sections that defined terms; set limits; and provided guidelines of performance, responsibility, ownership, and maintenance obligations of both the Company (as an independent contractor), and the City (as the new owner of the condemned facilities and properties). The major components of the 1965 Operating Agreement are listed below:

- a. Established guidelines for the Company and City;
- b. Retained Company's experienced personnel to operate canal system;
- c. Clarified Company personnel are not City employees;
- d. Protected shareholder and contract obligees' rights to receive water;
- e. Limited Company from engaging in new business;
- f. Froze Company shares at 14,055;
- g. Kept new shares from being issued;
- h. Allowed City to encumber shares in default;
- i. Established limits of liability for the City;
- j. Established right of City and Company to access records of each other;
- k. Protected all fixed works, equipment, and improvements;
- l. Required Company to patrol and maintain properties condemned to the City;
- m. Required Company to perform all capital improvements or replacements necessary for the Company's delivery of irrigation water;
- n. Required Company to notify City when shares are sold or transferred;
- o. Required Company to only deliver water to land within the Gage service area;
- p. Permitted City to cover canal at City cost;
- q. Required City to pay related property taxes, and Company to reimburse City;
- r. Allowed City to utilize excess canal flowage capacity;
- s. Required City to reimburse Company for costs of excess production;
- t. Required City to provide make-up water to keep shareholders whole;
- u. Required City to pay Company for all City owned shares;
- v. Allowed City to terminate agreement if Company fails to perform any term or condition of the Operating Agreement.

City's Offer to Purchase Shares

As part of the 1965 judgment, the City offered to purchase shares from existing shareholders at a value of \$400 per share through the *Agreement For Sale Of Gage Canal Company Shares* (Attachment 4). If a shareholder chose to execute this agreement, the City would pay the shareholder \$225 upfront per share, with \$175 held back as final payment once the shares were turned over to the City. Under this agreement, the City would purchase the shareholder's stocks and associated water entitlement and the shareholder could continue to exercise their water delivery rights until such time the shareholder wished to surrender their shares. Once the shares were surrendered back to the City, the final payment of \$175 per share was made by the City to the shareholder. Shares could also transfer to the City if a shareholder was in default of payment for more than 180 days.

In July 1965, the City held 1,268 shares (or 9%) in the Company. On July 30, 1965, there were 9,137 shares represented (of the 12,787 outstanding shares) that chose to execute the agreement for sale to the City for the initial \$225 per share payment. There were also 113 shares that were sold outright to the City for the \$400 per share total payment. The City is now the majority shareholder in the Company with 8,569 (or 61%) of the 14,055 total shares. Of the outstanding 5,486 shares there are 4,787 (or 87%) represented by an executed sale agreement.

Contracts for Delivery of Irrigation Water

Gage stock was tied to a formal property description so when that description changed a contract could be issued to allow the new property description to continue to receive irrigation water from the canal. As part of the 1965 judgment, irrigation contracts could be issued to shareholders as a part of the City's original *Agreement For Sale Of Gage Canal Company Shares*. Under an irrigation contract (Attachment 5), the City would receive the shares but would "contract out" the water delivery entitlement to the customer under contract. Once the customer decided they no longer needed the water, and the contract was cancelled, the City would make the final \$175 per share payment to the shareholder. Contracts are typically in effect for 50 years and can transfer with a bona fide sale of property. The Company is required to notify the City of any transfers of a contract. The City currently has 69 contracts issued for an equivalent of 457 contracted shares of water delivery entitlement.

WA-8 Water and Gage Canal Flowage Agreement

In 1993, the City established the WA-8 Greenbelt Irrigation Service water rate. Under WA-8 rates the City increases its Riverside Canal deliveries to the Gage Canal, at the Olivewood Booster Station, and the Company transports the water to the WA-8 customers via a Flowage Agreement. This rate allowed property owners not owning shares in the Company to receive irrigation water for agricultural use from the canal under the terms of the rate. The customer requests service from the City in writing and provides property and crop information. The City verifies with the Company that the property has a physical connection to the canal to receive irrigation water. Once approved for service, the Company schedules and delivers the irrigation water to the property and bills the City for the amount delivered. The City then bills the customer using the City's billing system. The cost for the WA-8 irrigation water is typically about double what an actual Company shareholder pays due to transportation and other charges related to the Flowage Agreement when usage is proportional to their agricultural acreage.

City's Seats on the Company's Board of Directors

The City has historically held three (3) of the Company's 11 Board of Director's seats. Currently, the City's three (3) seats are filled by the Utilities General Manager, the Utilities Assistant General Manager/Water, and one member from the Board of Public Utilities.

Amendments to the Operating Agreement

There have been six (6) amendments to the Operating Agreement (Attachment 3). The primary purpose of most amendments was to address how certain sections of canal right of way were to be used and whose responsibility it was to patrol and maintain them. The amendments are listed below by date of execution and primary purpose.

Amendment No.	Date Executed	Primary Purpose
1 st	March 23, 1976	Allowed City's use of certain canal property for bike paths
2 nd	March 12, 1982	Allowed City's use of certain canal property for bike/walk paths
3 rd	January 25, 2001	Allowed Lot 30 development over canal at UCR property
4 th	May 7, 2001	Modified reimbursement for electrical costs
5 th	May 24, 2007	Allowed license agreement with Islamic Center for parking lot
6 th	September 8, 2010	Released Company from maintenance responsibility of pipeline and some property segments

DISCUSSION:

During the September 28, 2020 Board of Public Utilities meeting, the Board requested clarification of: (1) the purpose of the Operating Agreement; and (2) how the costs of capital improvements to prior Gage infrastructure are allocated between the City and the Company.

Operating Agreement's Primary Purpose

The primary purpose of the Operating Agreement is to protect the rights of Gage shareholders to receive irrigation water from the canal. The City is required to employ the Gage Canal Company for such delivery. Section 3 of the Operating Agreement provides the following:

"It is the purpose of this agreement to make available to the City of Riverside the knowledgeable irrigation water production and distribution supervision, management, operation and maintenance personnel and facilities and experience of the Company for the purpose of carrying out the duties and obligations of the City assumed and imposed by law as a result of the Judgment, for the benefit of the citizens of the City and in particular for the benefit of the shareholders and contractual obligees who possess water delivery and other contractual rights which the City has assumed and which it recognizes. Subject to the terms of the Judgment, it is the purpose of this agreement to assure that all persons lawfully entitled to receive water pursuant to the ownership of shares in The Gage Canal Company on the date of the Judgment will be protected in their respective rights to have and receive for use upon their lands irrigation water delivered in the manner to which they have become accustomed, for so long as the water is put to beneficial use on lands within the Service Area".

The Operating Agreement can only be amended or terminated by mutual agreement of the City and the Company.

Operating Agreement and Capital Cost Allocation

Section 15 of the Operating Agreement outlines how capital improvement costs are to be handled.

“All capital improvements, additions and replacements necessary to fully exercise the water rights condemned to the use of the City and necessary to the Company’s performance of this agreement shall be paid for by the Company, installed only on former Gage properties condemned to the City and shall be the property of the City. The Company shall submit an annual capital expenditure budget for approval by the City; costs of such improvements necessary to efficient performance of this agreement shall be borne by all shareholders, including the City, and/or contractual obligees as operating expense in accordance with previous practices and existing agreements; except the City shall assume the shareholders’ allocation of expense for canal covering instigated by the City”.

The Company pays for required work to deliver irrigation water and then spreads the costs across all Company shareholders. Each shareholder, including the City, would then pay the proportionate amount based on the number of shares held in the Company at that time. Currently, the City pays approximately 61% of the costs of required improvements, additions or replacements.

History of Gage Well Rehabilitations and Refurbishments

As water levels continue to decline in the Bunker Hill Basin, the City will need to deepen and improve former Gage wells to ensure their proper and adequate production capability. The wells formerly owned by the Company and acquired by the City have been used to deliver water to both the shareholders of the Company and water customers of the City. Per the Operating Agreement, the City can take any excess available water production above that needed to serve the irrigation delivery needs of the shareholders, while staying within the limits of the appropriate water rights.

Since 1966 there have been three (3) wells replaced (29-3R, 31-1R, and 46-1R), four (4) wells added (92-1, 92-2, 92-3, and 98-1) and a relocated Meeks and Daley well (Tippecanoe). For clarity, well 92-2 was the second well drilled in the year 1992. The “R” designation indicates a replacement well. For example: 46-1R means the original well was drilled in 1946 and it was subsequently replaced.

Of the three (3) Gage wells replaced, two (2) of them were fully funded by RPU (29-3R in 2020 and 31-1R in 2013) for a total of \$8,067,000. Of the four (4) wells added, three (3) of them (92-1, 92-2, and 92-3) were fully funded by RPU in 1993 for a total of \$1,195,784. The 98-1 well replaced the old Gage 21-2 well (originally drilled in 1921) and was nearly fully funded by FEMA. The cost for the new Tippecanoe well (drilled in 2007) was \$1,411,279 with the City paying \$240,000 and the remainder being paid by Caltrans. See Attachment 6 for a table of the Gage well rehabilitation history and associated costs.

The Company has also periodically refurbished the Gage wells to maintain operation and capacity.

According to Section 15 of the Operating Agreement, the Company is required to maintain the capacity to fully exercise the water rights and obligations and to deliver irrigation water to shareholders. The amount of irrigation water to be delivered to shareholders has progressively decreased from 1965, based upon demand from shareholders. This obligation currently has been met by the production capacity of the former Gage wells in the Bunker Hill Basin.

Historically, Gage met its demand in part from Riverside Basin sources, including the DeBerry well, three Olivewood wells and the Riverside Canal. At this time, the DeBerry well is no longer in service.

Equitable Portion of Capital Costs

There have been questions from the Board of Public Utilities regarding how much of the capital costs for former Gage well replacements, or well rehabilitations, should be covered by the City. As the majority shareholder in the Company, the City will automatically pay their prorata share of any approved capital expenditures made by the Company as part of their shareholdings (currently 61%). Attachment 6 illustrates how some of the well improvements have been funded by the Company, some by the City, and some being joint ventures with other governmental agencies.

The interpretation of the intent of the Operating Agreement is challenging in determining if all Company shareholders should be burdened with a prorata contribution towards all capital improvement costs related to well replacement or rehabilitations. As an example, a \$5,000,000 well project spread across all 14,055 shares equates to a prorata contribution of about \$356 per share, with the City's portion being approximately \$3 million. A five-acre parcel with ten (10) shares of Company stock would need to contribute about \$3,500, on top of their annual water tax assessment per share. If there was an option for this shareholder to reimburse the \$3,500 over 30 years at 5% interest the annual reimbursement payment would be about \$225, or approximately \$19 per month. However, the City would need to show that the capital improvement is needed for the Company to deliver irrigation water to shareholders.

FISCAL IMPACT:

There is no fiscal impact associated with this report.

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Approved as to form:	Gary G. Geuss, City Attorney

Attachments:

1. Agreement for Operation of Gage Canal Facilities (June 9, 1965)
2. Sixth Amendment to the Agreement for Operation of Gage Canal Facilities (Sept. 8, 2010)
3. Agreement For Sale Of Gage Canal Company Shares
4. Contract for Delivery of Irrigation Water
5. Table of Gage Well Rehabilitations
6. Opinion, Erwin, et al, vs Gage Canal Company (1963)
7. Presentation