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February 16, 2011



VIA E-MAIL & FIRST CLASS MAIL

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RE: County of San Luis Obispo
State Revolving Fund Request
Los Osos Waste Water Treatment Project
Date of Hearing: March 1, 2011

Attachments: Depiction of LOCSD Boundary, Prohibition Zone and Water Purveyors

Dear Gentlepersons:

I represent the Los Osos Community Services District as District Legal Counsel. Please accept the following as my comments and concerns related to the above application to the State Water Resource Control Board for State Revolving Fund financing.

The LOCSD expects that the County's SRF loan package will include repayment of the LOCSD \$6,486,144.00 SRF loan as referenced in Governor Schwarzenegger's September 20, 2006 signing statement to AB- 2701.

a. The Outstanding LOCSD SRF Loan Balance

As you are aware, the State Water Resource Control Board (SWRCB) has filed and served its first amended complaint for the recovery of \$6,486,144.00 in the Superior Court of the State of California, County of Sacramento Case No. 05ASo5422. As a result of settlement in a lawsuit titled "Tax Payers Watch vs. The Los Osos Community Services District, Et al," Superior Court

of the State of California, County of San Luis Obispo Superior Case No. CV 05862, the State Water Resource Control Board received partial recovery in the amount of \$348,150.00. Therefore the outstanding loan balance is **\$6,137,994.00** (herein \$6.1 million dollars).

b. Interest On The LOCSD SRF Loan Amount

The Governor's signing statement does not require the repayment of interest. Furthermore, interest on the debt is barred from the date the District filed bankruptcy pursuant to 11 U.S.C. §502(b)(2). I suggest that no interest be included in refinancing the LOCSD's SRF debt.

c. Exclusion For Repayment Of Grants

The SWRCB has filed an unsecured non-priority creditor's claim in the LOCSD's bankruptcy case in the amount of \$8,636,565.57. The creditor's claim includes a \$2,000,000.00 claim for repayment of a grant used to purchase land (Broderson property) for the LOCSD's wastewater project. Please be advised that that the Broderson property will be used by the County's' LOWWTP as a discharge site. The LOCSD requests that the SWRCB reduce its creditors claim by the \$2,000,000.00 grant funding and exclude the \$2,000,000.00 from any repayment as part of the County's request for SRF funding.

d. Potential For Unequitable Result.

The LOCSD provides water service within a discrete Zone of Benefit located within the LOCSD boundary (LOCSD Water Department) . The LOCSD Water Department is also located within the Prohibition Zone. Exhibit A (attached) depicts the LOCSD Water Department and the other purveyors that provide water service with the Prohibition Zone and within the LOCSD boundary.

The LOCSD's current proposed Bankruptcy Debt Adjustment Plan (the Plan) includes the repayment of the \$6.1 million dollars to the SWRCB as part of the County's SRF financing package. As things stand now Monterey Mechanical (a Bankruptcy creditor) is contesting the Plan, contending that the LOCSD's Water Department can and should be sold to satisfy creditors, including the creditor's claim of the SWRCB. The LOCSD believes that California law doesn't permit LOCSD to sell the Water Department without a vote of the registered voters within the Water Department and, even if Water Department voters approved the sale of the Water Department to satisfy creditor claims, Proposition 218 prohibits using the proceeds from the sale of the Water Department to pay wastewater system debt. At this point the LOCSD expects that this issue will be litigated either before the bankruptcy court or state court if the bankruptcy case is dismissed.

If Monterey is successful in selling the LOCSD Water Department, the proceeds of that sale should be used to satisfy, partially or in whole, all creditor claims including the SWRCB creditor's claim, thereby further reducing the \$6.1 million dollar payback pursuant to the

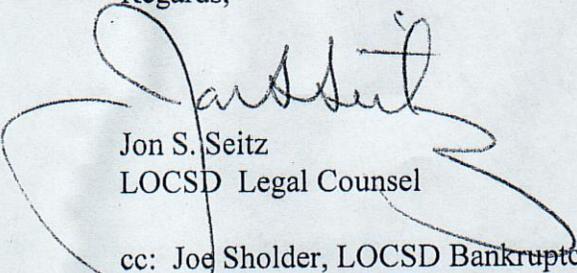
Ann Hartridge
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Governor's signing statement. If the SWRCB releases its creditor's claim as part of the SRF loan deal with the County, then there is no chance for a reduction in SWRCB claim against the LOCSD which will further drive project costs.

The SWRCB will act on the County's application for SRF funding prior to resolution of the LOCSD bankruptcy issues, which (at the earliest) will be in the second half of 2011. There is thus the possibility that, after acting on the SRF Loan, the LOCSD's proposed debt adjustment plan may not be approved by the Bankruptcy Court and the creditors may eventually force a sale of the LOCSD Water Department. If that happens, a portion of the sale proceeds should go to the SWRCB, reducing the SRF repayment obligation. That will only happen, however, if the SWRCB preserves its claim against the LOCSD when approving the SRF Loan, in effect treating the San Luis Obispo County SRF repayment as an advance payment, subject to reduction in case of a recovery from the proceeds of sale of the LOCSD Water Department. Therefore, please consider taking the position that the SWRCB should approve the SRF funding for the County's project, but treat San Luis Obispo County's SRF repayment as an advance, subject to reduction and refund in the event SWRCB ultimately recovers a portion of the SRF repayment amount from the sale of the LOCSD Water Department. This would simply require the SWRCB to maintain a position as a LOCSD creditor and absent a court approved Dept Adjustment Plan, the SWRCB will deduct any monetary recovery it receives from the sale of the Water Department (if it should occur) from the \$6.1 million dollar SRF repayment. This will ensure fairness to LOCSD Water Department customers and Prohibition Zone residents, in the unlikely event, the LOCSD is forced to sell the Water Department.

Thank you for considering my comments. If you should have questions, please do not hesitate to contact me.

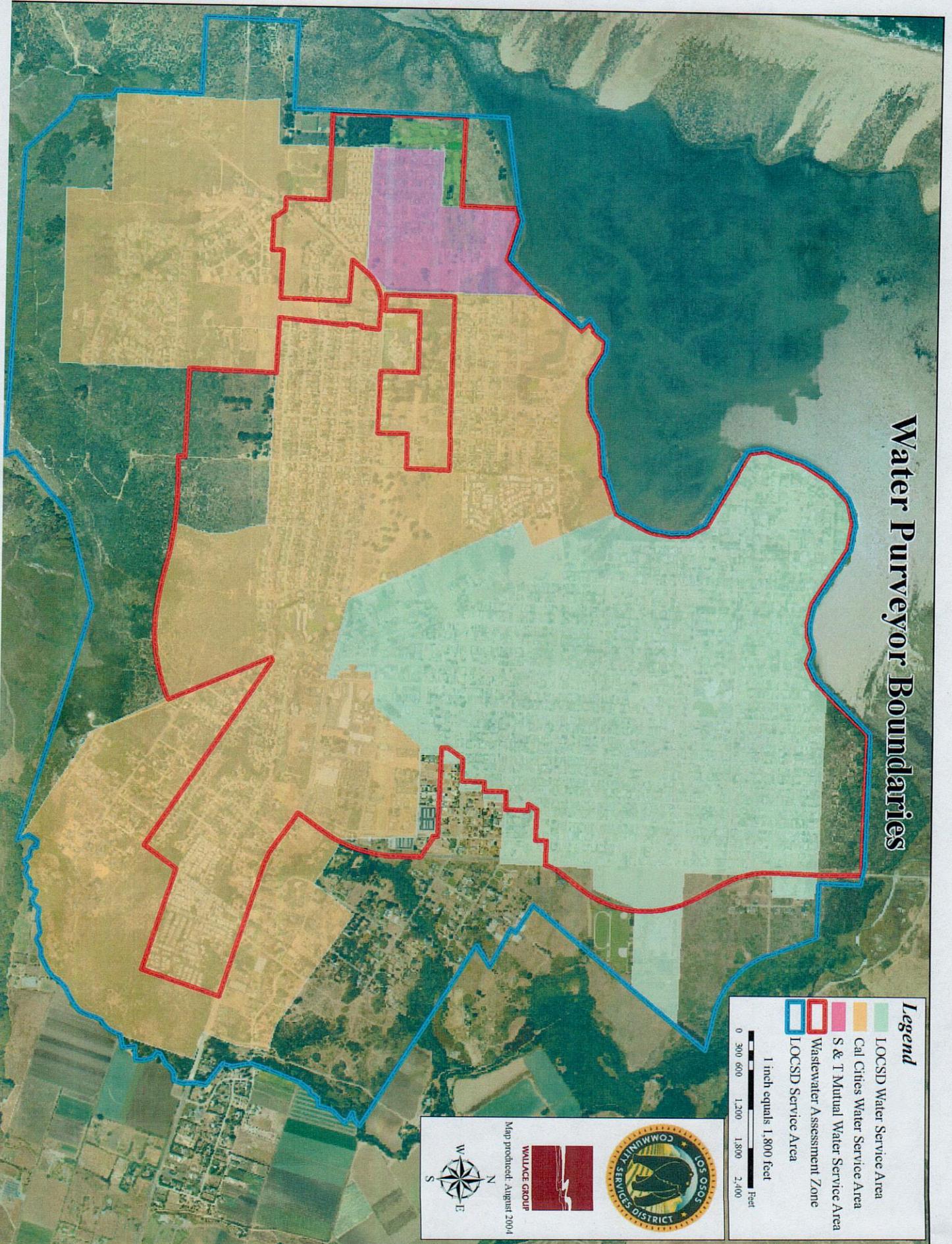
Regards,



Jon S. Seitz
LOCSD Legal Counsel

cc: Joe Sholder, LOCSD Bankruptcy Counsel via E-mail
Dan Gilmore, LOCSD, General Manager via E-mail

Water Purveyor Boundaries



Legend

- LOCSD Water Service Area
- Cal Cities Water Service Area
- S & T Mutual Water Service Area
- Wastewater Assessment Zone
- LOCSD Service Area

1 inch equals 1,800 feet

0 300 600 1,200 1,800 2,400 Feet



Map produced: August 2004

