



CITY OF OAKLAND  
Office of the City Auditor

## INVESTIGATION

**DATE:** February 10, 2022

**TO:** Mayor Schaaf, President Bas, Members of the City Council, City Administrator Reiskin, City Attorney Parker, and Oakland Residents

**FROM:** City Auditor Courtney Ruby, CPA, CFE

**SUBJECT:** **Lack of Documentation Leads to Questions About Sewer Franchise Fee Origins, Rationale, and Reasonableness**

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### Background

#### **Sewer Services Are Funded by Oakland Customers**

The Department of Public Works assists the City of Oakland (City) operate a sewer collection system with hundreds of miles of sewer main line, thousands of sewer structures, and seven pump stations. The City provides property-related maintenance to residential and commercial customers including water, sewer, storm drainage, and solid waste services.

The City sets fees and charges that are imposed on customers for these services. Specifically, Oakland water customers pay a flat Sewer Service Charge through payments to the City's water provider, East Bay Municipal Utility District (EBMUD).<sup>1</sup>

The City of Oakland's Sewer Service Charge is subject to State law which grants cities the authority to assess fees and charges for services they provide. To adjust for changing operation and maintenance costs, the City implements periodic fee increases of the sewer service charges based on the Bay Area Consumer Price Index (CPI). These fees were most recently increased in January 2022. Exhibit 1 shows how charges vary by dwelling type and size.

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<sup>1</sup> EBMUD is a public utility district – a service provider – delivering water and sewage treatment services for the East Bay sub-region of the San Francisco Bay Area.

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## Exhibit 1: Schedule of Flat Rates for the Sewer Service Charge

**NEW CHARGES AS OF JANUARY 1, 2022**

For single-family residences, the monthly Sewer Service Charge increases from \$42.03 to \$43.35 (from \$84.06 to \$86.70 every two months.)

For multi-family dwellings on shared meters, the monthly Sewer Service Charge is:

Duplexes: \$48.64 per month (or \$97.28 bi-monthly)  
Triplexes: \$72.96 per month (or \$145.92 bi-monthly)  
Fourplexes: \$97.28 per month (or \$194.56 bi-monthly)

For all other accounts, the charge is based on water consumption or metered sewage discharge as follows:

Apartment Bldgs. (5+ Units): \$2.97 per 100 cubic feet  
Industrial Accounts: \$2.69 per 100 cubic feet  
Commercial Accounts: \$2.97 per 100 cubic feet  
Restaurants/Hotels: \$3.06 per 100 cubic feet  
Hospitals: \$3.28 per 100 cubic feet  
Laundromats/Carwashes: \$3.46 per 100 cubic feet  
Metered Sewage Accounts: \$3.58 per 100 cubic feet

The minimum monthly charge for all accounts is \$43.35 (or \$86.70 bi-monthly).

By law, Sewer Service Charge funds can only be used for the construction, maintenance and operation of the sanitary sewer system.

**COMMUNITY IMPROVEMENT**

The sewer rehabilitation program is part of a continuing effort to improve Oakland and its environment. The program will result in a cleaner, healthier environment that will enhance our quality of living. It also will ensure that Oakland has a reliable sewer system for years to come. This year, the City plans to rehabilitate approximately 13 miles of sewer main.

We thank you for sharing in these efforts. Oakland's future depends upon our commitment.

Source: Screenshot from City of Oakland's January 2022 notice as included in EBMUD's bill to water customers.

After collecting the Sewer Service Charge from customers through its billing process, EBMUD transfers collected revenue to the City of Oakland, which is to be used to fund operation, maintenance, and capital improvements to the sanitary sewer system in Oakland.

### Franchise Agreements with the City of Oakland

Franchise agreements are negotiated contracts between public agencies and service providers. The agreements formally document that public agencies, with the approval of the City Council, have granted permission for service providers to use public space to deliver services to customers. Franchise agreements may include terms such as limits to the service providers' use of public space, and the specific timeframe during which the service providers will deliver services. Franchise agreements also outline terms for "franchise fees," which are fees charged to utility service providers by government agencies for the utility service providers' use of public space or the public right-of-way.

The Oakland City Council authorized the City Administration to enter into franchise agreements with various service providers. For example, the City of Oakland charges a franchise fee to PG&E (gas and electricity provider), AT&T and Comcast (cable providers) and Waste Management and California Waste Solutions (waste collection providers).

The Government Finance Officers Association (GFOA)<sup>2</sup> recommends cities treat the water and sewer funds as if they were privately owned and operated. In addition to setting rates at levels necessary to fully cover the cost of providing water and sewer services, this means assessing reasonable franchise and property tax in-lieu fees. As with other utilities, the purpose of the franchise fee is to reasonably compensate the City for use of its public rights-of-way.

## Investigation History

In January 2020, a resident inquired about the legitimacy of the franchise fee for the City of Oakland's Sewer Service Charge Fund (Sewer Service Fund).

In response, the Office of the City Auditor (Office) performed a preliminary review of the Sewer Service Fund's franchise fee.

After completing the preliminary review, the Office launched an investigation. The Investigation Methodology section details the work performed during the investigation.

## Investigation Objectives

The objective of the investigation was to

- confirm the existence of the Sewer Franchise Fee, and if applicable, determine whether it was implemented pursuant to Oakland's Municipal Code (O.M.C.), and
- if applicable, identify its origins, rationale, and reasonableness.

## Investigation Findings

### **1. The City Council Authorized Increases in the Sewer Service Charge in 2010**

In July 2010, the City Council passed Ordinance 13035 amending Chapter 13 of the Oakland Municipal Code (O.M.C. 13.04.020). At the same time, Council increased the Sewer Service Charge and provided for annual fee increases of 16 percent through January 1, 2013 and increases based on the CPI thereafter.

The City Council made the following findings and determinations in support of adopting the Ordinance,<sup>3</sup> in compliance with Article XIII D of the California Constitution:

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<sup>2</sup> GFOA is a nonprofit professional association of government finance officers that seeks to enhance and promote the professional management of governments for the public benefit by identifying and developing financial policies and practices.

<sup>3</sup> Ordinance No. 13035 City Manager Series (C.M.S.)

- a) *Revenues derived from the sewer service charge do not exceed the funds required to provide the property related service, and*
- b) *Revenues derived from the sewer service charge will not be used for any purpose other than that for which the charge was imposed, and*
- c) *The amount of the sewer service charge imposed upon any parcel or person as an incident of property ownership does not exceed the proportional cost of the service attributable to the parcel, and*
- d) *The proposed sewer service charge increase is based on the cost of providing the service of the sanitary sewer system, and*
- e) *The City of Oakland submitted written notice to the record owner of each parcel subject to the proposed sewer service charge increase, in compliance with the majority protest proceeding requirements, notifying (1) the amount of the sewer service charge proposed to be imposed upon each, (2) the basis upon which the amount of the proposed sewer service charge was calculated, (3) the reason for the sewer service charge increase, and (4) the date, time and location of a public hearing on the proposed sewer service charge increase, and*
- f) *There was no majority protest at the City Council's July 20, 2010 public hearing to hear public comments and protests, and*
- g) *All other requirements for the imposition of the increased fee have been met.*

The O.M.C. states that the monies collected should be deposited to a City fund known as the "sewer service charge fund" and may only be used for the construction, maintenance, and operation of the City's sewer system. Additionally, the monies should be distributed as follows: at least ninety-five (95) percent for the sanitary sewer system; and, up to five percent for the storm sewer system.

While these findings and determinations were documented, the City should formally document its ongoing compliance on a regular basis. Furthermore, neither the Ordinance nor the O.M.C. identifies a franchise fee.

## **2. The City's General Purpose Fund<sup>4</sup> Collects a Franchise Fee from the Sewer Service Fund**

The investigation confirmed the City's Sewer Service Charge revenue and expenditure transactions occur in the enterprise fund<sup>5</sup> called the Sewer Service Charge Fund (Sewer Service Fund). Additionally, the Sewer Service Fund is charged approximately 10 percent as a sewer franchise fee by the City that is directed to the General Purpose Fund. Exhibit 2 below summarizes the revenues collected between fiscal years (FY) 2012-13 through 2020-21, and the corresponding franchise fees.

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<sup>4</sup> The General Purpose Fund is the City's primary operating fund and its revenues are not restricted for specific purposes and activities.

<sup>5</sup> An enterprise fund is a separate accounting and financial reporting mechanism for which revenues and expenditures are segregated into a fund with financial statements separate from all other governmental activities. The City uses enterprise funds to account for the operations of the Sewer Service System and the Parks and Recreation operations. The sewer service fund is considered to be a major fund of the City.

**Exhibit 2: Nine-Year Summary of Revenues from Sewer Service Charges and Franchise Fees between FY 2012-13 through FY 2020-21 (thousands)**

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
<b>Sewer Service Fund</b>	48,920	52,685	57,435	58,552	60,041	62,652	66,017	68,662	70,465
<b>Franchise Fee</b>	4,435	4,766	5,714	5,850	5,998	6,196	6,363	6,619	6,644
<b>% of Franchise Fee</b>	9.07%	9.04%	9.95%	9.99%	9.99%	9.89%	9.64%	9.64%	9.43%

Source: City Auditor’s summary of franchise fee revenues as recorded in the City of Oakland’s financial management system

**3. There is No Evidence the Sewer Franchise Fee was Properly Authorized**

The most substantive documented information we were able to find about the Sewer Franchise Fee was through the City’s Legistar<sup>6</sup> records. Specifically:

1. The earliest reference to the Sewer Franchise Fee is a December 14, 2004 staff report, which references a “slight shortfall in East Bay MUD franchise fees.”
2. The earliest reference to the 10 percent franchise fee payment to the General Purpose Fund is from a withdrawn item on the June 17, 2010 City Council meeting. The subject of the item is *“Subject: Sewer Service Fund - Franchise Fee Payment From: Budget Office Recommendation: Adopt A Resolution To Fully Appropriate The Sewer Service Fund 10% Franchise Fee Payment To The General Purpose Fund.”* Around the same time this item was withdrawn, the City Council was considering (and eventually approved) an increase in the Sewer Service Charge (13035 CMS, item passed on July 27, 2010). However, there was no reference to the 10 percent franchise fee in the legislation that changed the Sewer Service Charge.
3. A December 14, 2010 staff report also references the City’s General Purpose Fund collecting a 10-percent franchise fee from the Sewer Service Fund.

We also contacted employees in the City Clerk’s Office, Finance Department, City Attorney’s Office, and the Department of Public Works in search of records authorizing a franchise agreement between the City’s General Purpose Fund and the City’s Sewer Service Fund.

None of these Departments were able to produce a copy of a franchise agreement (between the City’s Sewer Service Fund and the general government) that defines the terms for the franchise fee.

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<sup>6</sup> Legistar is a system that helps the City of Oakland manage the legislative process including the City Council meeting schedule, agendas, minutes, resolutions, videos, etc. Legistar can be accessed here: <https://oakland.legistar.com/Calendar.aspx>

The O.M.C. requires a new franchisee to apply for an application with the City Council and the City and “the amount shall be as specified in the award of the franchise, the contract or both.” Additionally, we did not find anything in the O.M.C. covering franchise fees for the Sewer Service Fund exclusively.

Even though the Sewer Franchise Agreement is not between the City and a private entity, the City should be transparent and document the fee, which then should be approved by the City Council. Absent documentation, there is no way of determining whether the franchise fee is in alignment with the aforementioned California State law governing fees and charges.

## Investigation Conclusions

The investigation confirmed the City’s General Purpose Fund collects an approximately 10-percent Sewer Franchise Fee from the City’s Sewer Service Fund. The investigation found no evidence the fee was properly authorized by City Council.

The documentation regarding the Sewer Franchise Fee is lacking, which has made it impossible to determine whether the fee is appropriate and reasonable.

We are concerned about the lack of documentation and accordingly, made several recommendations for the City Administration’s consideration, which will help provide assurance the franchise fee is authorized and appropriate, and provide transparency and accountability to the public.

## Recommendations

We recommend the City Administration:

1. Analyze the City’s Sewer Service Charge to ensure it remains compliant with the Oakland Municipal Code. This analysis should be formally documented and completed on a regular basis.
2. In consultation with the City Attorney’s Office, research and document the functional and legal merits of the Sewer Franchise Fee. This analysis should be both retrospective and prospective.
3. Present the analysis and findings to the City Council and the public.
4. In consultation with the City Attorney’s Office, develop and present to the City Council, for its consideration, a franchise agreement between the Sewer Service Fund and the City of Oakland’s general government.

## Next Steps

Within six months from the date of this report, the City Administration should provide a written report on the status of the recommendations outlined in this investigation report to the Office of the City Auditor. The Office will publicly report on the status of the recommendations to the City Council and the general public after receiving a report from the City Administration and verifying the status of the recommendations.

## Methodology

The Office performed a preliminary review of the whistleblower report to confirm understanding of the reported allegations, and determine if all the following four investigation criteria were met:

1. The alleged incident(s) involved City of Oakland property, infrastructure, employees, officials, or otherwise falls within the City's jurisdiction.
2. If true, the concern meets the definition of "fraud," "waste," OR "abuse."
3. The alleged incident(s) occurred within 12 months of being reported.
4. The alleged incident(s) are not known to be the subject of current litigation.

After completing the preliminary review, the Office conducted an investigation to arrive at the findings and conclusions in this report. This investigation included:

- Reviewing City documents;
- Reviewing City legislative records;
- Interviewing current and former City staff members;
- Reviewing the City Charter and City Municipal Code;
- Reviewing City financial records; and
- Reviewing City franchise agreements.



# WHISTLEBLOWER HOTLINE

## To File a Complaint

Call the **WHISTLEBLOWER HOTLINE**  
1-888-329-6390 (Interpreter available)

SUBMIT A REPORT ONLINE  
[www.OaklandAuditor.com/Whistleblower](http://www.OaklandAuditor.com/Whistleblower)

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