



**ANNE ARUNDEL COUNTY
OFFICE OF THE COUNTY AUDITOR**

March 14, 2011

The Honorable Members of the County Council
The Honorable John R. Leopold, County Executive
Anne Arundel County, Maryland
44 Calvert Street
Annapolis, Maryland 21401

Dear Members and Mr. Leopold:

In accordance with Section 311 of the County Charter, I am calling to your attention and taking exception to the following improper procedure.

Under § 13-5-805 (b) of the County Code, the County Executive shall set the charges for water and wastewater in accordance with § 4-11-105 of the County Code. The County Executive may increase the charges in an amount not to exceed 5% of the then current charges. Increases greater than 5% require County Council approval via ordinance. Section 4-11-105 provides that the rates shall be fixed on a basis to provide revenues sufficient to pay the amounts appropriated for utility services as outlined in § 4-11-104, and § 4-11-104 requires the budget to include anticipated revenue from metered water delivered charges.

Section 13-5-807 also requires the County Executive to submit to the County Council an annual report on utility charges stating any anticipated operating deficit, the estimate operating expenses, and "any recommended changes in the rates" to maintain a minimum of two months of budgeted operating expenses in the ensuing fiscal year. Although this report is due no later than May 1, and, in practice, the County Executive includes the report in the proposed Current Expense budget book submitted to the County Council, the report is not required to be submitted with and is not part of the proposed budget.

The fiscal year 2010 Annual Report was prepared by the Budget Office and included in the proposed Fiscal Year 2010 Current Expense Budget book (p. 337). It states that there will be a "proposed 5% rate increase" effective on January 1, 2010 that "will change the water rate per thousand gallons from \$2.32 to \$2.43." (Emphasis added.) An increase from \$2.32 to \$2.43 is a 4.74% increase, less than the 5% limit imposed by § 13-5-805(b).

During the fiscal year 2010 annual audit, we noted the County increased the water rate on January 1, 2010 to \$2.44 per thousand gallons, which is a 5.17% increase. We could find no written document from the County Executive setting this rate or memorializing his decision, and the only public document that makes an explicit reference to the rate is the Annual Report. When we asked how the rate was set at \$2.44 instead of the \$2.43 in the Annual Report, we were told an employee in the Department of Public Works informed an employee in the Office of Finance to use the rate of \$2.44 in the utility billing system, and the employee in the Office of Finance did so. The fiscal impact of charging \$2.44 instead of \$2.43 was additional revenue of approximately \$113,000 of water user revenue and \$23,000 of environmental protection fees.

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In response to our audit inquiries, the Administration asserted that the \$2.43 rate in the fiscal year 2010 Annual Report was a typographical error made by the Budget Office, and that the resulting 5.17% rate increase to \$2.44 rounds down to 5% and is, therefore, in compliance with the provisions of the County Code.

I do not agree with the Administration's assertion that setting the rate at \$2.44 complies with the provisions of § 13-5-805(b). This rate increase was 5.17%, exceeding the 5% limit imposed by County Code. Further, the only public document required to be submitted by the County Executive to the County Council stated the rate would be \$2.43. Neither the County Council nor the public had explicit notice of the \$2.44 rate until the County started sending water bills for calendar year 2010.

I sought the advice of the County Attorney on whether the Administration complied with the relevant provisions of the County Code (attached). In his response (also attached), Deputy County Attorney David Plymyer writes:

"In summary, we do not conclude that the imposition by the Office of Finance of a water rate charge for calendar year 2010 of \$2.44 for each one thousand gallons of usage was wrong as a matter of law. However, the County left itself vulnerable to legal challenge in part because of a combination of two circumstances. The first was fact that the County Executive's decision on the water rate for calendar year 2010 was not memorialized in a definitive fashion, and the second was a typographical error in the only public document that reported that decision."

To avoid any ambiguity or challenge to the rates established for water and sewer usage in future years, I recommend that the County Council amend the County Code to require the rates be set via ordinance, as is done with all other utility charges, the solid waste residential pick-up fee, and taxes, and as was done prior to the enactment of Bill No. 6-05, which allowed the County Executive to set the annual rate without Council approval, provided any increase in the rate did not exceed 5%.

Alternatively, the Council may wish to enact an ordinance that (1) imposes a formal reporting and rate setting requirement on the County Executive so that the rate set is clearly established and memorialized by the County Executive, and not by employees in the Department of Public Works, the Office of Finance, or the Office of the Budget without the County Executive's knowledge or formal approval, and (2) clearly states that the rate increase may not exceed an absolute limit of 5.0% without County Council approval.

Management's Response

The Auditor contends that the water rate of \$2.44 per thousand gallons exceeds the 5% increase permitted under the County Code. The County Code, in the context of utility usage rate increases, is written in terms of an allowable percentage increase, not a specific rate per thousand gallons. To bolster her argument that the Administration exceeded its authority in the setting of the water rate for CY2010, the Auditor references the Utility Fund Annual Report prepared by the Budget Office, which incorrectly stated that a 5% increase results in a rate of \$2.43 per thousand gallons. However, as explained below, this mathematical error contained in the Utility Fund Annual Report is of no consequence given the County Code's utilization of a percentage increase as the determinant of the allowable increase in the utility consumption rate.

As noted by the Auditor in her letter, § 13-5-805 (b) of the County Code states "...the County Executive shall set the charges for water and wastewater in accordance with § 4-11-105 of the County Code. The County Executive may increase the charges in an amount not to exceed 5% of the then current charges." (emphasis added)

The County Code clearly allows an administrative increase of 5% annually in utility rates. The issue then is to translate the permitted 5% increase into a rate per thousand gallons. It must be noted that the actual language in the County Code is 5%, or a whole percent, which in the world of mathematics, implies a degree of precision of 1%. This is relevant when it comes to the application of a 5% increase upon the rate utilized in CY2009 in order to determine the CY2010 rate. For CY2009 the rate for water was \$2.32 per thousand gallons. Applying a 5% increase to this amount results in a rate of \$2.4360 per thousand gallons. Under the conventional rules of mathematical rounding, a rate of \$2.4360 when rounded to the nearest cent becomes \$2.44.

The Auditor alleges that a rate of \$2.44 which is 5.17% greater than a rate of \$2.32 (actually 5.172413793....), is violative of the County Code's 5% limit. However, it must be remembered that the County Code's limit is 5%, which implies a degree of precision of 1%. Had the Code stated that the limit was 5.0%, then the degree of precision would be one-tenth of a percent. Under the rules of mathematical rounding, 5.17% rounds to 5% at the one percent degree of precision, and to 5.2% at the one-tenth of a percent degree of precision. Since the County Code is written in terms of a degree of precision of 1%, a rate of \$2.44 is a 5% increase from a rate of \$2.32.

Indeed, the Auditor acknowledges the issue of the degree of precision in the County Code's language when she recommends that should the County Council wish to take curative action, that the 5% limit be restated to 5.0%, a clear recognition of the concept of degree of precision.

Further, the correctness of the Administration's application of the 5% increase was affirmed by the County Council's own lawyer when Mr. Plymyer wrote "In summary, we do not conclude that the imposition by the Office of Finance of a water rate charge for calendar year 2010 of \$2.44 for each one thousand gallons of usage was wrong as a matter of law."

Not only is the Auditor's noted exception incorrect given the language of the County Code, but the immaterial nature of the allegation is demonstrated when the sewer rate that was utilized for CY2010 is taken into account. In the case of the sewer rate, the rate for CY2009 was \$4.08 per thousand gallons. A 5% increase in that rate results in a rate of \$4.2840, which rounds to the nearest penny to a rate of \$4.28, which was the rate utilized for CY2010. The percentage increase from \$4.08 to \$4.28 was 4.90%, which rounds to 5%. Therefore, in actuality the rate for water was rounded up 4 tenths of a cent (\$2.436 to 2.44), while the sewer rate was rounded down by the same 4 tenths of a cent (\$4.284 to \$4.28). Since the vast majority of utility customers receive both County water and sewer service, the net increase in the rate on their bills was exactly 5%.

Please call if you have any questions regarding my findings and recommendations.

Sincerely,



Teresa Sutherland, CPA
County Auditor

Attorney/Client Privileged – Work Product

To: Teresa Sutherland, County Auditor

Through: Jonathan A. Hodgson, County Attorney /s/

From: David A. Plymyer, Deputy County Attorney /s/

Date: December 3, 2010

Subject: Water Usage Rate, Calendar Year 2010

Question

This memorandum responds to the inquiry that you sent by email dated November 8, 2010. In that email, you asked whether the water "rate" of \$2.44 for each one thousand gallons of usage imposed by the Office of Finance for calendar year 2010 conforms to the requirements of § 13-5-805(b) of the County Code.

Under § 13-5-805(b), the County Executive is required each year to set the charges for water and wastewater usage after applying the criteria set forth in § 4-11-105 of the County Code. The County Executive may increase the charges in an amount not to exceed 5% of the then current charges. However, any increase in charges in an amount greater than 5% must be approved by ordinance of the County Council. Your question is whether the rate of \$2.44 for calendar year 2010, which was not approved by the County Council, exceeded the 5% limit.

Standard of Review

As a threshold matter, we point out that you are asking the Office of Law to review an administrative action that already has taken place. More is required than the interpretation of a discrete provision of law; the action in question involved the application of law to a particular series of facts. Consequently, our review is limited to determining whether the action taken constituted a *reasonable* application of the governing law to the relevant facts. This is a deferential standard, and means that we conclude that an administrative action was unlawful only if based on interpretations of law that were clearly erroneous or if not based on substantial evidence; in other words, only if arbitrary and capricious.

We do not make independent findings of fact and accept as accurate the facts as reported to us by the agency that took the action; also, we view all inferences from those facts in the light

most favorable to the agency. We accede where appropriate to the expertise of the agency in the subject matter of the laws that it administers.

At the same time, we recognize that the duties of the County Auditor may require us to give you a more comprehensive answer. Therefore, if an action creates a potential future liability, we also try to provide you with an accurate assessment of the strength of the County's position should we be required to defend the action against a legal challenge.

Answer

We conclude that the rate of \$2.44 did not violate § 13-5-805(b) as a matter of law. We cannot state that the interpretations of law upon which it was based were clearly erroneous, or that there was no substantial evidence supporting the action as described by the Budget Officer. However, our conclusion is by no means free from doubt, and must be qualified as follows: If a user challenges the rate in court, a court would make its own findings of fact and draw its own inferences from those facts. Moreover, a court will give no deference to the legal interpretations upon which the County action was based, and will apply its own interpretations of the governing law.

In our opinion, while the Office of Law can defend the actions taken by the Office of Finance as a reasonable application of the law to the facts, there is no assurance that we could do so successfully. It is not possible to predict the outcome of a legal challenge to the rate with any degree of certainty. However, we believe that an outcome unfavorable to the County is at least as likely as an outcome that is favorable.

Analysis

The answer to your question requires us to address two separate issues. The first of the two issues is whether the Office of Finance was bound by the apparent establishment of the rate at \$2.43 as described in the only extant document that reported the rate for calendar year 2010. The second issue is whether the rate of \$2.44 exceeded the 5% limit imposed by § 13-5-805(b) of the County Code.

You attached to your inquiry an "Annual Report" on the Water and Wastewater Operating Fund that was appended to the FY 2010 Approved Budget. That report, prepared by the Budget Office, states in pertinent part that there will be a "proposed 5% rate increase" effective on January 1, 2010 that "will change the water rate per thousand gallons from \$2.32 to **\$2.43.**" (Emphasis added.)

Section 13-5-805(b) of the County Code anticipates an affirmative *decision* made each year by the County Executive as to the charges for metered water and wastewater usage. Section 13-5-805(b) does not require that any particular formality accompany the setting of the charges by the County Executive, and no formality has been adopted in practice.

The lack of a legally-mandated or other formality for memorializing the decision by the County Executive obviously raises the following question regarding the rate for calendar year

2010: How do we determine what that decision was? For an answer, we look first for a document signed by or otherwise attributable to the County Executive that reasonably can be described as setting the rate for calendar year 2010. We made inquiries of all affected agencies, and it does appear that the Annual Report to which you refer is the only public document that makes an explicit reference to the rate, which it lists as \$2.43.

However, the Budget Officer states that the \$2.43 as described in the Report was a scrivener's error inconsistent not only with the intent of the County Executive, but also with the information and calculations that accompanied the budget documents and supporting presentations, including revenue projections. He states that the context unequivocally demonstrates that the rate was to be \$2.44, not \$2.43.

From the facts as reported to us, it appears that the County Executive made the decision to increase the rate by the maximum amount allowable without approval by the County Council. The Budget Officer implemented that decision by performing the necessary calculations. There is no document in which the rate for calendar year was formally memorialized. Viewed in the light most favorable to the County, the Annual Report is described as an erroneous report of the County Executive's decision, not as a record of his decision.

The Budget Officer explains that, in accordance with longstanding past practice, he implemented the decision of the County Executive to increase the rate by 5% by multiplying the existing rate of \$2.32 by 1.05, resulting in a product of \$2.436. Using the accepted rounding convention, he rounded that number to \$2.44. (As indicated elsewhere in § 13-5-805(b), the rate for water and wastewater usage is set to two decimal places.)

The use of the rounding convention meant that the actual increase in rate was 5.1724%; however, the Budget Officer points out that the maximum allowable increase in rate as stated in the ordinance is a whole number (5%), and that 5.1724% rounds to 5% after applying accepted rules of precision. He stated that the rounding convention has been consistently applied, meaning that when appropriate the figure for the rate was rounded down, as well as up, in past years. In fact, he observes that the rate for wastewater usage in calendar year 2010 was rounded down by \$0.004.¹

For the reasons described at the beginning of this memorandum, we accept as correct the Budget Officer's representation that, in effect, it was the decision of the County Executive to set the rate at \$2.44, and it was that decision that was implemented by the Office of Finance, despite the error contained in the Annual Report. However, there is a considerable body of law that would allow an independent tribunal to disregard undocumented statements of intent and other circumstantial evidence of a decision in favor of the only written manifestation of that decision.²

¹ There are no rounding conventions prescribed by County law. The Budget Officer states that he employed generally accepted rounding conventions and rules of precision.

² To be clear, we are not assuming that the County Executive stated that the rate would be \$2.44; there is no record of that. We accept as correct that the County Executive instructed the Budget Officer to increase the rate to the limit of 5%, and the Budget Officer acted on those instructions. Viewed in the light most favorable to the County, we construe the result to be that, as required by § 13-5-805(b), it was the act of the County Executive that set the rate at \$2.44 for calendar year 2010.

The fact that the Annual Report was appended to a budget document is of no direct legal significance because, as described above, no particular format is required for memorializing the decision of the County Executive under § 13-5-805(b). If the rate does not exceed the 5% limit, the approval of the County Council is not required. Nevertheless, including a misleading figure in the proposed and then in the "approved" budget documents will be a source of controversy if this matter is placed in dispute.³

Most importantly, the \$2.43 rate was the only rate of which the County Council and the public had explicit notice until water bills started to be sent for calendar year 2010. Nothing in § 13-5-805(b) precludes the County Council from passing an ordinance *reducing* the rate set by the County Executive. Giving effect to the prerogative of the County Council to reduce the rate proposed by the County Executive requires that the County Council have definitive notice of the rate proposed by the County Executive, a requirement that appears to have been satisfied only by the \$2.43 figure given in the Annual Report. We are willing to assume that it is unlikely that the County Council would have acted in order to reduce the rate by \$0.01; however, we also recognize the legal significance of giving the County Council the opportunity to do so.

In other words, even if it is accepted as factually correct that the *intent* was to set the rate at \$2.44, that finding may not resolve this issue in the County's favor. There is considerable support in the law for the proposition that the decision of a governmental official is not a "decision" until it is written down and published in some manner. Consequently, there is a distinct possibility that this first issue could be resolved on the basis of what the decision was as reported in writing, as opposed to what it was supposed to be.

The issue of whether the County was bound by the \$2.43 rate described in the Annual Report becomes especially problematic because of the second issue. The second issue is whether the 5% figure used in § 13-5-805(b) was intended as an "absolute" limit, which could not be exceeded directly or indirectly by the use of rounding conventions: Stated another way, should the 5% limit be construed to mean 5.000000%?

In the judgment of the Budget Officer, an actual increase in rate of 5.1724% was permissible because the accepted "rules of precision" implied by the use of a whole number (5%) for the limit allowed the rounding of 5.1724% to the nearest whole number. He concluded that the rate therefore was not increased beyond the limit of 5% within the intent of the ordinance. As noted in our prefatory comments, we defer to the expertise of the Budget Office unless that expertise is constrained by law.

We have located no case law precisely on point, and none that compels the conclusion that the Budget Officer acted in violation of the law by using rounding conventions and applying commonly-accepted rules of precision. However, in trying to predict whether a court would allow the use of rounding convention and rules of precision in the application of the limit imposed on the authority of the County Executive by § 13-5-805(b), we have to be mindful of the

³ The fact that the figure of \$2.43 appeared in the budget documents does dispose of any argument we might have that the County Council approved the proposal to increase the rate to \$2.44.

possibility that a court would resolve any doubts against the County and in favor of the ratepayer, in the same manner as it would do regarding a fee or a tax. *See Comptroller of Treasury v. J/Port, Inc.*, 84 Md. App. 608, 622 (2009). Applying the general rules of statutory construction, a court well may conclude that 5% means 5%, not 5.1724% (or 5.444%, etc.).

Standing alone, this second issue might be less problematic. However, the irony is that the only explicit public description of the rate could be construed as taking the more conservative approach on this issue, which would be to *truncate* the product to \$2.43 rather than to round it up to \$2.44, in order to stay within 5% as an "absolute" limit on any increase not approved by the County Council. We cannot say that it is beyond the realm of possibility that an independent tribunal would allow its decision on the first issue to be influenced by doubts about the second, or vice versa.

In summary, we do not conclude that the imposition by the Office of Finance of a water rate charge for calendar year 2010 of \$2.44 for each one thousand gallons of usage was wrong as a matter of law. However, the County left itself vulnerable to legal challenge in part because of a combination of two circumstances. The first was the fact that the County Executive's decision on the water rate for calendar year 2010 was not memorialized in a definitive fashion, and the second was a typographical error in the only public document that reported that decision.

Additionally, not only are we confronted with a difficult factual situation, we have a problematic interpretation of the law. Even if a court concludes that it was the decision of the County Executive to increase the rate by the maximum amount allowed by law without approval by the County Council, the court could conclude that the implementation of that decision violated the unambiguous limits of the ordinance.

cc: John Hammond, Budget Officer
Richard Drain, County Controller

Appendix

FY2010 Approved Budget

FY10

**Anne Arundel County, Maryland
Water and Wastewater Operating Fund**

Annual Report

The fund balance in the Water and Wastewater Operating Fund as of June 30, 2008 was \$20.9 million. The estimated revenue for fiscal year 2009 is \$83.4 million, just \$0.3 million less than the amount projected in the approved budget. With actual expenditures for fiscal year 2009 projected to be \$87.5 million, \$1.8 million less than the amount projected in the approved budget, the County will use \$4.1 million in fund balance in fiscal year 2009. The fund balance at the end of the current fiscal year is projected to be \$16.8 million.

For fiscal year 2010, revenues are projected at \$87.6 million. The increase in revenue for fiscal year 2010 is due primarily to a proposed 5% rate increase, which becomes effective January 1, 2010. This rate increase will change the water rate per thousand gallons from \$2.32 to \$2.43 and the wastewater rate per thousand gallons from \$4.08 to \$4.28. The proposed operating budget book provides the support for the fiscal year 2010 budget request of \$88.5 million. This amount is above the estimated revenue and projects the use of \$0.9 million of fund balance.

The projected fund balance at the end of fiscal year 2010 is \$15.9 million (\$16.8 million balance at the end of fiscal year 2009 minus the \$0.9 million used in fiscal year 2010 operations). The calculated two-month fund balance requirement is approximately \$14.8 million. The projected balance at the end of fiscal year 2010 is sufficient to cover any reasonably unexpected shortfall in this fund.

§ 13-5-805. Metered water and wastewater charges.

(a) **Generally.** Charges for metered water and wastewater service are established as provided in this section, and the charges shall begin when a lot is connected to the County's water or wastewater system.

(b) **Charges.** Except for water purchased by a commercial hauler, the charge for each 1,000 gallons of water usage is \$2.00 for water and \$3.52 for wastewater. For the fiscal year beginning July 1, 2006, and for each fiscal year thereafter, the County Executive shall set the charges for water and wastewater usage in accordance with § 4-11-105 of this Code and may increase the charges in an amount not to exceed 5% of the then current charges. Any increase in charges in an amount greater than 5% shall be set by the County Council by ordinance. There is an account maintenance charge of \$6.00 per billing cycle regardless of the amount of usage.

(c) **Commercial haulers.** For water purchased by a commercial hauler, the quarterly charge for each 1,000 gallons of water usage is 120% of the usage charge paid by customers connected to the County system.

(d) **Reduction of sewerage charge.** For a residential user, where the water usage of the first full billing quarter beginning after April 30 exceeds 120% the average of the previous three billing quarters, the owner's sewerage charge shall be reduced by 50% of the amount over 120% of the average.

(e) **Minimum quarterly usage charge if property not in compliance with connection requirements.** The minimum quarterly usage charge for water and wastewater service for a property not in compliance with the connection requirements of § 13-5-304 is equal to 40% of the usage charge for water and wastewater that would be incurred if the property were to be connected to the County system as computed by the Department.

(1985 Code, Art. 6, § 5-201.2) (Bill No. 22-88; Bill No. 53-88; Bill No. 69-90; Bill No. 35-93; Bill No. 116-93; Bill No. 49-94; Bill No. 28-95; Bill No. 49-96; Bill No. 54-99; Bill No. 24-03; Bill No. 80-03; Bill No. 63-04; Bill No. 6-05; Bill No. 10-05)

§ 4-11-104. Department of Public Works budget.

(a) **Expense detail.** In compliance with §§ 717 and 718 of the Charter, the current expense and capital budgets for water and wastewater utilities submitted by the Director of Public Works for each fiscal year shall contain the following expense detail:

- (1) anticipated operating expenses for the water utility and wastewater utility, including the expenses of maintenance and replacement of worn-out facilities and equipment, making new connections and extensions, not to be financed from bond funds, supplies, additional equipment, personnel, direct and indirect administrative overhead, purchase of water or wastewater treatment by the County;
- (2) anticipated expenses of planning and design not payable from bond funds;
- (3) anticipated expenses of debt service on general obligation and revenue bonds or other obligations issued by the County for utility capital improvements, or to be issued in accordance with the capital budget in the ensuing fiscal year for those purposes;
- (4) anticipated expense of meeting sinking fund requirements;
- (5) other anticipated costs and expenses considered necessary to maintain the utilities in good operating condition in accordance with sound engineering practice; and
- (6) anticipated expenses of payments in lieu of taxes as required by § 717 of the Charter.

(b) **Revenue detail.** In compliance with §§ 717 and 718 of the Charter, the current budgets for water and wastewater utilities submitted by the Director of Public Works for each fiscal year shall contain the anticipated revenues from:

- (1) water connection charges, wastewater connection charges, water readiness-to-serve charges, private fire protection charges, metered water delivered charges, wastewater use charges, and public fire hydrant charges;
- (2) special water benefit charges, special wastewater benefit charges, and area benefit charges that may be established as provided in §§ 13-5-601 et seq. of this Code;
- (3) all assessments and other charges imposed;
- (4) prior years' surplus or collections and from interest on any invested funds of the utilities, including bond proceeds; and
- (5) miscellaneous revenues or sources established by ordinance of the County Council.

(1985 Code, Art. 6, § 8-104) (Bill No. 23-04; Bill No. 63-04)

§ 4-11-105. Rates for water and wastewater services.

(a) **Requirement.** The rates, assessments, and other charges for water and wastewater utility services furnished by the County, or for direct or indirect benefits accruing from the water and wastewater utility services, shall be fixed as prescribed in the Charter and this Code on a basis to

provide gross revenues from the utility services sufficient to pay the amounts appropriated for the utility services from the current revenues of the utility services as outlined in § 4-11-104.

(b) **Rule of construction.** This section may not be construed to prevent inter-fund cash borrowing authorized by §§ 711(c) and 718(c) of the Charter; supplementary or emergency appropriations for the utilities as authorized by § 712 of the Charter; or appropriation of tax revenues to redeem a pledge of the full faith and credit of the County made under the Sanitary Commission Act or under § 4-10-103.

(1985 Code, Art. 6, § 8-105)