California Court of Appeal Holds City’s Tiered Water Rate Structure Violates Proposition 218

But City May Charge Potable Customers for the Costs of Developing Alternative Supply Projects, Such as Recycled Water

In an opinion anxiously awaited by many water agencies throughout California, the Fourth District Court of Appeal, Division Three, ruled on Monday that a city’s inclining, tiered block rate structure violated Proposition 218’s proportionality requirements (California Constitution, article XIII D, section 6).

Although the opinion in Capistrano Taxpayers Association v. City of San Juan Capistrano held that tiered rates, or inclining block rates that go up progressively in relation to usage, are compatible with Proposition 218, in this instance, the court concluded that the City failed to demonstrate that the tiers correspond to the actual cost of providing service at a given level of usage. The court rejected reliance on article X, section 2 to promote water conservation as the sole basis for establishing tiers, holding the city had to show that the various usage tiers corresponded with its actual costs of delivering water in those increments.

The City of San Juan Capistrano adopted an allocation-based rate structure in August 2012. The rate structure consisted of four tiers with the rates in each tier determined based on predetermined water usage budgets. The first two tiers were based on the amount of water the City concluded was required for reasonable indoor and outdoor water usage. The third and fourth tiers were based on what the City concluded to be excessive or overuse of water, respectively. The City was also in the process of constructing a recycled water treatment plant and related facilities, which were funded in part through its potable water service fees. The Capistrano Taxpayers Association sued challenging the validity of the City’s rates under Proposition 218.

First, the Court of Appeal held that the City’s rates were not proportional to the cost of service because the City did not calculate the incremental cost of providing water at the level of use represented by each tier. Specifically, the
court criticized the City for not correlating its rates within each tier to the prices of water used within each tier. In interpreting the provisions of Proposition 218, the court noted that “[i]f the phrase ‘proportional cost of service attributable to the parcel’ is to mean anything, it has to be that [Proposition 218] assumes that there really is an ascertainable cost of service that can be attributed to a specific - hence that little word ‘the’ - parcel.” The court concluded that the administrative record justifying the City’s rates did not contain any breakdown as to the relative cost of each source of supply and therefore did not justify an ascertainable cost attributable to specific parcels.

Second, the court rejected the City’s argument that the rates in tiers three and four do not have to be cost justified. The City asserted the higher tiers are penalties structured consistent with the provisions of article X, section 2 of the California Constitution. Article X generally requires conservation of the water resources of the State and is often cited by public agencies in support of tiered rates as a means of promoting conservation. The court, however, took a narrow interpretation of article X, section 2, concluding that it does not trump the cost of service provisions of Proposition 218.

Finally, the appellate court sided with the City that Proposition 218 does allow public water agencies to pass on to their customers the capital costs of improvements to provide additional water, including building a recycling plant, because “each kind of water is providing the same service,” even if not all customers (e.g., residential) are capable of utilizing the alternate water source. The court, however, went on to question whether residential rate payers with very low water consumption (“super-conservers”) “should be required to pay for recycling facilities that would not be necessary but for above-average consumption.” The court therefore sent this portion back to the trial court for further findings on the issue of whether the cost to develop the City’s recycling operation were appropriately allocated to those who use water at the lowest levels.

Best Best & Krieger LLP Partner Kelly Salt appeared amicus curiae for the Association of California Water Agencies, the League of California Cities and the California Association of Counties.

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