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Santa Margarita
Water District

Practical and Legal Tools to Protect your Agency in Rate Setting

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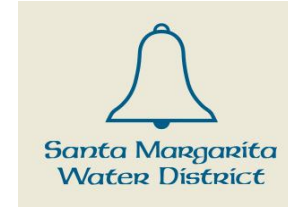
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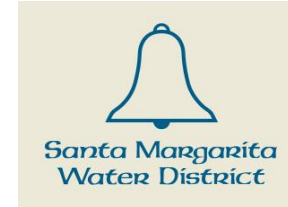
Introduction



- California public agencies are faced with conflicting priorities:
 - Conserve public resources and penalize waste, while recovering costs proportionately based exclusively on individual cost of service
- Further, rate setting is heavily regulated by the California Constitution:
 - This means that these rules cannot be changed without a statewide election
 - Courts have conflicting interpretations of rules, with trend moving toward strict interpretation
 - Litigation – local agency ratemaking decisions can lead to high-stakes litigation, involving significant potential damages

Overview

- Propositions 218 governs rate-setting for property-related fees including water and solid waste
- Rates are established based on assumptions and projections
- Agency bears evidentiary burden to show compliance with Proposition 218
- Other fees are subject to Proposition 26 and other statutory and constitutional limitations



Proposition 218



- Adopted by voter initiative in 1996
- Adds articles XIII C and XIII D to the California constitution
- Adds procedural and substantive requirements for property related fees, including water, sewer, solid waste

Proposition 218 (1996)



- Further restricts local revenues
- Allows voters to repeal or reduce taxes, assessments, fees, and charges by **initiative** process
- Reiterates voter approval requirements for general taxes (majority) and special taxes (2/3)
- Intended to make winning lawsuits against public agencies easier



Property-Related Fees: Article XIII D, § 6



What is a Property Related Fee?



- “Fee” or “charge” - “any levy other than an *ad valorem* tax, special tax or assessment, imposed by an agency upon a parcel or upon a person as an incident of **property ownership**, including user fees or charges for a **property related service**”
- “Property-related service” - “a public service having a direct relationship to **property ownership**”
- “Property ownership” - includes “tenancies of real property where **tenants are directly liable** to pay the assessment, fee, or charge in question”

Bighorn Desert-View Water Agency v. Verjil



- Water service is related or incidental to property ownership
 - This is a service that is delivered through pipes connected to the property for use on the property
- By implication, wastewater and solid waste service fees are property-related fees
- Conversely, water delivered for purpose other than use on property *is not* a property-related service

Rate-making Considerations



- Source of supply
 - Where does the water come from?
 - Multiple sources? How much do they cost?
 - Availability and pricing for recycled water?
- Infrastructure costs
 - Aging system?
 - Disparate or uniform water demand patterns?
- Customer base
 - Uniform or varied customer base?
- Fire flow considerations
- Environmental and conservation/water-use efficiency standards



Other types of fees and charges



- Other fees and charges not governed by Proposition 218
 - Capacity fees and connection fees
 - Miscellaneous fees for services/products
 - Penalties and violations of local rules
- Generally, capacity and connection fees, and miscellaneous fees for services/products must be tied to proportional cost of service
- Penalties and deposits do not

Procedural and Substantive Requirements



Proposition 218 – Procedural Requirements

- Agency must hold public hearing prior to adopting new or increased rates
- Agency must mail notice to all property owners and customers of record at least 45 days prior to public hearing
- Rates cannot be adopted if majority protest exists



Proposition 218 – Substantive Requirements

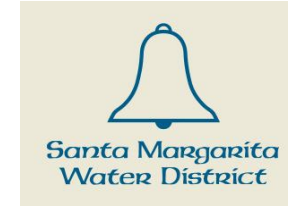


- Revenues cannot exceed cost of service
- Rates must be proportional to cost of service to parcel
- Revenues can only be used for providing the service
- Burden is on the public agency to prove compliance with substantial, reliable evidence

Revenues Cannot Exceed Cost of Service



HJTA v. City of Roseville (2002)



- Roseville provided water, sewer and trash service
- Charged ratepayers an in-lieu franchise fee for the “lost opportunity” cost of having a private utility
- The fee was 4% of utility rate revenues, and used for general governmental services
 - City did not show that the fee was a reimbursement for utility-related costs
- Fee violated Proposition 218 because it caused rates to exceed cost of utility service



Moore v. City of Lemon Grove (2015)



- Lemon Grove transferred utility rate revenues to reimburse general fund for costs incurred on behalf of utility
- Methodology was imperfect, relied on estimates and assumptions
- Sewer rates may recover all operating costs and an agency has a “reasonable degree of flexibility to apportion the costs”
- Apportionment in accordance with the City’s informal, best cost estimates is sufficient

Rates must be Proportional



City of Palmdale v. Palmdale Water Dist. (2011)



- District adopted budget based rates pursuant to AB 2882
- AB 2882 was designed to promote conservation of water resources and prevent unreasonable use of water
- District Board went against consultant recommendations to reallocate costs for benefit of residential customers
- City, an irrigation customer, challenged the fees for failing to meet the proportionality requirements of Article XIII D, § 6(b)

City of Palmdale v. Palmdale Water Dist. (2011)



- Budget based water rates and tiered rate structures do not inherently violate Article XIII D, § 6(b)
- Here, rates for one customer class were not proportionate to the cost of service, not supported by evidence
- Lesson: Show your work!



Griffith v. Pajaro Valley Water Mgmt. Agency (2013)



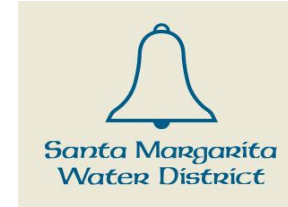
- Groundwater basin subject to overdraft
- Groundwater augmentation charges are fees for water service
- Groundwater augmentation charges are not subject to voter approval

Griffith v. Pajaro Valley Water Mgmt. Agency (2013)



- Property-related fees do not have to be established on a parcel-by-parcel basis
- It is appropriate to group similar users together (i.e., calculating fees on a class-by-class basis)
- Apportionment is not a determination that lends itself to precise calculation

CTA v. City of San Juan Capistrano (2015)



- City adopted budget-based rates with four inclining tiers
- The tiers were designed to promote conservation
- City did not try to correlate tiers to cost of service; instead, treated them as a means to incentivize efficient water usage



CTA v. City of San Juan Capistrano (2015)



- Court held that inclining block rates that go up progressively in relation to usage, are compatible with Proposition 218
- In fact, they are a good idea to protect low water users from paying costs their level of usage does not warrant
- However, City failed to meet its burden to demonstrate that the tiers correspond to the actual cost of providing service at a given level of usage



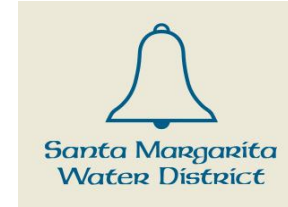
CTA v. City of San Juan Capistrano (2015)



- Upper tiers should reflect marginal costs
 - Water supply
 - This includes funding alternative sources of water, such as recycled water
 - Capital costs
 - Costs for implementing conservation programs

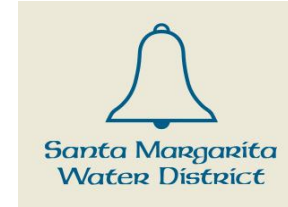


Coziahr v. Otay Water District (2024)



- *Coziahr* involved a class-action challenge to Otay's tiered water rates
 - Tiers were established to promote conservation and affordability
 - District's evidence supported conclusion that tiers were based on the concept that higher water users place greater demand on the system, and residential customer use water similarly
 - There was little district-specific evidence; the study relied on industry standards and assumptions

Coziahr v. Otay Water District (2024)



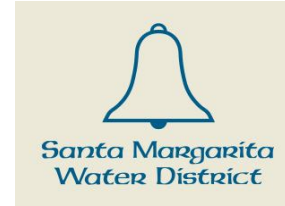
- Court of appeal upheld trial court's invalidation of rates
 - Insufficient evidence to show that tiers were based on actual costs
 - No connection between higher water use and peak demands
 - No “cogent reason” to differentiate between customer classes
 - Court indicated that more evidence was needed to rely on peaking factors, differentiate between customer classes, and support rates, but did not say what evidence would be sufficient
- Additional cases on this issue are currently making their way through the courts

Coziahr v. Otay Water District (2024)



- Key lessons:
 - Trial court will uphold rates only if there is substantial, reliable evidence that can withstand independent review
 - Conclusory statements without evidence are insufficient
 - Deference to trial court's finding, upholding so long as there is substantial evidence supporting their determination
 - Reliance on industry standards is insufficient

Patz v. City of San Diego (2025)



- City of San Diego was sued over its tiered water rates
 - Plaintiffs alleged that tiers did not reflect actual cost of service
 - Plaintiffs further alleged that rates discriminated against single family residential customers
 - Called use of peaking into question, as well as source of supply
- Trial court ruled against the City, currently on appeal
 - Tentative ruling affirmed trial court opinion
 - However, oral arguments occurred on 5-6-25, and it now seems like they may reverse
- *Patz* could help agencies claw out of impossible standards created by *Coziahr*

Risk Mitigation and Defenses



Mitigating Risk



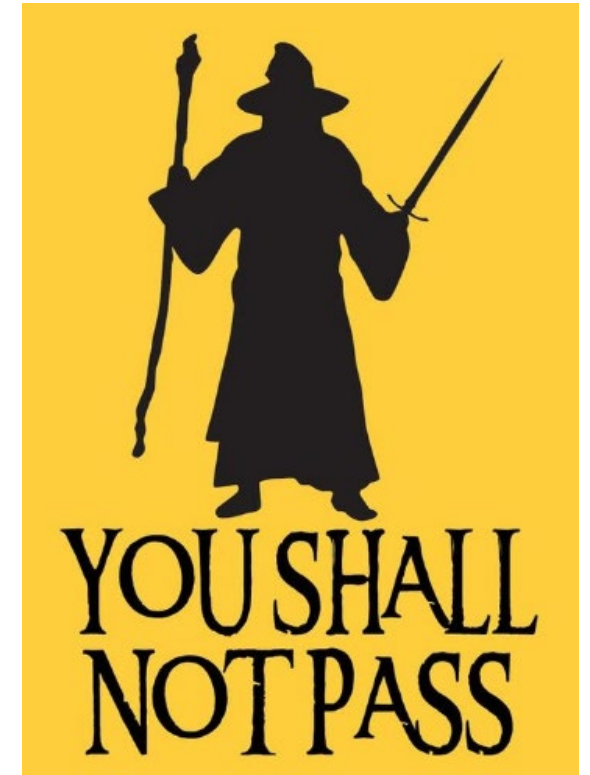
- Public agency bears the burden of proving, with substantial and reliable evidence, that rates comply with Proposition 218
- This is a significant burden that is strictly applied by courts
- Underscores the importance of having a strong evidentiary record
 - Agencies hire a rate consultant to conduct a cost of service analysis and rate study to identify and allocate costs
- Also underscores importance of procedural defenses

Validation

Government Code section 53759



- “***Any judicial action*** or proceeding to attack, review, set aside, void, validate, or annul an ordinance, resolution, or motion adopting a fee or charge for ***water or sewer service*** . . .”
- Why?
 - Agencies could face challenges to rates and claims for refund years after rates are adopted, so that the budget and rates were never truly “safe” for fiscal planning
- What?
 - Three Key Requirements:
 - Agency must notify public in Prop 218 notice
 - Any suit must be brought within 120 days of the effective date or date of final passage, whichever is later
 - Any suit must comply with Validation Statutes (Code of Civil Procedure Sections 870, et seq.)

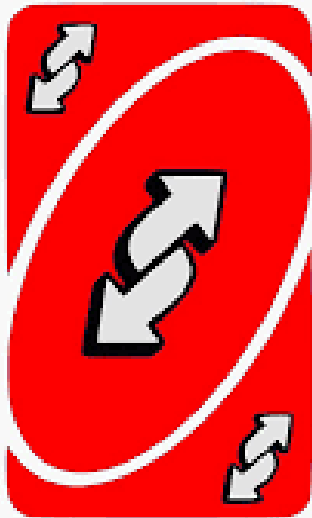


Validation Action



- An early option for bulletproofing rates through affirmative legal action by ratemaking agency
- Procedures:
 - Written notices during Proposition 218 notice process must include statement identifying 120-day statute of limitation
 - 120 days to file, followed by summons issued to all interested persons, and published in newspaper of general circulation
 - Agency filing may occur shortly after rate adoption which could result in a default judgment and validation of rates prior to 120-day statute of limitations expiring
 - Failure of interested party to appear after date specified in summons precludes challenge
 - Priority of action and conclusiveness of judgment

Reverse and Passive Validation



- Reverse Validation – If a government agency does not bring a validation action, an interested member of the public may bring a “reverse validation” proceeding by adhering to the same procedural requirements
- Passive Validation – If neither the public agency nor an interested member of the public brings a validation action within the 120-day timeframe, the rates are “passively” validated because they are immune from any further challenge

Jurisdictional and Mandatory

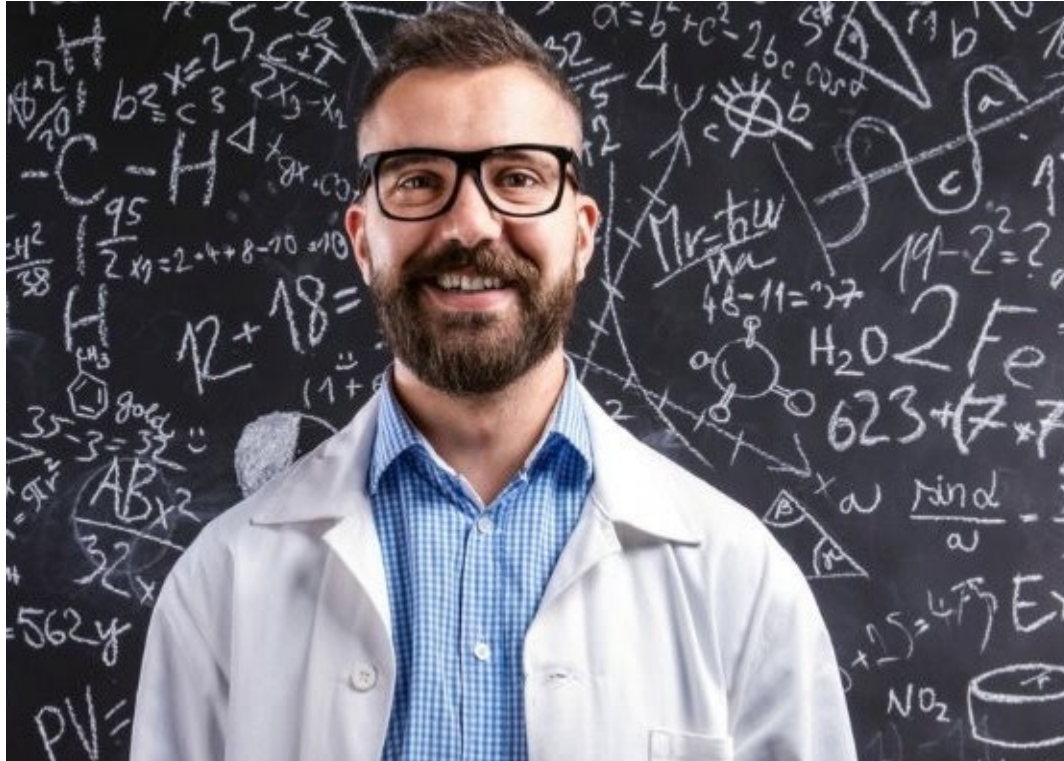


- Compliance with these statutory requirements are the only way for a court to retain jurisdiction over the matter
- A litigant's invocation of reverse validation procedures is not "optional;" instead, "when validation is permitted, it [is] the exclusive means to seek judicial review"



Exhaustion of Administrative Remedies and Extra-Record Evidence

Proposition 218 & Extra-Record Evidence



- ***Malott v. Summerland Sanitary District (2020)***

- **Summary:** Owner of apartment building filed writ of mandate against sanitary district challenging sewer rates under Proposition 218 and sought to introduce extra-record evidence of an expert opinion on the district's method of calculating wastewater service rates. The district argued that extra-record evidence was inadmissible because a writ petition should be decided on administrative record alone
- **Takeaways:**
 - Despite writ proceeding, expert testimony relevant and admissible
 - Plaintiff **not** required to present expert testimony at public hearing
 - Extra-record *expert* evidence may be allowed, but open question regarding extra-record fact evidence

Assembly Bill 2257 – Exhaustion Requirements



- A new statute, but not new law
- Create an administrative procedure to raise legal objections to proposed water rates before final action
- Must be exhausted to allow ratepayer to sue
- Statute only applies to water and sewer; unclear whether it would also work with solid waste
- Agency Requirements:
 - *Proposition 218 Notice* – Identify and describe exhaustion requirements (e.g. written objection) and timing for submission
 - *Notice and Publication* – Availability of fee or assessment; online posting of basis for fee or assessment; mailing upon request
 - *Timing* – Agency establishes deadline at least 45 days after Proposition 218 Notice, and prior to Proposition 218 Hearing
 - *Responses* – Respond in writing to all written objections, including *substantive* basis for response

Assembly Bill 2257 – Extra-Record Evidence



- Presumptive Limitation on Extra-Record Evidence:
 - Cost of service analysis
 - Transcript of minutes of public meeting
 - Proposition 218 notices
 - Written objections
 - Agency correspondence
 - Agency supporting evidence
- Exceptions:
 - Class action certification
 - Jurisdiction (*standing and capacity*)
 - Affirmative defenses (*laches, estoppel, res judicata, etc...*)
 - Completeness of administrative record
 - Compliance with exhaustion procedures and Proposition 218 procedural requirements

Concluding Thoughts



- Rules and regulations of public finance and local agency revenues are dynamic
- Rate setting is inherently very complicated
- In addition, it is subject to strict constitutional limitations, with the potential for high-stakes litigation generating significant damages
- Consultants, lawyers, and public agencies are working together to find workable, legally compliant solutions that protect local interests and public resources



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Questions?

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