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Proposition 218 Today – Legal Landscape, Rate Resilience & Legislative Updates

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Presenters



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Introduction



- California public agencies are faced with conflicting priorities:
 - Conserve water resources and penalize water waste, while recovering water costs proportionately based exclusively on individual cost of service
- Further, water 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
 - Rates are frequently subject to litigation, and costs could be significant – both in terms of damages as well as in terms of potential attorneys' fees awards

Proposition 218

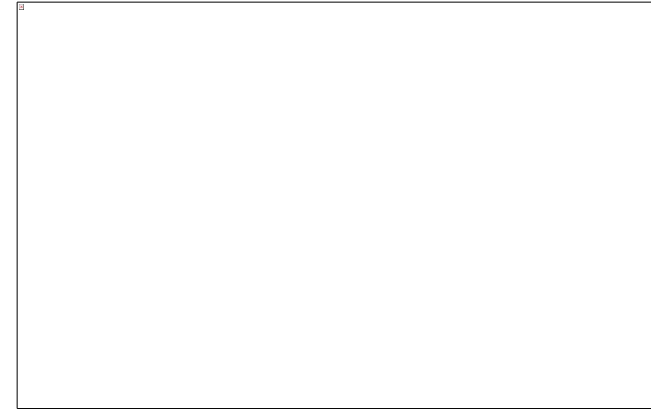


- Adopted by voter initiative in 1996
- Adds articles XIII C and XIII D to the California constitution
- Adds procedural and substantive requirements for property related fees, including water, sewer, solid waste

Proposition 218



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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
- Additional procedures to implement administrative remedy



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

Rates must be Proportional



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)



Groundwater augmentation charges did not exceed the proportionate cost of providing the service because ***all groundwater users benefit*** from the Agency's groundwater management activities, not just the coastal users receiving supplemental water

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



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- 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)



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- City adopted budget-based rates 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
- Argued higher tiers were penalties



CTA v. City of San Juan Capistrano (2015)



- Tiered rates are consistent with Prop 218 if they correlate to proportional cost of service within each tier
 - Rates must protect against inter-class and intra-class subsidies
 - Higher tiers cannot be penalties
 - Infrastructure costs for water supply projects could be allocated to higher tiers
- City failed to meet its burden
- Article X, section 2 cannot be interpreted to allow for rates that “exceed the true cost of supplying water”



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 argued that higher water users require more infrastructure, and as such, higher users should pay higher rates
 - 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 questioned why *any* fixed costs (i.e. infrastructure costs) were allocated to variable rate
- Otay could not rely on "non-cost objectives such as conservation" and "affordability concerns" in structuring rates

Patz v. City of San Diego (2025)



- Class action challenge to San Diego's water rates
 - Tiered for SFR, flat for others
- City's stated objectives:
 - Promote water conservation
 - Recover costs of increasingly expensive supply
- City relied on cost of service analysis that looked at historic consumption data and peaking factors to allocate infrastructure costs

Patz v. City of San Diego (2025)



- Tiered rates must reflect actual cost of service within each tier
 - Cannot be justified by conservation or other non-cost objectives
 - Looked to evidence in the record that rates were designed to promote conservation
- City's reliance on peaking factors, industry assumptions, and historic data was insufficient to meet evidentiary burden
 - Failed to explain what would be sufficient besides time-of-use metering
 - Indicated that all fixed costs should be allocated to fixed charge, not variable charge
- The Court seemed to indicate that source of supply allocations are also at risk



Dreher v. LADWP (2025)



- LADWP adopted budget-based tiered water rates for single-dwelling unit customers
- The rates included a low-income subsidy adjustment (LISA) funded by all non-subsidized customers
- Tiers were supported by source of supply and infrastructure costs
- Plaintiffs claimed rates violated Prop 218
 - LISA violated proportionality requirement
 - Insufficient evidence to support tiers
- Trial court upheld the rates (except for LISA); Court of Appeal affirmed



Dreher v. LADWP (2025)



- No molecule-by-molecule tracing is required to allocate sources of supply
- Infrastructure costs can be allocated to customers that drive the need for such infrastructure through reliance on non-specific data
- Tier breakpoints could be set to promote conservation
- LISA violates Prop 218 insofar as it requires some customers to pay more to subsidize others

Rate Study Process

Policy Framework

Identify Key Policy Objectives (Revenue Stability, Customer Affordability, etc.)

Which rate structure reflects our value?

Financial Plan

Develop Multi-year Cash Flow Projections to Determine Annual Rate Revenue Requirement

How much revenue do we need?

Cost-of-Service Analysis

Allocate the Rate Revenue Requirement to Customers in Proportion to Use of and Burden on the Water / Wastewater System

Who should pay for what?

Rate Design

Identify Appropriate Rate Structure Changes and Calculate Proposed Rates

What are the impacts of the proposed rate structure?

Documentation

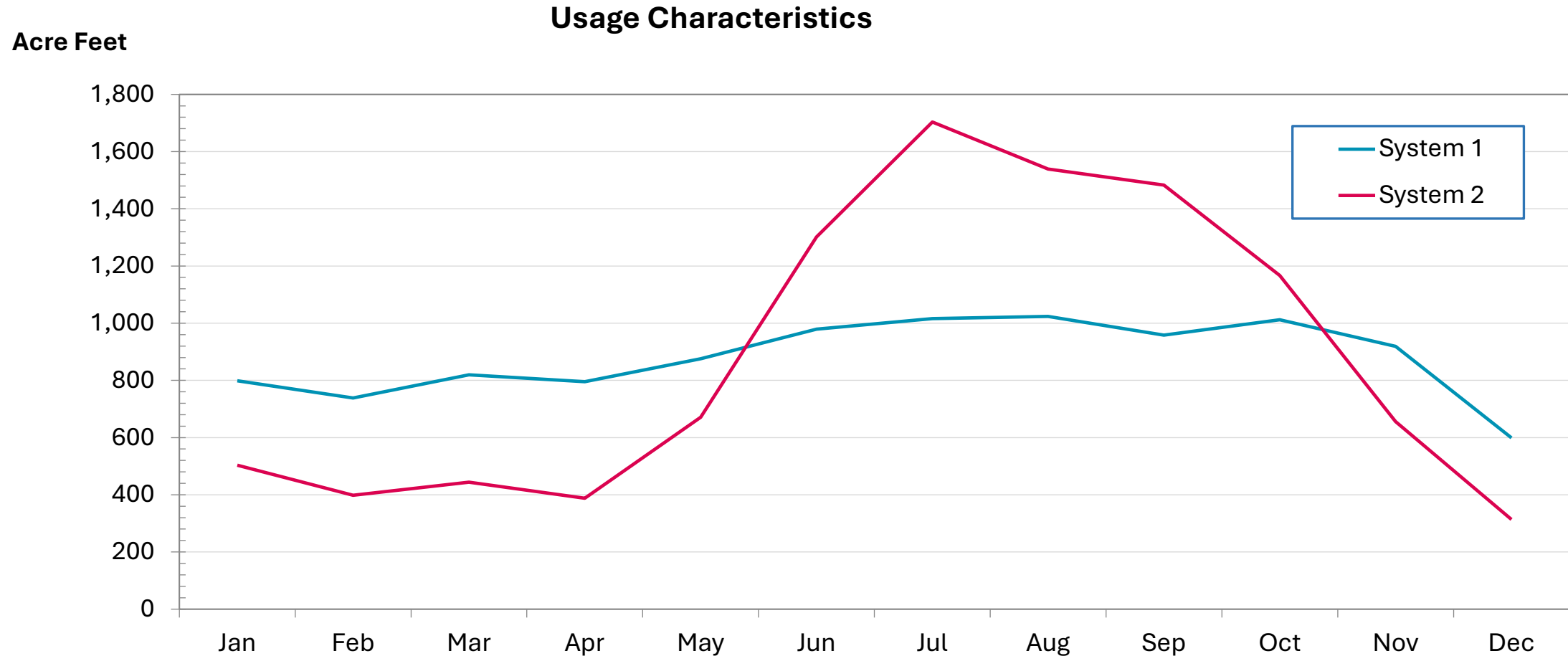
Develop a Study Report to Provide Transparency and Defensibility

Is there a report that shows the proportionality of the rates?

Cost-of-Service Overview

- Cost-of-Service is the Standard Methodology Used to Establish Water Rates in the United States
- **Guiding Principle:** Each Customer Should Pay Their Fair Share
- **Goal:** Recover Costs From Customers in Proportion to Their Use of the Water System
 - For example, Certain Costs May be Allocated:
 - **Per Account** (e.g., billing and customer service costs)
 - **Based on Meter Size/Capacity** (e.g., capital repair & replacements)
 - **Based on Water Use** (e.g., electricity costs to move water)

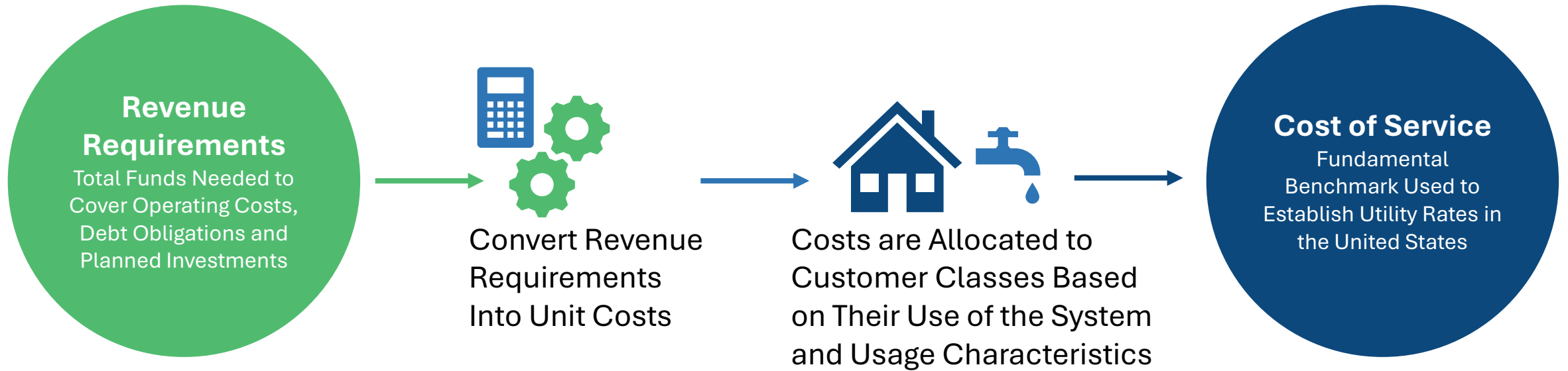
Water System Costs and Peaking Demand



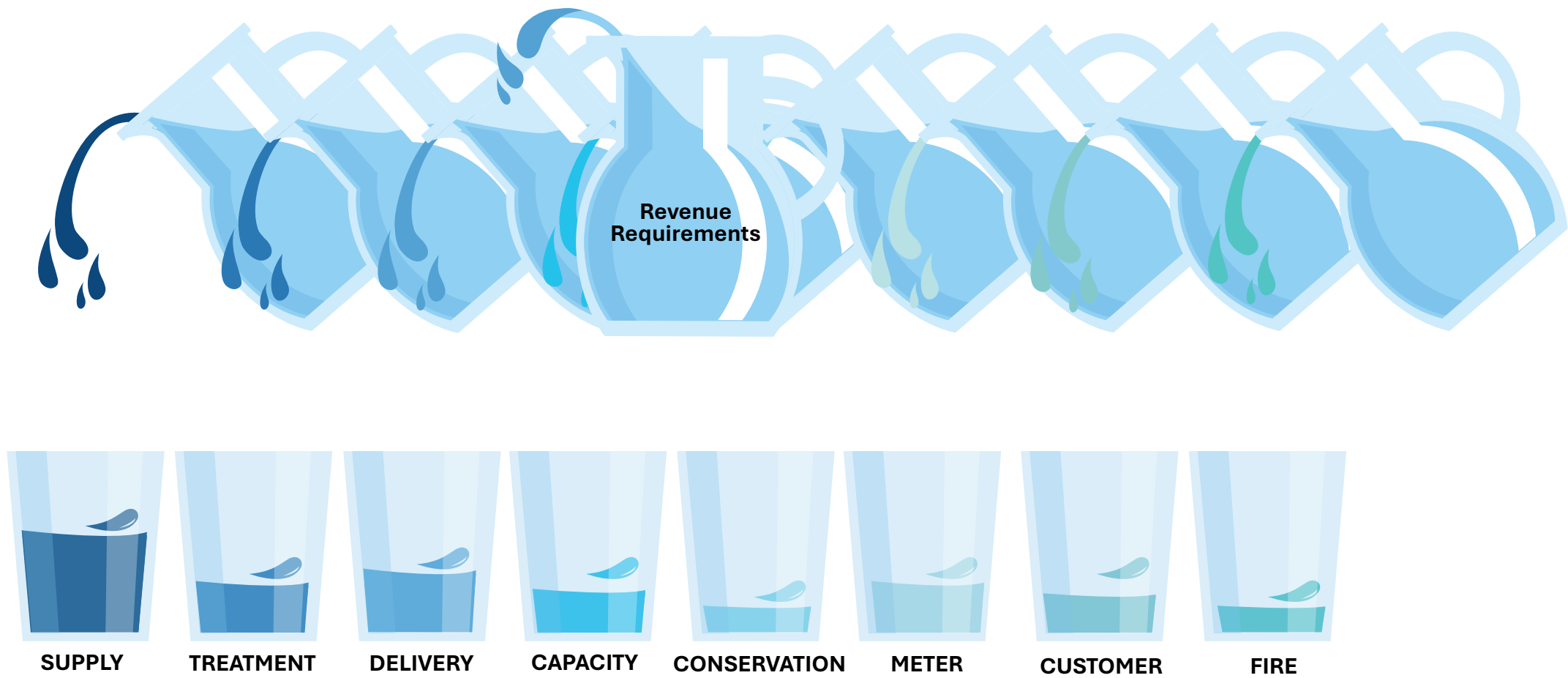
Both water systems have annual demand of approximately 10,500 AF / year.

Which water system requires larger facilities/infrastructure?

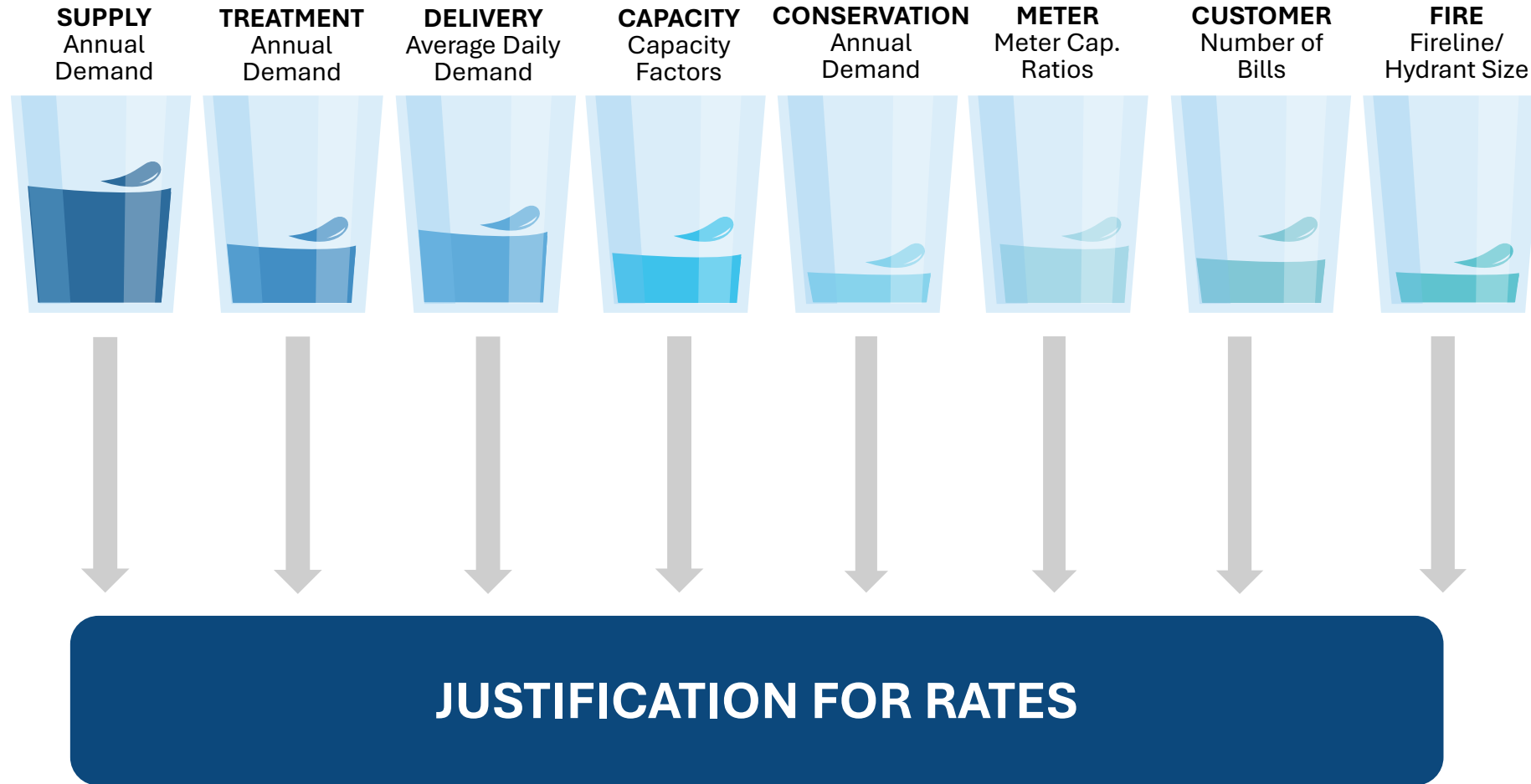
What is Cost of Service?



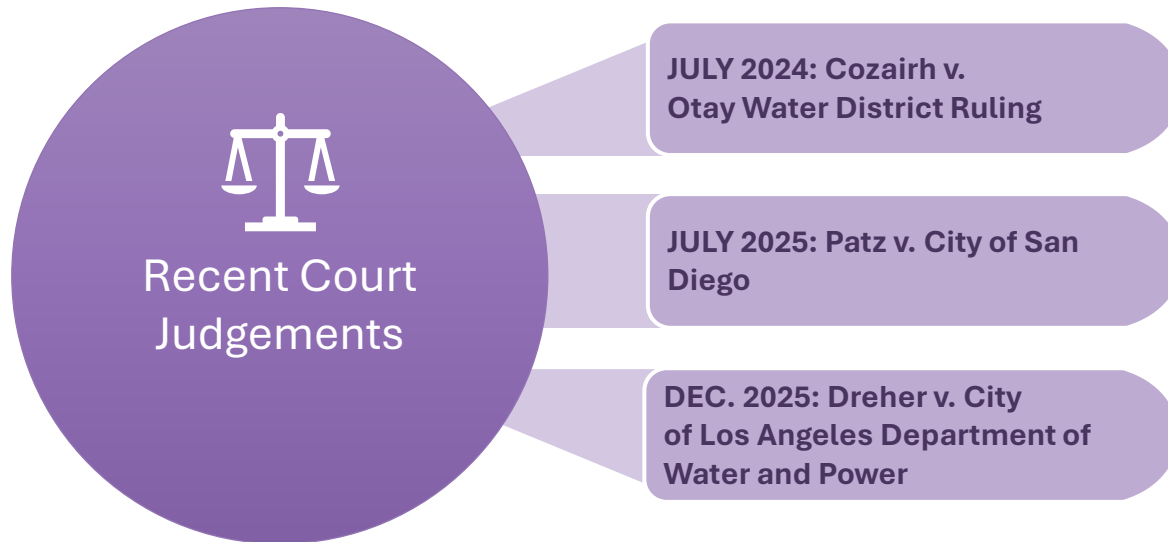
Distribute to Cost Components



Distribute to Customer Classes



Recent Proposition 218 Litigation



- **Implications:**

- **Rates Primarily Designed** to Promote Water Efficiency/Conservation, *Even When Compliant with Industry Standards*, May Not Meet Prop 218 Requirements
- **Tiered Rates** Require a Higher Level of Justification and Are Vulnerable to Legal Challenges
- **Different rates by Customer Class**, a higher level of burden is required to justify different rate structures
- **Higher Degree of Uncertainty** Regarding Which Rate Structures Will Pass Legal Muster



Why do courts seem contradictory?

- We have different rulings on tiered water rates
 - Coziahr and Patz ruled against the traditional tiered water rates
 - Dreher ruled in favor of the water budget tiered water rates
- Why?
 - Most individuals want to blame the judges
 - However, if we take the time to read the rate study, we see another reason

2013 Otay Report

AWWA provides some basic guidelines for these types of structures. First the consumption-related cost is divided into the base, maximum-day, and maximum-hour cost of service. Then, as shown in Table 2-3 the threshold between blocks (tiers) 1 and 2 is set at the transition between average indoor use and average outdoor use. The objective of this is to have block 1 consumption approximate indoor usage and to charge a higher amount for outdoor usage in block 2 to promote conservation. Block 1 pricing is normally set just below the average cost of water and block 2 is set just above the average cost of water. Block 3, which is considered to be in excess of both average interior and exterior water usage, is set at a higher price differential. This is based on the fact that above average use of water is using a larger portion of the water system and therefore should be required to pay for the cost of maintaining this extra capacity to serve their needs. All water systems must be designed for peak or excess use, not average use.

To set the rates in each block, the District uses a standard pricing structure. AWWA suggests that block 2 should be set at a level 30 percent higher than block 1 to reflect the cost incurred for increased capacity costs and supply purchases. Block 3 is then set at a price differential of 2 times the rate of block 1 because the capacity requirement is twice that of block 2 (e.g. single family block 1 breakpoint is 10 HCF and block 3 begins at 23 HCF).

2017 Otago Report

HDR spent considerable time reviewing individual customer data and information to estimate and determine reasonable peaking factors by customer class of service. This information is used to equitably allocate the capacity related costs within this study.

- However, the report does not show this analysis
 - It is not enough to state that you did it, you need to show your work

2013 San Diego Report

Table 21 Volumetric Cost Recovery over Tiers

Description	Percentage of Cost Recovery in				Total
	Tier 1	Tier 2	Tier 3	Tier 4	
Base Demand Costs	40%	50%	10%	0%	100%
Maximum Day Costs	15%	45%	30%	10%	100%
Maximum Hour Costs			30%	70%	100%

- Why is base demand not spread to all tiers equally?
- Rationale of Max Day?
- Rationale of Hour Cost?

Summary of Otay and San Diego reports

- Otay Water District (2013/2017) — study lacked detailed justification; relied on vague “industry standards.”
- San Diego (2013/2015) — rate logic was inconsistent; irrigation rates lower than residential outdoor use, costs arbitrarily assigned to tiers
- **Lesson: Courts expect clear, parcel-specific data, showing calculations, not generalities or industry standards.**

LADWP Rate Study Summary

- Water Rate Study is 418 pages
- Clearly shows how cost are allocated

Figure 12: Cost Causation Factor Criteria and Marginal Cost Units

Functional Cost Component	Cost Causation Factor	Marginal Cost Units
Transmission (Capital)	Consumption volume by customer class	\$/HCF/annual
Supply (O&M)	Consumption volume by customer class	\$/HCF/annual
Supply (Plant)	Consumption volume by customer class	\$/HCF/annual
Supply, Adder for BDCP Delta Fix, Cap and Trade	Consumption volume by customer class	\$/HCF/annual
Supply, Purchased Water / Long Run Supply	Seasonal coincident peak by customer class	\$/peak HCF/annual
Local Pumping	Consumption volume by customer class	\$/HCF/annual
Water Quality and Regulatory Capital	Consumption volume by customer class	\$/HCF/annual
Water Purification	Consumption volume by customer class	\$/HCF/annual
Distribution Storage (Plant)	Consumption volume by customer class	\$/HCF/annual
Distribution Storage (O&M)	Consumption volume by customer class	\$/HCF/annual
Distribution (Plant)	Consumption volume by customer class	\$/HCF/annual
Distribution (O&M)	Consumption volume by customer class	\$/HCF/annual
Customer Service, Billing	Number of Customers	\$/HCF/annual
A&G and General Plant Adder	Percent of (Proportionate to) All Other Costs	\$/HCF/annual

These cost causation factors form the basis for the determination of marginal unit costs for each functional component (and sub-component). Based on appropriate allocation criteria, the cost causation factors are also utilized for the allocation of unit marginal costs to customer classes.



Take Away

- We can have conservation / tiered water rates that are legally justifiable
- We need to have a well documented report that shows all the math that derived the rates
 - “Show your work”
- There are limitations on the pricing of tiered rates, we can not “arbitrarily” have high rates to promote conservation / water efficiency
 - The rates needs to reflect the cost structure of the utility

Back to Basics

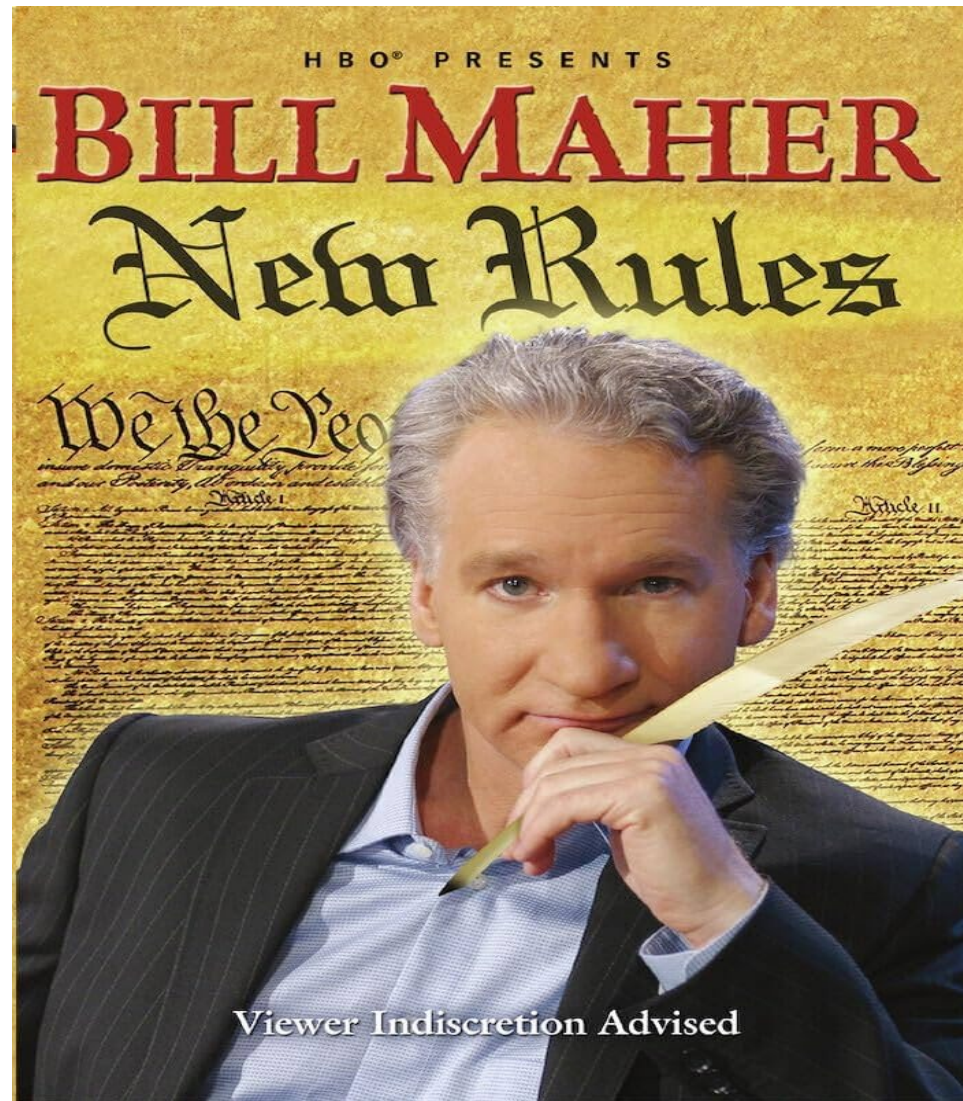


- Start with where you are
 - What does your current rate structure look like? How is it working for your agency?
 - Balance between fixed and volumetric, projections of future demand, meeting revenue needs, drought rates
 - Are there legal vulnerabilities?
 - tiered rates
 - disparities between customer classes
 - low-income assistance or other programs
- Let this analysis help to drive changes

Lessons Learned From Recent Cases



- Tell your story
 - Use agency specific data where you can
 - Explain your reasoning (e.g. sources of water supply)
 - Address what is and is NOT feasible
- Jargon
 - How not to talk to a judge (e.g. “Base-Extra Capacity”)
- “Conservation” is not a dirty word, but use it carefully



New Rules



- AB 1827 - Codifies the use of incrementally higher costs of water service due to higher parcel demand, maximum potential use (meter size) and peaking factors in rate-setting. These costs may be allocated using any method that reasonably assesses the water service provider's cost of serving those parcels that are increasing potential water usage demand, maximum potential water use, or projected peak water usage.
- SB 1027 - No refunds, but in the next procedure to impose or increase the fee or charge, credit the amount of the fee or charge attributable to the violation against the amount of the revenues required to provide the property-related service.
- SB 323 – 120-day statute of limitation and reverse validation applies. The agency may choose to file its own rate validation action.
- AB 2257 – Requires exhaustion of administrative remedies prior to filing rate challenge and provides guidance on the scope of the administrative record, provided notice and objection procedures are followed

Coming Soon: AB 2180!

- Give yourself plenty of time
 - Schedule – work backwards to assure you meet your timeline
 - Develop the data and decision points
 - Identify need for Board Input
 - Review the draft COSA and Rates
 - For accuracy
 - To assess that it clearly conveys how the analysis supports the allocation of costs
 - Public communication and workshops
 - Develop a webpage with FAQs and rate calculator for the public
 - Talking Points for your board

- Posting and Mailing Prop 218 Notice
 - At Least 45 days prior to public hearing
 - Include SB 323 and AB 2257 legally required language to preserve these rights
- AB 2257 Objections Process
 - At least 45-day objection period (can run concurrent with protest period)
 - Time to develop agency response
 - Must explain the substantive basis for retaining or altering the proposed fee
 - Must be presented to the agency board for determination of next steps
 - Consider this an opportunity to improve the record, correct any errors
 - Recirculation of Prop 218 notice – depends on the scope of any proposed changes
 - One or Two step process – Depends





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Questions?

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