

Case No. G048969

In the
Court of Appeal
of the
State of California
FOURTH APPELLATE DISTRICT
DIVISION THREE

CAPISTRANO TAXPAYERS ASSOCIATION, INC.

Appellee and Plaintiff

vs.

CITY OF SAN JUAN CAPISTRANO,

Appellant and Defendant.

Appeal from the Superior Court of California, County of Orange

Case No. 30-2012-00594579

Honorable Gregory Munoz, Judge Presiding,

**SUPPLEMENTAL BRIEF OF AMICI CURIAE IN SUPPORT OF
APPELLANT CITY OF SAN JUAN CAPISTRANO**

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I.
INTRODUCTION

Amici appreciate the opportunity to provide additional information that we believe will assist the court in analyzing the important issues in this case that affect all public agency water purveyors. The questions posed by the court fully align with the arguments presented by Amici in our brief previously submitted to the court, and demonstrate that there is no single “one size fits all” approach to water rate design. This is further evidenced by the wide range of rate designs used throughout California,¹ including the differing approaches used by amicus Mesa Water District and appellant City of San Juan Capistrano (the “City”).

The public agency water purveyors in California are as diverse as our population.² Some agencies are urban, others are rural. Some are large, some are small. Some have a multitude of water supply sources—e.g., groundwater, surface water, desalinated water, and recycled water. Others rely entirely on a single source of supply, such as imported water or groundwater. Some agencies have made significant investments in water

¹ In a survey completed in 2013, over half of water agencies in California have tiered water rates. (Sanjay Gaur & Drew Atwater, *California Water Rate Trends*, Journal AWWA Jan. 2015 107:1 (2015).)

² The Association of California Water Agencies’ diverse membership of over 450 water agencies includes cities, municipal water districts, irrigation districts, county water districts, California water districts and special purpose agencies.

conservation programs, while others have yet to meter all service connections. Some have long-range infrastructure plans requiring multiple debt issues, others fund their capital programs on a pay-as-you-go basis. Some may have service areas that generate high utility costs because pumps are required to lift and deliver the water to customers in higher elevations. Others system are largely gravity driven. The average per capita income in one may be as high as \$100,000, while in another the average per capita income may be at or near the poverty level. The Legislature has recognized this diversity. (*See* Cal. Water Code § 10608(h) (recognizing the diversity of factors impacting water use efficiency targets).) In short, the costs of providing water service are different for each public agency water purveyor and are not wholly dependent on the supply price of the water delivered.

The members of the legislative bodies of these public agencies are just as diverse in their opinions, experience and backgrounds as the communities they serve. Their diversity influences their decision-making, and the goals and policies that guide their agencies, including their determination of what is a fair and equitable rate structure for their customers within the constraints of the law, namely California Constitution articles X, section 2 (“Article X”) and XIII D, section 6(b) (“Article XIII D”).

Because of this diversity, we urge the court to consider that the substantive provisions of Article XIII D do not, and were not intended, to

reduce the legislative discretion of a public agency water purveyor to price its water resources, or to design rates, in a manner that reflects their goals and policies. (*See Brydon v. E. Bay Mun. Util. Dist.* (1994) 24 Cal.App.4th 178, 194-195 (analyzing the voters' intention and water rate structure design in the context of Article X and California Constitution article XIII A [Proposition 13]).) Revenues from its water service fees may not exceed the costs of providing service and the costs of service must be reasonably and equitably distributed among the customer classes. Once that is shown, upon a court's inquiry need go no further in conducting its independent judgment of water rates under the standards of Article XIII D. At least three authorities make this point:

- *Brydon, supra*, 24 Cal.App. 4th at p. 194 (“in pursuing a constitutionally and statutorily mandated conservation program, cost allocations for services provided are to be judged by a standard of reasonableness with some flexibility permitted to account for system-wide complexity”).
- *Griffith v. Pajaro Valley Water Mgmt. Agency*, (2013) 220 Cal.App.4th 586, 601 (“Apportionment is not a determination that lends itself to precise calculation Given that Proposition 218 prescribes no particular method for apportioning a fee or charge other than the amount shall not exceed the proportional cost of the service attributable to the

parcel, . . . grouping similar users together for the same . . . rate and charging the users according to usage is a reasonable way to apportion the cost of service”).

- *Morgan v. Imperial Irrigation Dist.* (2014) 223 Cal.App.4th 892, 908-909 (“There is nothing in section 6 that prohibits an agency from charging different rates to its customers as long as the fees paid by customers are proportional and the total amount the agency collects does not surpass the cost of providing the service. These substantive requirements help section 6 achieve the voters’ objective of limiting the local government revenue.”).

With these premises in mind, we turn to the questions posed by the court.

Response to Question 1:

Conceptually, if the amount of water distributed by a local agency water purveyor to each customer is the same each billing period over the course of the year, and there is no difference in the cost of serving that water based on the type of customer being served (e.g., residential versus commercial), and the only cost consideration in determining the rate to be imposed on each customer is the price of the water purchased or pumped from specific sources of water (including fixed costs and overhead costs), then under the assumed facts the district’s pricing system is compliant with

California Constitution article XIII D, section 6 (“Article XIII D, section 6”), subdivision (b)(3). As described below, however, rate setting is a forward looking process that is based on a longer planning horizon than a single billing period. Further, general rate-setting principles account for other factors that affect the cost of water service (which encompasses more than a single delivery of water in isolation) and policy considerations that influence how those costs are allocated among customers that the hypothetical does not address.

In the first hypothetical, it may be argued that the rates do not exceed the proportional cost of service because all customers have access to each block or tier of water. In addition, each customer is provided an equal (i.e., proportional) share of the water available in each block or tier. It is only through a customer’s personal decision to use more water that the customer will use water priced in the next block or tier and therefore pay a higher rate for the additional water it uses. (*See Paland v. Brooktrails Township Cmty. Serv. Dist. Bd. of Dir.* (2009) 179 Cal. App. 4th 1358, 1370 (water service is immediately available as required by Article XIII D, subd. (b) (4) despite a locked meter because “it is the unilateral act of the property owner . . . that causes the service not be actually used.”).)

Response to Question 2:

Assuming the same qualifications to our response to Question 1 above, this rate structure arguably is compliant with Article XIII D, section 6, subdivision (b)(3). Although this hypothetical appears to result in surplus revenues, as noted above, there are other policy decisions that may direct how those revenues are used. This hypothetical addresses the realities, principles and policy considerations that may go into rate-making design. By way of example, this hypothetical uses the surplus revenue to fund water resource management strategies. As argued at length in our amicus brief, and recognized by the California Court of Appeal in *Brydon v. East Bay Municipal Utility District* (1994) 24 Cal.App.4th 178, 193, the management of water resources through rate structure design ensures full cost recovery while also requiring those who place the greatest burdens and demands on a water system bear the greatest share of the cost. Thus, the district in the hypothetical may require the customers who use more water to pay for a greater share of the costs of the district's water resource demand management and reliability strategy of constructing a water recycling or desalination plant. Both of these projects are potable water reliability projects for the common benefit all users, regardless of whether they ever receive recycled or desalinated water. (*Griffith, supra*, 220 Cal.App.4th at pp. 591, 600, 602-604.) This conclusion is further supported by statute.

As discussed in our amicus brief, Senate Bill 7X7 (2009-2010 7th Ex. Sess.) (“SB 7”) established legislation requiring the State to achieve a twenty percent reduction in urban per capita water use by December 31, 2020, with incremental progress measured by a ten percent reduction by December 31, 2015. (Cal. Water Code § 10608.16.) Pursuant to SB 7, the Legislature made certain declarations and policy determinations that highlight the diversity of our water supplies statewide and the need for water supply demand management and reliability practices that benefit all water users. Including:

- (a) Water is a public resource that the California Constitution protects against *waste and unreasonable use*.
- (b) Growing population, climate change, and the need to protect and grow California’s economy while protecting and restoring our fish and wildlife habitats make it *essential that the state manage its water resources* as efficiently as possible.
- (c) *Diverse regional water supply portfolios will increase water supply reliability* and reduce dependence on the Delta.
- (d) *Reduced water use through conservation provides* significant energy and environmental *benefits*, and can help protect water quality, improve streamflows, and reduce greenhouse gas emissions.

(e) The success of state and local water conservation programs to increase efficiency of water use is best determined on the basis of measurable outcomes related to water use or efficiency.

(f) *Improvements in technology and management practices offer the potential for increasing water efficiency* in California over time, providing an essential water management tool to meet the need for water for urban, agricultural, and environmental uses.

(g) The Governor has called for a 20 percent per capita reduction in urban water use statewide by 2020.

(h) *The factors used to formulate water use efficiency targets can vary significantly from location to location* based on factors including weather, patterns of urban and suburban development, and past efforts to enhance water use efficiency.

(i) Per capita water use is a valid measure of a water provider's efforts to reduce urban water use within its service area. However, per capita water use is less useful for measuring relative water use efficiency between different water providers. Differences in weather, historical patterns of urban and suburban development, and density of housing in a particular location

need to be considered when assessing per capita
water use as a measure of efficiency.

(Cal. Water Code § 10608 (emphasis added).)

Urban retail water suppliers are required to state in urban water management plans their own targets and methods for achieving the twenty percent conservation goal and to assess the means and methods to do so. (*Id.* at §§ 10608.20, 10608.36.) Urban retail water suppliers must develop long-term strategies for developing water conservation and water resource management and reliability programs and practices that will be sufficient to reach their State-mandated interim and overall water use targets. Recycled water is an important component of a long-term water resource management strategy for many water agencies.³

³ (See generally, Ellen Hank, Finding Water for Growth: New Sources, New Tools, New Challenges, 43 J. Am. Water Resources Ass'n 1024 (2007); see, California Public Utilities Commission Opinion: Decision Adopting a Comprehensive Policy Framework and Minimum Project Criteria Requirements for Recycled Water Projects, 6.

Against the backdrop of urbanization, population growth, climate change and water scarcity, recycled water is recognized as an increasingly important component of the urban water supply portfolios of both publicly-owned and investor-owned water utilities. Nationally, about 7% to 8% of municipal wastewater is reused; and an estimated one-third has the potential to be reused. California is a leader in municipal wastewater recycling, using over 600,000 acre-feet (AF) annually, mostly in Southern California.

2014 Cal. PUC LEXIS 424 (footnotes omitted).)

A variety of statutory provisions demonstrate that recycled water is a potable water supply reliability project that may be a part of a long-term resource management strategy that benefits all water users.

(1) The waters of the state are a limited and renewable resource subject to ever-increasing demands.

(2) The conservation and efficient use of urban water supplies are of statewide concern; however, the planning for that use and the implementation of those plans *can best be accomplished at the local level.*

(3) *A long-term, reliable supply of water is essential* to protect the productivity of California's businesses and economic climate.

(4) As part of its long-range planning activities, every urban water supplier should make every effort to ensure the *appropriate level of reliability in its water service* sufficient to meet the needs of its various categories of customers during normal, dry, and multiple dry water years.

...

(6) Implementing *effective water management strategies, including groundwater storage projects and recycled water projects*, may require specific water quality and salinity

targets for meeting groundwater basins water quality objectives and *promoting beneficial use of recycled water*.

. . .

(b) This part is intended to provide assistance to water agencies in carrying out their *long-term resource planning responsibilities to ensure adequate water supplies* to meet existing and future demands for water.

(Cal. Water Code § 10610.2 (emphasis added).)

(a) The *management of urban water demands* and efficient use of water shall be actively pursued *to protect* both the people of the state and their *water resources*.

(b) The management of urban water demands and *efficient use of urban water supplies* shall be a guiding criterion in public decisions.

(c) Urban water suppliers shall be required to *develop water management plans* to actively pursue the efficient use of available supplies.

(*Id.* at § 10610.4.)

It is hereby declared that the people of the state have a primary interest in the *development of facilities to recycle water* containing waste to *supplement existing surface and underground water supplies* and to assist in meeting the future water requirements of the state.

(*Id.* at § 13510 (emphasis added).)

The Legislature finds and declares that a substantial portion of the future water requirements of this state may be economically met by *beneficial use of recycled water*.

The Legislature further finds and declares that the utilization of recycled water by local communities for domestic, agricultural, industrial, recreational, and fish and wildlife purposes will contribute to the peace, health, safety and welfare of the people of the state. *Use of recycled water constitutes the development of "new basic water supplies."*

(Cal. Water Code § 13511.)

The Legislature hereby finds and declares that the *use of potable domestic water for nonpotable uses*, including, but not limited to, cemeteries, golf courses, parks, highway landscaped areas, and industrial and irrigation uses, *is a waste or an unreasonable use of the water within the meaning of Section 2 of Article X of the California Constitution* if recycled water is available.

...

The recycled water may be furnished for these uses at a reasonable cost to the user. *In determining reasonable cost, the state board shall consider all relevant factors, including, but not limited to, the present and projected*

costs of supplying, delivering, and treating potable domestic water for these uses and the present and projected costs of supplying and delivering recycled water for these uses, and shall find that the cost of supplying the treated recycled water is comparable to, or less than, the cost of supplying potable domestic water.

(Cal. Water Code § 13550 (emphasis added).)

As part of its urban water management plan, an urban water supplier must describe its water demand management measures to reach the state-mandated ten percent and twenty percent reductions in urban water use. California Water Code section 10611.5 defines “demand management” as “those water conservation measures, programs, and incentives that prevent the waste of water and promote reasonable and efficient use or reuse of available supplies.” An urban water management plan must include “to the extent available, information on recycled water and its potential for use as a water source in the service area of the urban water supplier.” (*Id.* at § 10633.)

The Legislature has expressly recognized “conservation pricing” as a permissible demand management tool for attaining State water use goals. (*Id.* at § 10631, subd. (f)(1)(K).) Conservation pricing includes tiered water

rates such as those adopted by the district in the hypothetical and allocation-based rates such as those adopted by the City in this case.⁴

The Legislature has authorized the adoption and implementation of allocation-based conservation water pricing to effectuate the constitutional mandates of Article X, section 2—to prevent the waste and unreasonable use of water—and of Article XIII D, section 6(b)—to ensure that water service fees are proportionate to the cost of providing water service. (*See* Cal. Water Code § 370(a) (“The use of allocation-based conservation water pricing by public entities that sell and distribute water is one effective means by which waste or unreasonable use of water can be prevented and water can be saved in the interest of the people and for the public welfare, within the contemplation of Section 2 of Article X of the California Constitution.”) (emphasis added); § 372(a) (“A conservation charge shall be imposed on all increments of water use in excess of the basic use allocation. The increments may be fixed or may be determined on a percentage or any other basis, without limitation on the number of increments, or any requirement that the increments or conservation charges be sized, or ascend uniformly, or in a specified relationship. The volumetric prices for the lowest through the highest priced increments shall be established in an ascending relationship that is economically structured to

⁴ The City’s rate structure assigns each customer an allocation of water based on household and lot sizes and is, in that sense, “allocation-based.”

encourage conservation and reduce the inefficient use of water, consistent with Section 2 of Article X of the California Constitution.”.)

In adopting that statute as well as other provisions of the Water Code, such as section 10631, subd. (f)(1)(K) discussed above, the Legislature has explicitly determined that tiered rates and allocation-based water rates harmonize Article X with Article XIII D. Further, the Legislature has expressly determined that the development of alternative water supply projects, such as recycled and desalinated water, are *potable water supply reliability projects* that benefit all water users. These determinations of the Legislature are of great significance.

[W]here a constitutional provision may well have either of two meanings, it is a fundamental rule of constitutional construction that, if the legislature has by statute adopted one, its actions in this respect is well nigh, if not completely, controlling. When the legislature has once construed the constitution, for the courts then to place a different construction upon it means that they must declare void the action of the legislature. It is no small matter for one branch of the government to annul the formal exercise by another and coordinate branch of power committed to the latter, and the courts should not and must not annul, as contrary to the constitution, a statute passed by

the legislature, unless it can be said of the statute that it positively and certainly is opposed to the constitution. This is elementary. But plainly this cannot be said of a statute which merely adopts one of two reasonable and possible constructions of the constitution.

(*San Francisco v. Indus. Accident Comm'n* (1920) 183 Cal. 273, 279; accord *Woodcock v. Dick* (1950) 36 Cal.2d 146, 148-149; *Methodist Hosp. of Sacramento v. Saylor* (1971) 5 Cal.3d 685, 692.)

Most recently, in the historic legislative package establishing a groundwater regulatory framework for California, the Legislature again specifically authorized the imposition of tiered rates for groundwater extraction charges subject to Article XIII D. (Cal. Gov't Code § 10730.2(d), added by 2014 Stats., ch. 347 (the legislative package included AB 1739 (2014 Stats., ch. 347), SB 1168 (2014 Stats., ch. 346), and SB 1319 (2014 Stats., ch. 348).)

There is one problematic aspect of the rates posited in the second hypothetical, however: water in the lowest tier is priced below the cost the hypothetical states the district incurs to make that water available. If service is to be provided at less than cost, the implied subsidy must be funded from discretionary revenues such as *ad valorem* property tax revenues. If it is funded by over-charging other customers then it involves a cross-subsidy

between customer classes and violates the substantive requirements of Article XIII D.

Response to Question 3:

Assuming the same qualifications to our response to Question 1 above, and based on the arguments that we made in our amicus brief and our response to question 2 above, this rate structure complies with Article XIII D, section 6. As described further below, this rate structure, as well as the one described in the second hypothetical, are consistent with industry-recognized rate making principles. Those principles, other factors that may impact the cost of water, and policy considerations that may influence how those costs are allocated to customers are described below.

Principles of Rate Structure Design

The American Water Works Association “Principles of Water Rates, Fees, and Charges: Manual of Water Supply Practices M1 (the “M1 Manual”), used by the City’s rate consultant, establishes commonly accepted professional standards for cost of service studies. (*See Griffith, supra*, 220 Cal.App.4th at p. 600; *Morgan, supra*, 223 Cal.App. 4th at pp. 899-900.) The M1 Manual general principles of rate structure design are described below.

In establishing cost-based water rates, it is important to understand that a cost-of-service methodology *does not prescribe a single*

approach. Rather, as the First Edition of the M1 manual noted, “the (M1 Manual) is aimed at outlining the basic elements involved in water rates and suggesting alternative rules of procedure for formulating rates, thus permitting *the exercise of judgment and preference to meet local conditions and requirements.*”

(American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1, 5 (6th edition 2012) (quoting American Water Works Association Manual: Water Rates Manual 1 (1st ed. 1954) (emphasis added); *see also Griffith, supra*, 220 Cal.App.4th at p. 601 (apportionment is not a determination that lends itself to precise calculation; Proposition 218 prescribes no particular method for apportioning a fee; that there may be other methods favored by plaintiff’s does not render defendant’s method unconstitutional).)

According to the M1 Manual, the first step in the ratemaking analysis is to determine the adequate and appropriate funding of a utility. This is referred to as the “revenue requirements” analysis.⁵ This analysis considers the short-term and long-term service objectives of the utility over

⁵ “The revenue requirements are the summation of the operation, maintenance, and capital costs that a utility must recover during the time period for which the rates will be in place.” (American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1, 5 (6th edition 2012); *see Griffith, supra* 220 Cal.App.4th 600-601.)

a given planning horizon, including capital facilities and system operations and maintenance, to determine the adequacy of a utility's existing rates to recover its costs. (See American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1, 4-6 (6th edition 2012) for an overview of the generally accepted rate-setting methodology; *Griffith, supra*, 220 Cal.App.4th at p. 600.) Unlike the hypothetical, the planning horizons for American water utilities is generally 1-5 years. (American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1, 10 (6th edition 2012).) A number of factors may affect these projections, including the number of customers served, water-use trends, nonrecurring sales, weather, conservation, use restrictions, inflation, interest rates, wholesale contracts, capital finance needs, changes in tax laws, and other changes in operating and economic conditions. (*Id.* at p. 11.)

After determining a utility's revenue requirements, a utility's next step is determining the cost of service. Utilizing a public agency's approved budget, financial reports, operating data, and capital improvement plans, a rate study generally categorizes (functionalizes) the costs, expenses, and assets of the water system among major operating functions to determine the cost of service. The major operating functions may include water transmission, distribution, sources of supply, storage, treatment, general utility plant and operations, customer-related plant and operations,

power costs, general administration, net debt service, rate-financed capital, and associated operating and maintenance expenses. (*See id.* at § II.)

After the assets and the costs of operating those assets are properly categorized by function, the rate study allocates those “functionalized costs” to the various customer classes (e.g., single-family residential, multi-family residential and commercial) by determining the characteristics of those classes and the contribution of each to incurred costs such as peaking factors or different delivery costs, service characteristics and demand patterns.⁶ This analysis includes a review of such matters as system

⁶ The California Supreme Court in *Hansen v. City of San Buenaventura* (1986) 42 Cal.3d 1172, 1181 described this process as follows:

Revenue requirements are allocated to various classes [of customers] based on each group’s proportionate use of the system, including use of physical plant facilities and consumption of water, among other elements. A preliminary step in determining revenue requirements is the establishment of appropriate classes among which costs will be allocated. The next step is to calculate the costs which properly should be assessed each group. For this analysis, two alternative methods exist: the cash basis and the utility basis. Very generally, the cash method sets revenue requirements based on actual operating and maintenance expenses plus allowable charges for system replacement, debt principal repayment, and other capital costs. The utility method also considers actual operating and maintenance expenses, but instead of looking to cash expenses such as system replacement and debt principal

operations and water usage data—e.g., capacity (peak demand),⁷ commodity (average demand),⁸ number of customers,⁹ customer service and accounting,¹⁰ equivalent meter size, and public fire protection services.¹¹ The impact that these matters have on system operations generally will determine how the costs are allocated among the various customer classes. (See *id* at § III.)¹²

repayment, the method focuses on depreciation attributable to outside use and on rate of return on investment.

⁷ System capacity is the system's ability to supply water to all delivery points when demanded. It is measured by each customer's water demand at the time of greatest system demand. The time of greatest demand is known as "peak demand." Peak demand costs recover the costs of facilities needed to meet the peak use, or demands, placed on the system by each customer class. (See *Rincon Del Diablo Mun. Water Dist. v. San Diego County Water Auth.* (2004) 121 Cal.App.4th 813, 817.) Both operating costs and the capital-asset-related costs incurred to accommodate peak flows are generally allocated to each customer class based upon its contribution to the peak day event. (See, American Water Works Association, *Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1* Appendix A (6th ed. 2012).)

⁸ Commodity refers to the volume of metered water use over a specific time period, typically twelve months.

⁹ Some operating and administrative costs (e.g., billing costs) vary directly with the number of customers.

¹⁰ Some customer classes may require more effort and time to provide accounting services (e.g., residential customers typically require more customer service staff to serve them per unit than large industrial water users such as a brewery).

¹¹ This refers to the need to increase the size of mainlines to provide the volume of water needed to fight fire.

¹² (See also *Griffith*, *supra* 220 Cal.App.4th at 601 (parcel-by-parcel analysis is not required; "Given that Proposition 218 prescribes no particular method for apportioning a fee or charge other than that the

The ideal solution to developing rates for water utility customers is to assign cost responsibility to each individual customer served and to develop rates to derive that cost. Unfortunately, it is neither economically practical nor often possible to determine the cost responsibility and applicable rates for each customer served. However, the cost of providing service can reasonably be determined for groups or classes of customers that have similar water-use characteristics and for special customers having unusual water-use or service characteristics.

(*Id.* at p. 75.)

Rate design is the final part of the M1 Manual's rate-making procedure and generally uses the revenue requirement and cost of service analysis to determine appropriate rates for each customer class. (*See id.* at § IV.) Most water rate structures include a fixed component (sometimes referred to as a base, meter, or readiness-to-serve charge) and a volumetric component (sometimes referred to as a commodity or service charge). The fixed component of the rate structure is generally based the size of the

amount shall not exceed the proportional cost of the a service attributable to the parcel, defendant's method of grouping similar users together for the same . . . rate and charging users according to usage is a reasonable way to apportion the cost of service."); *Calif. Farm Bureau Fed'n*, 51 Cal.4th 421, 438 ("The question of proportionality [under Proposition 13] is not measured on an individual basis. Rather it is measured collectively, considering all rate payors.").

water meter serving a property and is calculated to recover a portion of a public water purveyor's fixed costs of operating, maintaining, and delivering water—e.g., personnel, billings and collection, and other similar costs.¹³ Such basic service charge recognizes that, even when a customer uses no water, the public agency incurs fixed costs to maintain its ability to serve each customer on demand. (*See Paland v. Brooktrails Township Comt'y Servs. Dist.* (2009) 179 Cal.App.4th 1358, 1370-1371.)

Rate design is both discretionary and quasi-legislative. (*See Pac. Tel. & Telegraph Co. v. Pub. Util. Comm'n* (1965) 62 Cal.2d 634, 655; *Brydon, supra*, 24 Cal.App.4th at p. 196 (ratemaking is quasi-legislative, and inclining block rate structure does not violate Proposition 13); *see, e.g.*, Cal. Water Code section 370(c) ("The Legislature does not intend to limit the discretion of public entities to evaluate and select among different methods for conserving water or to create a presumption that the election to not use a particular method is a waste or unreasonable use of water by the public entity.").) When Article XIII D refers to establishing rates that are proportional to the cost of providing service attributable to a parcel, without specifying who should make that attribution or how, it preserves the

¹³ Meter size is used as a proxy for the estimated demand that each customer can place on the water system. A significant portion of a water system's design and in turn, the utility's operating and capital costs are related to meeting capacity requirements. (*See, American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1* 138-139, 270-275, Appendix B (6th ed. 2012).)

legislative discretion afforded by earlier law to public agencies—such as the district in the hypothetical and the City of Capistrano in this case—to determine how to allocate costs of service, provided they act reasonably.

A utility is presented with a major challenge when it sets out to select a rate structure that is responsive to the philosophy and objectives of both the utility and its community. . . . When diverse and competing objectives are well understood and evaluated, a utility has the opportunity to design a rate structure that does more than simply recover its costs. A properly selected rate structure should support and optimize a blend of various utility objectives and should work as a public information tool in communicating these objectives to customers.

(American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1 91 (6th edition 2012).)

One of the primary objectives of rate-making in California is to discourage waste and encourage efficient uses of water. (*See* Cal. Const. art. X, § 2; Cal. Water Code § 370 *et seq.*)¹⁴ This is most commonly done

¹⁴ ACWA's adopted water conservation policy principles recognize that water conservation is central to enhancing California's water supply reliability (Policy 1), is a statewide responsibility (Policy 3) that is best managed at the local level (Policy 5), but a one size fits all policy does not work (Policy 10), and innovative pricing structures and water recycling are important tools to achieve water conservation (Policies 11 and 13). (<http://www.acwa.com/sites/default/files/post/conservation/2010/02/>

through the development of an increasing block rate structure.¹⁵ “Properly designed increasing block rates recover class-specific cost of service while sending a more conservation-oriented price signal to that class.” (American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1 111 (6th edition 2012).) Increasing block rates are most commonly used for single-family residential customers because of their relatively homogenous use. Customer classes, such as commercial customers and multi-family customers, that do not demonstrate uniform demand patterns or have very little outdoor water use might be adversely impacted by an increasing block structure. (*See id.* at 114.) Consequently, a different rate structure may be applied to these customers. (*See Griffith, supra*, 220 Cal. App. 4th at p. 601 [proportionality requirement of Article XIII D is satisfied by groundwater replenishment rates that distinguish metered wells, unmetered wells, and wells within the agency’s delivered water zone].) Because of the variability of the factors impacting the cost of water service, “[t]aken together, increasing block

[acwawaterconservationwuepolicyprinciples03-2009.pdf](#)> [as of Nov. 22, 2014]]. As Amici discussed at length in its previous brief, and reiterate here, the law allows local agencies the flexibility to adapt rates and charges to achieve water management obligations consistent with constitutional obligations.

¹⁵ The M1 Manual refers to “increasing-block rates” whereas the *Brydon* court used the term “inclining block rates.” The terms are synonymous. (American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1 111 (6th edition 2012); *Brydon, supra* 24 Cal. App. 4th 183-184.)

rates typically recover the average cost of a utility,” rather than allocating costs based on a specific source of water supplied during a specific billing period. (*See* American Water Works Association, Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1 223 (6th edition 2012).)

In making policy decisions regarding rate structure design, if conservation is the policy goal, then the public agency water purveyor takes the risk that if it collects the majority of its costs from water sales in the upper tiers, and everyone conserves so as to avoid buying water in those tiers, insufficient revenue will be generated. If revenue stability is the goal, then the agency takes the risk that placing a substantial portion of its costs on the fixed charge component of its rates may result in larger quantities of water being used than anticipated, thereby jeopardizing its water supply reliability—flat or uniform rates (like those used by amicus Mesa Water District) tend to dampen the price signal to conserve. In either circumstance, an agency makes a reasoned judgment of the best method to recover its costs in light of its policy objectives. An agency manages those risks throughout the year by adjusting its budget, where appropriate, or investing in projects or programs that further its policy objectives. Ultimately, those adjustments are designed to ensure the fees imposed do not exceed the cost of providing water service.

Response to Question 9:

A water district may recover, through existing potable water rates, the cost of prospective capital improvements for water supply and delivery such as a recycling or a desalinization plant. As discussed above, recycled water and desalinated water are *potable water reliability projects* that benefit all potable water users, not just those who receive recycled or desalinated water. As such, it is appropriate that potable customers pay for their development and construction of such projects until users receive the recycled or desalinated. Moreover, after the projects are constructed, potable water customers continue to reap their benefits and may pay a portion of the costs of producing and delivering recycled or desalinated water.¹⁶ This is fully supported by *Griffith*.

There, Pajaro Valley Groundwater Basin had been subjected to chronic overuse, resulting in overdraft and seawater intrusion, particularly near the coast. To protect the groundwater basin (the primary water supply source of water users in the basin), the Pajaro Valley Water Management Agency (“Agency”) implemented a program to deliver supplemental water to some coastal users and develop other supplemental water projects,

¹⁶ In some instances the recycled water and desalinated water is indistinguishable from potable. For example, recycled or desalinated water may be blended with well water, injected into a groundwater basin, or to a potable water reservoir.

including a recycled water project.¹⁷ The recycled water produced from the recycled water project was blended with well water and delivered to coastal well users. The cost of the program was to be shared by all properties served by a well within the Agency, including those outside of the delivered water zone.¹⁸

The appellant argued that the revenues derived from the groundwater augmentation charges are used for purposes other than that for which the charges were imposed. The first item challenged under this argument was debt service. The court rejected this argument, noting that the Agency's authorizing act allowed it to recover the costs of debt service. (*Griffith, supra*, 220 Cal.App.4th at p. 598. The court also found that payment of ongoing debt does not exceed the cost required to provide groundwater management services if the debt was incurred to build service facilities. (*Id.* (the costs of the project “necessarily include debt service incurred to construct facilities to capture, store, and distribute supplemental water”).)

The appellant claimed that the groundwater augmentation charges were being used to fund a service that is not “immediately available” to

¹⁷ The groundwater management strategy is “to use recycled wastewater, supplemental wells, captured storm runoff, and a coastal distribution system.” (*Griffith, supra*, 220 Cal.App.4th at p. 590.)

¹⁸ The theory for sharing the cost among all well users is that ““even those taking water from [inland] wells benefit from the delivery of water to [coastal users], as that reduces the amount of groundwater those [coastal users] will extract [from their own wells], thereby keeping water in [all] wells from becoming too salty.”” (*Id.* at pp. 590-591.)

property owners because the ordinance establishing the charge provided that the charge will be used to identify and determine future supplemental water projects. (*Id.*) The court dismissed this argument and held that identifying and determining the future needs of the Agency is part of the Agency's present-day services. The costs of planning for such future needs therefore may be recovered from charges imposed on current users. (*Id.* at p. 602.)¹⁹

Response to Question 10:

There is nothing to suggest that the voters adopted Proposition 218 they intended²⁰ that public agencies be precluded from funding, through existing potable water rates, the cost of prospective capital improvements for water supply and delivery, such as a recycling or a desalinization plant.

¹⁹ While it is common for a public utility to finance a portion of its capital improvement program from annual revenues (generally referred to as “pay-as-you-go”), large capital projects are more commonly financed through debt financing. Major capital projects are typically debt financed to allow for the repayment of the debt over a number of years. This “reduces fluctuations in annual revenue requirements, spikes in rates, and more closely matches capital costs to the useful life of the facility. Thus, existing customers will not be required to pay 100 percent of the initial cost of facilities to be used by future customers.” (American Water Works Association, *Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1* 40 (6th edition 2012).)

²⁰ “When interpreting a provision of our state Constitution, our aim is ‘to determine and effectuate the intent of those who enacted the constitutional provision at issue.’ [Citation.] When, as here, the voters enacted the provision, their intent governs. [Citation.] To determine the voters’ intent, ‘we begin by examining the constitutional text, giving the words their ordinary meanings.’ [Citation.]” (*Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal.4th 205, 212.)

If that were the case, a public agency water purveyor would have few choices for funding such projects. An agency would have to use any unrestricted revenues available to it (e.g., *ad valorem* property tax revenue, grant funding), or submit a special tax ballot measure to the voters for approval.

II.

CONCLUSION

California's water management challenges are extraordinary. There is no "silver bullet" solution. Article XIII D requires that public agency water purveyors reasonably apportion the cost of the providing water service so that the fees and charges imposed do not "exceed the proportional cost of service attributable to the parcel." It does not mandate a particular rate structure, nor does it forbid any particular fees or charges. The manner of apportionment, the nature and extent of the services provided, the proportional attribution of costs, and the manner of budgeting and funding an agency's enterprise operations are all discretionary decisions that should be left to the sound judgment and discretion of the local agency. There is no basis in Article XIII D for this court to find otherwise.

Accordingly, Amici urge this Court to reverse the trial court ruling and provide declaratory relief that the City water rates here comply with Article XIII D and are otherwise lawful.

Dated: November 24, 2014

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CERTIFICATE OF WORD COUNT

The text of this Appellant's Opening Brief consists of 5,578 words as counted by the Microsoft Word 2010 word-processing program used to generate said document.

Dated: November 24, 2014

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CERTIFICATE OF SERVICE

I, Lisa Grennon, declare:

I am a resident of the State of California and over the age of eighteen years, and not a party to the within action; my business address is Best Best & Krieger LLP, 655 West Broadway, Fifteenth Floor, San Diego, California 92101-3542. On November 24, 2014, I served the within document(s):

**SUPPLEMENTAL BRIEF OF AMICI CURIAE IN
SUPPORT OF APPELLANT CITY OF SAN JUAN
CAPISTRANO**

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I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on November 24, 2014, at San Diego, California.



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