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Court Issues Long-Anticipated Ruling on Conservation Water Rates and Proposition 218

On Monday, the Court of Appeal issued its decision analyzing whether conservation water rates (also known as tiered water rates or inclining block rates) are consistent with the provisions of Proposition 218 that a fee charged to a property owner shall not exceed the proportional cost of the service attributable to the property. The case is *Capistrano Taxpayers Association, Inc. v. City of San Juan Capistrano* Case No. G048969.

The city of San Juan Capistrano had adopted a tiered rate structure that imposed a higher per-unit cost based on increased water use. The rate structure followed the "M-1" manual issued by the American Water Works Association. The city ascertained its total costs, including debt service, costs of billing, and cost of water treatment. The city then identified classes of customers and calculated four possible budgets of water usage based on historical data. These four budgets served as the basis for calculating rates for four distinct tiers. Taken together, the anticipated revenues for the four tiers would equal the city's total costs for water service and therefore would be revenue neutral.

In interpreting Prop. 218, the court emphasized that conservation water rates, standing alone, were not prohibited. However, the court concluded that Prop. 218 requires that each tier must reflect the actual costs of service for property owners falling in each of the tiers. The court further held that the city had the burden of proof to demonstrate compliance with Prop. 218. Applying an independent review standard, the court held that the city failed to meet its burden of proof in that the record before the court failed to disclose that the rates for each tier reflected the actual cost of service.

In reaching this conclusion, the court rejected the city's argument that Article X, Sec. 2 of the California Constitution supports the use of conservation water rates. Although the court recognized that Article X, Sec. 2 does support the conservation of water and that the waste, or unreasonable use, of water be prevented, the court concluded that Article X, Sec. 2 does not trump Prop. 218's requirement that a tiered rate structure reflect the actual cost of service to the property owners for each tier.

The court further considered and rejected the city's argument that the rates for the highest tiers are a penalty or fine, which are excluded from Prop. 218. The court determined that deeming these rates to be penalties or fines would improperly circumvent Prop. 218 in that water retailers could manipulate their rate structures by setting base rates at a low level and then imposing "penalty" rates for usage in excess of the base rate that have no relation to the actual cost of providing service.

Attorneys for the League, the California State Association of Counties (CSAC), the Association of California Water Agencies (ACWA) and the state are still studying the decision and we will be providing additional analysis and guidance in the near future.

The League thanks Kelly Salt, with Best Best & Krieger, for the drafting the amicus brief in this case for the League, ACWA, and CSAC.