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# Muddying the Water: Tiered Water Rates After San Juan Capistrano

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# MUDDYING THE WATER: TIERED WATER RATES AFTER *SAN JUAN CAPISTRANO*

*Travis Kaya\**

*In the face of chronic drought, water utilities across California have turned to tiered water rates to promote conservation and curb consumer demand. However, recent legal challenges have called the constitutionality of tiered-rate schemes into question, threatening to deprive utilities of a critical conservation tool.*

*A patchwork of recent court decisions—the landmark Capistrano Taxpayers Association v. City of San Juan Capistrano most notable among them—have exposed an unresolved conflict between the California Constitution’s water rights and taxation provisions. Namely, how does Proposition 218’s restrictions on assessments for “property related services” apply to tiered water rates set by public water utilities?*

*This article calls on the California courts to expressly acknowledge the existence of the constitutional conflict and to provide clear guidance on how to resolve it. Previous decisions have presented two potential solutions: (1) requiring that rates be calculated based on aggregate water supply costs across the entire system, or (2) requiring that rates be calculated based on atomized water supply costs to individual parcels. As this article argues, the latter method—as adopted by the court in San Juan Capistrano—forces water utilities to undertake the impossible task of calculating individual water supply costs for millions of parcels. Courts*

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*should instead require that rates be set based on aggregate costs across the entire system.*

*Finally, this article looks at the legacy of the San Juan Capistrano decision and includes a case study of the Los Angeles Department of Water and Power's rate scheme, which was introduced in San Juan Capistrano's wake.*

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## I. INTRODUCTION

In California, drought has become the new normal. The state spent eight of the past ten years in drought, with 2012 to 2016 representing the driest four-year period in a century of record-keeping.<sup>1</sup> As annual global temperatures reach record highs with each passing year,<sup>2</sup> the specter of water scarcity in California will undoubtedly loom for decades to come.

For California water providers, the drought has added increased complexity to the monumental task of delivering water to millions of customers across the state. Water utilities oversee a labyrinthine water supply system that begins with the collection of water from a variety of sources, including groundwater, surface water, and imported water.<sup>3</sup> Utilities must then transmit, treat, store, and distribute the water to their many customers.<sup>4</sup>

As the difficulties of collecting and distributing water mount during prolonged drought conditions, state and local agencies have taken significant steps to decrease consumer demand for water.<sup>5</sup> Utilities statewide have employed a combination of public education initiatives, mandatory use restrictions, and pricing schemes aimed at discouraging water waste.<sup>6</sup> This approach fits squarely within a long-standing rule in California—codified in article X, section 2 of the State Constitution—giving water utilities wide latitude to make “beneficial use” of water resources “to the fullest extent of which they are capable.”<sup>7</sup>

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1. CAL. DEPT. OF WATER RES., DROUGHT AND WATER YEAR 2016: HOT AND DRY CONDITIONS CONTINUE (2016), [http://www.water.ca.gov/water\\_conditions/docs/a3065\\_Drought\\_8page\\_v8\\_FINALsm.pdf](http://www.water.ca.gov/water_conditions/docs/a3065_Drought_8page_v8_FINALsm.pdf).

2. See *Global Climate Report – December 2016*, NOAA NAT’L CTRS. FOR ENVTL. INFO. (Jan. 2017), <http://www.ncdc.noaa.gov/sotc/global/201612>.

3. L.A. DEP’T. OF WATER & POWER, 2014 WATER SERVICE COST OF SERVICE STUDY, (2015), <https://www.ladwp.com/ladwp/faces/ladwp/aboutus/a-financesandreports/a-fr-waterrates/a-fr-wr-rateactionreport> (follow “Chapter 4: 2014 Water Service Cost of Service Study” hyperlink).

4. *Id.*

5. Drought response in California has been guided by a series of executive orders issued by Governor Edmund G. Brown, Jr. See *Governor’s Conservation Executive Orders and Proclamations*, CAL. WATER BOARDS, [https://www.waterboards.ca.gov/water\\_issues/programs/conservation\\_portal/executive\\_orders.html](https://www.waterboards.ca.gov/water_issues/programs/conservation_portal/executive_orders.html) (last updated Jan. 31, 2018).

6. Elena Maggionni, *Water Demand Management in Times of Drought: What Matters for Water Conservation*, 51 WATER RES. RES. 125, 126 (2015).

7. CAL. CONST. art. X, § 2.

Tiered rate pricing and other market-based restrictions have proven effective tools in managing water demand.<sup>8</sup> Under a “tiered rate” structure, water utilities set prices based on the volume of water used.<sup>9</sup> If a consumer’s water-use exceeds the volume allotted in the base tier, then that consumer will be required to pay a higher rate for each unit of water used in excess of the base allotment.<sup>10</sup> Due to the system’s effectiveness in suppressing demand, more than two-thirds of California water-providers had adopted some form of tiered rate system by 2015.<sup>11</sup>

In recent years, however, anti-tax political organizations have challenged the constitutionality of tiered water rates.<sup>12</sup> Balancing the California Constitution’s tax and water rights provisions, courts have not deemed tiered water rates unconstitutional *per se*, but have required water providers to link higher prices to higher supply costs.<sup>13</sup>

Courts have differed, however, on exactly how utilities are required to quantify those costs. And these conflicting interpretations have created a complex and difficult-to-reconcile clash between the Constitution’s tax and water provisions.

In 2013, the Sixth District of the California Court of Appeal, in *Griffith v. Pajaro Valley Water Management Agency* (“Pajaro”),<sup>14</sup> held that higher-tier fees could be set proportionally to the cost of providing water to a class of consumers, or even the system as a whole.<sup>15</sup> Two years later, in the landmark *Capistrano Taxpayers Ass’n*

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8. Mary E. Renwick & Richard D. Green, *Do Residential Water Demand Side Management Policies Measure Up? An Analysis of Eight California Water Agencies*, 40 J. ENVTL. ECON. & MGMT. 37, 51 (2000).

9. CAL. WATER CODE § 372(a)(1) (West 2008).

10. See CAL. WATER CODE §§ 372(a)(2)–(4) (West 2008).

11. Beau Yarbrough, *California Drought: Court Rules Tiered Water Rates Violate State Constitution*, MERCURY NEWS (Apr. 20, 2015, 12:36 PM), <http://www.mercurynews.com/2015/04/20/california-drought-court-rules-tiered-water-rates-violate-state-constitution/>.

12. The Howard Jarvis Taxpayers Association is among the most vocal opponents of tiered rate structures in California, challenging the rate structures of local water districts on state constitutional grounds. See Jon Coupal & Jack Cohen, *Water Rates Under Prop. 218*, HOWARD JARVIS TAXPAYERS ASS’N, <https://www.hjta.org/propositions/proposition-218/water-rates-under-proposition-218/> (last visited Oct. 10, 2017).

13. See, e.g., *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 380–81 (Ct. App. 2015) (“Neither the voters nor the Constitution say anything we can find that would prohibit tiered pricing . . . . However, if a local government body chooses to impose tiered rates unilaterally without a vote, those tiers must be based on cost of service for the incremental level of usage . . . .”).

14. 163 Cal. Rptr. 3d 243 (Ct. App. 2013).

15. *Id.* at 255.

v. *City of San Juan Capistrano*<sup>16</sup> case, however, the Fourth District of the Court of Appeal apparently extended the rule to require utilities to justify fees based on the cost of supplying water to individual *parcels*.<sup>17</sup> However, the court also seemed to leave the door open to pricing schemes based on smaller groupings of customers, while stopping short of stating the acceptable make-up of those groups.<sup>18</sup>

This Article gives two critiques of the *San Juan Capistrano* rule. First, courts must acknowledge—and then reconcile—the obvious clash between the California Constitution’s water rights and tax provisions. Second, rather than requiring utilities to link higher-tier rates to water supply costs for millions of *individual* parcels, the courts should return to the *Pajaro* court’s rule that utilities should be free to set tiered rates based on *system-wide* supply costs.

Part II defines tiered rate structures, and explains why water utilities and government agencies have found them such a useful tool in their water conservation efforts.

Presenting my first critique, Part III describes the conflict between the California Constitution’s water and tax provisions, and argues that the courts must first acknowledge, and then resolve, the conflict.

Presenting my second critique, Part IV first provides an overview of the California Supreme Court’s landmark decision in *San Juan Capistrano*, then points out key inconsistencies in the court’s interpretation of the California Constitution and Water Code. Part IV also proposes two possible methods for resolving those inconsistencies, then advocates for a return to the *Pajaro* rule.

Finally, Part V presents analysis of newly implemented tiered water rates in the wake of *San Juan Capistrano*, and includes a case study of rate structures from the Los Angeles Department of Water and Power.

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16. 186 Cal. Rptr. 3d at 362.

17. *Id.* at 372 (“Why use the phrase ‘cost of the service to the parcel’ if a local agency doesn’t actually have to ascertain a cost of service to that particular parcel?”).

18. *Id.* at 381 (stating that while fees must match costs for individual parcels, the quantification of costs for individual households may not necessarily need to be calculated separately).

## II. TIERED RATE STRUCTURES: WHAT ARE THEY AND WHY DO THEY MATTER?

Due to chronic scarcity, water providers across California have turned to customer-use restrictions to suppress demand. Tiered water rates are among their most important tools.

This section provides a description of tiered water rates and how they are set, then gives an overview of statistical studies showing why tiered rates have been such a reliable tool in the conservation fight.

### *A. Defining Tiered Water Rates*

Tiered rate structures are set based on metered water use.<sup>19</sup> Each customer is assigned a “basic use allocation” which provides a “reasonable amount of water for the consumer’s needs and property characteristics.”<sup>20</sup> Utilities charge a base rate for water used within that allocation.<sup>21</sup> Beyond that, the utility is allowed to impose a conservation charge on all water used in excess of the basic use allocation.<sup>22</sup> Under California Water Code section 372:

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 encourage conservation and reduce the inefficient use of water, consistent with Section 2 of Article X of the California Constitution.<sup>23</sup>

Water providers are free to set their rate structures based on the unique needs and challenges of their communities.<sup>24</sup> For example, in 2010, the City of San Juan Capistrano—acting in its capacity as a

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19. CAL. WATER CODE § 372(a)(1) (West 2008).

20. *Id.* § 372(a)(2).

21. *Id.* § 372(a)(3).

22. *Id.* § 372(a)(4).

23. *Id.*

24. Water providers in California include a multitude of special district and municipal agencies, including municipal water districts, irrigation districts, county water districts and cities themselves. *See* Capistrano Taxpayers Ass’n v. City of San Juan Capistrano, 186 Cal. Rptr. 3d 362, 365 (Ct. App. 2015).



water utility—implemented a four-tiered rate structure calculated as follows:

It first ascertained its total costs, including things like debt service on previous infrastructural improvements. It then identified components of its costs, such as the cost of billing and the cost of water treatment. Next it identified classes of customers, differentiating, for example, between “regular lot” residential customers and “large lot” residential customers, and between construction customers and agricultural customers. Then, in regard to each class, [the City] calculated four possible budgets for water usage, based on historical data of usage patterns: low, reasonable, excessive and very excessive.<sup>25</sup>

### *B. Why Utilities Favor Tiered Rate Structures*

Water utilities and local governments rely heavily on local fees and taxes to fund their operations.<sup>26</sup> “[E]ighty-five percent of the more than thirty billion dollars spent annually on water supply, quality, flood and ecosystem management” are raised through local fees and taxes every year.<sup>27</sup>

On the demand side, residential consumption is a major component of total demand.<sup>28</sup> Thus, reducing residential consumption is a major focus of efforts to conserve the water supply.<sup>29</sup>

Local governments and utilities generally employ one of three types of restrictions to target water use: voluntary restrictions, mandatory restrictions, and market-based restrictions.<sup>30</sup>

Voluntary restrictions—including education programs and incentives or rebates—encourage consumers to participate voluntarily in water conservation efforts.<sup>31</sup> California municipalities and water agencies have been dedicated to the state-wide implementation of

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25. *Id.* at 365–66.

26. See Brian Gray et al., *Paying for Water in California: The Legal Framework*, 65 HASTINGS L.J. 1603, 1603 (2014).

27. *Id.* at 1604.

28. Md. Mahmudul Haque et al., *Quantification of Water Savings due to Drought Restrictions in Water Demand Forecasting Models*, 140 J. WATER RES. PLAN. MGMT. 1, 1 (2013).

29. See Ryan Cahill & Jay Lund, *Residential Water Conservation in Australia and California*, 139 J. WATER RES. PLAN. MGMT. 117, 119 (2013).

30. Maggionni, *supra* note 6, at 128.

31. See *id.* at 128–29.

voluntary water conservation programs.<sup>32</sup> Despite buy-in from a wide array of water agencies, however, there is little evidence that the measures have directly led to water-use reductions.<sup>33</sup> Voluntary restrictions must therefore be buttressed by more stringent use controls.<sup>34</sup>

Mandatory restrictions—including outdoor watering restrictions and fines for failing to fix leaks—impose water use requirements on consumers by fiat.<sup>35</sup> While mandatory restrictions have been shown to reduce water usage, the benefits of government-imposed mandates are often limited and inconsistent.<sup>36</sup>

Market-based restrictions—including tiered rate structures—use prices to influence consumer behavior.<sup>37</sup> Under a tiered-rate scheme, rates increase along with water consumption to suppress demand.<sup>38</sup> Price-based restrictions are an effective method for stimulating water conservation at the household level.<sup>39</sup> However, their effectiveness depends heavily on the elasticity of water demand to price, urban density (i.e., the prevalence of residential outdoor landscaping), and consumer attitudes toward conservation.<sup>40</sup>

“[R]esidential water demand is relatively price-elastic,” meaning that increases in water rates dependably lead to decreases in consumption by individual households.<sup>41</sup> In addition, price-elasticity

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32. Sara Hughes, *Voluntary Environmental Programs in the Public Sector: Evaluating an Urban Water Conservation Program in California*, 40 POL’Y STUD. J. 650, 659 (2012) (noting that more than 100 California water agencies have participated in a statewide Memorandum of Understanding to implement a menu of water conservation measures).

33. *Id.* at 667 (noting that, for water agencies, signing the MOU might be more of a political tool than a means to target water consumption); see also Renwick & Green, *supra* note 8, at 51 (“More stringent mandatory policies, such as use restrictions and water allocations, reduced aggregate demand more than voluntary measures, such as public information campaigns and retrofit subsidies.”).

34. Renwick & Green, *supra* note 8, at 51.

35. Maggioni, *supra* note 6, at 128.

36. See *id.* (citing a long line of studies of water-saving policies that produced mixed results); Heather E. Campbell et al., *Prices, Devices, People, or Rules: The Relative Effectiveness of Policy Instruments in Water Conservation*, 21 REV. OF POL’Y RES. 637, 653–54 (2004) (finding that water-waste enforcement measures alone led to an increase in water consumption, but that a combination of water conservation measures working in concert contributed to a 3.5 percent decrease in overall water use).

37. See Maggioni, *supra* note 6, at 127.

38. See *id.*

39. See Renwick & Green, *supra* note 8, at 51 (“Aggregate single family household demand was responsive to price changes.”).

40. Maggioni, *supra* note 6, at 125.

41. Jasper M. Dalhuisen et al., *Price and Income Elasticities of Residential Water*, 79 LAND ECON. 292, 306 (2003); see also Andrew C. Worthington & Mark Hoffman, *An Empirical Survey*

is significantly higher where there are ascending block rates, or tiered rates, in place.<sup>42</sup> Therefore, tiered rate structures can be an effective tool for managing consumer water demand.

Water agencies have seen the highest reduction in water use when they have implemented voluntary, mandatory, and market-based restrictions in concert.<sup>43</sup> A statistical analysis of consumer demand in Los Angeles during the implementation of water use restrictions from 2008 to 2010 showed that voluntary restrictions did not impact demand, while mandatory restrictions coupled with rate increases yielded the highest reduction in water use.<sup>44</sup> Between 2009 and 2010, water use in Los Angeles fell between 19 and 23 percent “due to a combination of stringent mandatory restrictions that included limiting irrigation to two days per week, limiting the time and frequency of irrigation, a water rate increase and a decrease in the household allocation quantity.”<sup>45</sup>

### III. CRITIQUE NO. 1: IGNORING A CONSTITUTIONAL CONFLICT

Legal battles over tiered water rates have unearthed a conflict between two major provisions of the California constitution—article X, section 2, which addresses water rights, and articles XIII C and XIII D, which addresses voters’ right to authorize taxes and fees. This section provides an overview of the pertinent California constitutional provisions and case law on water rates. While courts have found ways to harmonize the two provisions,<sup>46</sup> this section will argue that the provisions may not be so easily reconciled based on the development of relevant law over the past eight decades. Moving forward, courts must first make clear that the conflict exists, and, second, provide clear guidance on how it should be resolved.

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*of Residential Water Demand Modelling*, 22 J. ECON. SURVS. 842, 867 (2008) (“Price elasticity estimates are generally found in the range of zero to 0.5 in the short run and 0.5 to unity in the long run.”).

42. Dalhuisen et al., *supra* note 41, at 297.

43. See C. Mini et al., *The Effectiveness of Water Conservation Measures on Summer Residential Water Use in Los Angeles, California*, 94 RES. CONSERVATION & RECYCLING 136, 141 (2014).

44. *Id.*

45. *Id.* at 144.

46. See, e.g., *City of Palmdale v. Palmdale Water Dist.*, 131 Cal. Rptr. 3d 373, 381 (Ct. App. 2011) (holding that a water district was required to comply with both constitutional provisions in setting tiered rates); see also *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 374–77 (Ct. App. 2015) (holding that the constitutional provisions were compatible).

A. Article X, Section 2 – The Water Rights Provision

1. Text and History

Article X, section 2 of the California Constitution<sup>47</sup> declares that: [B]ecause of the conditions prevailing in this State the general welfare requires that the water resources of the State be put to beneficial use to the fullest extent of which they are capable, and that the waste or unreasonable use or unreasonable method of use of water be prevented, and that the conservation of such waters is to be exercised with a view to the reasonable and beneficial use thereof in the interest of the people and for the public welfare.<sup>48</sup>

The amendment was shaped by the tension between the rights of “riparian” landowners and those of appropriators seeking access to water.<sup>49</sup> Under the common law, riparian owners—those with property abutting free-flowing water sources—traditionally had unlimited use of that water,<sup>50</sup> and could deny access to downstream landowners and anyone else seeking access to it.<sup>51</sup> Concerned that unfettered riparian rights would cut off water sources for California’s burgeoning population centers downstream, the governor and state legislators pushed for a voter initiative to write a “reasonable use” restriction into the California Constitution.<sup>52</sup> With voter approval, the water rights amendment became part of the state’s constitution in 1928.<sup>53</sup>

Proponents of the amendment sought specifically to overrule the 1926 California Supreme Court decision in *Herminghaus v. Southern California Edison*,<sup>54</sup> which enjoined a public utility from constructing a dam across the San Joaquin River because it would interfere too

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47. At the time of its adoption, the constitution’s water rights provision was codified as article XIV, section 3. The provision was reenacted verbatim and recodified as article X, section 2 on June 6, 1976. Brian E. Gray, “In Search of Bigfoot”: *The Common Law Origins of Article X, Section 2 of the California Constitution*, 17 HASTINGS CONST. L.Q. 225, 225 n.1 (1989) [hereinafter *Bigfoot*].

48. CAL. CONST. art. X, § 2.

49. See *Bigfoot*, *supra* note 47, at 260; see also Harrison C. Dunning, *Article X, Section 2: From Maximum Water Development to Instream Flow Protection*, 17 HASTINGS CONST. L.Q. 275, 276–77 (1989).

50. See *Herminghaus v. S. Cal. Edison Co.*, 252 P. 607, 613 (Cal. 1926).

51. *Bigfoot*, *supra* note 47, at 260.

52. *Id.* at 264.

53. *Id.* at 263.

54. 252 P. 607 (Cal. 1926).

heavily with the riparian rights of downstream landowners.<sup>55</sup> In siding with the landowners, the *Herminghaus* court reaffirmed the long-standing California property law doctrine that “the rights of the riparian owners to the use of the waters of the abutting stream were paramount to the rights of any other persons thereto.”<sup>56</sup>

The *Herminghaus* court acknowledged, then rebuked, the gradual softening of legal protections for riparian landowners.<sup>57</sup> In the decades leading up to *Herminghaus*, the California Supreme Court found that the “reasonable use doctrine” limited riparian rights where the greater social benefit outweighed the private benefit in *Southern California Investment Co. v. Wilshire*,<sup>58</sup> and again in *Half Moon Bay Land Co. v. Cowell*.<sup>5960</sup> In dicta, the *Herminghaus* court suggested that the state might be able to use its police power to implement “some general plan or system for the equitable adjustment of rights and uses in its flowing streams with a view to the conservation, development, and distribution . . . of their waters.”<sup>61</sup> While opening the door to potential limitations on riparian rights, however, the *Herminghaus* decision expressly applied “only as between different riparian proprietors.”<sup>62</sup> The government would therefore still be required to exercise its eminent domain power when the “higher interests of the public” called for interference with private riparian rights.<sup>63</sup> Fearful that court

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55. *Id.* at 613; see *Nat'l Audubon Soc'y v. Superior Court*, 658 P.2d 709, 725 (Cal. 1983); *Capistrano Taxpayers Ass'n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 375 (Ct. App. 2015); *Light v. State Water Res. Control Bd.*, 173 Cal. Rptr. 3d 200, 210 (Ct. App. 2014).

56. *Herminghaus*, 252 P. at 613; see also *Lux v. Haggin*, 10 P. 674, 753 (Cal. 1886) (“[T]he right to a water-course begins *ex jure naturae*, and, having taken a certain course naturally, it cannot be diverted to the deprivation of the rights of the riparian owners below.”) (emphasis in original); *Ferrea v. Knipe*, 28 Cal. 340, 343–44 (1865) (“Every proprietor of lands through or adjoining which a water-course passes has a right to a reasonable use of the water; but he has no right to so appropriate it as to unnecessarily diminish the quantity in its natural flow.”).

57. *Bigfoot*, *supra* note 47, at 261 (citing *Herminghaus*, 252 P. at 621–22).

58. 77 P. 767 (Cal. 1904).

59. 160 P. 675 (Cal. 1916).

60. *Half Moon Bay*, 160 P. at 678 (“[W]hen the water is insufficient for all the land or for all of the uses to which it might be applied thereon, and there is enough only for that use which is most valuable and profitable, the shares may properly be limited to and measured by the quantity sufficient for that use, and the proportions fixed accordingly.”); *S. Cal. Inv. Co.*, 77 P. at 768 (“[I]n cases where there is not water enough to supply the wants of both, that each owner has the right to the reasonable use of the water, taking into consideration the rights and necessities of the other.”); *Bigfoot*, *supra* note 47, at 261 (citing *Herminghaus*, 252 P. at 621).

61. *Bigfoot*, *supra* note 47, at 261 (citing *Herminghaus*, 252 P. at 621).

62. *Herminghaus*, 252 P. at 615; see also *Anaheim Union Water Co. v. Fuller*, 88 P. 978, 980 (Cal. 1907) (holding that the owner of a tract of land not abutting a river could not claim riparian rights to use the river water).

63. *Herminghaus*, 252 P. at 615.

protection of riparian rights would further limit access to water for growing downstream communities, the governor and state legislature helped place water rights reform on the 1928 ballot.<sup>64</sup>

With the passage of the 1928 referendum and addition of the water rights amendment, California voters uprooted existing case law to limit private water rights for the greater public benefit.<sup>65</sup> For the first time, the constitution rendered “available for beneficial use that portion of the waters of our rivers and streams which . . . was of no substantial benefit to the riparian owner.”<sup>66</sup> The amendment also removed the need for the state to exercise its eminent domain power to protect the state’s water, and placed it instead “within the sphere of the police power.”<sup>67</sup>

Interpreting the 1928 amendment in subsequent decisions, the California Supreme Court “relied on the doctrine of reasonable use to decide that an appropriation should take precedence over the rights of downstream riparians.”<sup>68</sup> Significantly, in *Peabody v. City of Vallejo*,<sup>69</sup> the court held that a water appropriator could “enter[] a field of water supply and seek by appropriation to take water from such supply” where there was more than sufficient water for “all reasonable beneficial uses” by the riparian owner.<sup>70</sup>

## 2. Supporting Statutes

Since 1928, the legislature has expanded state water law by way of the California Water Code and provisions in the California Government Code.

California Government Code section 53750 defines “water” as “any system of public improvements intended to provide for the production, storage, supply, treatment, or distribution of water from any source.”<sup>71</sup> In its 2014 amendment to section 53750, the state legislature expressly expanded the meaning of “water” under California law to include potable and nonpotable water “from any

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64. *Bigfoot*, *supra* note 47, at 263.

65. *Chow v. City of Santa Barbara*, 22 P.2d 5, 16 (Cal. 1933).

66. *Id.*

67. *Id.*

68. *Bigfoot*, *supra* note 47, at 265.

69. 40 P.2d 486 (Cal. 1935).

70. *Id.* at 498.

71. CAL. GOV'T CODE § 53750 (West 2014).

source.”<sup>72</sup> The legislature also expressly stated 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 . . . if recycled water is available.”<sup>73</sup>

Following the passage of Proposition 218 (“Prop 218”) to amend the California Constitution, discussed *infra*, the legislature also passed California Government Code section 53756 to guide water utilities on how to set rates and schedule rate increases in compliance with the constitution’s new tax and fee restrictions.<sup>74</sup> Section 53756 allows water utilities to adopt automatic water rate increases, including adjustments for inflation, so long as the “fee or charge for a property-related service” does “not exceed the cost of providing that service.”<sup>75</sup>

The California Water Code also governs the acquisition and maintenance of water rights, especially with regard to governmental control of water.<sup>76</sup> Two provisions are especially germane to the discussion of tiered water rates.

California Water Code section 31020 states that a “district may do any act necessary to furnish sufficient water in the district for any present or *future* beneficial use.”<sup>77</sup> In applying the statute, the *San Juan Capistrano* court held that a water district could therefore increase consumer rates to fund a planned recycled water infrastructure project, even if the consumers were not yet reaping its benefits.<sup>78</sup>

In addition, California Water Code section 372 provides detailed criteria for “allocation-based conservation water pricing,” which encompasses many of the extant tiered rate schemes across the state.<sup>79</sup>

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72. Legis. Serv., Assemb. B. 2403, Ch. 78 (Cal. 2014). Similarly, in *San Juan Capistrano*, the court held “water to be part of a holistic distribution system that does not distinguish between potable and non-potable water.” *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 370 (Ct. App. 2015).

73. Legis. Serv., Assemb. B. 2403, Ch. 78 (Cal. 2014).

74. Legis. Serv., Assemb. B. 761, Ch. 611 (Cal. 2008).

75. CAL. GOV’T CODE § 53756(b) (West 2012).

76. *See, e.g.*, CAL. WATER CODE § 372 (West 2008); CAL. WATER CODE § 31020 (West 1949).

77. CAL. WATER CODE § 31020 (West 1949) (emphasis added).

78. *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 370–71 (Ct. App. 2015). Still, the court found the record insufficient to determine whether utilities could require “superconservers” to pay for recycling facilities “that would not be necessary but for above-average consumption.” *Id.*

79. CAL. WATER CODE § 372 (West 2008).

Under section 372, a utility may employ “allocation-based conservation water pricing” if the pricing scheme meets the following four criteria:

First, billing must be based on “metered water use.”<sup>80</sup>

Second, utilities must establish a “basic use allocation . . . for each customer account that provides a reasonable amount of water for the customer’s needs and property characteristics.”<sup>81</sup> To calculate the individual allocations, utilities may consider, *inter alia*, “the number of occupants, the type or classification of use, the size of lot or irrigated area, and the local climate data for the billing period.”<sup>82</sup>

Third, a “basic charge” must be imposed “for all water used within the customer’s basic use allocation. . . .”<sup>83</sup> However, public entities may lower rates for a portion of the water used if the reduction is the result of “superior or more than reasonable conservation efforts” by the consumer.<sup>84</sup>

Fourth, a “conservation charge shall be imposed on all increments of water use in excess of the basic use allocation.”<sup>85</sup> Utilities have the power to set the number and structure of the increments “to encourage conservation and reduce the inefficient use of water, consistent with section 2 of article X of the California Constitution.”<sup>86</sup>

Section 372 and California water laws in general appear to provide clear cover for tiered water rates. Given California’s growing list of restrictions on taxes and fees,<sup>87</sup> however, water utilities may not have such an easy time designing tiered rate structures that do not run afoul of the state constitution.

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80. *Id.* § 372(a)(1).

81. *Id.* § 372(a)(2).

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *See, e.g.*, CAL. CONST. art. XIII C, D.



## B. Articles XIII, C and D – The Tax Provisions

### 1. Text and History

In rejecting tiered water rates, courts have drawn heavily on articles XIII C and D of the California Constitution.<sup>88</sup> Both amendments took effect in 1996 with the passage of Prop 218, a ballot initiative requiring voter approval for the majority of tax and fee increases by government bodies in the state.<sup>89</sup>

Article XIII C requires voter approval for “tax levies” by local governments.<sup>90</sup> The amendment creates two categories of taxes: general taxes and special taxes.<sup>91</sup> “General taxes” are “imposed for general governmental purposes” and can only be assessed by local governments.<sup>92</sup> Thus, “special purpose districts or agencies” are prohibited from levying general taxes.<sup>93</sup> Under the amendment, “[n]o local government may impose, extend, or increase any general tax unless and until that tax is submitted to the electorate and approved by a *majority vote*.”<sup>94</sup> On the other hand, “special taxes” are imposed for “specific purposes,” such as one-off infrastructure development projects.<sup>95</sup> Under the amendment, “[n]o local government may impose, extend, or increase any special tax unless and until that tax is submitted to the electorate and approved by a *two-thirds vote*.”<sup>96</sup> However, the amendment does exempt a number of taxes and fees from the ballot requirement. Local governments may, for example, assess penalties and fines without voter approval.<sup>97</sup>

Where article XIII C applies to taxes, article XIII D applies to “all assessments, fees and charges, whether imposed pursuant to state statute or local government charter authority.”<sup>98</sup> Article XIII D, section 6 applies particularly to “Property Related Fees and Charges,”

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88. See, e.g., *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 369 (Ct. App. 2015); *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 255–56 (Ct. App. 2013).

89. Gray et al., *supra* note 26, at 1612–13.

90. CAL. CONST. art. XIII C, § 2(a)–(c).

91. *Id.*

92. CAL. CONST. art. XIII C, § 1(a).

93. CAL. CONST. art. XIII C, § 2(a).

94. CAL. CONST. art. XIII C, § 2(b) (emphasis added).

95. CAL. CONST. art. XIII C, § 1(d).

96. CAL. CONST. art. XIII C, § 2(d) (emphasis added).

97. CAL. CONST. art. XIII C, § 1(e)(5).

98. CAL. CONST. art. XIII D, § 1.

and includes “Requirements for Existing, New or Increased Fees and Charges.”<sup>99</sup> Section 6, subsection b states, in part:

(1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.

(2) Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed.

(3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.

(4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4.<sup>100</sup>

## 2. Propositions 13, 218, and 26

Article XIII is best understood within the context of California’s decades-long debate over the voters’ right to approve taxes, and the three ballot propositions that animate it: Propositions 13, 218, and 26.<sup>101</sup>

Proposition 13 (“Prop 13”)—passed by popular vote on June 6, 1978—limited property taxes to one percent of each parcel’s estimated value, and capped price increases at two percent annually.<sup>102</sup> Prop 13 also required majority voter approval for “special taxes” to pay for specific government programs.<sup>103</sup> While water fees themselves were not considered “special taxes” and were therefore exempt from the voter approval requirement, Prop 13’s restrictions on property taxes cut deeply into available revenue for water utilities.<sup>104</sup>

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99. CAL. CONST. art. XIII D, § 6.

100. CAL. CONST. art. XIII D, § 6(b).

101. Gray et al., *supra* note 26, at 1608.

102. *Id.* at 1610.

103. *Understanding Proposition 218*, CAL. LEGIS. ANALYST’S OFF. (Dec. 1996), [https://lao.ca.gov/1996/120196\\_prop\\_218/understanding\\_prop218\\_1296.html](https://lao.ca.gov/1996/120196_prop_218/understanding_prop218_1296.html).

104. Gray et al., *supra* note 26, at 1610.

During the two decades following the passage of Prop 13, local governments and utilities circumvented the new cap on property taxes through the use of assessments, property-related fees and general purpose taxes.<sup>105</sup> As a result, Prop 218 aimed to close those alternative avenues of government funding in the same way that Prop 13 did for property taxes.<sup>106</sup> Following its passage on November 5, 1996, Prop 218 added articles XIII C and XIII D to the California Constitution.<sup>107</sup> Among other changes to California tax law, Prop 218:

(1) Clarifies that “general taxes” require a majority of voter approval, while “special taxes” require a two-thirds vote.

(2) Prohibits special districts from levying general taxes, thus requiring water utilities to fund projects and programs through “special taxes” approved by a two-thirds vote.

(3) Places the burden of proof on local agencies to show that the benefit conferred to each parcel is proportionate to the rate of the assessment.

(4) Requires that proposed assessments be approved in an election in which votes are weighted by the amount of assessment paid by each parcel owner.<sup>108</sup>

Prop 218 also established new standards for fees and charges levied for any “property-related service.”<sup>109</sup> Despite early confusion about Prop 218’s applicability to water rates, state courts have since established that once a water source has been connected to a property, water supply becomes a “property-related service” subject to Prop 218.<sup>110</sup> In addition, Prop 218—as interpreted in subsequent years by the courts—placed the burden on water utilities to prove that the price assessed to each parcel does not exceed the cost of providing water to each parcel.<sup>111</sup>

In an attempt to close remaining loopholes in the tax law, California voters enacted Proposition 26 (“Prop 26”)—the latest of the

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105. *Understanding Proposition 218*, *supra* note 103; *see also* Silicon Valley Taxpayers’ Ass’n v. Garner, 156 Cal. Rptr. 3d 703, 705–06 (Ct. App. 2013).

106. *Understanding Proposition 218*, *supra* note 103.

107. CAL. CONST. art. XIII C.

108. Gray et al., *supra* note 26, at 1610–11.

109. CAL. CONST. art. XIII D.

110. Bighorn-Desert View Water Agency v. Verjil, 138 P.3d 220, 225 (Cal. 2006); *see* Richmond v. Shasta Cmty. Servs. Dist., 83 P.3d 518, 528 (Cal. 2004).

111. CAL. CONST. art. XIII D.

three constitutional tax amendments—on November 10, 2010.<sup>112</sup> Prop 26 amended Prop 13 to require that changes in state law resulting in “any taxpayer paying higher tax” be enacted by a two-thirds vote of the state legislature.<sup>113</sup> Previously, under Prop 13, the legislature could avoid the two-thirds vote requirement by enacting taxes that were “revenue neutral” overall, even if it raised taxes for some people and reduced them for others.<sup>114</sup>

### C. Conflicts Emerge in the Case Law

Over the past decade, a stream of state appellate decisions has defined the constitutional tax provisions as they apply to water rights. This section traces the birth and development of the ongoing conflict between the constitution’s water and tax provisions.

After the passage of Prop 218, it was unclear to water utilities and the courts whether the resulting constitutional amendment, which applied expressly to all “assessments, fees and charges,” had any impact on water rates at all.<sup>115</sup> In *Richmond v. Shasta Community Services District*,<sup>116</sup> the court distinguished between assessments for “new service connections” and for supplying water once the connections had been made.<sup>117</sup> The court reasoned that because the one-time connection fee was assessed “only on individuals who request a new service connection, the capacity charge is not an assessment within the meaning of article XIII D.”<sup>118</sup>

Two years later in *Bighorn-Desert View Water Agency v. Verjil*,<sup>119</sup> the court affirmatively extended Prop 218’s restrictions on taxes and fees to assessments by water utilities.<sup>120</sup> The court held that:

Once a property owner or resident has paid the connection charges and has become a customer of a public water agency, all charges for water delivery incurred thereafter are charges for a property related service, whether the charge is

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112. Gray et al., *supra* note 26, at 1614.

113. *Id.* (emphasis added).

114. *Id.*

115. *Richmond*, 83 P.3d at 520.

116. 83 P.3d 518 (Cal. 2004).

117. *Id.* at 523.

118. *Id.*

119. 138 P.3d 220 (Cal. 2006).

120. *Id.* at 224.

calculated on the basis of consumption or is imposed as a fixed monthly fee.<sup>121</sup>

Once the courts affirmed that water fees fell within the scope of Prop 218, they faced questions regarding the way utilities were permitted to set their rates.

In *City of Palmdale v. Palmdale Water District*,<sup>122</sup> the court barred rate differentiation for different classes of users.<sup>123</sup> The court held that a water utility could not charge “irrigation users”—i.e., farmers—at a higher rate than residential and commercial users, where there was no showing that providing water to irrigation users was relatively more expensive.<sup>124</sup>

Two years later in *Pajaro*, the California Court of Appeal held that a water utility could uniformly charge all users for the cost of an infrastructure project, even if some parcel owners did not receive any of the newly sourced water.<sup>125</sup> The court held:

Given that Proposition 218 prescribes no particular method for apportioning a fee or charge other than that the amount shall not exceed the proportional cost of the service attributable to the parcel, defendant’s method of *grouping similar users together* for the same augmentation rate and charging the users according to usage is a reasonable way to apportion the cost of service.<sup>126</sup>

Despite attempts by water utilities to defeat Prop 218 with article X, section 2’s facially sweeping mandate that water “be put to beneficial use to the fullest extent of which they [water utilities] are

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121. *Id.* at 227.

122. 131 Cal. Rptr. 3d 373 (Ct. App. 2011).

123. *See id.* at 381 (“[I]t is the irrigation-only user . . . who is ‘potentially the most impacted,’ without a corresponding showing in the record that such impact is justified under Article X, section 2, or permissible under Article XIII D, section 6.”).

124. *Id.* at 379.

125. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 254–55 (Ct. App. 2013). Distinguishing the *Palmdale* decision, the *Pajaro* court held that the fees could be implemented uniformly across a system so long as there was no discrimination among different user classes. *Id.* at 255.

126. *Id.* (emphasis added).

capable,”<sup>127</sup> California courts found it possible—perhaps, even preferable—for water utilities to comply with both.<sup>128</sup>

In *Palmdale*, for example, a water district argued that its tiered rate structure was beyond the reach of Prop 218 because the district was “entitled to promote conservation” under article X.<sup>129</sup> However, the court rejected the argument, finding that the district could comply with both constitutional provisions so long as “conservation is attained in a manner that shall not exceed the proportional cost of the service attributable to the parcel.”<sup>130</sup>

Going a step further, the *San Juan Capistrano* court found that pricing water at its true cost was not just possible, but actually “compatible with [article X, section 2’s] theme of conservation” because higher water prices could disincentivize water use during times of drought.<sup>131</sup> Therefore, under the courts’ recent decisions, it appears that article X, section 2 provides little protection against challenges to tiered rate structures on Prop 218 grounds.

#### D. Addressing the Conflict

The water rights and tax provisions of the constitution create an unavoidable conflict when it comes to tiered rates. In attempting to harmonize the provisions, courts have dodged the obvious conflict and instead allowed tiered rate structures to exist in a toothless form. By allowing tiered rate structures that cap rates only at the market cost for providing water to individual parcels, the courts have barred utilities from setting rates high enough to discourage use by water-guzzlers—the very *raison d’être* of tiered water rates.<sup>132</sup> Moving forward, the

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127. CAL. CONST. art. X, § 2; *see also* *Newhall Cty. Water Dist. v. Castaic Lake Water Agency*, 197 Cal. Rptr. 3d 429, 442 (Ct. App. 2016) (“The Agency attempts to justify the challenged rates by relying on the conservation mandate in the California Constitution . . . .”); *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 374 (Ct. App. 2015) (water utility argues that tiered water rates need not correlate with actual cost of supplying water because subsidized rates are “somehow required by article X, section 2”); *City of Palmdale v. Palmdale Water Dist.*, 131 Cal. Rptr. 3d 373, 379 (Ct. App. 2011) (water district “says it is entitled to promote conservation in such a manner pursuant to article X, section 2, of the California Constitution”).

128. *Newhall Cty. Water Dist.*, 197 Cal. Rptr. 3d at 443.

129. *Palmdale*, 131 Cal. Rptr. 3d at 379.

130. *Id.* at 381 (internal citations omitted); *see also Newhall Cty. Water Dist.*, 197 Cal. Rptr. 3d at 443 (“Moreover, article X’s conservation mandate cannot be read to eliminate Prop 26’s proportionality requirement.”); *San Juan Capistrano*, 186 Cal. Rptr. 3d at 376 (“[N]othing in article X, section 2, requires water rates to exceed the true cost of supplying that water . . . .”).

131. *San Juan Capistrano*, 186 Cal. Rptr. 3d at 374–77 (emphasis added).

132. *See Dalhuisen et al.*, *supra* note 41, at 304 (“Increasing block rate pricing makes the demand for water more elastic . . . .”).

courts must clearly articulate that a constitutional conflict exists, and then provide a clear roadmap for its resolution.

The overlapping mandates of the water rights and tax provisions of the constitution create a clear conflict over the question of water rates. As discussed *supra*, the 1928 water rights referendum—the precursor to today’s article X, section 2—was aimed at imposing “reasonable use” restrictions on private water rights for the greater public benefit.<sup>133</sup> Coming seventy years later, article XIII D, section 6 of the California Constitution attempted to protect individual interests by requiring that fees for government services be strictly proportional to the costs.<sup>134</sup> While the *Palmdale* and *San Juan Capistrano* courts found no conflict between the water rights and tax provisions of the constitution, a closer look at the development of the water rights amendment shows that their reconciliation might not be so simple. In *Palmdale*, the court found that there was no inherent conflict between article X’s “reasonable use” restriction and article XIII’s proportionality requirement.<sup>135</sup> The *Palmdale* court stated that articles X and XIII are not at odds as long as “conservation is attained in a manner that ‘shall not exceed the proportional cost of the service attributable to the parcel.’”<sup>136</sup> Likewise, in *San Juan Capistrano*, the court stated that the emphasis of article X, section 2 is “on a policy that favors the beneficial use of water as against the waste of water for nonbeneficial uses.”<sup>137</sup> The court continued, “nothing in article X, section 2, requires water rates to exceed the true cost of supplying that water, and in fact pricing water at its true cost is compatible with the article’s theme of conservation with a view toward reasonable and beneficial use.”<sup>138</sup>

While article X, section 2 of the California Constitution does not “require” government agencies to set water rates above the cost of supplying it, the water rights provision does not preclude government agencies from doing so either. In fact, article X, section 2 gives the legislature wide latitude to “enact laws in the furtherance of the

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133. *Herminghaus v. S. Cal. Edison Co.*, 252 P. 607, 613 (Cal. 1926).

134. CAL. CONST. art. XIII D.

135. *Palmdale*, 131 Cal. Rptr. 3d at 381.

136. *Id.* (quoting CAL. CONST. art. XIII D).

137. *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 376 (Ct. App. 2015).

138. *Id.*

policy.”<sup>139</sup> With that authority, the legislature has passed a water code that includes statutes to encourage conservation, incentivize recycled water use, and monitor groundwater levels.<sup>140</sup> In addition, California Water Code sections 370 through 374 authorize municipal governments to impose “allocation-based conservation water pricing” as a means to prevent water waste “in the interest of the people and for the public welfare, within the contemplation of section 2 of article X of the California Constitution.”<sup>141</sup>

The *Palmdale* and *San Juan Capistrano* courts would authorize allocation-based water rates only where they are strictly proportional to the cost of supplying water.<sup>142</sup> The *San Juan Capistrano* court suggested that, during times of drought, the resulting higher water rates would themselves disincentivize water waste.<sup>143</sup> However, as the above research on water consumption suggests, tiered water rates work precisely because strict proportionality between water rates and water supply costs are insufficient to promote water conservation.

In addition, given the complexity and scale of today’s water infrastructure, such requirements impose a great burden on utilities who must now specifically link water fees to water supply costs for millions of individual consumers. Moreover, to the extent that utilities are able to justify their tiered rate structures, that justification hinges on the mathematical fiction that it is even possible to reconcile the specific costs of providing water to millions of discrete consumers—representing millions of discrete demand profiles—with a one-size-fits-all rate.<sup>144</sup> The *Palmdale* and *San Juan Capistrano* courts,

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139. CAL. CONST. art. X, § 2. Prior to the passage of Proposition 218, the California Court of Appeal, First District, in *Brydon v. East Bay Mun. Util. Dist.*, 29 Cal. Rptr. 2d 128 (Ct. App. 1994), held that the water rights provision of the California constitution permits the use of block-rate pricing to encourage water conservation. The court held that higher rates were justified for higher users because “[t]o the extent that certain consumers overutilize the resource, they contribute disproportionately to the necessity for conservation, and the requirement that the District acquire new sources for the supply of domestic water.” *Id.* at 142.

140. Gray et al., *supra* note 26, at 1650.

141. CAL. WATER CODE §§ 370–74 (West 2008).

142. *City of Palmdale v. Palmdale Water Dist.*, 131 Cal. Rptr. 3d 373, 381 (Ct. App. 2011); *San Juan Capistrano*, 186 Cal. Rptr. 3d at 377.

143. *See Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 376 (Ct. App. 2015) (“We would note here that in times of drought—which looks increasingly like the foreseeable future—providing water can become very pricey indeed.”).

144. In *Morgan v. Imperial Irrigation Dist.*, 167 Cal. Rptr. 3d 687 (Ct. App. 2014), the court held that the authors of Proposition 218 likely envisioned different rates for different users based on their proportional share of overall water usage. However, given the complexity of the water distribution system, the court did not require that fees match costs down to the penny. *Id.* at 708



therefore, appear to set a contradictory standard: on the one hand, utilities must be able to clearly correlate water rates to supply costs; on the other, the standard for showing the correlation is incredibly low and, perhaps, may be based on shaky cost estimates.<sup>145</sup>

This standard also calls upon factfinders—generally not well-versed in the intricacies of water pricing policy—to determine when a water provider has met its burden under article XIII. Thus, the suggested reconciliation between the constitution’s water and tax provisions simply does not work with regard to allocation-based conservation water pricing, and, in fact, encourages utilities to skate by the rule by conjuring up numerical justifications.

Neither the *San Juan Capistrano* nor the *Palmdale* court was forced to resolve the actual conflict between the constitutional provisions because they found that the tiered water rates in their respective cases could be struck down for lack of a sufficient correlation between water fees and costs.<sup>146</sup> However, the *San Juan Capistrano* court stated that even if a conflict did exist, article XIII D should be read to carve out an exception to article X, section 2 because Prop 218 “is both more recent and more specific.”<sup>147</sup> Given the fact that conflict with regard to tiered water rates appears unavoidable, article XIII D would ultimately bar utilities from enacting tiered water rates.

The courts greatly muddy the waters by refusing to acknowledge the conflict between the constitution’s tax and water rights provisions and then articulating an ambiguous rule in an attempt to reconcile them. Moving forward, the courts should acknowledge that a conflict is unavoidable with regard to tiered water rates, and articulate clearly how that conflict can be resolved. Simply stating, as the *San Juan Capistrano* court did, that Prop 218 constitutes the carving out of an “exception” to article X, section 2 does not provide sufficient guidance

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(“While it is clear the District’s water measurement system is not perfect, section 6 does not require perfection.”).

145. *San Juan Capistrano*, 186 Cal. Rptr. 3d at 373 (“Since City Water didn’t try to calculate the actual costs of service for the various tiers, the trial court’s ruling on tiered pricing must be upheld simply on the basis of the constitutional text.”).

146. *See id.* at 381; *Palmdale*, 131 Cal. Rptr. 3d at 381.

147. *San Juan Capistrano*, 186 Cal. Rptr. 3d at 377; *see also* *Greene v. Marin Cty. Flood Control & Water Conservation Dist.*, 231 P.3d 350, 358 (Cal. 2010) (“As a means of avoiding conflict, a recent, specific provision is deemed to carve out an exception to and thereby limit an older, general provision.”).

to future courts on exactly what types of rate structures are allowed under state law.

#### IV. CRITIQUE NO. 2: IMPRACTICALITY AND AMBIGUITY IN *SAN JUAN CAPISTRANO*

The Fourth District of the California Court of Appeals refined the rule on tiered rates in its 2015 decision in *San Juan Capistrano*. Under the decision, utilities are no longer allowed to set their rates based on system-wide costs for providing water.<sup>148</sup> Rather, utilities apparently must set their rates in proportion to the cost of supplying water to *individual* parcels.

This section provides an overview of the *San Juan Capistrano* court's decision, and explains the differences in reasoning between *San Juan Capistrano* and previous decisions in *Pajaro*, *White* and *California Farm Bureau Federation*. Analysis of the *San Juan Capistrano* rule reveals a contradictory reading of Prop 218 on the part of the court. This section proposes two possible methods of resolving that inconsistency, then advocates for a return to the *Pajaro* rule in which rates are set proportionally to costs at a system-wide level, rather than for individual parcels. It also calls on the courts to clear up critical ambiguities in the *San Juan Capistrano* decision to assist agencies in setting new rates.

##### A. *Summarizing San Juan Capistrano*

In *San Juan Capistrano*, the California Court of Appeal placed new restrictions on how water utilities could set their rates.<sup>149</sup> Abandoning the *Pajaro* approach, the *San Juan Capistrano* court found that water fees must be proportional to the cost of providing water to individual consumers, rather than to the system as a whole.<sup>150</sup> The City of San Juan Capistrano—in its capacity as a retail water provider—created four tiers of water pricing based on historical patterns of usage ranging from “low” to “very excessive” use.<sup>151</sup> The city did not try to calculate the incremental cost of providing water for each tier, and, in fact, “effectively used revenues from the top tiers to

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148. See *San Juan Capistrano*, 186 Cal. Rptr. 3d at 372 (“Why use the phrase ‘cost of the service to the parcel’ if a local agency doesn’t have to actually ascertain a cost of service to that particular parcel?”).

149. *Id.* at 373.

150. *Id.*

151. *Id.* at 366.

subsidize below-cost rates for the bottom tier.”<sup>152</sup> Based on the text of article XIII D, section 6 of the California Constitution, the *San Juan Capistrano* court held that the tiered rate structures were unconstitutional.<sup>153</sup> The court found that the water utility not only had to balance its total costs against its total revenues, but “also had to correlate its tiered prices with the *actual cost* of providing water at those tiered levels.”<sup>154</sup>

### B. Expanding the San Juan Capistrano Rule

In 2016, the Second District Court of Appeal in *Newhall County Water District v. Castaic Water Agency*,<sup>155</sup> extended the *San Juan Capistrano* court’s ruling to include both water retailers and wholesale water providers.<sup>156</sup> The court struck down wholesale water rates on Prop 26 grounds, finding that the price-setting method did not “bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from” the wholesaler’s activity.<sup>157</sup> In addition, the court found that wholesalers could not charge retail agencies for “groundwater management activities” because “the benefit to the retailers from those activities is at best indirect” and, therefore, violated article XIII C of the California Constitution.<sup>158</sup> Extending *San Juan Capistrano* and directly challenging the rule from *Pajaro*, the court also stated, “Where charges for a government service or product are to be allocated among only four payors, the only rational method of evaluating their burdens on, or benefits received from, the governmental activity, is individually, payor by payor.”<sup>159</sup> Put simply: a rate structure is only acceptable if the water provider can justify the cost for each and every consumer individually, not just the system at large.

### C. The Impracticability of San Juan Capistrano

Less than two years after *San Juan Capistrano*, water utilities and municipalities are still grappling with the decision’s heightened

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152. *Id.*

153. *Id.* at 373.

154. *Id.* (emphasis added).

155. 197 Cal. Rptr. 3d 429 (Ct. App. 2016).

156. *Id.* at 436–37.

157. *Id.* at 437 (quoting CAL. CONST. art. XIII C).

158. *Id.*

159. *Id.* at 438.

burden to link water costs to water rates. As a matter of policy, it seems fair that water consumers should only have to pay fees that correspond in some way to the actual cost of providing the water. And, indeed, article XIII D of the California Constitution requires as much.<sup>160</sup> However, as seen with the diverging *Pajaro* and *San Juan Capistrano* decisions, courts have differed on exactly how to balance the benefits and costs. Namely, should fees be calculated using costs for each individual consumer, for groupings of consumers, or for the system as a whole?

The *San Juan Capistrano* court held that article XIII D requires water utilities to set water fees proportionally to the cost of supplying water to individual *parcels*.<sup>161</sup> The court stated:

If the phrase “proportional cost of the service attributable to *the* parcel” is to mean anything, it has to be that article XIII D, section 6, subdivision (b)(3) assumes that there really is an ascertainable cost of service that can be attributed to a specific—hence that little word “the”—parcel . . . . Why use the phrase “cost of the service to the parcel” if a local agency doesn’t actually have to ascertain a cost of service to that particular parcel?<sup>162</sup>

The *San Juan Capistrano* court’s reading of the constitution’s tax provision was an apparent constriction of the *Pajaro* rule, in which the court held that fees could be set proportionally to the cost of providing water for a group of consumers or the system as a whole.<sup>163</sup> The *Pajaro* court stated:

Given that Proposition 218 prescribes no particular method for apportioning a fee or charge other than that the amount shall not exceed the proportional cost of the service attributable to the parcel, [the water utility]’s method of grouping similar users together for the same augmentation

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160. CAL. CONST. art. XIII D (“The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.”).

161. *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 373 (Ct. App. 2015).

162. *Id.* at 372.

163. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 255 (Ct. App. 2013).

rate and charging the users according to the usage is a reasonable way to apportion the cost of service.<sup>164</sup>

The *Pajaro* court also recognized that it may be difficult—or perhaps impossible—for water utilities to apportion water costs down to the level of the individual parcel.<sup>165</sup> In its decision, the *Pajaro* court drew on the finding of the California Supreme Court two years earlier in *California Farm Bureau Federation v. State Water Resources Control Board*,<sup>166</sup> which also held that “the question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors.”<sup>167</sup>

In *Pajaro*—as in *White* and *California Farm Bureau* before it—the court set a standard that realistically accounted for the difficulty of determining water supply costs for individual parcels and instead required only that rates match costs at a system-wide level.<sup>168</sup> The *San Juan Capistrano* court’s decision makes no such acknowledgement of that reality.

In addition, requiring proportionality at the level of the individual parcel conflicts with the *San Juan Capistrano* court’s own understanding of the California Government Code’s definition of water as “any *system* of public improvements intended to provide for the production, storage, supply, treatment or distribution of water from any source.”<sup>169</sup> The *San Juan Capistrano* court held that, for purposes of its Prop 218 analysis, the law does not distinguish between potable and nonpotable water sources because water is part of a “holistic distribution system.”<sup>170</sup> Water utilities are therefore free to charge consumers to supply any combination of potable and nonpotable water without having to parse out the exact proportion of the type of water being provided. The court reasoned that even if some customers only use potable water while others only use nonpotable water, a water utility should be free to charge a uniform rate for providing both types of water because “[b]oth are getting water that meets their needs.

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164. *Id.*

165. *Id.* at 255 (citing *White v. Cty. of San Diego*, 608 P.2d 728, 731 (Cal. 1980) (en banc)).

166. 247 P.3d 112 (Cal. 2011).

167. *Id.* at 124.

168. *Pajaro*, 163 Cal. Rptr. 3d at 255.

169. CAL. GOV'T CODE § 53750(m) (West 2014) (emphasis added).

170. *Capistrano Taxpayers Ass'n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 370 (Ct. App. 2015).

Nonpotable water for some customers frees up potable water for others.”<sup>171</sup>

Moreover, the *San Juan Capistrano* court found that a water provider could pass on the present cost of constructing a water recycling plant to consumers even if the project would take five years to complete.<sup>172</sup> According to the court, “Water Code section 31020 gives local water agencies the power to do acts to ‘furnish sufficient water in the district for any present or *future* beneficial use.’”<sup>173</sup>

The *San Juan Capistrano* court provided contradictory guidance in its decision. On the one hand, the court interpreted the constitution to require that rates be strictly proportional to the cost of supplying water to the individual parcels.<sup>174</sup> On the other, the court determined that all customers could be charged at a higher rate to account for the cost of providing potable water, whether or not an individual customer used any potable water, and that current customers could be charged for future infrastructure development, whether or not they would reap the project’s benefits.<sup>175</sup> This leaves open a key question: if article XIII D requires that “[t]he amount of a fee or charge imposed upon any parcel or person . . . shall not exceed the proportional cost of the service attributable to the parcel”, what exactly might “the service attributable to the parcel” include?<sup>176</sup>

Courts may answer this question in one of two ways: (1) mandate that water utilities set rates proportionally to the *actual* and *present* cost of supplying water to individual parcels; or (2) interpret the constitutional provision to set rates proportionally to the cost of supplying water to the broader system.

Under the first option, water utilities would again be forced into the difficult—if not impossible—task of quantifying water costs for individual parcels. Going even further than the *San Juan Capistrano* rule, utilities would also be required to parse out differences in potable and nonpotable water costs, and calculate the present costs of infrastructure projects based on estimates of future benefits to individual consumers. The court would, therefore, be asking utilities to rely on shaky arithmetic to set rates, which might still very well

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171. *Id.* at 369.

172. *Id.* at 370.

173. *Id.* (quoting CAL. WATER CODE § 31020 (West 1949)).

174. *See id.* at 372.

175. *See id.* at 370.

176. CAL. CONST. art. XIII D, § 6.

violate Prop 218's proportionality requirement. In addition, forcing utilities to provide such detailed justification would saddle them with a large administrative burden, creating a complex and costly morass of billing rates, especially for larger urban water districts.

The second option—which closely resembles the rule adopted by the *Pajaro*, *White* and *California Farm Bureau* courts—meets Prop 218's proportionality requirement while acknowledging the challenge of pricing water accurately. Under this second option, water rates would be set based on the costs of providing water across the entire system, matching the California Government Code's definition of "water" as a part of a holistic system. The rule would also be consistent with the *San Juan Capistrano* court's own view that water utilities need not distinguish between potable and nonpotable water, and present and future costs.

#### D. *The Ambiguity of San Juan Capistrano*

In the closing paragraphs of its ruling, the *San Juan Capistrano* court walked back its apparent requirement that fees must match supply costs to individual parcels.<sup>177</sup> The court appeared to leave the door open to rate-setting schemes based on the cost of providing water to *groupings* of customers, rather than individual parcels.<sup>178</sup> The court wrote that its rejection of the city's price scheme "is not to say [the agency] must calculate a rate for 225 Elm Street and then calculate another for the house across the street at 226."<sup>179</sup> Rather, the court suggested that a water agency may "figure out the costs of given usage levels that require [the agency] to tap more expensive supplies, and then bill users in those tiers accordingly."<sup>180</sup>

Here, the court appears to be speaking out of both sides of its mouth. While the court suggested that fees need not be atomized to the level of the individual household, it did not explicitly state whether those groupings would be ruled constitutional either.<sup>181</sup> As a result, water agencies have been left to determine for themselves what level of customer aggregation falls within the *San Juan Capistrano* guidelines.

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177. See *San Juan Capistrano*, 186 Cal. Rptr. 3d at 380–81.

178. *Id.*

179. *Id.* at 380.

180. *Id.* at 381.

181. See *id.* at 380–81 ("This is not to say City Water must calculate a rate for 225 Elm Street and then calculate another for the house across the street at 226.").

Given the importance of reducing water consumption in an increasingly dry California, water agencies should be given greater flexibility to set their rates with an eye toward the twin tasks of augmenting water supply and reducing consumer demand. In order to clean up the muddle that the *San Juan Capistrano* rule presents, the court should return to its holding from *Pajaro*: water rates should be set proportionally to the cost of supplying water to the broader system, not to individual parcels.<sup>182</sup>

If the courts are to mandate that agencies link fees to supply costs, water agencies deserve guidance on exactly what level of cost-calculation the law requires. In doing the onerous cost-accounting apparently required by *San Juan Capistrano*, water agencies should not have to worry at each turn that a court might strike down their tiered rates as unconstitutional. Moving forward, the courts must, therefore, provide a framework for water agencies to determine how to set rates that do not run afoul of Prop 218.

## V. TIERED RATES AFTER *SAN JUAN CAPISTRANO*

In the aftermath of *San Juan Capistrano*, government agencies and environmental groups across the state expressed concern over the future viability of tiered rate structures as a water-conservation measure. This section provides a survey of the immediate reactions to the decision, and describes the ways in which water agencies have incorporated the Court's rule into new tiered rate structures. Finally, this section presents a case study of the Los Angeles Department of Water and Power's new tiered rate structure to show the implementation of *San Juan Capistrano* in action.

### A. *Immediate Aftermath of San Juan Capistrano*

Coming amidst severe drought in California, the *San Juan Capistrano* court decision was pilloried by Governor Jerry Brown as putting "a straitjacket on local government at a time when maximum flexibility is needed."<sup>183</sup> On June 5, 2015, the California Attorney General sent a letter to the California Supreme Court on behalf of the

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182. Griffith v. Pajaro Valley Water Mgmt. Agency, 163 Cal. Rptr. 3d 243, 255 (Ct. App. 2013).

183. *Governor Brown Issues Statement on 4th District Court of Appeal Decision*, OFF. OF GOVERNOR EDMUND G. BROWN, JR. (Apr. 20, 2015), <https://www.ca.gov/archive/gov39/2015/04/20/news18928/index.html>.



State Water Resources Control Board requesting de-publication of the decision to limit its impact on other water agencies across the state.<sup>184</sup> Calling the decision “overbroad” and pointing to potentially problematic dicta in the decision, the Attorney General wrote:

If the opinion remains published, it is likely to create confusion for water suppliers, courts, and litigants, and to frustrate the State’s efforts to respond to the severe drought conditions.<sup>185</sup>

The Supreme Court also received letters in support of de-publication from the Natural Resources Defense Council,<sup>186</sup> the Association of California Water Agencies, the California State Association of Counties, and the League of California Cities.<sup>187</sup> On July 22, 2015, the Supreme Court denied all motions and refused to de-publish the decision.<sup>188</sup>

### *B. Emerging Interpretations of San Juan Capistrano*

State officials believed that *San Juan Capistrano* had the potential for far-reaching impact, given that two-thirds of California’s water agencies used tiered billing structures at the time of the ruling.<sup>189</sup> As anticipated, a number of water agencies have faced legal challenges to

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184. Letter from Kamala Harris, Attorney Gen., State of Cal. Dep’t of Justice, to Justices of the Sup. Ct. of Cal. (June 5, 2015) (on file with the California State Water Resources Control Board), [http://www.waterboards.ca.gov/waterrights/water\\_issues/programs/drought/pricing/docs/capistrano\\_depub\\_request.pdf](http://www.waterboards.ca.gov/waterrights/water_issues/programs/drought/pricing/docs/capistrano_depub_request.pdf) (following the *San Juan Capistrano* ruling, the City of San Juan Capistrano withdrew its petition for rehearing and did not file an appeal with the California Supreme Court).

185. *Id.* at 7.

186. Letter from Nat. Res. Def. Council, to Justices of the Sup. Ct. of Cal. (2015) (on file with author).

187. Letter from Ass’n of Cal. Water Agencies, Cal. State Ass’n of Cty. & League of Cal. Cities, to Justices of the Sup. Ct. of Cal. (June 5, 2015), <https://www.cacities.org/Resources-Documents/Member-Engagement/Professional-Departments/City-Attorneys/Request-Amicus-Support/Recent-Filings/Letters/Capistrano-Taxpayers-Association-v-City-of-San-Jua>.

188. *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, No. S226906, 2015 Cal. LEXIS 5268 (July 22, 2015).

189. See Morgan Cook, *Water Rate Scheme Struck Down*, SAN DIEGO UNION-TRIB. (Apr. 20, 2015, 9:51 PM), <http://www.sandiegouniontribune.com/news/watchdog/sdut-san-juan-capistrano-water-rate-case-2015apr20-htmlstory.html>; Matt Stevens, *State Attorney General Challenges Ruling Against Tiered Water Rates*, L.A. TIMES (June 11, 2015, 7:39 PM), [http://www.latimes.com/local/lanow/la-me-ag-challenges-water-ruling-20150611-story.html?utm\\_source=dlvr.itutm\\_medium=twitterdlvr=649324](http://www.latimes.com/local/lanow/la-me-ag-challenges-water-ruling-20150611-story.html?utm_source=dlvr.itutm_medium=twitterdlvr=649324).

their rate structures in the wake of *San Juan Capistrano*, with lawsuits still pending in the state courts.<sup>190</sup>

While the *San Juan Capistrano* court seemed to suggest that higher-tiered rates must match specific supply costs to *individual parcels*, water agencies have construed certain language in the decision to mean that rates may instead be set based on an average of the marginal cost for supplying water to *all parcels* in a given tier.<sup>191</sup> The *San Juan Capistrano* court said, in dicta:

[W]e see nothing in article XIII, section 6, subdivision (b)(3) [of the California Constitution] that is incompatible with water agencies passing on the true, *marginal cost* of water to those consumers whose extra use of water forces water agencies to incur higher costs to supply that extra water.<sup>192</sup>

### C. Los Angeles Department of Water and Power – A Case Study

The new rate structure introduced in 2016 by the Los Angeles Department of Water and Power (“DWP”)—the nation’s largest municipal water utility<sup>193</sup>—provides a good illustration of how utilities are justifying their rates in *San Juan Capistrano*’s wake.

On April 15, 2016, one year after *San Juan Capistrano*, DWP implemented a new rate structure, meant to last through the year

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190. See, e.g., Arin Mikailian, *Group Files Suit Over Glendale’s Tiered Water Rates*, L.A. TIMES (May 8, 2015, 5:40 PM), <http://www.latimes.com/tn-gnp-group-files-suit-over-glendales-tiered-water-rates-20150508-story.html>; Paul Rogers, *California Drought: Wealthy Hillsborough Residents Sue, Saying Water Rates Are Too High*, MERCURY NEWS (Nov. 30, 2016, 6:00 AM), <http://www.mercurynews.com/2016/11/30/california-drought-wealthy-hillsborough-residents-sue-saying-water-rates-are-too-high/>; Claire Trageser, *Lawsuit Threatens Sweetwater’s Tiered Water Rates But Not San Diego’s*, KPBS (Apr. 21, 2015), <https://www.kpbs.org/news/2015/apr/21/sweetwaters-tiered-water-rates-threatened-lawsuit/> (plaintiff in the lawsuit against Sweetwater, CA was represented by the same lawyer who brought suit in the *San Juan Capistrano* case); Nick Welsh, *Farmers Sue Goleta Water District*, SANTA BARBARA INDEP. (Sept. 3, 2015), <http://www.independent.com/news/2015/sep/03/farmers-sue-goleta-water-district>.

191. Kelly J. Salt, *Structuring Tiered Water Rates Under Conflicting Court Decisions: Interpreting the California Constitution*, 108 J. - AM. WATER WORKS ASS’N 32, 38 (2016) (citing *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 381 (Ct. App. 2015)) (“[T]he court noted that there was nothing in the record to explain why the city could not calculate the costs of service at given usage levels that require it to tap into more expensive water supplies and then bill its users in the higher tiers accordingly.”).

192. *Capistrano Taxpayers Ass’n v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 381 (Ct. App. 2015) (emphasis added).

193. *About Us: Who We Are*, L.A. DEP’T OF WATER & POWER, [https://www.ladwp.com/ladwp/faces/ladwp/aboutus/awhoweare?\\_adf.ctrlstate=q8e8hveqs\\_4&\\_af.rLoop=386119097889823](https://www.ladwp.com/ladwp/faces/ladwp/aboutus/awhoweare?_adf.ctrlstate=q8e8hveqs_4&_af.rLoop=386119097889823) (last visited Feb. 11, 2017) [hereinafter LADWP, *About Us*].

2020.<sup>194</sup> The development of the revised rate structure was guided by Mayor Eric Garcetti's Executive Directive 5, issued on October 14, 2014, which ordered a 20 percent reduction in potable water use by 2017 and a 50 percent reduction by 2024.<sup>195</sup> To that end, DWP expressly stated that its rate structure would "continue to incentivize conservation, using water budget allotments and tiered rates."<sup>196</sup> However, DWP acknowledged that its ability to set tiered rates was limited by Prop 218 and the *Pajaro* decision.<sup>197</sup> In its Water System Rate Action Report of July 2015, DWP quotes language from the *San Juan Capistrano* decision, which says that "there is nothing in Proposition 218 that prevents water agencies from passing on the incrementally higher costs of expensive water to incrementally higher users."<sup>198</sup> However, DWP made no mention of the portions of the same decision pertaining to individual parcel costs, and instead states that it has "elected to set its rates by customer class."<sup>199</sup>

The stated goal of DWP's new rate structure is "to ensure revenue from each customer class is *relatively* proportionate to the cost of providing service to that class."<sup>200</sup> DWP has established four broad customer classes: (1) Single-Dwelling Unit Residential; (2) Multi-Family Residential; (3) Commercial; and (4) Other, which includes recycled water service and private water service.<sup>201</sup> There are four

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194. City of L.A., Cal., Water Rate Ordinance 184130 (Apr. 15, 2016), <https://www.bomagla.org/sites/bomagla.org/files/City%20of%20LA%20Water%20Rate%20Ordinance%204-15-16.pdf>.

195. Executive Directive from Eric Garcetti, Mayor, City of L.A., (Oct. 14, 2014), [https://www.lamayor.org/sites/g/files/wph446/f/page/file/ED\\_5\\_-\\_Emergency\\_Drought\\_Response\\_-\\_Creating\\_a\\_Water\\_Wise\\_City.pdf?1426620015](https://www.lamayor.org/sites/g/files/wph446/f/page/file/ED_5_-_Emergency_Drought_Response_-_Creating_a_Water_Wise_City.pdf?1426620015).

196. L.A. DEP'T OF WATER & POWER, WATER SYSTEM RATE ACTION REPORT, CHAPTER 2: INTRODUCTION AND BACKGROUND, (2015), [https://www.ladwp.com/cs/idcplg?IdcService=GET\\_FILE&dDocName=OPLADWPCCB435622&RevisionSelectionMethod=LatestReleased](https://www.ladwp.com/cs/idcplg?IdcService=GET_FILE&dDocName=OPLADWPCCB435622&RevisionSelectionMethod=LatestReleased) [hereinafter LADWP, CHAPTER 2].

197. *Id.* ("The California Court of Appeal decision concerning Proposition 218 (Griffith vs. Pajaro Valley Water Management Agency, Sixth Appellate District) that supports grouping similar customers into classes and setting rates by customer class as a reasonable way to apportion the cost of service.").

198. L.A. DEP'T OF WATER & POWER, WATER SYSTEM RATE ACTION REPORT, CHAPTER 5: WATER RATE DESIGN, (2015), [https://www.ladwp.com/cs/idcplg?IdcService=GET\\_FILE&dDocName=OPLADWPCCB43562&RevisionSelectionMethod=LatestReleased](https://www.ladwp.com/cs/idcplg?IdcService=GET_FILE&dDocName=OPLADWPCCB43562&RevisionSelectionMethod=LatestReleased) [hereinafter LADWP, CHAPTER 5].

199. *See id.*

200. *Id.* (emphasis added).

201. *Finances & Reports: Water Rates*, L.A. DEP'T OF WATER & POWER (last visited Feb. 18, 2017), [https://www.ladwp.com/ladwp/faces/ladwp/aboutus/a-financesandreports/a-firaterresares?\\_adf.ctrl-state=mtdykfrui\\_4&\\_afLoop=228335324196460](https://www.ladwp.com/ladwp/faces/ladwp/aboutus/a-financesandreports/a-firaterresares?_adf.ctrl-state=mtdykfrui_4&_afLoop=228335324196460).

block rate tiers applied to customers within the Single-Dwelling Unit Residential class: Tier 1 (Basic Indoor Use); Tier 2 (Efficient Drought Resistant Water Use); Tier 3 (Above Average Outdoor Water Use); and Tier 4 (Excessive Use).<sup>202</sup> Tiered rates are further differentiated based on the lot size of each single-dwelling unit, with five “Lot Size Groups” ranging from Group 1 (1–7,499 square feet) to Group 5 (43,560 square feet and above).<sup>203</sup> In the summer months (June to September), tiered pricing also differs based on a unit’s temperate zone, with lots in cooler areas paying less than those in warmer areas.<sup>204</sup>

Under DWP’s volumetric rate scheme, the rate customers pay for their water depends on how much water they use.<sup>205</sup> For each tier, DWP sets “water budget allotments” to determine how much water is available to Single-Dwelling Unit Residential customers at that tier price.<sup>206</sup> For example, if the allotment for the First Tier is set at 100 volumetric units, then customers pay the First Tier price for the first 100 units, and the Second Tier price for the 101st unit of water and beyond. Reducing the allotment available at the lower tiers suppresses demand as customers use up their allotment of cheaper water more quickly and subsequently reduce usage of higher-priced water.<sup>207</sup>

DWP has developed a complex system for determining how much to charge for water at each tier. DWP water rates are generally comprised of a base rate, which includes the cost of general operations and administration, and various “adjustment factors,” which may include costs of adding to the water supply, enhancing water quality, and improving infrastructure.<sup>208</sup> Under the DWP scheme, the key “adjustment factors” for setting tiered rates are the “Peak Pumping and Storage” and “Water Supply Cost” adjustments.<sup>209</sup> At the lower tiers, DWP uses cheaper sources of water to fill consumer demand, and

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202. *Id.*

203. *Customer Service: Water Rates*, L.A. DEP’T OF WATER & POWER, [https://www.ladwp.com/ladwp/faces/wcnav\\_externalId/r-cs-wtr-rate?\\_adf.ctrl-state=33ihh6nu4\\_4&\\_afirLoop=462475787070242](https://www.ladwp.com/ladwp/faces/wcnav_externalId/r-cs-wtr-rate?_adf.ctrl-state=33ihh6nu4_4&_afirLoop=462475787070242) (last visited Feb. 18, 2017).

204. *Id.*

205. LADWP, CHAPTER 5, *supra* note 198.

206. *Id.*

207. *Id.*

208. *Id.*

209. *Id.* (see table for a clear breakdown of the sources of costs that form the basis of DWP’s rate-setting).

therefore can charge less for each unit of water it delivers.<sup>210</sup> As consumer demand increases, however, DWP is forced to find and distribute more expensive sources of imported water—as captured by the “Water Supply Cost Adjustment”—and invest more in costly water supply and storage programs—as captured by the “Peak Pumping and Storage Adjustment.”<sup>211</sup>

DWP develops rates—the marginal price per unit of water—for each customer class by dividing overall water supply costs by the number of units required.<sup>212</sup> At the higher tiers, DWP then adds marginal cost values for additional water supply and storage measures necessitated by higher water demand across the class of users.<sup>213</sup> For example, under the DWP rate scheme, only Tier 4 and 5 customers pay for “Peak Pumping and Storage” because storage is only necessary when there is a high volume of water demanded.<sup>214</sup>

DWP sets rates for customers based on how much their individual usage contributes to overall water supply costs for their class, rather than the actual cost of providing water to each individual parcel.<sup>215</sup> Given the complexity of DWP’s water distribution system, the cost of service does not align perfectly with revenue, meaning that revenue collected from some customer classes slightly exceeds the cost of providing water to that class.<sup>216</sup> Indeed, with 681,000 water customers across Los Angeles County,<sup>217</sup> DWP would likely find perfectly matching water supply costs to revenue for each parcel an onerous, if not impossible, undertaking.

In creating its new rate structure, DWP has hung its hat on the *Pajaro* decision, which “supports grouping similar customers into classes and setting rates by customer class as a reasonable way to apportion the cost of service.”<sup>218</sup> In doing so, DWP has adopted an

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210. *Id.*

211. *Id.*

212. *See id.* (“The calculation of each of the remaining adjustment factors . . . is based on the total aggregate revenue requirement for each factor divided by total aggregate usage of Schedules A, B, and C.”).

213. *Id.*

214. *See id.*

215. *See id.* (“[R]ates can be set to produce revenue from each major customer class proportionately to the costs of service for that customer class.”).

216. *See id.* While variances between the cost of service and revenue exist, DWP considers a variance of less than 10% to be “reasonable,” and has successfully kept variances below that level. *See id.*

217. LADWP, *About Us*, *supra* note 193.

218. LADWP, CHAPTER 2, *supra* note 196.

expansive reading of *San Juan Capistrano*, turning away from an interpretation of the decision that would require a more-atomized accounting of water delivery fees—perhaps even down to the level of the individual parcel.<sup>219</sup> The apparent split in California appellate court decisions on the method for setting tiered rates means that, should DWP’s tiered rates ever face a legal challenge, the trial courts may choose to apply the rule from either case.<sup>220</sup> However, absent guidance from the California Supreme Court on how agencies must link supply costs to consumer fees, DWP and water agencies across California can never be certain that their tiered rates comply fully with the law.<sup>221</sup> This must change.

## VI. CONCLUSION

After *San Juan Capistrano*, the growing body of case law on tiered water rates emerging out of the California Court of Appeals has turned rate-setting into an untenable guessing game. By first refusing to reconcile the contradictory water rights and tax provisions of the California constitution, and secondly laying down impracticable and ambiguous rules for setting tiered water rates, the California courts have left water agencies to determine for themselves what level of customer aggregation falls within the *San Juan Capistrano* guidelines. Moving forward, the courts must provide a framework for water agencies to determine how to set rates that do not run afoul of Prop 218.

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219. See Salt, *supra* note 191, at 40.

220. See *Auto Equity Sales, Inc. v. Superior Court of Santa Clara Cty.*, 369 P.2d 937, 940 (Cal. 1962) (holding that when conflicting appellate court decisions exist, “the court exercising inferior jurisdiction can and must make a choice between the conflicting decisions.”).

221. See Salt, *supra* note 191, at 40.

