

Date of Hearing: April 24, 2024

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Juan Carrillo, Chair

AB 1827 (Papan) – As Amended April 4, 2024

SUBJECT: Local government: fees and charges: water: higher consumptive water parcels.

SUMMARY: Provides that fees or charges for property-related water service may include the incrementally higher costs of water service, as specified. Specifically, **this bill**:

- 1) Provides that the fees or charges for property-related water service imposed or increase pursuant to the California Constitution may include the incrementally higher costs of water service due to any of the following:
 - a) The higher water usage demand of parcels.
 - b) The maximum potential water use.
 - c) Projected peak water usage.
 - d) Any combination of a) through c) above.
- 2) Specifies that the incrementally higher costs of water service associated with higher water usage demands, the maximum potential water use, or projected peak water usage may be allocated using any method that reasonably assesses the water service provider's cost of serving those parcels that are increasing potential water usage demand, maximum potential water use, or projected peak water usage.
- 3) Provides that in addition to any other method consistent with the California Constitution, the incrementally higher costs of water service associated with higher water usage demand, maximum potential water use, or projected peak water usage may be allocated among customer classes, within customer classes, or both, based on meter size or peaking factors, as those methods reasonably assess the water service provider's cost of serving parcels that increase water usage demand, maximum potential water use, or projected peak water usage.
- 4) States that this bill is declaratory of existing law.

FISCAL EFFECT: None.

COMMENTS:

- 1) **Financing Water Infrastructure.** Local governments in California provide most water related services in the state which include water service, sewer service, flood control, and storm water management. A 2014 Public Policy Institute of California (PPIC) report, *Paying for Water in California*, outlines four sources of funding currently used for water in California: a) Fees, which include water and waste water bills, property assessments or fees, developer or connection fees, and permitting fees; b) Taxes, which include both general and special taxes, including parcel taxes; c) Fines and penalties, which include excessive pumping on groundwater or directly to customers in violation of rationing restrictions during drought emergencies; and, d) Bonds, which include general obligation and revenue bonds.

Local agencies frequently point to the series of constitutional reforms, Proposition 13 (1978), Proposition 218 (1996), and Proposition 26 (2010), that have made it increasingly more difficult to generate the necessary revenue to fund the costs of providing water and other essential services.

- 2) **Proposition 218.** The California Constitution requires voter approval for taxes and many other fees and charges. Proposition 218 (1996) added Article XIIIID to the California Constitution, which imposed voter approval requirements for most “property-related fees”—any levy other than an *ad valorem* tax, a special tax, or an assessment imposed by an agency on a parcel or on a person as an incident of property ownership, including a user fee or charge for a property-related service.

Before a local government can charge a new property-related fee, or increase an existing one, Proposition 218 requires local officials to:

- a) Identify the parcels to be charged.
- b) Calculate the fee for each parcel.
- c) Notify the parcels’ owners in writing about the fees and the hearing.
- d) Hold a public hearing to consider and count protests.
- e) Abandon the fees if a majority of the parcels’ owners protest.

New, increased, or extended property-related fees generally require voter approval by one of the following: a majority-vote of the affected property owners; two-thirds registered voter approval; or weighted ballot approval by the affected property owners.

Fees or charges for property related services cannot exceed the proportional cost of providing service to the parcel and must be used only for the purposes for which they were collected. Property-related fees must also only fund services actually used by or immediately available to the property owner, not based on potential or future use. Finally, Proposition 218 prohibits local governments from imposing property-related fees or charges for general governmental services—including fire, police, ambulance, or library services—if the service is available to the public at large in substantially the same manner as it is to property owners.

Water, sewer, and refuse collection services are exempt from Proposition 218’s voter approval requirements, but must meet all other procedural and substantive requirements in Proposition 218, including the requirement to hold a protest hearing not less than 45 days after mailing a notice of new or increased rates to affected property owners. If a majority protest the fee, based on the proportional obligation of the affected property, then the local agency cannot impose the fee.

- 3) **Proposition 218 Omnibus Implementation Act.** Proposition 218 is a complex statute and has been the subject of many court cases and rulings that often conflict with one another. In the past, the Legislature has weighed in to provide clarity on how to apply Proposition 218’s provisions and statutorily reinforced court rulings that align with the Legislature’s priorities. In particular, immediately after the passage of Proposition 218, the Legislature enacted the Proposition 218 Omnibus Implementation Act to translate many of Proposition 218’s

requirements into statutory definitions and procedures [SB 919 (Rainey), Chapter 38, Statutes of 1997]. More recently, the Legislature amended the Proposition 218 Implementation Act to define “water” in a manner that is consistent with an appellate court decision that provided greater flexibility to water agencies when setting rates [AB 2403 (Rendon) Chapter 78, Statutes of 2014]. SB 231 (Hertzberg) Chapter 536, Statutes of 2017, defined "sewer" for the purposes of the Proposition 218 Omnibus Implementation Act, and SB 1386 (Moorlach), Chapter 240, Statutes of 2020, provided that fire hydrants are a part of water service for the purposes of Proposition 218.

- 4) **Water Rates.** Setting water rates can be a complex endeavor, and local agencies impose water rates in many different ways. Since the voters approved Proposition 218's requirements, how public agency water providers impose these fees is a common debate. One increasingly common form of rates are tiered rates. According to the PPIC report *Paying for Water in California*, “By the mid-2000s, over half of the state’s urban water utilities used tiered rates, and the practice has been growing as more utilities aim to reduce per capita urban water use, still high in California relative to comparable economies with similar climates, such as Australia, Spain, and Israel. The legal issue is whether these rate structures are consistent with Proposition 218’s requirement that fees be proportional to the cost of service. This accounting requirement turns out to be more complex than voters may have anticipated when they approved this constitutional reform. The courts have ruled that agencies cannot set different price tiers for different customer categories unless the rate differentials are based on differences in costs of service among categories. This ruling is beneficial insofar as it discourages the artificial subsidization of water use.”

In 2015, *Capistrano Taxpayers Association v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, the court ruled that the City’s water pricing violated the constitutional requirement that fees not exceed the proportional cost of the service attributable to the parcel. The court continued by saying, “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. Neither the voters nor the Constitution say anything we can find that would prohibit tiered pricing.” The court also stated that “And, we emphasize, there is nothing at all in subdivision (b)(3) or elsewhere in Proposition 218 that prevents water agencies from passing on the incrementally higher costs of expensive water to incrementally higher users.” Lastly, the court noted that “...we 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.” Courts have interpreted the application of Proposition 218’s constitutional provisions numerous times, and despite the ruling in *Capistrano*, disputes over how best to determine rates continue to this day.

As noted by supporters of this bill, a 2021 trial court decision, *Patz vs. City of San Diego*, invalidated the City’s water rates, concluding that the City failed to demonstrate, by substantial evidence, that the tiered water rates were imposed in compliance with Proposition 218. Two of the major issues at hand in the *Patz* case are the use of “peak water usage” and charging different rates to different customer classes (i.e. residential, commercial, etc.), which this bill seeks to address. *Patz* is currently in the process of appeal.

- 5) **Bill Summary.** This bill make makes changes to the Proposition 218 Implementation Act by providing that fees or charges for property-related water services imposed or increased may

include the incrementally higher costs of water service due to the higher water usage demand of parcels, the maximum potential water use, projected peak water usage, or any combination of the three. This bill also specifies that the incrementally higher costs of water service, as specified, may be allocated among customer classes, within customer classes, or both, based on meter size or peaking factors. Lastly, this bill would declare that these provisions are declaratory of existing law. The California Coastkeeper Alliance and Irvine Ranch Water District are the sponsors of this bill.

- 6) **Author's Statement.** According to the author, "To meet demands driven upward by high-water users, a water supplier often has higher costs associated with building, operating, and maintaining a larger water system that can meet those larger water demands. They also have added costs for the additional water supplies needed to serve those larger uses."

"While collectively, all customers pay for the water service costs, contribution by higher use parcels per Proposition 218 should be proportionately larger than smaller use parcels. Recent trial courts' imposition of increasing degrees of granularity and precision, instead of well accepted methods for cost allocation, have made the allocation of costs to higher water users nearly impossible.

"AB 1827 affirms that existing law allows water suppliers to use reasonable and well-accepted methods of assessing the incremental costs associated with higher water usage demands to high water users; thereby, confirming what Proposition 218 requires for water rates and charges."

- 7) **Policy Consideration.** Proposition 218 imposes constitutional limitations on property-related fees. As a result, the Legislature is limited in the actions it can take to change how the Proposition works, absent a constitutional amendment. The Legislature can enact statutes to help shape the courts' interpretations of constitutional provisions, but in the end, the courts will ultimately interpret Proposition 218's constitutional requirements. Nonetheless, the case at issue in this bill may be suited to legislative intervention. Courts have ruled that tiered water rates can be utilized by water providers.

Ultimately, if the courts find a conflict between Article XIII D and the provisions of this bill, they will be bound to follow the Constitution, meaning this bill may not have the desired effect on the litigation at hand. The Committee may wish to consider the need for the bill in light of existing constitutional constraints.

- 8) **Previous Legislation.** SB 1386 (Moorlach), Chapter 240, Statutes of 2020, provided that fire hydrants are a part of water service for the purposes of Proposition 218.

SB 231 (Hertzberg), Chapter 536, Statutes of 2017, defined "sewer" for the purposes of the Proposition 218 Omnibus Implementation Act.

SB 1298 (Hertzberg) of 2016 would have specified the definition of "sewer" for the purposes of the Proposition 218 Omnibus Implementation Act. SB 1298 died on the inactive file in the Assembly.

AB 1362 (Gordon) of 2015, would have provided a definition for "stormwater" to mean "any system of public improvements, or service intended to provide for the quality, conservation, control, or conveyance of waters that land on or drain across the natural or man-made

landscape" in the Proposition 218 Omnibus Implementation Act. AB 1362 would have only become operative if a constitutional amendment was approved by the voters. The introduced version of AB 1362 was subsequently amended into a different issue area to address mosquito and vector control districts.

AB 2403 (Rendon), Chapter 78, Statutes of 2014, expanded the definition of "water" in the Proposition 218 of 1996 Omnibus Implementation Act to mean any system of public improvements intended to provide for the production, storage, supply, treatment, or distribution of water from any source.

SB 919 (Rainey), Chapter 38, Statutes of 1997, enacted the Proposition 218 Omnibus Implementation Act to prescribe specific procedures and parameters for local jurisdictions in complying with Article XIII C and Article XIII D of the California Constitution.

- 9) **Related Legislation.** SB 1072 (Padilla) requires that, if a property-related fee or charge creates revenues in excess of the local government's reasonable cost of providing the specific benefit or specific government service, the excess revenues be used only to reduce the subsequently adopted and following property-related fee or charge. This bill is currently in the Senate Local Government Committee.
- 10) **Arguments in Support.** According to the California Coastkeeper Alliance and Irvine Ranch Water District, the sponsors of this bill, "This important measure, which is supported by a coalition of statewide associations, environmental organizations, water suppliers and regional stakeholders, would ensure water suppliers can continue to use meter size and peaking factors to proportionally allocate the costs associated with providing water service among customers.

"California courts have ruled many times over that public water suppliers must allocate costs associated with higher water demands to those customers whose extra water use causes the supplier to incur higher costs. Water suppliers have long relied on meter size and peaking factors—a factor that estimates the peak demands due to high water users as compared to normal demands—to proportionally allocate costs among customers. Recent lawsuits, however, have sought to prevent the use of these legitimate factors. AB 1827 provides time sensitive clarification to the courts considering such cases that attempt to call the use of these factors into question.

"AB 1827 reinforces the authority of public water agencies under the law to ensure water suppliers can continue to use meter size and peaking factors to proportionally allocate the costs associated with providing water service among customers. AB 1827 does this by amending Proposition 218's implementing statute to confirm that these long-standing cost allocation methods may be used consistent with Proposition 218. Because of lawsuits that threaten California water suppliers' ability to use these well-accepted methods of cost allocation, this measure is critical to preventing these costs from being passed on to low-water users."

- 11) **Arguments in Opposition.** According to the Howard Jarvis Taxpayers Association, "Article XIII D, Section 6(b)(4) clearly states, '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.'

Thus, basing a charge on ‘maximum potential water use’ is not permitted under Proposition 218.

“Similar concerns are raised by subdivision (b)(2) of proposed section 53750.6. It states, ‘In addition to any other method consistent with Section 6 of Article XIII D of the California Constitution, the costs associated with higher water usage demands, the maximum potential water use, or a projected peak water usage demand cost may be allocated based on meter size or peaking factors, as those are two methods that reasonably assess the water service provider’s cost of serving those parcels which are increasing demand or potential water use.

“In addition to the problem discussed above, where customers could be charged in advance for ‘potential water use,’ this subdivision introduces the possibility of a charge for ‘peaking factors,’ which are often based on an assumed ‘maximum hour consumption,’ even though very few (if any) public water agencies have time-of-use technology that could even theoretically identify the ‘maximum hour’ for water consumption, let alone measure that consumption in a manner that could be used to reasonably determine peaking factors. In practice, many public water agencies just plug in a ‘maximum hour’ ratio that yields a preferred result, because they lack the data required to actually measure or quantify this ratio. Thus, in the absence of time-of-use technology, peaking factors are generally make-believe.

“...Often, such peaks are caused by water-intensive industrial users, not residential users who end up paying higher rates due to fabricated peaking factors. This methodology is also unconstitutional, because it results in a disproportionate rate structure, in violation of Article XIII D, Section 6(b)(3), which provides that ‘[t]he 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.”

REGISTERED SUPPORT / OPPOSITION:

Support

California Coastkeeper Alliance [SPONSOR]
Irvine Ranch Water District [SPONSOR]
7th Generation Advisors
Association of California Water Agencies
California Council for Environmental & Economic Balance
California Municipal Utilities Association
California Special Districts Association
California Water Association
California Water Efficiency Partnership
City of Sacramento
Coachella Valley Waterkeeper
Community Water Center
Eastern Municipal Water District
Friends of the River
Humboldt Waterkeeper
Inland Empire Waterkeeper
Las Virgenes Municipal Water District
Los Angeles Alliance for a New Economy

Los Angeles Waterkeeper
Monte Vista Water District
Monterey Waterkeeper
Orange County Coastkeeper
Otay Water District
Russian Riverkeeper
San Diego Coastkeeper
San Gabriel Valley Water Association
Santa Barbara Channelkeeper
Santa Clara Valley Water District
Shasta Waterkeeper
Sierra Club California
Social Eco Education
South Yuba River Citizens League
Southern California Water Coalition
Sweetwater Authority
Three Valleys Municipal Water District
Trabuco Canyon Water District
Upper San Gabriel Valley Municipal Water District
Yorba Linda Water District
Yuba River Waterkeeper

Opposition

Howard Jarvis Taxpayers Association

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