Date of Hearing: June 26, 2024

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Juan Carrillo, Chair
SB 1072 (Padilla) – As Amended June 17, 2024

SENATE VOTE: 31-5

SUBJECT: Local government: Proposition 218: remedies.

SUMMARY: Provides that, if a court determines that a fee or charge for a property-related service violates Proposition 218, then the local agency must credit that amount against the cost of providing the property related service. Specifically, **this bill**:

1) Provides that if a court determines that a fee or charge for a property-related service, including water, sewer, and refuse collection, violates Section 6 of Article XIII D of the California Constitution, then the local agency shall, in the next procedure to impose or increase the fee or charge, credit the amount of the fee or charge attributable to the violation against the amount of the revenues required to provide the property-related service unless a refund is explicitly provided for by statute.

2) Specifies that this bill does not apply to claims related to billing errors.

3) Finds and declares that this bill furthers the purposes and intent of the Right to Vote on Taxes Act, approved by the voters as Proposition 218 at the November 5, 1996, statewide general election, and the Proposition 218 Implementation Act [SB 919 (Rainey), Chapter 38, Statutes of 1997] by accomplishing all of the following:

    a) Finding that Proposition 218 does not contain any affirmative intent to authorize a refund remedy.

    b) Recognizing that water and sewer agencies, and local governments providing property-related services, set charges to merely recover costs annually and receive no profit.

    c) Further recognizing that lawsuits seeking refunds for property-related service rate determinations threaten to compromise the financial stability of water and sewer agencies and local governments providing property-related services and the critical public services they provide.

    d) Further recognizing that any refund would need to be funded by raising rates on future ratepayers, further reducing the affordability of essential public services.

    e) Protecting ratepayers by requiring that the entity charging the property-related service fee or charge credit against future revenues the amount of any fee or charge in violation of Proposition 218.

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 XIIID 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. 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.

   Neither Proposition 218, nor the Proposition 218 Omnibus Implementation Act, provide an explicit remedy for violations to ratepayers beyond invalidating the fee amounts moving forward. In other laws, the Legislature has explicitly authorized specific remedies in statute. For example, the Mitigation Fee Act, which sets forth rules governing how local agencies impose fees on development projects, requires local agencies to refund unexpended fee revenue in certain circumstances. For instance, when sufficient funds have been collected to complete financing on incomplete projects, and the project remains incomplete, the local agency is required to identify, within 180 days, a date that the construction of the project will commence, or the local agency must refund a specified amount of the unexpended portion of the fee and any interest.

   However, individuals may have opportunities to receive a refund even when statute does not explicitly provide one. For example, the Government Claims Act establishes a standardized procedure for bringing claims against local governmental entities. Even if statute does not provide an explicit remedy, and the Government Claims Act does not apply, courts can still order a remedy for violations of a provision of the California Constitution. Under *Katzberg v. Regents of University of California* (2002) 29 Cal.4th 300, 317, the California Supreme Court applied a two-prong test to identify circumstances when a constitutional violation allows for a refund:

   a) Does the constitutional provision demonstrate an intent to permit or preclude damages as a remedy?

   b) If the constitutional provision does not expressly prohibit awarding damages, do certain factors weigh in favor of allowing a remedy?

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. While this bill is not limited to rates for

drinking water, such rates have often been the subject of legal challenges. The imposition of tiered water rates have especially become a target for litigation in recent years. 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.

5) **Otay Water District.** According to the Otay Water District (District), it provides water, recycled water, and sewer service to over 225,000 customers across roughly 125 square miles of southeastern San Diego County. The District imposes a tiered rate structure for single-family residential customers to encourage water conservation. Otay Water District's tiered rate structure has three components. First, all customers pay a fixed monthly charge based on the size of their water meter. Second, customers pay a variable usage fee based on their water consumption, meaning heavier water users pay more per unit of water than lower water users. Third, the District sets an energy charge and an improvement-district charge. In 2013, to ensure these rates met constitutional requirements, the District hired a consultant to complete a comprehensive rate study. In 2017, the District hired a different consultant to ensure its rates remained consistent with Proposition 218.

   Ratepayers challenged the District's rates, claiming they were not proportional to the cost of service for each parcel, as required by Proposition 218 (*Coziahr v. Otay Water District*). Specifically, some ratepayers claimed the rates the District charged exceeded the costs for the District to serve them. In 2022, the San Diego Superior Court filed a judgment in favor of the ratepayers, and ordered Otay Water District to refund ratepayers approximately $18 million plus just over $200,000 each month, plus interest, until the District brings its rates into compliance with Proposition 218. The District says the total cost could add up to be more than $30 million.

The District has appealed the ruling. According to the District, oral arguments and a decision are expected in July and October of this year, respectively. In its appeal, the District claims its rate tiers, which charge higher-volume users more to ensure its water system ensures can meet peak demands, are consistent with Proposition 218. The District contends, since higher volume users cause these higher peak demands, they should pay more so a water system can meet the higher demand they cause. Additionally, the District asserts that, even if its rates were not proportional to the cost of service, the Court should not have awarded a refund because Proposition 218 only authorizes prospective relief.

Other water providers have faced similar challenges. For example, in 2021, the San Diego Superior Court invalidated the City of San Diego's tiered water rates finding they were not proportional to the cost of service attributable to each parcel as required by Proposition 218 (*Patz vs. City of San Diego*, San Diego County Super. Ct. No. 37-2015-23413-CU-MC-CTL). Like *Coziahr*, the Court ordered the City to refund customers. The City appealed the Court's ruling in *Patz*, but the case has not yet been resolved.

6) **Bill Summary and Author's Statement.** This bill provides that, if a court determines that a fee or charge for a property related service, including water, sewer, and refuse collections violates Proposition 218, then the local agency must, in the next procedure to impose or increase the fee or charge, credit that amount against the cost of providing the property related service, unless statute explicitly provides a refund remedy. The measure also states it does not apply to claims related to billing errors. The City of San Diego and the Otay Water District are the sponsors of this bill.

   According to the author, "SB 1072 is a critical protection to ensure that we can deliver clean, reliable, and affordable water to our constituents. Water agencies pass fair and reasonable rates to cover the costs of operations and investments, not to make a profit. This kind of reform is a necessary step to ensure we protect our constituents from rate hikes while providing individual ratepayers with the opportunity for a refund when administrative errors are made. It is critical to give these public agencies the flexibility necessary to operate without jeopardizing water deliveries to its constituents."

7) **Policy Considerations.** This bill could ultimately prevent ratepayers that a court found overpaid for a property-related service from getting a direct refund. Instead of refunding these ratepayers, any excess fees collected would go to reduce the cost for the local agency to provide that service moving forward. As mentioned by the opposition, the ratepayers that overpaid and have moved out of the jurisdiction of the local agency would not see the benefit of a successful proposition 218 challenge. On the other hand, supporters argue that all ratepayers, including those that overpaid and continue to live within the agency's jurisdiction, would pay less for that service moving forward. In the case of tiered water rates, lower-consumption users could avoid paying more to refund higher-consumption users, and all ratepayers could pay less the next time the agency increases its fees. The Committee may wish to consider if this bill strikes the right balance of fairness for both ratepayers a court has found overpaid and everyone else.

8) **Related Legislation.** AB 1827 (Papan) provides that fees or charges for property-related water service may include the incrementally higher costs of water service, as specified. AB 1827 is currently pending in the Senate Local Government Committee.

AB 2257 (Wilson) establishes a procedure whereby a ratepayer for water or sewer services must exhaust specified administrative remedies to contest a new or increased fee or assessment in order for that ratepayer to be eligible to bring a lawsuit contesting the fee or assessment. This bill is currently pending in the Senate Local Government Committee.

9) **Arguments in Support.** According to the sponsors of this bill and a coalition of local governments and associations, "Proposition 218, approved by voters in 1996, amended the California Constitution and requires water, sewer, and refuse collection rates to be reasonably proportional to the costs of providing those services to a given property. The legislature enacted SB 919 'The Proposition 218 Omnibus Implementation Act' to clarify specific provisions of the proposition. SB 1072 seeks to further clarify the types of remedies available to customers who challenge water, sewer, and refuse collection rates.

"Writs of mandate, declaratory relief, and injunctive relief – which direct a public agency to change their rates in the future - are the traditional and appropriate remedies that courts have imposed for violations of Proposition 218. In contrast to these remedies, new class-action lawsuits have sought multi-million-dollar refunds, which, if ordered by a court, would force public agencies who merely recover annual costs and receive no profit to raise rates on future ratepayers in order to pay refunds to past users.

"No part of Proposition 218 provides for a refund, nor does any published case. SB 1072 will declare and clarify existing law that if a court determines that a fee or charge for a property-related service, including water, sewer, and refuse collection, violates Section 6 of Article XIII D of the California Constitution, then the local agency shall, in the next procedure to impose or increase the fee or charge, credit the amount of the fee or charge attributable to the violation against the amount of the revenues required to provide the property-related service unless a refund is explicitly provided for by statute. Therefore, a challenger's remedy will be to require the agency to change their rate structure going forward. The bill will significantly help agencies maintain predictable rates for water, sewer, and refuse collection services by making it clear in the Government Code that refunds are prohibited except when explicitly provided for in law, or in the case of billing errors."

10) **Arguments in Opposition.** According to the California Business Roundtable, "SB 1072 would require that, following a court's determination of a Prop. 218 violation of property-related fees or charges, the responsible local agency would only need to credit the specific amount attributed to the violation against future bills. This provision effectively eliminates the possibility of refunds for overcharged fees, depriving taxpayers of proper restitution.

"Currently, local governments are not bound by statutory requirements to subject fees to a public vote. This underscores the necessity for safeguards such as refund remedies to protect ratepayers when fees exceed the funds necessary for the related service. Existing barriers for refund remedies, including the detailed description of fee violations required in the pre-suit by the Government Claims Act, are already in place to ensure that challenges are substantive.

"True protection for ratepayers should derive from trust in their local government's commitment to fair and transparent fee assessments for essential property-related services. By eliminating ratepayers' ability to seek appropriate refund remedies, which has been established by existing case law, SB 1072 undermines this trust."

REGISTERED SUPPORT / OPPOSITION:

Support

City of San Diego [SPONSOR]
Otay Water District [SPONSOR]
Association of California Water Agencies
California Municipal Utilities Association
California-Nevada Section, American Water Works Association
California Special Districts Association
California State Association of Counties
Coachella Valley Water District
Desert Water Agency
El Dorado Irrigation District
Fallbrook Public Utility District
Helix Water District
League of California Cities
Metropolitan Water District of Southern California
Olivenhain Municipal Water District
Orange County Sanitation District
Padre Dam Municipal Water District
Palmdale Water District
Rainbow Municipal Water District
Rincon Del Diablo Municipal Water District
Rowland Water District
San Diego County Water Authority
San Gabriel Valley Water Association
Santa Fe Irrigation District
Sweetwater Authority
Trabuco Canyon Water District
Vallecitos Water District
Valley Center Municipal Water District
Valley Sanitary District
Vista Irrigation District
Walnut Valley Water District

Opposition

California Business Roundtable
Howard Jarvis Taxpayers Association
1 Individual

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