Rate Study - Attachment 3

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Court Upholds Minimum Monthly Water Charges

by

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Introduction. On July 31, 2009, the First District Court of Appeal in San Francisco held that a minimum monthly charge for water service imposed without respect to actual use of water was properly included in a water rate regime approved under Proposition 218's majority-protest process and was not an assessment for which a mailed-ballot "assessment protest" was required under Proposition 218. The case is *Paland v. Brooktrails Township Community Services District Board of Directors*, 2009 WL 2344595.

Critical to GMCSD as we have water and sewer connections to every lot in the district. If we did not have connections at each lot, we could not assess a Standby Fee as we do today.

Background. Proposition 218, adopted by California's voters in 1996 added rules to the California Constitution governing taxes, assessments and a new class of fees and charges known as "property related fees and charges." Property related fees imposed by local governments for water, sewer, and government-provided trash service require a majority protest proceeding after 45 days' mailed notice under Article XIII D, § 6(a). However, if no majority protest – meaning written protests from owners of an absolute majority of the properties sold – is received by the end of the public hearing on the fees, the local government can impose them without an election among voters or property owners. Article XIII D, § 6(a), (c). Property related fees for other services – such as flood control and urban water quality fees – are also subject to an election among either property owners (who may approve the fee by a simple majority) or registered voters (who may approve the fees by a two-thirds vote). Article XIII D, § 6(c).

While the process for approving water, sewer and trash fees is substantially within the control of local governments, because no election is required, they are subject to a number of limitations on how the proceeds of those fees are used under Article XIII D, § 6(b). Among these is the rule of § 6(b)(4), which 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. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4.

Under this rule, standby charges – *i.e.,* charges collected via the property tax roll on undeveloped properties to fund capital improvements to utility systems so those properties can be served in the future – cannot be imposed as other charges are. They must be imposed as assessments with property owner approval in a mailed-ballot protest proceeding. As few property owners can be expected to vote to pay for a service they do not yet need, few agencies have increased standby fees or imposed new standby fees since Proposition 218 was adopted in 1996. Such fees do make economic sense, of course, because the availability of utility service makes property developable and therefore much more valuable than property which cannot be developed and there is a real cost to maintain capacity for such future development sites that other, current utility customers ought not be required to pay.

The Paland Decision. No court until the *Paland* case considered when a utility service is "immediately available to" property owners and when a fee is based only on "potential or future use." In *Paland*, the Brooktrails CSD, which serves some 1500 parcels in or near Willits, California, imposed a water rate structure, common to many utilities, which combined a minimum monthly fee for active accounts with a volumetric charge based on the amount of water consumed in a billing period. As a courtesy to its customers, the CSD did not charge the minimum monthly charge to accounts which had no water consumption for a period of time – as when voters went on vacation. In 2003, the State Department of Health Services imposed a moratorium on new hookups to the District's water utility until it increased its storage capacity. This confronted the District with a need to fund a substantial capital improvement and a loss of revenue from connection fees. In response, the District discontinued its policy of waiving minimum monthly fees for properties with active meters, even if no water was consumed. In Paland's case, the District charged its minimum fees even though it had turned off his meter and locked it due to non-payment. Paland sued, seeking declaratory and injunctive relief that the fees could not be charged because water service was not immediately available to him and the fee was therefore a standby charge made subject to Proposition 218's assessment rules by Article XIII D, § 6(b)(4), quoted above.

The San Francisco Court of Appeal disagreed:

> [W]e conclude the water and sewer base rates imposed on parcels with water or sewer connections regardless of whether they are active or inactive, and whether or not the property owner uses the services, is a fee subject to the provisions of article XIII D, section 6, not an assessment subject to the requirements of article XIII D, section 4.

2009 WL 2344595 at *8.

This is not a surprising result – Proposition 218's intent to treat local government fees for water, sewer and government-provided trash service more leniently than other fees is plain and

minimum monthly account charges are a very common feature of water rates because water utilities have very large fixed costs and only a small portion of their costs relates to how much water is consumed. This is because they have to maintain their entire system and pay a staff to do so, to sell one drop of water or to sell all the water they can deliver. However, the fact that Paland's meter was locked for non-payment does make this case a bit less obvious than it would otherwise have been.

Discussion. A number of elements of the Court's decision are noteworthy. First the Court confirms that utility service fees may properly recover capital costs and that provisions in Proposition 218 and other laws allowing assessments to be used for that purpose do not require that assessments be used:

> These provisions establish that an assessment may be imposed to pay maintenance and operation costs of a public improvement. They do not, however, establish that any levy imposed to pay maintenance and operation costs of a public improvement is necessarily an assessment. As previously noted, article XIII D, section 6, subdivision (b) authorizes agencies to impose fees to cover the cost of providing immediately available water service, which necessarily includes maintenance and operating costs.

Id. at *4, n.11.

The Court explained that a property related utility service is "immediately available" to a property owner, such that rates are subject only to the majority-protest requirement if the property owner alone can take the steps necessary to make use of the service:

> The terms "immediately available" and "potential or future use of a service" as used in the initiative are relative and inherently imprecise. Construed narrowly, service is "immediately available" only if, as Paland suggests, water flows out of a faucet when the property owner turns on the tap. However, voters might reasonably have intended "immediately available" to include circumstances where the District has provided utility connections directly to the owner's parcel and the service is "immediately available" subject only to the volitional decision of the property owner to request service.
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> … This scheme [of Proposition 218 distinguishing between fees and assessments] suggests that voters perceived a greater danger of government abuse in the imposition of water (and sewer) related assessments imposed on real property than in the imposition of fees, and also recognized the need for agencies to determine rates for such services, allowing the agency to provide for necessary

> continuing operation and maintenance of the systems without the undue burden of potential owner veto.

Id. at *6. Thus, the Court concluded that the key issue is property-owner control over service delivery:

> We conclude the "immediately available" requirement is logically focused on the agency's conduct, not the property owner's. As long as the agency has provided the necessary service connections at the charged parcel and it is only the unilateral act of the property owner (either in requesting termination of service or failing to pay for service) that causes the service not to be actually used, the service is "immediately available" and a charge for the service is a fee rather than an assessment (assuming the other substantive requirements of a fee are satisfied).

Id. at *7. The Court noted that if Paland were correct that fees on customers voluntarily not using a service had to be distinguished from fees on customers who do use a service that those involuntary service fees would be akin to development impact fees (like charges for new connections) and entirely exempt from Proposition 218 under the reasoning of *Richmond v. Shasta Community Services District*, 32 Cal.4th 409 (2004) (water connection fees not assessments under Prop. 218 because the parcels on which they are imposed cannot be identified in advance by the agency setting the fees).

The Court also rejected Paland's argument that the CSD could recover the capital cost of providing a utility system to serve him only once, via an initial connection fee, affirming that utility rates may recover both capital and operation costs:

> Nor does he cite statutory or other legal authority barring the District from charging him for maintenance, operation, and capital improvements to the existing systems once he has paid a connection fee. Both Proposition 218 and the Government Code authorize the District to do just that. (Art. XIII D, § 6, subd. (b)(1)-(4); § 66013, subd. (b)(3) [authorizing capacity charges].) Common sense dictates that continuous maintenance and operation of the water and sewer systems is necessary to keep those systems immediately available to inactive connections like Paland's. As a practical matter, it would be difficult if not impossible for an agency to forecast the costs of operating and maintaining a system into the indefinite future for the purpose of charging all users their proportional share of those costs at the time they first connect to the system.

Id.

Conclusion. The result of this case is not surprising. It is helpful, however, to have such plainly stated affirmation that the common practices of public water providers – to charge minimum monthly charges to all active accounts – is permissible without voter or property owner approval, provided that the rate structure itself has been the subject of the majority protest proceeding required by Proposition 218. It also provides a firm rejection of common argument that periodic utility fees may not recover system capital costs. A helpful decision for local utilities, indeed.