

While researching the legalities regarding penalty rates for drought conservation measures, I came across this document written by Attorney Kelly Salt, a partner with Best Best & Kreiger. This is a must read.

## **LEGAL OPTIONS FOR WATER PROVIDERS IN TIMES OF DROUGHT**

The Water Code, Prop 218, Prop 26 and more ... Attorney Kelly Salt reviews the legal provisions in the State constitution and the Water Code that govern water providers in times of drought

As the State Water Resources Control Board considers adopting a stronger regulation for urban water conservation, water agencies and localities are going to need all the tools in the toolbox to deal with customer demand. So what are the legal options available?

Attorney Kelly Salt, a partner with the law firm Best Best & Kreiger, is experienced in assisting cities and water districts with utility rates and fees, including reviewing utility rate and fee studies, preparation of notices of public hearings, and establishing new and increased taxes, assessments, fees and charges. At the 2015 NWRI Drought Response Workshop, Ms. Salt gave a presentation on the legal tools available in the state constitution and water code that are of concern to water agencies and localities as they consider rate changes, water conservation programs, and fines and penalties.

*“The preeminent law that governs us all when it comes to water use is Article 10, Section 2, simply stated, says that the constitution requires that the water resources of the state shall be protected, and unreasonable water use prevented,”* Kelly Salt began. That amendment was adopted in 1928, but there are other provisions that govern water use, she said.

### **Provisions in the Water Code**

*“Water Code Section 10632 does require you to develop an urban water management plan,”* said Ms. Salt. *“As part of that, you are required to include a water shortage contingency analysis in your urban water management plan that includes phases of action, actions to be undertaken to prepare for and implement during a catastrophic interruption and emergencies. You’re also supposed to include additional mandatory provisions against specific water use practices during shortages, consumption reduction methods and penalties, and you’re required to include a drought water shortage contingency resolution or ordinance.”*

Under Water Code Section 350, an agency may declare a water shortage emergency whenever it determines that the ordinary demands of its consumers cannot be satisfied without depleting the water supply distributor to the extent that there would be insufficient water for human consumption, sanitation, and fire protection, Ms. Salt said. *“There are many things you can do during water shortage emergencies, including establishing priorities for the use of water, denying applications for new or additional service*

*connections, and may include provision for enforcement by discontinuing service to your consumers who are violating the regulations and restrictions,” she said.*

Water Code Section 375 authorizes agencies to adopt and enforce water conservation programs, she said. *“As part of that water conservation ordinance or resolution it may encourage conservation through rate structure design,”* she said, noting that allocation-based water rate structures are an example of this. *“All of this has to be taken in context of Prop 218.”*

With Water Code Section 375.5, agencies may undertake water conservation and public education programs, she said. *“The best way to start those changes often are with children,”* she said. *“Many of you have seen studies with regard to use of tobacco as well as solid waste recycling that the development of education programs for children at the school age level modify that behavior from a very young age.”*

*“You may take into account the cost of those programs through your rate structure,”* Ms. Salt pointed out. *“I want you to take a mind set of thinking but for those individuals who place the greatest demands on your water system, you would not have all the costs you’re going to have to incur through your water conservation programs, developing additional water supply reliability projects, developing alternative water supplies, banking water – all these things are costs to your agency as a result of individuals who use more water. Therefore it is appropriate to shift the costs of those programs to those places where there are demands on the system.”*

The goal of developing these types of programs is to develop a new mindset of permanent conversation and environmental stewardship, and to establish rules and regulations that will go into effect based upon water shortage conditions that will reduce demand, she said.

*“You have to prepare for the inevitable water shortages that are going to occur in California,”* she said.

## **Prop 218**

Ms. Salt said there were two different aspects of Proposition 218: procedural provisions and substantive provisions.

*“With procedural provisions, you have to have a public hearing and you have to file a notice of the public hearing and your proposed rates any time you are going to increase your water services and charges,”* she said, pointing out that if you are developing conservation rates or implementing a water conservation program that is going to result in an increase to any of your customers, you are going to have to go through a Prop 218 hearing.

The substantive provisions in Prop 218 require that the fee should be proportionate to the cost of service, she said. *“In other words, the fee shall not exceed the reasonable cost of providing the service, so there must be a cost and revenue nexus, and second, the fee shall not exceed the proportional costs of providing service attributable to the parcel on*

*which it is imposed.” Allocation-based rates do that by structuring individualized budgets for each customer, but tiers are aimed at essentially at developing allocations of costs of water through the increased demand that individuals place on a system, Ms. Salt noted.*

She then reviewed a few court cases. Before Proposition 218, in 1994 there was Bright versus EMWD. *“In that case, it was the first challenge to the tier rate structure, and the court was basically analyzing whether the tiered water rates violated Article 13a of the California constitution, which was adopted by Prop 13; what Prop 13 basically stated was that a fee cannot exceed the cost of service, otherwise it’s a tax, so the tiers were challenged as a tax under Prop 13,” she said. “The court in that case essentially said that it’s appropriate to shift the costs of environmental degradation to those who place the greatest demands on the system, so it’s the same concept of what you’re doing through tiered rates structures.”*

The first challenge to an allocation rate-based structure was in 2011 with the City of Palmdale versus Palmdale Water District, she said. *“The issue in that case had to do with whether or not there was sufficient evidence in the administrative record of the public agency on how they basically established their tiered rates,” she said. “The tiered rates for the irrigation customers came sooner than all the other customer classes, and there was not sufficient evidence in the record to demonstrate why that one customer class was paying more for the cost of service than others. Essentially, what that case tells you that you have to have a very strong administrative record to justify your rates.”*

Allocation-based rate structures were challenged again in Howard Jarvis Taxpayers Association versus City of San Juan Capistrano, she said. *“The challenge again was based on whether or not there was sufficient evidence in the administrative record to justify the tiers that were allocating costs to various customers,” she said. “Another portion of that case had to do with their recycled water rates. A portion of the cost of the recycled program is funded through their potable water customers. The court at the trial level struck down both the tiered rates as well as the allocation of costs for the recycled water program to their potable customers. The case was just heard January 21<sup>st</sup>, so we’re waiting to hear what’s going to happen.”*

*“Just a couple things I want to share with you that were of concern to the court during that oral argument,” she said. “In particular, the importance lies in understanding how the costs are being allocated in the upper tiers, so what would the marginal cost of providing costs to those who use more water? It goes back again to the Palmdale and justifying the costs that you are allocating into your own tiers as you go through the development of your rates, because you’re trying to use your rate structure to incentivize conservation.”*

## **Prop 26**

In 2010, there was the adoption of Proposition 26. *“Prop 26 amended the California constitution Article 13c by adding a new definition of the term ‘tax’,” she said. “That definition says that any fee or charge is a tax unless it meets one of several exceptions.”*

She focused on two exceptions:

*Regulatory fees: "What Prop 26 says is that a regulatory fee may only recover the actual costs of regulation and enforcement," she said. "If you're imposing any regulatory fees such as inspection fees, or if you are having to go out and turn off water because someone is violating your water conservation ordinance, the only amount of your tier cost can recover is the actual cost of regulation."*

*Fines and penalties: "Fines and penalties are one of the seven exceptions to a definition of a tax," she said. "The important thing about fines and penalties is that they can be used for any purpose of your agency, so if you want to use it for purposes of your water use efficiency program, or use it to offset some of your other costs, that's appropriate, but again keep in mind that fines and penalties are an exception."*

*There are statutory penalties, as well as civil administrative penalties, she said. "Statutory penalties would be such as in the California water code section 375 area for water conservation that says that a violation of a water shortage ordinance is a misdemeanor and subject to a specific fine or penalty. Those are only subject to the concept of that the penalty shall not be excessive."*

## **Water shortage surcharges, regulatory fees, and fines/penalties**

*One of the impacts of conservation during voluntary and mandatory cutbacks is reduction in revenues, so agencies will often adopt what's referred to as water conservation surcharges, or rates at specific water short stages, she said. "These are generally temporary charges, so agencies adopt entirely different rate schedules and some simply eliminate tiers, and in fact, these are designed to recover revenue loss as users reduce their usage as well as encourage conservation, but also proportionally allocate the cost of service again to those who place the greatest demands on the system. These costs can include the costs of your water efficiency program, net penalties, additional costs you incur through development of additional water supplies sources, things of this nature, so you want to start thinking and getting your minds around what are those costs that can be allocated to those upper tiers or to those who are exceeding your water use allocations during this stage. Now because of a resulting increase in rates, you're going to have to go through a Prop 218 hearing for that."*

*"Agencies may also establish rules and regulations on water use and enforcement through infractions and neighborhood policing," she said. "Remember you can recover your costs for enforcing those regulations but those fees you may impose for that purpose cannot exceed the cost of actual regulation and enforcement. So the goals here are basically here are to gain compliance, do enforcement, and change behavior, and the regulatory fees the goals are recovery of costs of regulation and enforcement."*

*"Violation of water conservation programs are misdemeanors and may be prosecuted and subject to statutory fines," she said. "Another option during water shortages is to adopt administrative fines and penalties; for example, if you set a water shortage stage where you say where we get to stage 3, no one may use any more than their allocation based rate structure or more than their actual water budget, and anybody who uses more than*

*their actual water budget will not only have to pay for the water that they purchased at whatever tier rate that is, but they also have to pay a fine or penalty for violating the water conservation ordinance.”*

*“One thing I do want to point out is administrative fines and penalties are authorized pursuant to government code section 53069.4 for a violation of an ordinance, so for those of you who are adopting a water shortage contingency plans, I would recommend that you adopt it as an ordinance if you want to include any fines or penalties in them, because that’s what your statutory authority derives from,” she added.*

### **In conclusion...**

*“So consider updating your water shortage contingency plan, and I would recommend that you do that in advance of completing your Urban Water Management Plan,” she said. “We’re obviously in a drought now, so if you want to make any of these changes, now is the time to do it. Adopt it by ordinance if you want to include fines and penalties for violations.”*

*“You can also consider alternative rate technologies to achieve conservation and manage your water resources; tiered rates or allocation based rates are obviously an effective tool,” she said. “Consider including advance approval for water shortage surcharges or rates in your Prop 218 notice, and then consider adopting water allocations and administrative fines and penalties in order to achieve that enforcement.”*

## **Drought Surcharges and Penalties**

- Drought Surcharges or Drought Rates – revenue recovery
- Penalties – punish for violations of water conservation ordinance or resolution

